Addressing the Family-Sized Hole Federal Tax Reform Left for States

State Child Tax Credits

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The Tax Cuts and Jobs Act (TCJA) modestly and temporarily decreased federal individual income taxes for most low- and middle-income families. However, the federal tax changes interacted with state laws in ways that meant—in some states—these same families could see state tax *increases*. Absent legislative action in 2018, state income taxes for many families with children may increase because some of their state's tax laws are linked to the new federal tax code. This brief discusses how implementing state child tax credits (CTCs) could help low- and middle-income families avoid state tax increases, as well as the benefits these tax credits could provide in all states with income taxes.

When the TCJA passed, Colorado, Idaho, Minnesota, New Mexico, North Dakota, South Carolina, Utah, and Vermont had systems that replicated both the federal standard deduction and personal exemption in their state tax, and Maine replicated only the personal exemption.[1] But none of these states had a state CTC that would automatically mirror the changes in the federal CTC. The TCJA altered these three provisions and, as we explain later, these changes provided modest federal tax cuts to low- and middle-income families. However, if a state continued to only replicate the federal standard deduction and personal exemption without a CTC (as was the law at the start of 2018 in these states), many families with children would see a state tax *increase*. To continue copying the federal standard deduction and personal exemption in their code but avoid tax increases, states had to create a state CTC or find another offset.[2]

A state CTC would also benefit the 23 states that offer a personal exemption but do not replicate the federal amount in their tax calculations: Alabama, Arizona, Georgia, Hawaii, Illinois, Indiana, Kansas,

Louisiana, Maryland, Massachusetts, Michigan, Mississippi, Missouri, Montana, New Jersey, New York, North Carolina, Ohio, Oklahoma, Rhode Island, Virginia, West Virginia, and Wisconsin.[3] Shifting from a state personal exemption to a state CTC, as happened at the federal level, could simplify tax filing in these states and provide more benefits to low- and middle-income families with children than exemptions could. New York and Oklahoma already offer a state CTC in addition to their personal exemption, but they could still shift the revenue from their personal exemptions to make their CTCs more generous.[4] And any of the 41 states with a broad-based income tax could add a CTC to support low- and middle-income families with children.

The benefits of a state CTC were essential for the nine states facing tax hikes at the beginning of 2018, advantageous for the 23 states with a personal exemption, and helpful for any state with an income tax.

This policy brief discusses the following:

- **The TCJA tax changes most consequential for low- and middle-income families: changes to the standard deduction, personal exemption, and CTC.** We describe how federal tax changes affected families of varying size with wage earnings of $20,000, $40,000, and $60,000, and how the changes combined to affect families with children under age 17, the largest beneficiaries of the federal CTC expansion (Maag 2018).
- **How the TCJA affected state taxes for low- and middle-income families and how some states then responded with their own reforms.** We show how state tax changes affected the sample families.
    - Colorado accepted the federal changes in its code without any offsets. Families in Idaho, Maine, Minnesota, North Dakota, New Mexico, South Carolina, Utah, and Vermont would have seen similar changes if they had done the same.
    - Idaho, Maine, and Vermont changed their tax laws in response to the TCJA, and we examine how these responses benefited different families in each state. These three divergent reforms are instructive to all states affected by the TCJA changes, but particularly Colorado, Minnesota, North Dakota, and New Mexico, which have yet to amend their tax codes in response to the TJCA. We also briefly describe tax changes passed in South Carolina and Utah.
- **A progressive alternative for states: converting state personal exemptions for children to state refundable CTCs**. A state CTC would conform with the federal law and provide tax relief for low- and middle-income families. We explain the benefits of a CTC compared with the personal exemption, specifically the benefits of a refundable credit.

The TCJA's Effect on State Taxes and Families

The TCJA is complex, with some provisions lowering federal income taxes and others increasing taxes relative to prior law.[5] The TCJA nearly doubled the standard deduction, which increases the fixed

amount of income a filer can exempt from income tax, thus lowering taxes relative to prior law for many low- and middle-income families. The increased CTC also reduced taxes for many families with children. However, these tax benefits were partly offset by the TCJA's elimination of the personal exemption (now worth $0), a provision that previously allowed families to exempt a certain amount of income from tax for each person in the tax unit. We describe these changes in more detail in the next section. All individual income tax provisions in the TCJA, except for a less generous measure of inflation used for indexing tax laws, are set to expire after December 31, 2025.

The TCJA's push and pull led to idiosyncratic tax effects at the federal level. On average, the TCJA reduces taxes modestly for many low-income families, gives larger cuts to middle-income families, and reduces taxes the most for very high–income households (TPC Staff 2017). Family size also makes a difference; among low-income families, smaller families (with zero, one, or two children) benefit more than larger families with children.

In addition to the federal income tax, 41 states and the District of Columbia also levy a broad-based individual income tax.[6] All 41 states link their state tax to the federal tax in some way, mostly through definitions of income or the tax base (Auxier and Sammartino 2018). When a state tax law is linked to a federal tax law, changes to the federal law can "flow through" and change the state tax law. Because the TCJA only slightly changed the federal individual income tax base,[7] most state income tax systems and their taxpayers were not significantly affected.

However, the new $0 federal personal exemption greatly affected the nine states that linked to the federal exemption amount: Colorado, Idaho, Maine, Minnesota, New Mexico, North Dakota, South Carolina, Utah, and Vermont. The exemption in these states mirrored the federal amount, so if they accepted the federal changes, their exemption would also fall to $0. Eight of these states also conformed with the larger standard deduction. Maine only conformed with the personal exemption. None of these states had a CTC that could adopt the changes in the federal CTC.

This brief's insights are relevant for all states with an income tax, though our primary focus is on the nine states where low- and middle-income families were most vulnerable to state tax increases (table 1). Despite federal links, this brief does not focus on Missouri, because it did not link to the personal exemption, and the District of Columbia, because it conformed to these rules for the first time in tax year 2018; both cases prevent tax hikes. This brief is most critical for Colorado, Minnesota, New Mexico, and North Dakota, which have not yet passed any tax legislation to avoid TCJA tax hikes (as of October 2018).

Without a CTC or other reforms, the TCJA's push and pull would have resulted in tax increases for low- and middle-income families in these nine states. Taxes would rise with each additional child because each lost exemption further increases the family's taxable income.[8]

TABLE 1

States That Replicated the Federal Standard Deduction and Personal Exemption in Their Code before the TCJA

	Standard deduction	Personal exemption	Responded to TCJA changes
Colorado	✓	✓	
District of Columbia	✓	✓	
Idaho	✓	✓	✓
Maine		✓	✓
Minnesota	✓	✓	
Missouri	✓		✓
New Mexico	✓	✓	
North Dakota	✓	✓	
South Carolina	✓	✓	✓
Utah	✓	✓	✓
Vermont	✓	✓	✓

Sources: States' statutes and legislation as of October 2018.

Notes: TCJA = the Tax Cuts and Jobs Act of 2017. States marked as conforming with the federal personal exemption conformed with both the federal count and amount ($4,050 in tax year 2017). Before the TCJA, Missouri's personal exemption used the federal personal exemption count but its own amount.

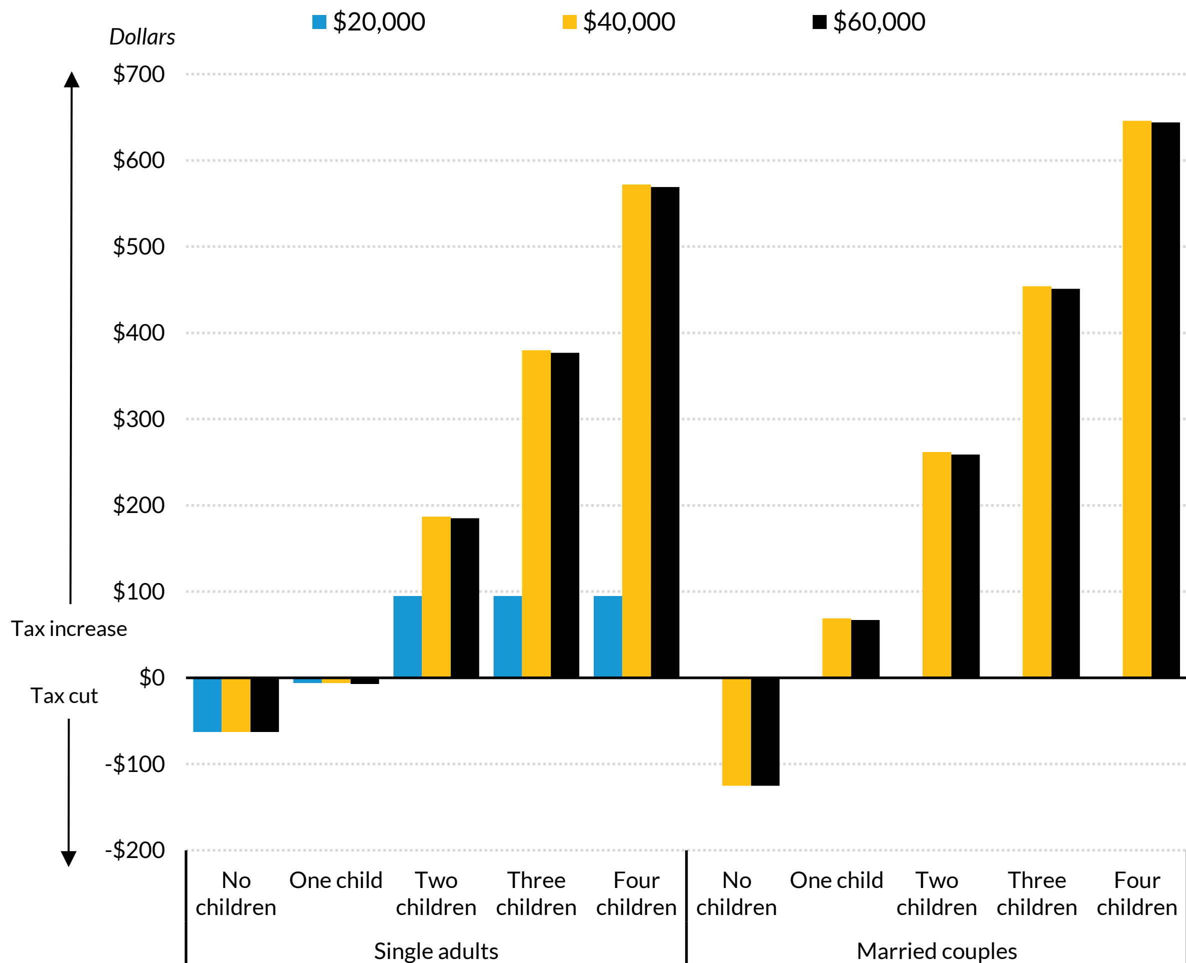
Colorado, which accepted the federal changes without state reforms, shows how the TCJA's push and pull affects families (figure 1). Colorado income taxes for single parents with at least two children and married couples with at least one child will increase in tax year 2018. Families with more children see larger tax increases because each additional child is another lost personal exemption, further increasing the family's taxable income.

Families in Minnesota, New Mexico, and North Dakota may experience tax changes like Colorado's, because, as of October 2018, they had not passed tax changes in response to the federal law.[9] Idaho, Maine, and Vermont's (and to a lesser extent South Carolina and Utah's) tax changes are explained later. Another 23 states that use a personal exemption, but a state-defined amount, in their tax calculation could also benefit from a state CTC (table 2). However, because they do not use the federal amount, their personal exemptions were not set to fall to $0, and thus low- and middle-income families in these states were not vulnerable to state tax increases. However, all 23 states could help such families by switching their personal exemption to a CTC. Further, at the start of 2018, 14 of these states used the federal personal exemption *count* in their tax code to varying degrees; some states explicitly told filers to copy their federal personal exemption count to their state tax form, and others only referenced the federal law in the state tax code. Even now, if and how the $0 federal personal exemption will affect personal exemptions in these 14 states is unclear. States that want to keep their exemption should change their state exemption count to be based on federal filers and dependents instead of personal exemptions (as Maryland, Michigan, and Wisconsin did) or make other changes to their code to clarify the rules for counting exemptions (as others have done). Changing the state personal exemption to a state CTC could also lessen confusion.

FIGURE 1

Colorado Income Tax Changes from TCJA Conformity

By income and family size



Source: Urban Institute.

Notes: TCJA = the Tax Cuts and Jobs Act of 2017. Calculations assume all income comes from earnings, tax units claim the standard deduction, and all children are under age 17. The negative numbers are tax cuts, and the positive numbers are tax increases.

At the start of 2018, only New York and Oklahoma had state CTCs linked to the federal CTC, but neither replicated the federal standard deduction or personal exemption. Therefore, if they accept the federal changes to the CTC, then families would receive larger credits. As such, we do not include these two states in the analysis presented later in this brief.

Finally, all states with an income tax could benefit from a state CTC, which would provide greater benefits to many low- and middle-income families with children than the exemptions.

TABLE 2

States Offering Personal Exemptions but with State-Defined Amounts

State	Used the federal count in calculation before TCJA
Alabama	
Arizona	
Georgia	
Hawaii	✓
Illinois	✓
Indiana	✓
Kansas	✓
Louisiana	✓
Maryland	✓
Massachusetts	✓
Michigan	
Mississippi	
Missouri	✓
Montana	
New Jersey	
New York	
North Carolina	
Ohio	✓
Oklahoma	✓
Rhode Island	
Virginia	✓
West Virginia	✓
Wisconsin	✓

Source: States' statutes.
Note: TCJA = the Tax Cuts and Jobs Act of 2017.

What Did the TCJA Change?

The TCJA increased the standard deduction, eliminated personal exemptions, and expanded the CTC, resulting in moderate tax cuts for most low- and middle-income families with children (table 3).

STANDARD DEDUCTION AND PERSONAL EXEMPTION

Taxpayers can exempt a base amount of income from their federal income tax through the standard deduction (based on filing status) or through itemized deductions (actual amounts spent on allowed deductible expenses).[10] Typically, families itemize their deductions if the sum of eligible expenses exceeds the standard deduction they are eligible for, though this is not a requirement (Tax Policy Center 2018). Most low- and middle-income families have few itemized deductions and instead use the standard deduction. The personal exemption works similarly, but the amount is multiplied by each eligible member of the tax unit and available to all filers (but was previously phased out at higher incomes).

TABLE 3

The TCJA's Changes to the Standard Deduction, Personal Exemption, and Child Tax Credit, 2018

	Pre-TCJA	Current law (TCJA)
Standard deduction	$6,500 (single) $13,000 (married) $9,550 (head of household)	$12,000 (single) $24,000 (married) $18,000 (head of household)
Personal exemption	$4,150 per person	$0
Child tax credit	$1,000 per qualifying child under age 17; phases out above $75,000 (single), $110,000 (married). Refundable portion equals 15 percent of earnings over $3,000	$2,000 per qualifying child under age 17; $500 for all other dependents; phases out above $200,000 (single), $400,000 (married). Refundable portion equals 15 percent of earnings over $2,500, up to $1,400

Source: "Analysis of the Tax Cuts and Jobs Act," Tax Policy Center, accessed November 5, 2018, https://www.taxpolicycenter.org/feature/analysis-tax-cuts-and-jobs-act.

Note: TCJA = the Tax Cuts and Jobs Act of 2017. Head-of-household filing status applies to most single parents.

Deductions and exemptions are worth more to higher-income taxpayers who face higher marginal tax rates than lower-income taxpayers with lower tax rates. A deduction's value for a taxpayer is determined by the size of the deduction and the taxpayer's marginal tax rate (i.e., the tax owed on the last dollar of taxable income). Taxes for people with a 10 percent marginal tax rate will drop by $1,000 if $10,000 of their income is exempted from taxation (the amount of untaxed income multiplied by the tax rate they would have owed if that income were taxed). Taxpayers who face a 40 percent marginal tax rate will see their taxes drop by $4,000 if $10,000 of their income is exempted from taxation.

Reducing the personal exemption from the pre-TCJA $4,150 to $0 and increasing the standard deduction work in opposite directions. These two pieces of the TCJA affect families of different sizes differently (table 4).

The TCJA's larger standard deduction more than offsets the loss of the personal exemption for single workers without children. Absent the TCJA, a worker using the standard deduction ($6,500) and personal exemption ($4,150) could have avoided tax on $10,650 of his or her income in tax year 2018. This would have reduced the worker's taxes by $1,065 if he or she was in the lowest tax bracket (10 percent). Under the TCJA, this same worker can exempt $12,000 from federal income taxes (the new standard deduction for this family type), avoiding tax on $12,000 of his or her income. This would be a $1,200 tax benefit if the worker was in the lowest tax bracket (10 percent). Under the TCJA, a married couple with no children can reduce their taxable income by $24,000 (instead of $21,300 before the TCJA).

For low- and middle-income families, the increased standard deduction covers the lost personal exemption for adults in the tax unit (and a single parent with one child). The swap benefits married couples and single adults without children and single parents. However, families with multiple children will exempt less income from taxation under the TCJA. In isolation, this would raise taxes, but these

families mostly did not see tax increases because the CTC was expanded simultaneously. If a tax unit itemized before the TCJA, they exempted more income than that shown in table 4.

TABLE 4

Income Excluded from Taxation Pre- and Post-TCJA for Families Using the Standard Deduction, 2018

By family type

	Pre-TCJA	TCJA
	Standard deduction + personal exemption (dollars)	Standard deduction (dollars)
Single		
No children	6,500 + 4,150 = 10,650	12,000
1 child	9,550 + 2*4,150 = 17,850	18,000
2 children	$9,550 + 3*4,150 = 22,000	18,000
Married		
No children	13,000 + 2* 4,150 = 21,300	24,000
1 child	13,000 + 3* 4,150 = 25,450	24,000
2 children	13,000 + 4*4,150 = 29,600	24,000

Source: Author's analysis of pre-TCJA and TCJA tax law.

Notes: TCJA = the Tax Cuts and Jobs Act of 2017. Under the TCJA, the personal exemption is $0. The value of the excluded income is calculated as the tax rate a person would owe on the excluded income multiplied by the excluded income. Under the TCJA, statutory tax rates vary from 10 percent to 37 percent.

CHILD TAX CREDIT

Tax credits directly reduce taxes owed. A nonrefundable credit's value cannot exceed taxes owed, but a refundable credit can be received as a tax refund in excess of taxes owed. The TCJA doubled the maximum CTC from $1,000 to $2,000 per child under age 17 and increased the refundable maximum to $1,400.[11] This expanded CTC prevents tax hikes on larger families at the federal level.

To date, the provisions that most significantly affect low- and middle-income families with children are scheduled to expire after 2025. But Congress has already signaled their intention to extend these cuts permanently before then.

RESULTS: FEDERAL TAX CALCULATIONS FOR DIFFERENT FAMILIES

Under the TCJA, different family types, even among low- and middle-income families, were affected differently by the new law's provisions. We analyzed families at three income levels: $20,000, $40,000, and $60,000. We assumed that all income was from wage earnings, all children in a family were under age 17 and qualified for the CTC, and families used the standard deduction both before and after the TCJA. If families itemized before the TCJA but benefited more from taking the standard deduction under the TCJA, their tax cut would be smaller than that shown.

The size of the tax cut varies along three different characteristics (figure 2):

- **Family income.** Holding family size constant, the lowest-income families received the smallest tax cut. For a single mother with two children, the TCJA reduced her taxes by just over $600 if she earned $20,000, by $1,600 if she earned $40,000, and by $2,250 if she earned $60,000.

Similarly, a married couple earning $20,000 sees smaller tax cuts than a married couple earning $40,000 or $60,000 across all family types shown.

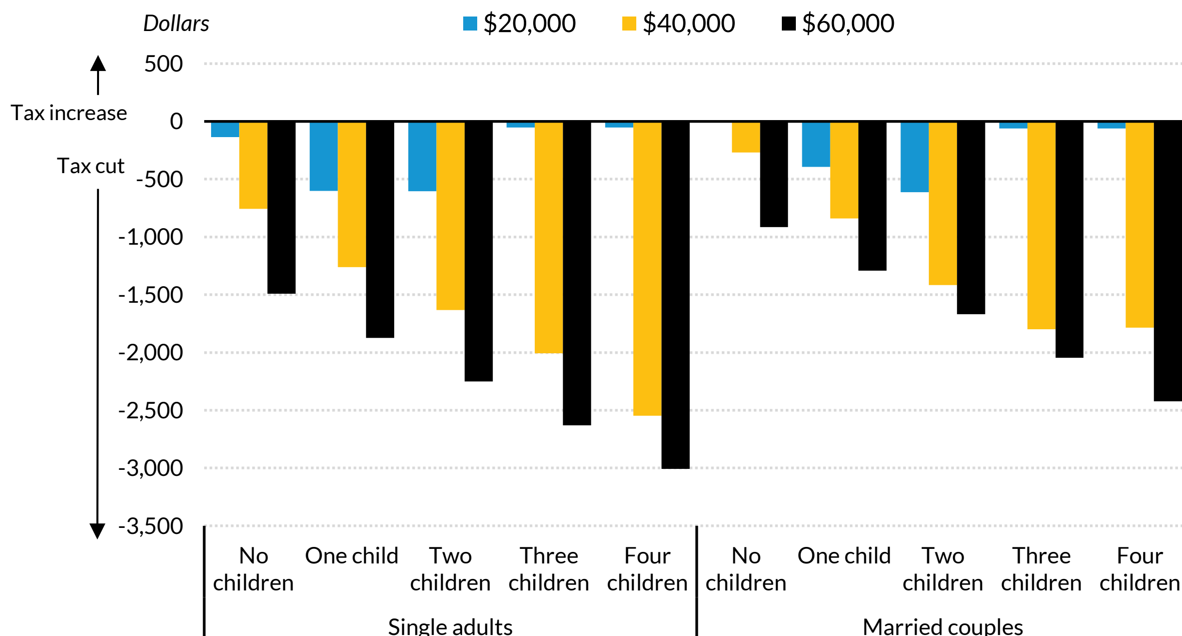
- **Marital status.** In most cases, married couples received smaller tax cuts than single adults, regardless of how many children were in the household. The TCJA reduced taxes for a married couple with one child under age 17 by just under $400 if the couple earned $20,000, by roughly $800 if the couple earned $40,000, and by just under $1,300 if the couple earned $60,000. In contrast, single parents with two children under age 17 received a $600 tax cut if the parent earned $20,000, almost $1,300 if the parent earned $40,000, and almost $1,900 if the parent earned $60,000.
- **Family size.** Among the lowest-income families, smaller households (with two or fewer children) tended to benefit more from the TCJA than larger households. The opposite is true at higher incomes.

Ultimately, most low- and moderate-income families saw small tax cuts from the shifting provisions. The loss of personal exemptions is offset by increases in the standard deduction and CTC. Because the legislation is projected to reduce revenues by $1.5 trillion over the 10-year budget window (TPC Staff 2017), most families saw their taxes fall, at least modestly.

FIGURE 2

Federal Tax Cuts from the TCJA, 2018

By income and family size



URBAN INSTITUTE

Source: "Tax proposal calculator," Tax Policy Center, accessed November 5, 2018, http://tpc-tax-calculator.urban.org/.

Notes: TCJA = the Tax Cuts and Jobs Act of 2017. Calculations assume all income comes from earnings, tax units claim the standard deduction, and all children are under the age of 17. Negative numbers indicate tax cuts, or decreases to taxes owed.

How States Responded to the TCJA

At the start of 2018, nine states (Colorado, Idaho, Maine, Minnesota, New Mexico, North Dakota, South Carolina, Utah, and Vermont) would have seen tax increases on families if they accepted federal changes without other reforms.

Five states in this group (Idaho, Maine, South Carolina, Utah, and Vermont) passed tax changes in response to the TCJA using different approaches. We highlight the reforms in Idaho, Maine, and Vermont. Each state's reform package prevented tax increases on families while demonstrating how different changes affect different families. South Carolina and Utah also passed changes, but we did not model them.

IDAHO

Idaho was the first state to respond to the TCJA, mostly replicating the federal changes in their state tax system by[12]

- maintaining conformity with the federal standard deductions and $0 personal exemption;
- reducing each of the state's seven income tax rates 0.475 percentage points; and
- creating a nonrefundable $205 CTC with eligibility based on the federal CTC.

These changes reduced Idaho tax revenue by roughly $125 million in tax year 2018.

Idaho's changes prevented possible tax increases from conformity for most low- and middle-income families (table 5). However, because Idaho's CTC is nonrefundable, many low-income families received no tax relief. Instead, the tax reductions were mostly concentrated among higher-income filers, specifically those with smaller families.

TABLE 5

Idaho Tax Changes after the TCJA with and without Reforms

	Tax Changes If Idaho Had Accepted the TCJA without Reforms									
	Single adults					Married couples				
Earnings ($)										
20,000	-$96	$0	$0	$0	$0	$0	$0	$0	$0	$0
40,000	-$100	-$11	$284	$567	$621	-$192	$98	$295	$195	$95
60,000	-$100	-$11	$296	$603	$910	-$200	$107	$414	$722	$1,027
Number of children	0	1	2	3	4	0	1	2	3	4
	Actual Tax Changes under the TCJA with Reforms									
Earnings ($)										
20,000	-$134	$0	$0	$0	$0	$0	$0	$0	$0	$0
40,000	-$233	-$320	-$231	-$153	$0	-$268	-$183	$0	$0	$0
60,000	-$328	-$416	-$314	-$211	-$109	-$371	-$269	-$167	-$65	$36
Number of children	0	1	2	3	4	0	1	2	3	4

Source: Urban Institute.

Notes: TCJA = the Tax Cuts and Jobs Act of 2017. Calculations assume all income is from wage earnings.

VERMONT

Vermont responded to the TCJA by breaking many of its ties to the federal income tax system. Its tax legislation[13]

- decoupled from the federal personal exemption and established a Vermont-defined personal exemption of $4,150 (adjusted annually for inflation), what the federal exemption would have been if Congress had not passed the TCJA;
- decoupled from the federal standard deduction and established a Vermont-defined standard deduction of $6,000 for single filers, $9,000 for heads of household, and $12,000 for married filers (adjusted annually for inflation). These amounts are slightly below the federal standard deduction amounts before the TCJA;
- reduced each of the bottom three tax rates 0.2 percentage points, combined the top two brackets, and reduced the top rate 0.2 percentage points;
- increased Vermont's refundable earned income tax credit from 32 percent to 36 percent of the federal credit; and
- eliminated all itemized deductions on the Vermont return and created a 5 percent nonrefundable credit for charitable contributions available to all filers.

Vermont's tax changes were designed to be revenue neutral.

Vermont both prevented possible tax increases from conformity for low- and middle-income families and provided many low-income families with tax cuts by increasing its refundable earned income tax credit, which is targeted at low-income families (table 6). Being refundable means the earned income tax credit can be issued as a refund if it exceeds a family's taxes owed. As a result, these filers saw the largest tax reductions from the state's tax reform.

TABLE 6

Vermont Tax Changes after the TCJA with and without Reforms

	Tax Changes If Vermont Had Accepted the TCJA without Reforms									
	Single					Married				
Earnings ($)										
20,000	-$48	-$1	$78	$78	$78	$1	$2	$4	$4	$4
40,000	-$48	-$1	$149	$269	$444	-$96	$57	$207	$354	$502
60,000	-$92	-$5	$142	$289	$437	-$96	$51	$199	$346	$493
Number of children	0	1	2	3	4	0	1	2	3	4
	Actual Tax Changes under the TCJA with Reforms									
Earnings ($)										
20,000	-$2	-$112	-$211	-$239	-$239	-$1	-$136	-$225	-$253	-$253
40,000	-$42	-$24	-$60	-$80	-$71	-$4	-$29	-$76	-$96	-$88
60,000	-$66	-$66	-$58	-$49	-$41	-$44	-$36	-$27	-$19	-$11
Number of children	0	1	2	3	4	0	1	2	3	4

Source: Urban Institute.

Notes: TCJA = the Tax Cuts and Jobs Act of 2017. Calculations assume all income from wage earnings.

MAINE

Maine passed its conformity bill in early September 2018. The legislation[14]

- ended Maine's state-defined standard deduction (which was larger than the pre-TCJA federal standard deduction) and conformed with the new federal standard deduction;
- decoupled from the federal personal exemption and created a Maine-defined personal exemption of $4,150 (the pre-TCJA federal amount) available to the filer and his or her spouse;
- created a nonrefundable $300 CTC based on federal eligibility; and
- expanded a property tax credit that benefits homeowners and renters.

Maine's tax legislation was roughly revenue neutral.

Maine's changes prevented possible tax increases from conformity for low- and middle-income families (table 7). Like in Idaho, however, most low-income families in Maine saw little tax relief from a new nonrefundable CTC. Most of the tax cuts are concentrated among those with higher incomes, specifically larger families.

TABLE 7

Maine Tax Changes after the TCJA with and without Reforms

	Tax Changes If Maine Had Accepted the TCJA without Reforms									
	Single					Married				
Earnings ($)										
20,000	$241	$128	$129	$129	$129	$1	$1	$1	$0	$0
40,000	$280	$482	$723	$964	$1,205	$481	$723	$952	$953	$953
60,000	$280	$560	$818	$1,058	$1,299	$481	$722	$963	$1,204	$1,444
Number of children	0	1	2	3	4	0	1	2	3	4
	Actual Tax Changes under the TCJA with Reforms									
Earnings ($)										
20,000	-$12	$1	$1	$1	$1	-$50	-$25	-$24	$1	$1
40,000	-$14	-$70	-$129	-$188	-$83	-$73	-$107	-$24	$1	$1
60,000	-$14	-$33	-$76	-$135	-$195	-$23	-$83	-$142	-$201	-$260
Number of children	0	1	2	3	4	0	1	2	3	4

Source: Urban Institute.

Notes: TCJA = the Tax Cuts and Jobs Act of 2017. Calculations assume all income is from wage earnings.

SOUTH CAROLINA AND UTAH

South Carolina maintained conformity with the federal standard deduction but decoupled from the federal personal exemption and created a new dependent exemption.[15] The new exemption is larger for children younger than age 6. South Carolina estimates its new exemptions will protect most low- and middle-income families from state tax increases. But because the state used exemptions and not a refundable credit, many low-income families will not receive tax cuts.

Utah's tax system is more complicated because, before the TCJA, the state did not replicate the federal standard deduction and personal exemption but used them in its calculation of a state tax credit.[16] Utah decoupled from the $0 federal personal exemption and replaced it with a state exemption.[17] Utah also lowered its flat tax rate from 5 percent to 4.95 percent in separate legislation. The Utah Office of the Legislative Fiscal Analysis estimates the exemption is too low to prevent increases in many families' state taxes.[18]

No state chose to only reduce tax rates. Though lowering tax rates was part of state reforms in four of these five states, only reducing rates would not have helped many families affected by the possible tax increases. Low- and middle-income families see tax increases from even a small increase in taxable income, but they do not have enough total taxable income to benefit from rate cuts. To reduce taxes for low- and middle-income families, state responses should be targeted at taxable income.

The three states we modeled show why the targeting matters for low- and middle-income families with children. As Idaho and Maine demonstrated, a CTC based on the federal credit is a simple addition to the state tax code that can reduce taxes for families and prevent the TCJA-created tax increases. But as Vermont demonstrated, tax credits need to be refundable to benefit low-income families. Next, we highlight another targeted change that combines these two approaches: a refundable CTC.

A Progressive Alternative for States: Converting Personal Exemptions to Refundable CTCs

Adding a refundable CTC to the tax code would benefit Colorado, Minnesota, New Mexico, North Dakota, and any state with an income tax (including states that already have a personal exemption that includes children) that wants to deliver benefits to low-income families with children. A refundable CTC harnesses the simplicity of the new state CTCs in Idaho and Maine because it mirrors the new federal law. But by making it refundable, as with Vermont's earned income tax credit, the credit can also deliver new tax benefits to low-income families that the nonrefundable state CTC or South Carolina's new personal exemption cannot.

For simplicity, we suggest states borrow the design of the federal CTC (like Idaho and Maine), phasing the credit in and out at the federal levels. However, a state could make its CTC more beneficial to very low–income families by allowing *all earnings* to be used in the calculation of the state CTC. Currently, the federal credit does not begin to phase in until a person has at least $2,500 in yearly earnings. And if states are concerned about revenue loss, they could phase it out at lower income levels than the federal credit, which begins to phase out by 5 percent once income reaches $200,000 ($400,000 if married).

TABLE 8

States' Child Tax Credit Amount Necessary to Replace Personal Exemption

Dollars

	Current personal exemption	Proposed child tax credit
Alabama	1,000	50
Arizona	2,300	83
Colorado	4,050	188
District of Columbia	4,050	263
Georgia	300	180
Hawaii	1,444	87
Idaho	4,050	300
Illinois	2,175	108
Indiana	1,500	48
Kansas	2,250	117
Louisiana	1,000	40
Maine	4,050	273
Maryland	3,200	152
Massachusetts	1,000	51
Michigan	4,000	170
Minnesota	4,050	286
Mississippi	1,500	75
Missouri	1,200	72
Montana	2,400	166
New Jersey	1,500	79
New Mexico	4,050	198
New York	1,000	65
North Carolina	2,500	137
North Dakota	4,050	83
Ohio	2,300	80
Oklahoma	1,000	50
Rhode Island	3,900	146
South Carolina	4,050	284
Vermont	4,050	275
Virginia	930	53
West Virginia	2,000	120
Wisconsin	700	44

Sources: Urban Institute calculation and state statutes and tax forms for tax year 2017.

Notes: We use tax year 2017 because some states changed their personal exemption amount for tax year 2018 in response to the federal law. However, in the District of Columbia and North Carolina, we use tax year 2018 because they made substantial changes to their exemptions for that tax year before the TCJA became law. These child tax credits would roughly replace the value of the state's current personal exemption for most low- and middle-income families. States that do not tax income or do not offer personal exemptions (including those that use personal credits) are not included. If a state offers different exemption amounts for the filer and dependent, the dependent amount is used. If the state offers different amounts based on the filer's income, the highest amount is used.

If a state currently offers a personal exemption for children, it can create an equal value CTC by multiplying the amount of income exempted from tax by the tax rate at which that income would be taxed if it were not exempt. That converts the value of the exemption into a credit. Colorado offered a $4,050 personal exemption in tax year 2017 (the year before the TCJA changes took effect), and its flat tax rate was 4.63 percent. The exemption times the rate equals $188, or the value of the exemption for most taxpayers. The credit is smaller than the personal exemption because an exemption reduces

taxable income (which is multiplied by a rate for tax), but a credit reduces tax directly (the final payment). Above, we calculate the CTC for each state with a personal exemption for children based on the value of that exemption in tax year 2017, before the TCJA took effect (table 8). If a state has an income tax but not a personal exemption (e.g., Pennsylvania), any amount is beneficial for low- and middle-income families because there is no exemption to replace. If a state has a personal credit instead of a personal exemption (e.g., Nebraska), it can tie the credit to the federal CTC and increase the amount, but there is also no exemption to replace.

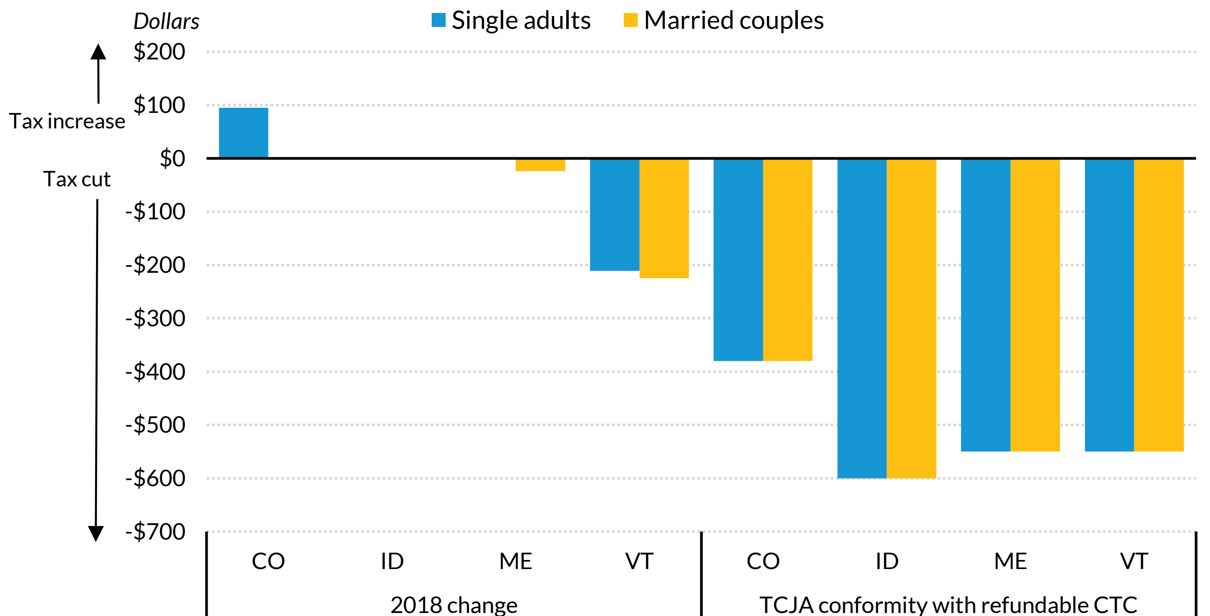
The CTC would not provide a benefit to the filer or spouse, who currently benefit from personal exemptions. The state could assist them by increasing the standard deduction (like the TCJA), maintaining the personal exemption for them (as Maine did), or creating a credit for them.

A refundable CTC can offset taxes owed and provide an additional benefit because it refunds any excess credit (not used to lower taxable income) to the taxpayer. This is integral to our proposal. To see how this effects state taxes, we show how taxes changed for families with two children earning $20,000 in Colorado, Idaho, Maine, and Vermont with the changes each of these states enacted, and what would have happened if these states accepted the TCJA changes and added our refundable CTC (figure 3). We choose $20,000 because families with those earnings did not get tax cuts in Idaho and Maine.

FIGURE 3

Refundable Child Tax Credits' Reduction to Low-Income Families' Taxes

Family with two children earning $20,000



Source: Urban Institute.

Notes: Calculations assume all income comes from earnings, tax units claim the standard deduction, and all children are under age 17. The negative numbers are tax cuts, and the positive numbers are taxes. Refundable child tax credit amounts are $188 in Colorado, $300 in Idaho, $273 in Maine, and $275 in Vermont.

With the actual changes made in these states in 2018 (or lack thereof in Colorado), families with two children earning $20,000 pay more in Colorado, see little to no change in Idaho and Maine, and get a roughly $200 tax cut in Vermont. Families in Minnesota, New Mexico, and North Dakota will see similar changes as those in Colorado, families in South Carolina will see changes like those in Vermont and Maine, and families in Utah should fall somewhere in between.

With the refundable CTC we propose, families in Colorado, Idaho, Maine, and Vermont would see tax cuts between $300 and $600. If Colorado, Minnesota, New Mexico, North Dakota, South Carolina, and Utah, or any of the other states highlighted in this brief, created a refundable CTC, they also would give families earning $20,000 a tax cut.

Conclusion

Low- and middle-income families faced many tax changes from the TCJA. Most germane were the increase in the standard deduction and the expanded CTC (which both lowered taxes) and the elimination of personal exemptions (which raised taxes). This push and pull meant different families saw different federal tax changes. Higher-income families benefited more from the tax law than lower-income families of the same size; married parents saw smaller tax cuts than single parents; low- and middle-income families with at least two children benefited less than smaller families; and families with older children benefited less than families with younger children. But nearly all families saw tax cuts or no change in their federal income tax.

However, in nine states, the TCJA could have increased state taxes for low- and middle-income families, with larger families seeing the largest tax increases. This is because these states conform with the federal standard deduction and personal exemption but not the CTC. If states accepted the new federal law without this missing piece, low- and middle-income families would pay higher taxes.

States had several options for responding to federal changes. The tax reform legislation passed in Idaho, Maine, and Vermont shows three ways of addressing these potential state-level tax increases from the TCJA, most importantly for low- and middle-income families with children:

- Idaho created a nonrefundable CTC.
- Maine created a nonrefundable CTC.
- Vermont increased its refundable EITC.

Because of these changes, low- and middle-income families avoided tax increases in all three states, but only in Vermont (because of its increased refundable earned income tax credit) did most of these low-income families also see tax cuts. South Carolina and Utah also passed tax changes in response to the TCJA that we did not model. Neither state added a CTC.

In contrast, Colorado, Minnesota, New Mexico, and North Dakota have not passed changes in response to the TCJA as of October 2018. These states must act if they want to avoid raising taxes on low- and middle-income families.

These states, and any state with an income tax, can target relief to low- and middle-income families by establishing a state CTC. In addition to avoiding tax increases in these five states, a CTC can be altered in ways a personal exemption cannot. States can make their CTC refundable and deliver tax relief to low-income families that an exemption (or nonrefundable CTC) would miss. Further, changing the CTC's income phase-in schedule would provide additional relief, and altering its income phase-out schedule could limit its cost. We have shown how to choose a CTC to replace the personal exemption for children.

Adopting a state CTC is a smart solution to a tricky problem for the four states facing possible tax increases next year and a good idea for any state policymakers looking to assist low- and middle-income families in their state.

Notes

[1] The District of Columbia also linked to these federal provisions but is omitted from this list because it conformed with the federal standard deduction and personal exemption for the first time in tax year 2018. If the District did not act, families would see not a tax increase but a smaller-than-anticipated tax cut. For more information, see Richard C. Auxier, "In the District, conformity giveth, and conformity taketh away," *TaxVox*, published June 5, 2018, https://www.taxpolicycenter.org/taxvox/district-conformity-giveth-and-conformity-taketh-away.

[2] Before the TCJA, Utah used the federal standard deduction and personal exemption, but only in its calculation of a state tax credit. As a result, the federal changes negatively affected Utah families, but responding would involve different steps than those described here for other states. For more on Utah's state tax credit, see "Taxpayer tax credit," Utah State Tax Commission, accessed November 5, 2018, https://incometax.utah.gov/credits/taxpayer-tax-credit.

[3] All 23 states set the value of their personal exemption, but at the start of 2018, 14 of them used the federal personal exemption count in their tax calculations. The new $0 federal personal exemption could complicate these state tax systems if their codes are not updated. In this brief, we assume all 14 states keep their exemptions.

[4] New York's CTC is 33 percent of the federal credit, but qualifying children must be at least 4 years old. Oklahoma's CTC is 5 percent of the federal credit, but only filers with adjusted gross income under $100,000 qualify.

[5] The TCJA, passed in December 2017, became public law 115-97, "an Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018."

[6] New Hampshire taxes only interest and dividends, and Tennessee taxes only bond interest and stock dividends. Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming do not tax any individual income.

[7] The TCJA repealed exclusions and deductions like moving expenses, alimony paid, bicycle commuting, and income from domestic production activities, which affect few taxpayers.

[8] States use "rolling" or "static" conformity. In rolling states (including Colorado, Missouri, New Mexico, North Dakota, and Utah), federal changes automatically flow through to the state tax code. In static states (including Idaho, Maine, Minnesota, South Carolina, and Vermont), the state must adopt the federal changes with legislation. Therefore, Minnesota and South Carolina could choose not to conform with the new federal changes. However, that would create complex issues with their state tax systems.

[9] Minnesota is a "static" conformity state, meaning its conformity to the federal code is tied to a specific date. Minnesota's date (December 16, 2016) was set before the TCJA. Therefore, if the state takes no action, it would preserve the pre-TCJA tax system in Minnesota. This would prevent tax increases but cause complex problems.

Colorado, New Mexico, and North Dakota are "rolling" conformity states, so the federal changes automatically took effect in these states. See Auxier and Sammartino (2018) for more on conformity.

[10] Allowable expenses include some state and local income or sales taxes, home mortgage interest, charitable deductions, and real estate taxes. For a more thorough list, see "Topic number: 500 – Itemized deductions," Internal Revenue Service, accessed November 5, 2018, https://www.irs.gov/taxtopics/tc500.

[11] Dependents who do not qualify for the CTC can qualify for a dependent credit of up to $500. This nonchild credit is not refundable. For a detailed explanation, see Maag (2018).

[12] H.B. 463, 64th Leg. 2nd Reg. Sess. (ID. 2018); H.B. 675, 64th Leg. 2nd Reg. Sess. (ID. 2018). Not all changes are reported here.

[13] H. 16, (VT. 2018), https://legislature.vermont.gov/bill/status/2018.1/H.16.

[14] An Act to Update References to the United States Internal Revenue Code of 1986 Contained in the Maine Revised Statutes, L.D. 1655, 128th Legislature, 2nd Spec. Sess. (ME. 2017).

[15] SC Taxpayer Protection and Relief Act, H. 5341, 122nd Sess. (SC. 2018).

[16] For more on Utah's state tax credit, see "Taxpayer tax credit," Utah State Tax Commission, accessed November 5, 2018, https://incometax.utah.gov/credits/taxpayer-tax-credit.

[17] Income Tax Code Amendments, H.B. 2003, 2nd Spec. Sess. (UT. 2018).

[18] Thomas Young, "Federal Tax Reform and Change to Tax Burden," Utah State Legislature, Office of the Legislative Fiscal Analysis, accessed November 5, 2018, https://le.utah.gov/interim/2018/pdf/00004142.pdf.

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