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M E M O R A N D U M

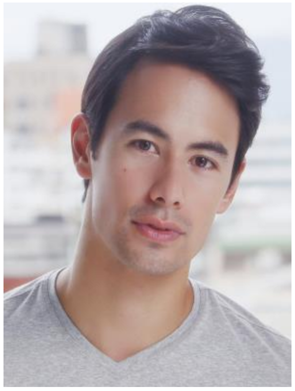
TO:	All Members Interim Joint Committee on Appropriations and Revenue
FROM:	Jennifer C. Hays, Committee Staff Administrator Appropriations and Revenue Committee
DATE:	October 25, 2018
SUBJECT:	House Bill 487 Impact on Individual Income Tax Scenarios

During the 2018 Regular Session of the General Assembly, the Appropriations and Revenue Committee staff received several requests to demonstrate the specific impact of certain tax reform changes on Kentucky's residents. Because the Legislative Research Commission only has access to aggregated data and does not have access to individual return data, the questions about who might be impacted could not be answered given these data constraints. After receiving several requests from legislators, I volunteered some very limited information from individuals that I personally assist with tax preparation.

I am not a paid preparer. I will not represent these individuals if their income tax returns are disputed. Finally, each person gave me permission to share their information, with the assurance that names would be changed to protect their identity.

These are real-life examples. However, these examples are not necessarily representative of Kentucky's entire population. Not all situations can be explained by these limited examples. There are aspects of Kentucky's tax reform that will cause more tax to be paid by some individuals or households and other aspects of tax reform that will cause less tax to be paid for some individuals or households. The net effect depends greatly on each taxpayer's circumstances.

Since federal tax reform was enacted just prior to the start of the 2018 Regular Session, these examples demonstrate the federal impact as well as the state impact of tax reform.



James is a young adult that recently graduated from college.

He is employed at a local accounting firm and is trying to save money before he gets married. James is interested in the stock market and makes routine small investments.

In his spare time, James works odd jobs on a farm and has miscellaneous non-employee income.

Because his employer does not provide a retirement plan, James has an IRA and makes monthly contributions. He is also paying off student loans and takes the standard deduction.

Using numbers filed on James' 2017 income tax return, James will pay less tax in 2018 for both Federal and Kentucky tax purposes totaling $464.

	2017	**2018**	**Impact to Amount of Tax Due**
Wages	32,025	32,025	
Investment Income	227	227	
Other Income	1,133	1,133	
IRA Contribution	(5,000)	(5,000)	
Student Loan Interest Paid	(141)	(141)	
Federal AGI	**28,244**	**28,244**	
Federal Income Tax			
Standard Deduction	(6,350)	(12,000)	Higher Standard Deduction
Personal Exemption	(4,050)	0	No Personal Exemption
Taxable Income	**17,844**	**16,244**	
Tax	**2,208**	**1,759**	Lower Tax Brackets
Retirement Savings Credit	(200)	(200)	
Tax Liability	**2,008**	**1,559**	**Less Federal Tax Due**
Kentucky Income Tax			
Federal AGI	**28,244**	**28,244**	
Standard Deduction	2,480	2,530[1]	
Taxable Income	**25,764**	**25,714**	
Tax	**1,310**	**1,285**	Flat 5% Tax Bracket
Personal Credit	(10)		No Personal Credit
Tax Liability	**1,300**	**1,285**	**Less Kentucky Tax Due**
Differences			
Federal		$449	
Kentucky		15	
Total Tax Savings		**$464**	

[1] KRS 141.081 allows the standard deduction to be increased each year by the Consumer Price Index. For 2018, Kentucky's standard deduction will be $2,530.

Paul and Mary were high school sweet hearts. While in high school, both found employment in their home town. Paul worked at a fast food chain and Mary worked at a local consignment clothing store. Soon after graduation, Paul and Mary decided to elope. Not long after that, they were expecting their first child and Mary decided to quit work. Layla was born in 2017. Paul continues to support his family with multiple part-time jobs.

Paul and Mary do not owe federal taxes in either year since they benefit from the standard deduction and personal exemption. Additionally, they would qualify for the federal refundable earned income tax credit, meaning that they would actually receive a refund of more than the federal tax paid.

However, the family will owe additional Kentucky income tax. Because the Family Size income tax credit eliminates only 90% of the family's tax liability, the flat tax rate of 5% is an increase for this family. By eliminating the 2%, 3%, and 4% brackets on the lower amounts of income, a tax increase is created.

Using numbers filed on their 2017 income tax return, additional tax of $6 is owed to Kentucky.

	2017	2018	**Impact to Amount of Tax Due**
Wages	20,800	20,800	
Federal AGI	**20,800**	**20,800**	
Federal Income Tax			
Standard Deduction	(12,700)	(24,000)	Higher Standard Deduction
Personal Exemption	(12,150)	0	No Personal Exemption
Taxable Income	**0**	**0**	
Tax	**0**	**0**	**No Impact to Federal Tax Due**
Earned Income Tax Credit	(3,400)	(3,400)	
Tax Liability[2]	**(3,400)**	**(3,400)**	
Kentucky Income Tax			
Federal AGI	**20,800**	**20,800**	
Standard Deduction	(2,480)	(2,530)	Higher Standard Deduction - COLA
Taxable Income	**18,320**	**18,270**	
Tax	**880**	**914**	Flat 5% Tax Bracket
Personal Credit	(30)		No Personal Credit
Family Size Tax Credit (90% credit)	(765)	(823)	
Tax Liability	**85**	**91**	**More Kentucky Tax Due**
Differences			
Federal		0	
Kentucky		6	
Total Additional Tax Due		**$6**	

[2] Since the tax liability is negative for both years on their federal tax return, Paul and Mary would receive a refund of all tax withheld from the wages earned by Paul plus an additional $3,400 from the federal earned income tax credit.

Thomas and Jill have been married for seven years. Both are college graduates. Thomas works as a grain specialist, assisting equine breeders in central Kentucky. Jill is a clinical social worker and has student loans from earning her master's degree.

Both employers provide health insurance, but the couple must pay for insurance for their two small children. Both employers offer a retirement plan.

Today, this couple rents their home because of high day-care expenses.

Using numbers filed on their 2017 income tax return, Thomas and Jill will <u>pay less tax</u> in 2018 for both Federal and Kentucky tax purposes totaling <u>$2,602</u>.

	2017		2018		**Impact to Amount of Tax Due**
Wages		$80,609		$80,609	
Investment Income		747		747	
Student Loan Interest Paid		(1,105)		(1,105)	
Federal AGI		**80,251**		**80,251**	
Federal Income Tax					
Standard Deduction		(12,700)		(24,000)	Higher Standard Deduction
Personal Exemption		(16,200)		0	No Personal Exemption
Taxable Income		**51,351**		**56,251**	
Tax		**6,774**		**6,369**	Lower Tax Brackets
Credit for Child Care		(1,200)		(1,200)	
Child Tax Credit		(2,000)		(4,000)	Higher Child Tax Credit
Tax Liability		**3,574**		**1,169**	**Less Federal Tax Due**
Kentucky Income Tax					
Federal AGI	**36,415**	**43,836**	**36,415**	**43,836**	
State Tax Refund		(747)		(747)	
Standard Deduction	(2,480)	(2,480)	(2,530)	(2,530)	Higher Standard Deduction - COLA
Taxable Income	**33,935**	**40,609**	**33,885**	**40,559**	
Tax	**1,785**	**2,174**		**3,722**	Flat 5% Tax Rate
Personal Credit	(20)	(20)		0	No Personal Credit
Combined Tax Liability		**3,919**		**3,722**	
Child Care Credit		(240)		(240)	
Tax Liability		**3,679**		**3,482**	**Less Kentucky Tax Due**
Differences					
Federal				$2,405	
Kentucky				197	
Total Tax Savings				**$2,602**	

Joe and Teresa have retired from Kentucky government jobs but still work to help children with certain expenses and to assist aging parents. Because a large portion of their service was prior to 1998, the reduced pension exclusion does not impact either Joe or Teresa. Joe maintains the family farm by producing beef cattle. Teresa has been reemployed by state government.

Joe and Teresa will benefit from the increased federal standard deduction and a lower federal tax rate in 2018. For Kentucky tax purposes, the elimination of the itemized deduction for taxes and the personal credit means that additional state tax would be due.

Even though Joe and Teresa will pay more tax to Kentucky in 2018, overall they have a net benefit from federal tax reform of $629.

	2017	2018	**Impact to Amount of Tax Due**
Wages	88,897	88,897	
Investment Income	271	271	
Taxable Refund	3,162	3,162	
Pension Income	85,819	85,819	
Schedule E	(3,450)	(3,450)	
Schedule F	(35,048)	(35,048)	
Federal AGI	**139,651**	**139,651**	
Federal Income Tax			
Itemized Deduction: Taxes	(11,031)		Switch to Standard Deduction
Itemized Deduction: Contributions	(12,816)		
Standard Deduction		(24,000)	
Personal Exemption	(8,100)	0	No Personal Exemption
Taxable Income	**107,704**	**115,651**	
Tax Liability	**18,304**	**17,322**	Lower Tax Brackets
Kentucky Income Tax			
Federal AGI	**139,651**	**139,651**	
Subtraction: State Refund	(3,162)	(3,162)	
Subtraction: Retirement Income	(85,819)	(85,819)[3]	No Impact on Retirement Income
Subtraction: Depreciation	(8,835)	(8,835)	
Subtraction: Taxes	(6,589)		No Itemized Deduction for Taxes
Subtraction: Contributions	(12,816)	(12,816)	
Taxable Income	**22,430**	**29,019**	
Tax	**1,118**	**1,451**	Flat 5% Tax Bracket
Personal Credit	(20)		No Personal Credit
Tax Liability	**1,098**	**1,451**	**More Kentucky Tax Due**
Differences			
Federal		$982	
Kentucky		353	
Total Tax Savings		**$629**	

[3] KRS 141.021 exempts federal, local, and state government retirement annuities accrued or accruing prior to January 1, 1998. For retirement annuities containing service before and after January 1, 1998, KRS 141.0215 provides a methodology for prorating the total retirement annuity. The retirement annuity is multiplied by a fraction, the numerator of which is the number of months of service performed after January 1, 1998, and the denominator of which is the total number of months of service. The result is the amount included in gross income.

Joyce is a widow. She lost her husband almost six years ago. Her health is now deteriorating. Joyce owns her own home and wants to live out the rest of her life where she is familiar with her surroundings.

Joyce retired from state government and also receives Social Security income. From years of saving, she has a small amount of investment income. Her fixed income maintained her standard of living until her health began to fail.

For federal purposes, the $10,000 limitation on the deduction for taxes paid and the elimination of the personal exemption increase the amount of federal tax due.

For state purposes, the elimination of the itemized deductions for taxes paid and medical expenses impact her calculation, but because she retired prior to 1998, all retirement income is excluded.

Joyce will pay a total of $192 more federal income taxes as a result of federal tax reform. There is no change to her Kentucky income tax liability.

	2017	2018	**Impact to Amount of Tax Due**
Investment Income	2,187	2,187	
Pension Income	40,206	40,206	
Taxable Social Security	12,811	12,811	
Federal AGI	**55,204**	**55,204**	
Federal Income Tax			
Itemized Deduction: Medical Expenses	(10,510)	(10,510)	
Itemized Deduction: Taxes	(12,056)	(10,000)	Deduction Limited to $10,000
Itemized Deduction: Contributions	(1,300)	(1,300)	
Exemption	(4,050)	0	No Personal Exemption
Taxable Income	**27,288**	**33,394**	
Tax	**3,625**	**3,817**	**More Federal Tax Due**
Kentucky Income Tax			
Federal AGI	**55,204**	**55,204**	
Subtractions: Social Security	(12,811)	(12,811)	
Retirement Income	(40,206)	(40,206)	No impact on Retirement Income
Medical Expenses	(10,510)	0	No Itemized Deduction for Medical
Taxes	(10,055)	0	No Itemized Deduction for Taxes
Contributions	(1,300)		
Standard Deduction		(2,530)	Standard Deduction
Taxable Income	**0**	**0**	
Tax	**0**	**0**	
Personal Credit	(10)	0	No Personal Credit
Tax Liability	**0**	**0**	**No Impact to Kentucky Tax Due**
Differences			
Federal		$192	
Kentucky		0	
Total Additional Tax Due		**$192**	