THE PEW CHARITABLE TRUSTS

The Revenue Effects of Conformity to Federal Personal Income Tax Expenditures

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Outline

- Background
- Simulation and findings
- Why it matters

The 1986 Experience

- Tax Reform Act of 1986
  - Broadened the base (repealed/limited certain deductions)
  - Increased standard deduction and personal exemptions
  - Expanded EITC
  - Reduced rates

The 1986 Experience

- States:
  - $5 billion projected revenue increase (~7% of PIT revenue)
  - States mostly adopted the base changes. But what to do with the revenue?

    - Increase standard deductions/personal exemptions

    - Reduce rates

    - Keep some

Goals

- A measure of how connected states are to federal tax expenditures
- Illustrate how federal changes can impact states
- Not a reform proposal

Simulation

Federal changes:

- Repealed the majority of federal non-business PIT expenditures:
  - 42 of 169 TEs
  - 80% of the tax expenditure dollars
- Repealed AMT
- Revenue neutral: reduced tax rates across the board by 40%

Simulation

States

- Revenue impact is calculated based on their current (2013) conformity to federal law.
  - i.e. conformity is held constant. States that conformed in 2013 are assumed to maintain that conformity and follow the federal repeal.

Simulation

Model

- Microsimulation of federal and state PIT systems for 2013.
- Captures the linkages between state and federal systems.
- Based on CPS, with imputations from other sources, and targeted to IRS data.

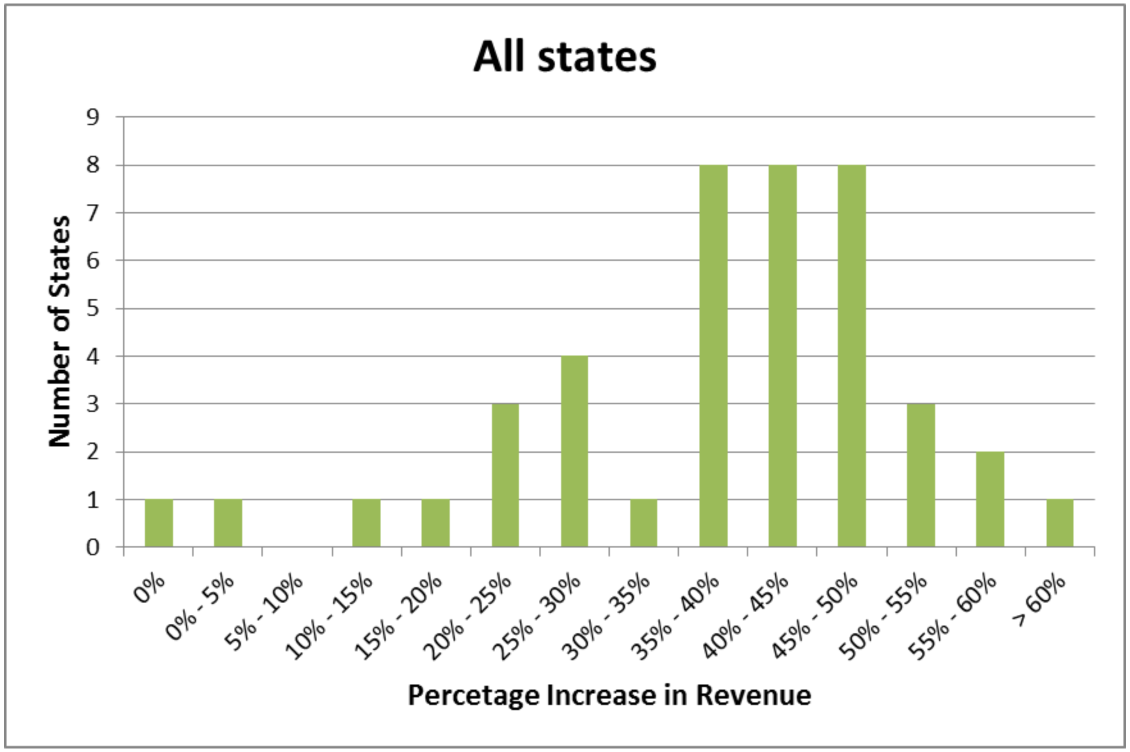
Findings

- All but one state links in some way to federal TEs.

- Total state PIT revenue increased by:
  - 34% nationwide
  - $100 billion

Findings

- The average percentage increase was 39%
  - Ranged from 2% to over 60%

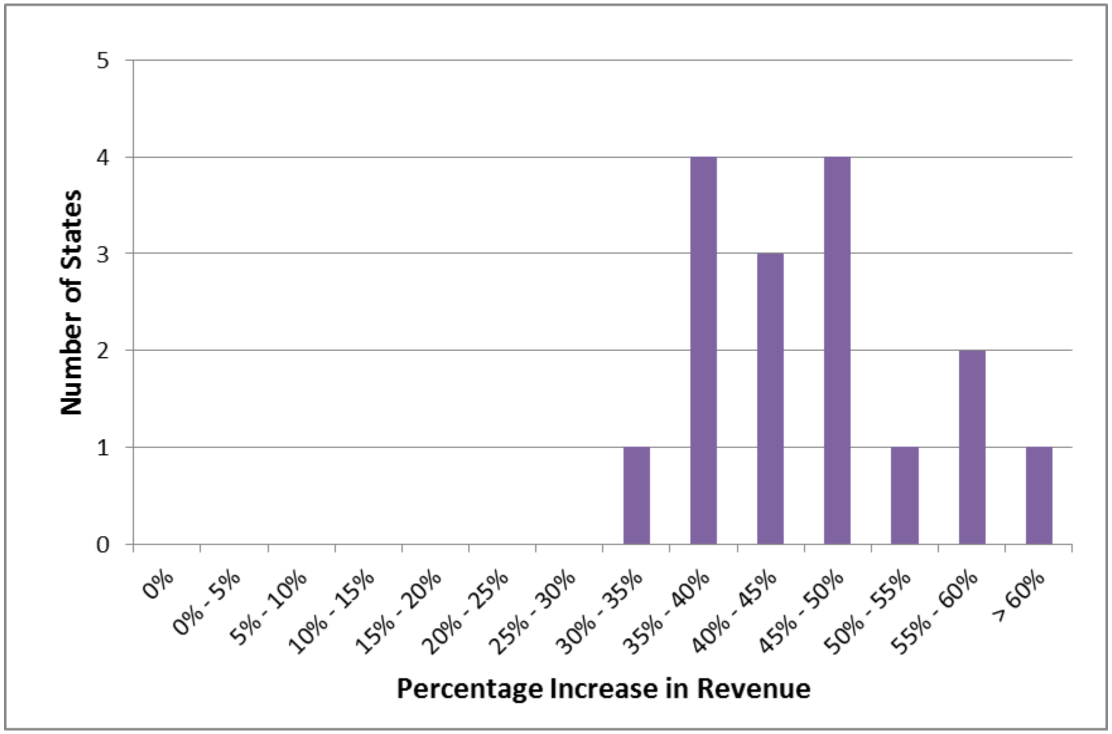


Findings

- 37 states and DC link to federal exclusions and adjustments
- 31 states and DC use federal itemized deductions
- 23 states and DC piggyback on the EITC

Findings

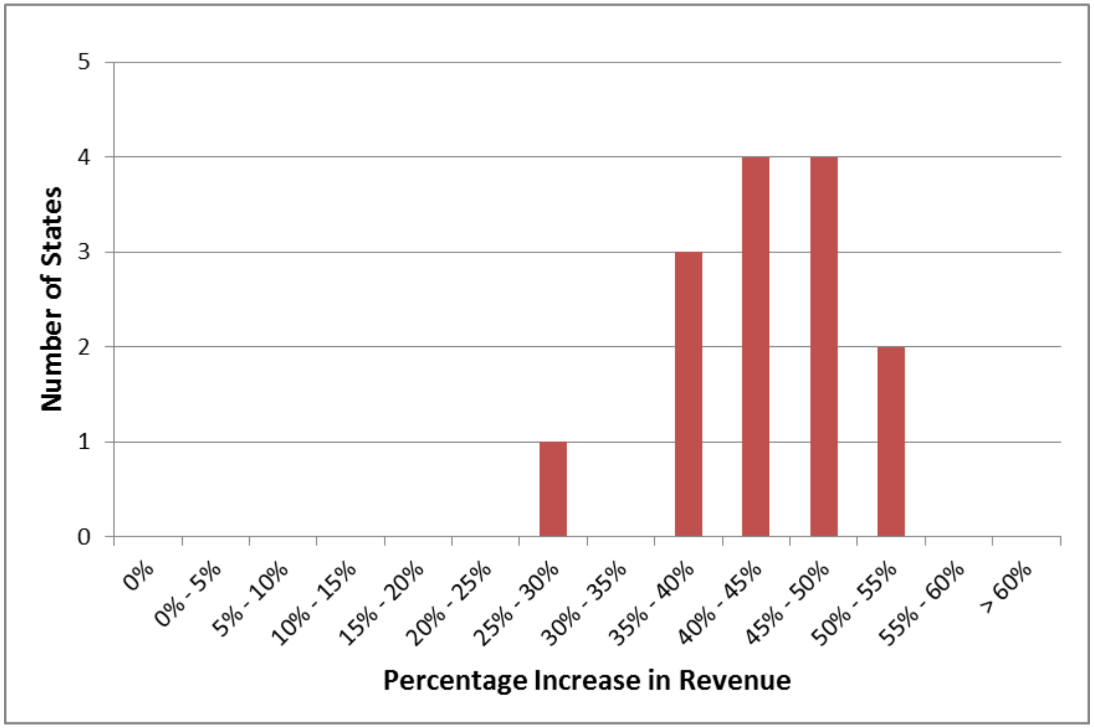
- 15 States and DC linked to all three of these categories



  - All had revenue increases above 30%
  - average percentage increase was 46%

Findings

- 14 states link only to exclusions/adjustments and itemized deductions



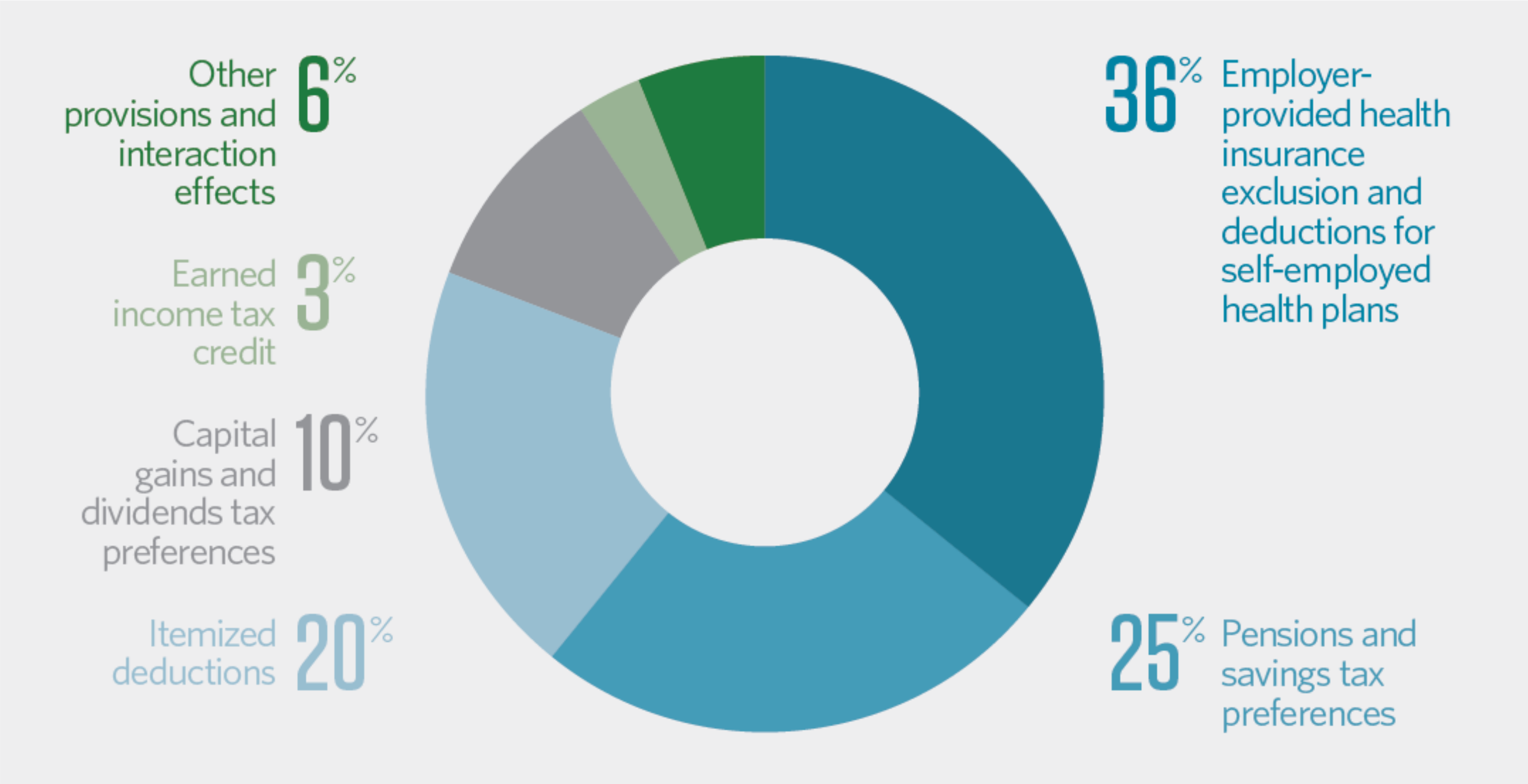
- All had revenue increases above 25%
- Average percentage increase was 44%

Potential Sources of Variation

- Nuances in conformity
- Other features of state tax systems
- Demographic and economic factors

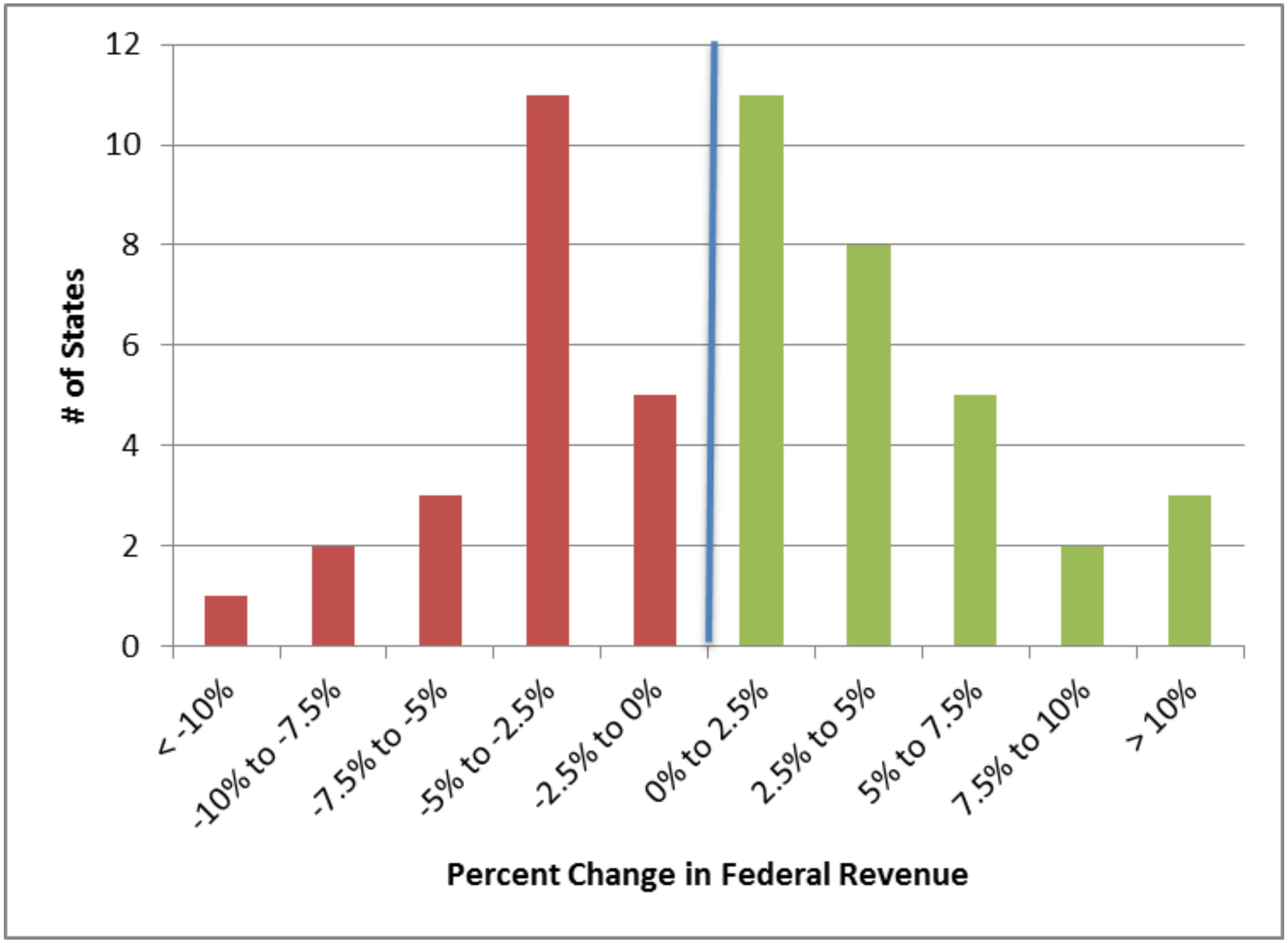
Impacts by Tax Expenditure Class

Share of nationwide increase in state revenue from repeal of selected federal tax expenditures, by category



Federal Revenue Impacts

Federal Revenue Change by State



Why should policymakers care?

- Some changes may be harder to decouple from

- Conformity is a choice for states and involves tradeoffs:
  - Revenue
  - Enforcement
  - Simplicity
  - Compliance
  - Reduce administrative costs
  - Let the Feds do the hard work of defining income

Tax Code Connections: How Changes to Federal Policy Affect State Revenue

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