Federal Tax Changes, State Responses, & (why not?) Amazon

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Introduction to ITEP

The **Institute on Taxation and Economic Policy** (ITEP)

Non-profit

Non-partisan research organization

Federal, state, and local tax policy issues

Mission:

Ensure elected officials, media, and general public have access to accurate, timely, and straightforward information that allows them to understand the effects of current and proposed tax policies with an emphasis on tax-incidence analysis.

Tax Incidence Analysis

- Provides answers to two vital policy questions:
  - Cost (or yield) of proposed tax cuts (or tax increases)
  - Impact of tax changes on taxpayers at different income levels

- Value
  - Intentional impact
  - Everyone impacted—how?

Overview

- Impact of TCJA on NM income taxes
  - Law changes
  - Revenue impacts
  - Taxpayer impacts
- Responses
  - Survey of states
- Recommendations
- Amazon & Localities

Implications of TCJA for NM Tax Law

New Mexico Tax Changes Effective 1/1/2018

New Mexico Tax Changes

- New Mexico bases its income tax on federal adjusted gross income and couples to federal deductions and personal exemptions

9.	**FEDERAL ADJUSTED GROSS INCOME.** (from federal Form 1040, line 38; Form 1040A, line 22 or Form 1040EZ, line 4)		9
10.	If you itemized your federal deduction amount, enter the amount of state and local tax deduction claimed on federal Form 1040, Schedule A, line 5. See the worksheet in the instructions	+	10
11.	Total Additions to federal adjusted gross income (PIT-ADJ, line 5). **Attach PIT-ADJ.**	+	11
12.	Federal standard or itemized deduction amount (from federal Form 1040, line 40; Form 1040A, line 24; or Form 1040EZ, line 5)	-	12
12a.	If you **itemized,** mark the box. 12a ☐		
13.	Federal exemption amount (from federal Form 1040, line 42; Form 1040A, line 26; or if you filed Form 1040EZ, leave blank)	-	13
14.	New Mexico low- and middle-income tax exemption. See PIT-1 instructions	-	14
15.	Total Deductions and Exemptions from federal income (PIT-ADJ, line 22). **Attach PIT-ADJ**	-	15

- Conformity to federal changes automatic unless action taken otherwise

New Provisions & Impact on State Budget

- You lose some, you win some…

- Revenue losses/Tax cuts
  - Itemized deductions
    - Elimination of PEASE disallowance
  - Increased standard deduction
  - Corporate income tax
    - Full expensing
    - Shift to territorial system

New Provisions & Impact on State Budget

- Revenue gains/Tax increases
  - SALT cap
  - Eliminating federal personal exemption
  - Eliminating state low- and moderate-income personal exemption
  - Permanent adoption of "chained CPI" as federal inflation measure
  - Corporate base broadeners

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New Provisions & Impact on State Budget

Incidence analysis: Eliminating Federal Personal Exemption

State Tax Change for Residents ($1000)
+203,000

2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than $19,000	$19,000 – $35,000	$35,000 – $55,000	$55,000 – $92,000	$92,000 – $178,000	$178,000 – $402,000	$402,000 – Or More
Average Income in Group	$12,000	$28,000	$44,000	$70,000	$123,000	$247,000	$973,000

Personal Exemption Elimination (Federal Only)							
Tax Change as % of Income	+0.01%	+0.2%	+0.4%	+0.5%	+0.4%	+0.2%	+0.1%
Average Tax Change	+1	+49	+178	+379	+545	+481	+721

New Provisions & Impact on State Budget

- Revenue gains/Tax increases
  - SALT cap
  - Eliminating federal personal exemption
  - **Eliminating state low- and moderate-income personal exemption**
  - Permanent adoption of "chained CPI" as federal inflation measure
  - Corporate base broadeners

New Provisions & Impact on State Budget

- Ambiguous state statutory language when it comes to personal exemptions that tie eligibility to federal exemptions

7-2-5.8. Exemption for low- and middle-income taxpayers.

A. An individual may claim an exemption in an amount specified in Subsections B through D of this section not to exceed an amount equal to the number of federal exemptions multiplied by two thousand five hundred dollars ($2,500) of income includable, except for this exemption, in net income.

- The consensus in states is mixed
  - MI and MO interpreted their statues as eliminating state exemptions
  - MD lawmakers disagreed as to effect so just changed language to clarify it wasn't impacted

New Provisions & Impact on State Budget

- Revenue gains/Tax increases
  - SALT cap
  - Eliminating federal personal exemption
  - Eliminating state low- and moderate-income personal exemption
  - **Permanent adoption of "chained CPI" as federal inflation measure**
  - Corporate base broadeners

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New Provisions & Impact on State Budget

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  - **Corporate base broadeners**

New Provisions & Impact on State Budget

- Net Impacts of Combined PIT Changes

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Income	Less than	$19,000 –	$35,000 –	$55,000 –	$92,000 –	$178,000 –	$402,000 –
Range	$19,000	$35,000	$55,000	$92,000	$178,000	$402,000	Or More
Average Income in Group	$12,000	$28,000	$44,000	$70,000	$123,000	$247,000	$973,000

Combined State-Level Effects *Assuming Federal Personal Exemption Eliminated*							
Tax Change as % of Income	+0.005%	–0.05%	+0.01%	+0.08%	+0.1%	+0.1%	+0.07%
Average Tax Change	+1	–13	+6	+53	+145	+355	+643
% with Income Tax Cut	7%	44%	52%	52%	47%	31%	22%
Avg. Tax Cut for Those w/ Cut	–1	–32	–48	–84	–122	–230	–421
Share of resident tax cut	0.1%	10%	16%	31%	30%	10%	3%
% with Income Tax Increase	31%	21%	18%	36%	50%	66%	77%
Avg. Tax Increase for Those w/ Increase	+2	+5	+176	+268	+405	+641	+955
Share of resident tax increase	0.2%	0.2%	7%	24%	38%	21%	9%

State Tax Change for Residents ($1000)
+46,000

% of Taxpayers w/Cut	39%
% of Bottom 80% with Cut	39%
% of Top 20% with Cut	42%
% of Taxpayers w/Increase	32%
% of Bottom 80% with Increa	26%
% of Top 20% with Increase	55%

New Provisions & Impact on State Budget

- Net Impacts of Combined PIT Changes

	State Tax Change for Residents ($1000)
	+46,000
Returns, 0 Children	—
Returns, 1 Child	+8,000
Returns, 2 Children	+20,000
Returns, 3 Children	+12,000
Returns, 4+ Children	+6,000

Responses to TCJA

Range of Responses

- Strategy #1: Do nothing—accept the tax increase on New Mexico taxpayers and higher revenues for the state
- Strategy #2: Decouple from federal tax code
- Strategy #3: Remain coupled to some provisions and decouple from others
- Strategy #4: Stay coupled and create an offsetting cut
  - How much?
  - Who?

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What Are Other States Doing?

- 21 states not impacted by federal conformity
- 4 addressed single provisions (decoupled or chose not to couple)
- 9 addressed major conformity issues, with 2 ultimately taking no action (ME, KS)
- 4 didn't address at all
  - AZ, MT, ND, NM
- 12 states and DC are still actively considering

Recommendations for Thinking Through the Issue of How to Respond

- Opportunity for evaluation of state tax system
  - Narrow, immediate view: Do we want to stay coupled to these changes and whether/how to hold taxpayers harmless?
  - Broad, longer-term view: How much do we want to rely on the federal tax code? Is our tax code on the best path to serve the long-term needs of our state? How might the changes we want to make in response to TCJA relate to conversations we've already been having about tax reform?

Principles for Response

- Response should be
  - Informed
  - Holistic (not responding to a particular tax change such as the SALT cap)
  - Conservative (account for uncertainties in estimates)
  - Take the long view regarding adequacy of state revenues to meet current and future needs
  - Promote tax equity

Principles for Response: Adequacy

- State needs adequate taxes to investment in its people and infrastructure

- Context
  - Looming federal budget cuts
    - Medicare, Medicaid, SNAP, non-defense discretionary funding (transportation and infrastructure, education and training, medical research, child and elder care, environmental protection, other)
    - Loss of federal grants-in-aid to state govts and increase the burden on states to provide services

Principles for Response: Adequacy

- Context cont'd
  - Adequacy of current state revenues
    - Recovering from years of budget cuts and crises
      - Demand rising among neighboring states (AZ, CO)
    - Rainy day funds?

Principles for Response: Adequacy

- Implications:
  - Reject any efforts to worsen your budget outlook through net cuts—particularly those that are permanent in nature and don't promote broad economic opportunity
  - Don't be like:
    - Georgia
    - Iowa
    - Idaho
    - Utah
    - Missouri

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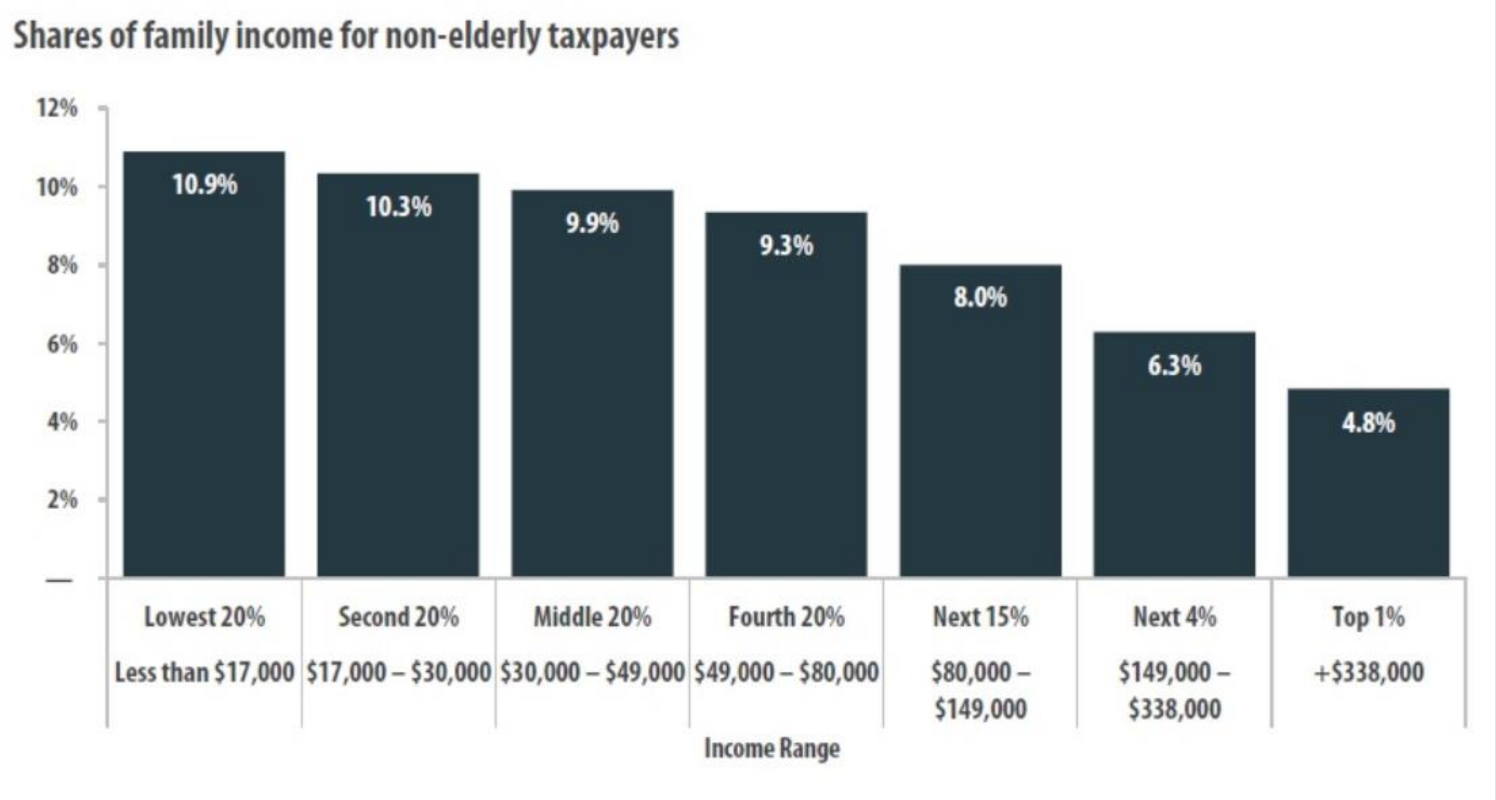
Principles for Response: Tax Equity

- State and local tax systems are regressive



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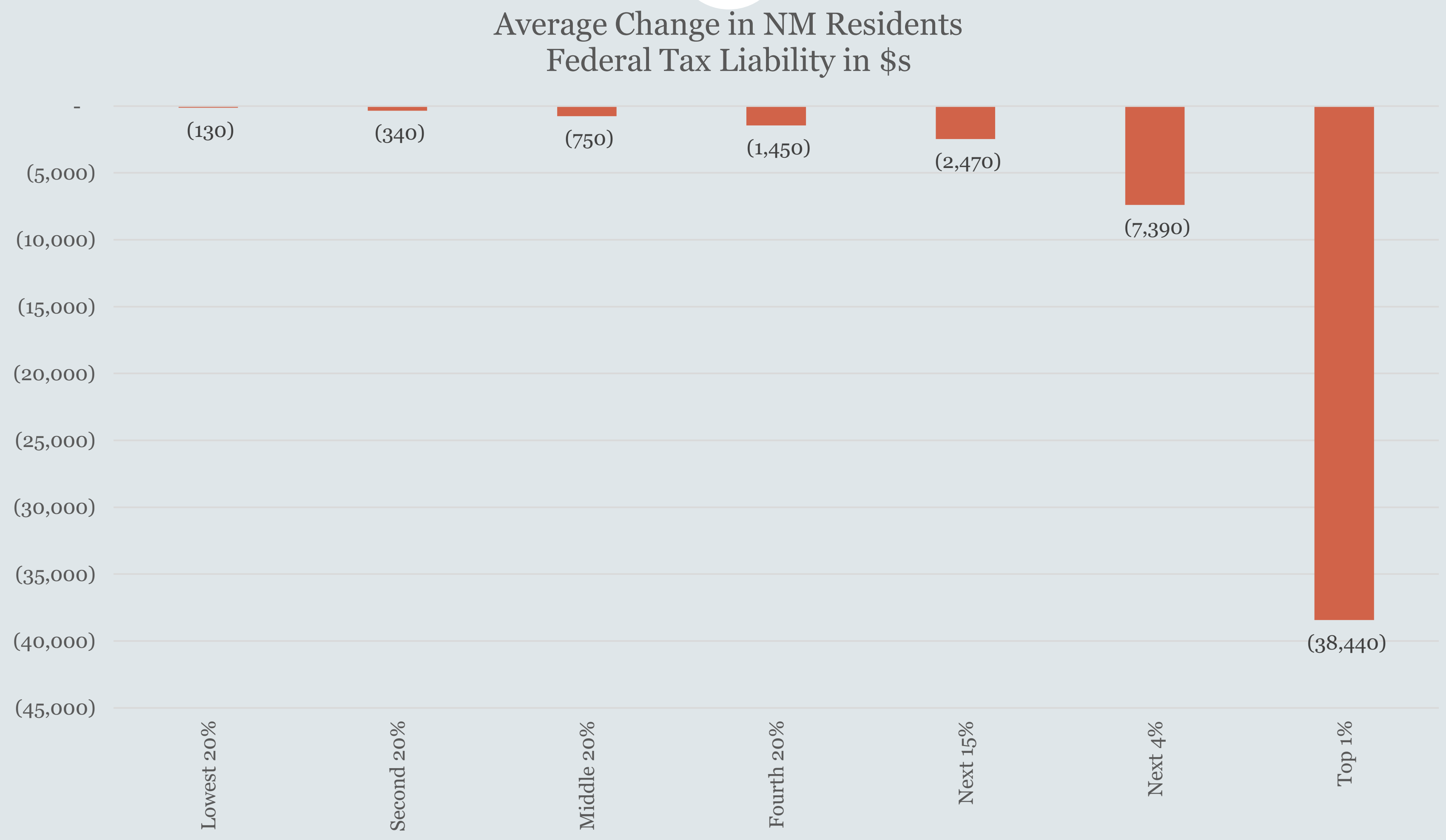
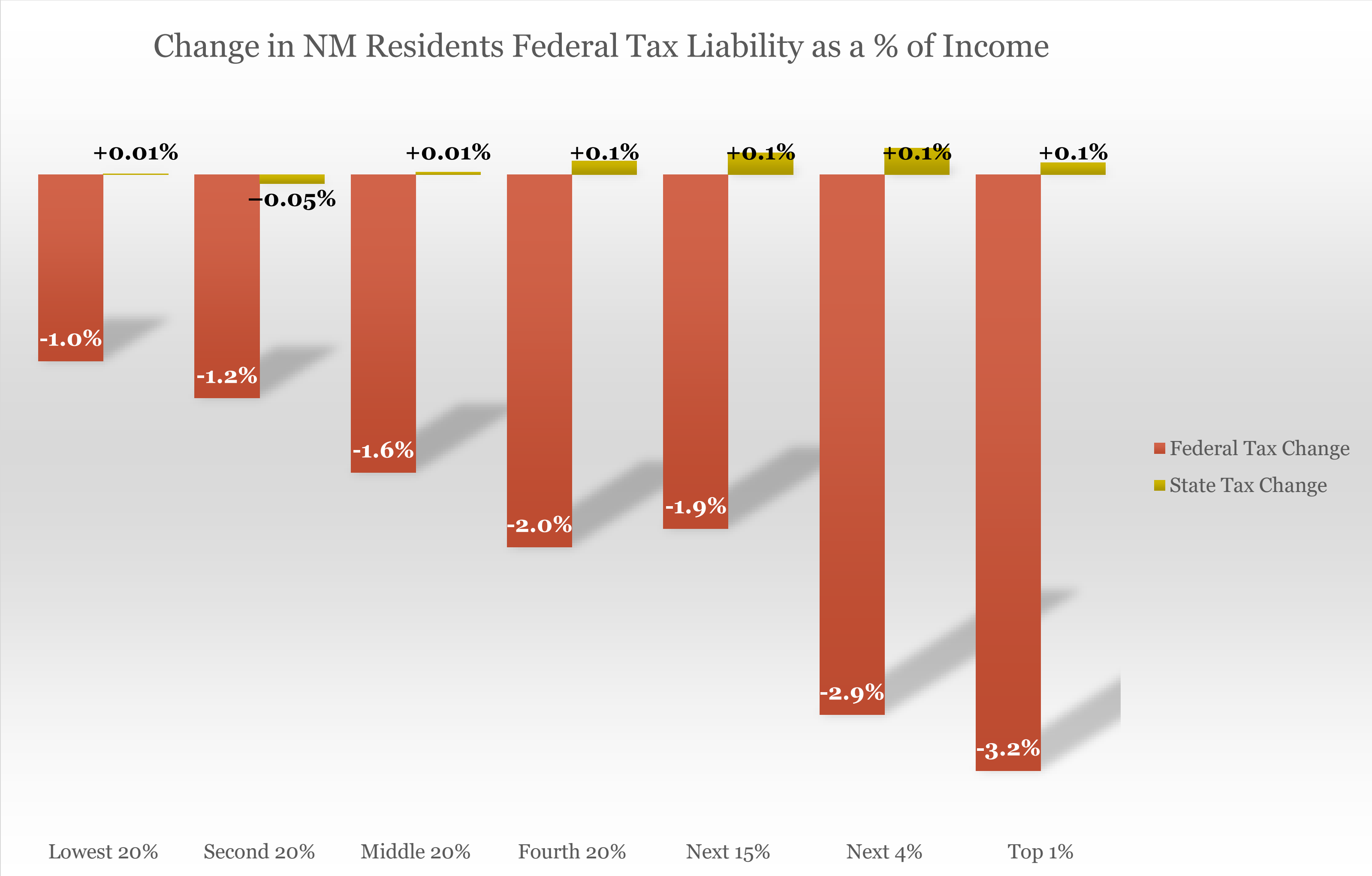
Principles for Response: Tax Equity

- Highest-income residents of every state received federal tax cuts that far exceed the cuts going to low- and middle-income families
- Federal tax cuts received far outweigh any state-level tax increases they might see as an effect

Principles for Response: Tax Equity



Principles for Response: Tax Equity



Principles for Response: Tax Equity

- Implications:
  - If you're going to cut taxes in response to federal tax reform, mitigate—not exacerbate—the regressive nature of federal tax changes that overwhelmingly benefited the highest-income Americans
  - Preferred mechanisms:
    - Decouple from federal personal exemption
    - Bolster targeted tax cuts for low- and middle-income families
      - Especially important in light of tax increases due to change in inflation standard

Recommendations

Scenario 1: Offset Tax Increase from Conformity

Need to answer the question of how much to offset?

- Option 1
  - Decouple from federal deduction and exemption changes
    - Enact standalone provisions (MI, SC personal exemption)
    - Couple to an earlier version of federal tax law
- Option 2
  - Bolster state low- and middle-income exemption (increase value, expand eligibility)

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Scenario 1: Offset Tax Increase from Conformity

- Option 3
  - Bolster state EITC
  - Targeted for families with children—the group most impacted by federal conformity changes
  - Increase from 10% to 18% of federal
    - Cost: $43 million
    - On average, holds harmless all taxpayers in bottom 80% from tax increases due to federal conformity

Scenario 1: Offset Tax Increase from Conformity

- Option 4
  - Create a state Child Tax Credit
  - Targeted for families with children—the group most impacted by federal conformity changes
  - Idaho enacted a non-refundable child tax credit of $205
  - $100 refundable credit, $45 million, 76% of cut goes to bottom 80%
  - $250 nonrefundable credit, $46 million, 51% of cut goes to bottom 80%

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Scenario 2: Conformity in Context of Broad Tax Reform

- Nothing like crisis to drive change!
- Conformity conversation to address longer-term needs of the state
- Even if that conversation takes a while to get started, make sure actions taken now to be consistent with goals set for future reforms

Scenario 2: Conformity in Context of Broad Tax Reform

- Reform Agenda
  - GRT
    - Either make it more like a true gross receipts tax or a true retail sales tax
  - Reduce reliance on extremely volatile income sources like receipts from oil and gas
    - *Over the long term, progressive income taxes are the most reliable revenue source available to states, displaying more robust growth than sales, property, or excise taxes*

Scenario 2: Conformity in Context of Broad Tax Reform

- Reform Agenda, cont'd
  - Promote more broad-based economic opportunity by reducing taxes of low- and middle-income households and increasing the share of taxes paid by the wealthy
    - Pare back or eliminate the capital gains exclusion
    - Repeal 2003 rate/bracket cuts
  - Prevent further base erosion of corporate income tax
    - Strengthen combined reporting
    - Especially important with move to territorial system

Amazon

Context

- Amazon.com made headlines last year when it began collecting every state-level sales tax on its direct sales
- BUT
  - Not collecting on sales in partnership with third-party vendors
  - Not collecting some local level taxes
- New Mexico is one of the states missing out!

The Stakes

- This collection gap is harming local governments' ability to fund vital programs
- Contributes to an unlevel playing field for local businesses because millions of shoppers are able to pay less tax if they choose to buy products from out-of-state companies over the Internet rather than at local stores
- Localities can't reap benefits of expanded sales tax collection authority that may soon be coming from US Supreme Court or Congress

The Issue

- The current structure of New Mexico sales tax laws prevents Amazon from collecting local-level taxes on its sales into those states
- “Origin-sourcing”
  - Location of the seller, rather than the buyer, determines the amount of local tax that must be added to a purchase
- In New Mexico’s case, Amazon lacks any in-state presence and therefore remits only the state-level (5.125 percent) tax that is owed on any sale originating outside the state

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The Fix

- State law to authorize “destination-sourced” taxes
- Require these types of sales to use the location of the buyer to determine the amount of tax collected
- Benefit: Put local retailers on an even footing with out-of-state or out-of-town retailers such as Amazon

For Good Measure: Alternative Perspective on Economic Growth, Tax Triggers

Why Income Taxes Matter: Supporting Economic Growth

- A sustainable revenue stream made possible by an income tax pays for state services that are vital to economic growth, like education, public safety, the courts, and transportation infrastructure

Why Income Taxes Matter: Supporting Economic Growth

- Evidence that investments in public goods matter:
  - Statistical research: Many empirical studies find positive correlation between quality of education and infrastructure (especially) and rate of state economic growth and growth in high-paying jobs
  - Business executives: Most surveys of business executives about what's important in their location decisions find quality of local labor force and infrastructure more influential than taxes/tax incentives
  - "Creative class": Growing body of research finding that fastest growing cities are those where highly-educated workforce is concentrated. They want good schools, parks, low crime, etc.

Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- Income taxes (corporate and personal) popular targets among proponents of tax cuts
- Thinking behind it? Theoretical predictions:
  - Demand-side: With fewer taxes, businesses will hire more people, invest in new facilities; individuals will spend more on goods and services that indirectly provide employment and income to the businesses/people furnishing them.
  - Supply-side: Changes incentives businesses have to make an investment/create a job/locate to a particular state and the incentives individuals have to work/live in a state

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Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- Problems with the demand-side argument
  - Every dollar cut for a business or household is one dollar in taxes raised on someone else or a dollar matched in spending cuts—money that is more likely to have been spent within the local economy
    - Previous spenders of state payments have to take it out of local economy immediately while recipient may not inject it immediately at all
    - Save or spend on out of state expenses
    - Invest in out of state pay bonuses, dividends

Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- Theoretically, supply-side benefits are supposed to offset negative demand-side effects of tax cuts
  - Tip the balance towards investment/jobs that wouldn't otherwise have happened at all: Tax cuts increase profitability of business investments, thus incentive to make them; can turn marginally-unprofitable investment into a marginally profitable one
  - Shift location of a business or investment and associated jobs into the state
  - Induce individuals to reside in one state rather than another (indirect impact on economic development due to shift in location of household spending)

Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- Difficulties facing the supply-side argument in practice?
  - Cutting taxes for businesses
    - State and local taxes paid by corporations make up a small share of total expenses (2-4%). Even substantial cuts won't move the needle much on profitability
    - Business investment responds primarily to anticipated demand for products, not small cut in tax expense or marginal rate
    - Taxes aren't a disincentive for hiring since wages are already fully deductible
    - Relocating is costly, rare, and makes up a tiny share of net job growth

Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- Difficulties facing the supply-side argument in practice, cont'd
  - Cutting taxes for businesses
    - Job growth among states based on ability to support start-ups that develop innovative technologies, products or business models and that grow rapidly (Facebook/Google/Amazon)
    - Tax cuts don't help these businesses takeoff because they earn little in any profit in the early years (money goes into R&D, marketing, etc.)
    - Lots of other things important to location decisions
      - Businesses: Distance to suppliers/customers; skill level of workforce; road quality
      - Households: Climate, school quality, distance to family/relatives/jobs

Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- Difficulties facing the supply-side argument in practice, cont'd
  - Cutting personal income taxes for individuals
    - Most people don't own businesses and most small and startups don't earn enough profit to get much from PIT cuts
    - Most small businesses don't employ anyone other than themselves and don't have any intention of ever doing so (not job creators)
    - PIT cuts don't attract entrepreneurs—they almost never move before starting their business. They start where they live, have local relationships, know the market, where industry is already clustered
    - Cutting family/friend ties is painful. New houses costly. New job hunting difficult and risky

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Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- What does the research show?
  - Relationship between state tax levels and state economic performance has been studied extensively by economists
  - People on both sides of the debate can point to well-done studies by reputable economists published in peer reviewed journals supporting the assertion that relative state tax levels do and don't affect relative rates of economic growth, job creation, etc.
    - **Results aren't robust**; several replications of widely-cited earlier studies have completed undermined them
    - **Results are contradictory**; one study will find CIT matters and PIT doesn't, and the next will find exactly the opposite
  - **The weight of academic research concludes that state and local tax levels have, at most, a small impact on relative rates of state economic performance**

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Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- What does the research show?
  - Business taxation
    - Considerable statistical research supports the conclusion that business tax cuts don' have ***major impact*** on state economic performance
    - Bartik's summary of the literature
      - 10% cut in total business taxes required to produce 2-3% boost in long-run (15-20 years) economic output and jobs, assuming quality of public services needed by business doesn't decline (have to offset by raising taxes on households instead of just cutting services)
      - Effects = $20,000 per job paying less than $40,000 (large subsidy)
      - 20-50% of jobs go to in-migrants instead of residents; 80% in the long-term go to in-migrants (who need roads, sewers, schools)
      - Significant revenue loss for small number of jobs

Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- What does the research show?
  - Personal income tax
    - Don't have same robust statistical summary of literature
    - Proponents of tax cuts can cite a couple of studies that find some inverse relationship between state PIT level and economic performance, but the majority find none

Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- Key Takeaways
  - Theoretically-possible positive incentive effects of cutting business taxes and PITs are so small that in short run they are not powerful enough to overcome negative impact on growth of reducing state spending to finance tax cut; net combined effect on state economic growth likely to be negative
  - Across-the-board tax cuts are not a cost-effective means of stimulating state economic growth/job creation
  - Preserving high-quality state and local services needed by businesses, especially education and infrastructure, should still be the primary economic growth strategy for states to pursue

Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- Key Takeaways, cont'd
  - If states are going to use more narrow tax incentives to stimulate economic growth, they really can't afford for them to take a form that isn't directly conditioned on in-state investment (e.g., capital gains tax cuts, single sales factor, and domestic production deduction conformity are misguided)

The Trigger Temptation

- Dangers of "triggered" tax cuts
  - Are based on inadequate information about projected revenues and spending
    - Need multi-year forecasts on cost of cuts when take effect and cost of services to responsibly evaluate impact
    - Best forecasts can't predict change in state needs, citizen preferences, and lawmaker priorities
  - Can take effect even during economic downturns or at other times when revenues are particularly needed
    - If based on achieving model revenue growth in a single year, cuts can take effect as soon as state's economy starts recovering despite being below pre-recession levels

The Trigger Temptation

- Dangers of "triggered" tax cuts, cont'd
  - Typically fail to account for state fiscal needs
    - Cuts triggered in most states even if recent revenue growth not enough to offset inflation, population growth, or other factors that affect cost of current services
    - Don't account for need to maintain adequate reserves for fiscal emergencies

The Trigger Temptation

- Dangers of "triggered" tax cuts, cont'd
  - Offer no meaningful benefits compared with deferring action on tax cuts until closer to the implementation date, when policymakers will know more about whether they are affordable
    - Benefits from knowing future tax rates likely quite limited when it comes to state taxes
      - State tax rates are low to begin with and unlikely to tip investment decisions
      - Most enacted in recent years involve personal income tax, and only a small minority of income tax payers are business owners making significant capital decisions

The Trigger Temptation

- Dangers of "triggered" tax cuts, cont'd
  - Enable policymakers to claim credit for cutting taxes while avoiding accountability for the consequences
    - Enacting an income tax cut with a future effective date — whether or not a trigger is attached — effectively acknowledges that the cut is not affordable now
    - Irresponsible to take political credit for approving the tax cuts, even if taxpayers won't actually benefit for years, and gamble that the cuts will turn out *not* to harm public services or the state's financial stability down the road
    - Lawmakers who agree to cut state revenues without knowing whether the cuts will be affordable abdicate their responsibility to prudently manage state finances, often at significant cost to the state's future

The Trigger Temptation

- Alternative to triggers
  - If you really want to cut taxes, figure out how to pay for it now and take responsibility for its consequences (fiscally and politically)

Lessons from Kansas

- Kansas Gov. Brownback and legislators enacted a nearly $800 million personal income tax cut
  - Exempted all pass through income from PIT
  - Repealed low-income tax credits
  - Reduced tax rate structure from three brackets to two and lowered rates.
  - Later hiked sales and cigarette taxes

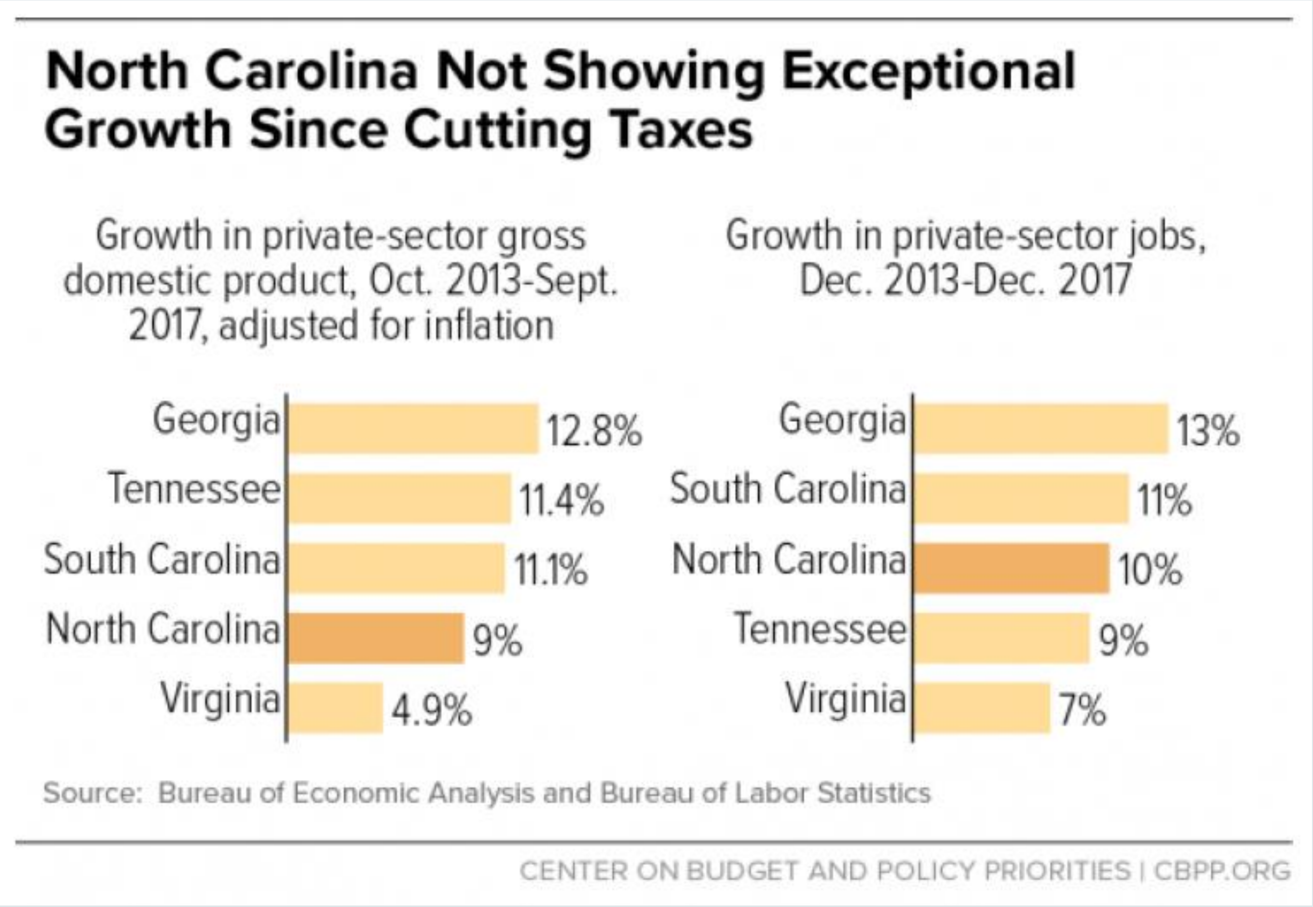
Impact of Kansas Tax Changes Between 2012 and 2015

2015 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Tax Change as % Income	1.5%	0.2%	-0.1%	-0.4%	-0.7%	-1.2%	-1.9%
Average Tax Change	$197	$66	-$29	-$316	-$983	-$3,587	-$24,632

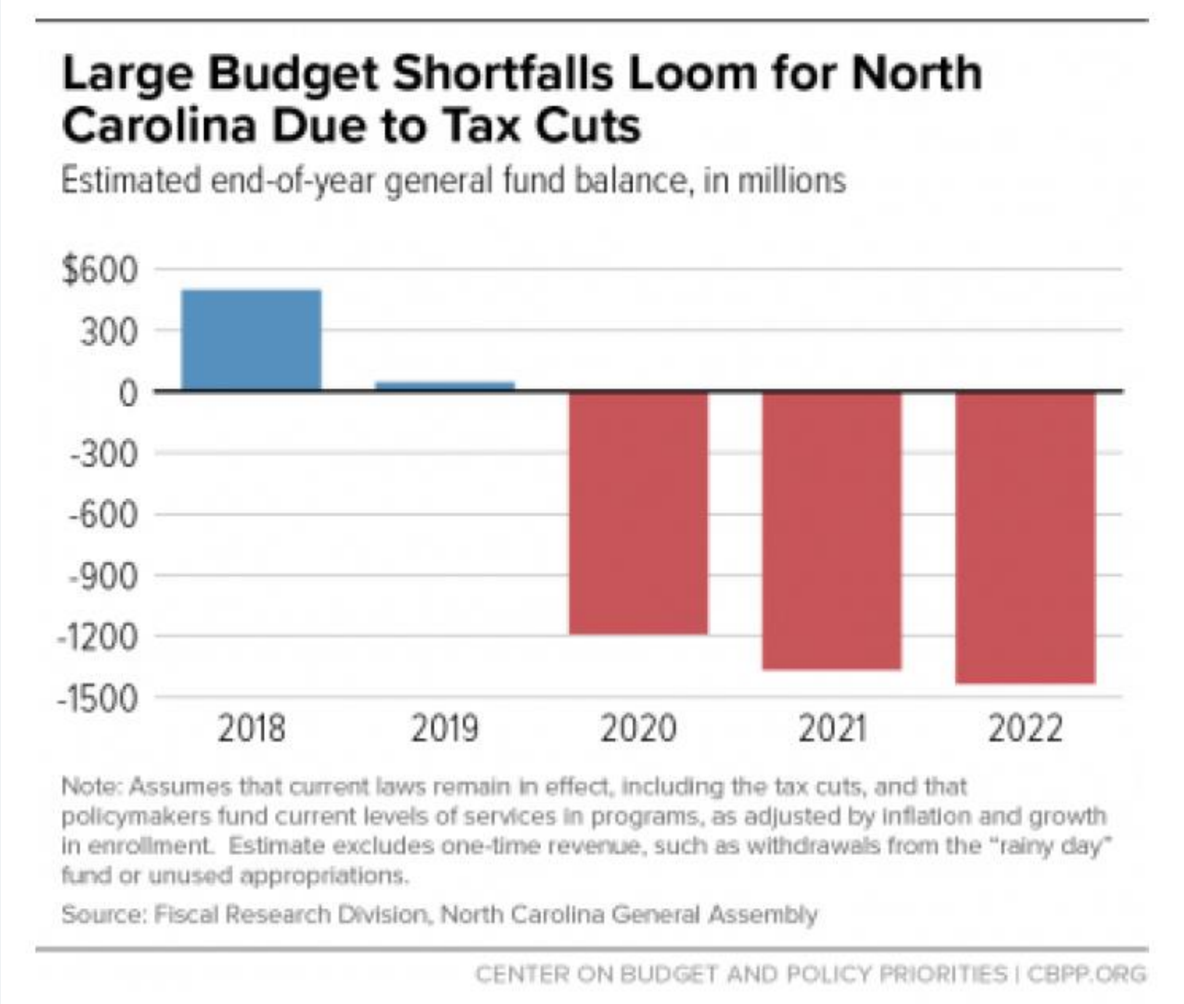
Lessons from North Carolina

- Hoped for economic gains haven't happened
  - Before 2014 cuts, NC outpaced nation and performed in line with neighboring states even with highest income tax rates in the region (and higher rates than today).
  - Since 2014 cuts, lagging GA & SC in GDP and private sector job growth and lagging nation's growth
- The budget crisis is coming

Lessons from North Carolina



Lessons from North Carolina



Questions?

Thank you for your time and attention!

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