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Tax Reform Moves to the States: State Revenue Implications and Reform Opportunities Following Federal Tax Reform.

Key Findings

- States incorporate provisions of the federal tax codes into their own codes in varying degrees, meaning that federal tax reform has implications for state revenue beyond any broader economic effects of tax reform.
- Because the base-broadening provisions of the new federal tax law often flow through to states, while the corresponding rate reductions do not, most states will experience a revenue increase. The vast majority of filers will receive a tax cut at the federal level, but they could easily see a state tax increase unless states act to prevent one.
- Eighteen states and the District Columbia have “rolling” conformity with the Internal Revenue Code, meaning that they will conform to relevant provisions of the new federal law automatically, while nineteen must update their fixed-date conformity statutes to adopt the new provisions. The remaining states only conform selectively.
- The largest revenue increases will be in states which conform to the now-repealed federal exemption, either directly or by linking their own personal exemptions to the number of exemptions claimed at the federal level. States which conform to both the standard deduction and the personal exemption will also experience a revenue increase.
- Six states will incorporate the new 20 percent deduction for pass-through business income unless they decouple from the provision or change their income starting point from federal taxable income to federal adjusted gross income.
- Unless they act, most states will not conform to an important pro-growth element of federal tax reform, the provision providing for immediate expensing of investments in machinery and equipment. The additional revenue from base broadening elsewhere may provide an opportunity to conform to this provision.
- States which include Subpart F income, a component of income for multinational businesses, in their base may receive a repatriation windfall, but should avoid building this one-time revenue into their budget baseline.
- States anticipating additional revenue should view this as an opportunity to make their tax codes more competitive. In the past, federal tax reform has initiated a round of state tax reform as well.
- State fiscal offices have an obligation to provide critical revenue estimate information to legislators during the 2018 legislative sessions.

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