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Federal Tax Cuts Trigger Stealth Tax Hikes in States.

In many states, taxes are going up without lawmakers ever needing to take a vote.

Republicans may have handed many Americans a big cut in federal taxes, but their plan is triggering a wave of state income tax increases across the country.

In many states, the tax hikes are coming without legislators ever needing to take a vote — thanks to state tax laws that are automatically synched to changes in the federal code. That's raising fears, particularly among business groups, that instead of reversing the increases, cash-hungry statehouses from New York to Minnesota to Colorado will just let their taxes go up.

"There's still time in the legislative sessions, and it's hard to know how many will be there at the end of the session, but thus far, most states are on track to keep the windfall," said Jared Walczek, a senior policy analyst at the Tax Foundation.

The increases vary widely, from $30 million next year in Vermont to more than $1 billion in New York. When Congress pares back tax breaks, as it did with the Tax Cuts and Jobs Act, those changes are duplicated in state codes around the country, often automatically. So, in many states, unless legislators reduce their own tax rates or make other changes in their own codes to offset those changes, they will suddenly raise more money.

The issue has gotten relatively little attention so far, overshadowed by the federal implementation of the new law and efforts by states like New York to wriggle around a new cap on a federal deduction for state and local taxes.

In an analysis last month, the consulting firm Ernst & Young predicted state corporate tax receipts will rise 12 percent over the next decade thanks to the stealthy tax increases.

The question of how to respond to the windfalls comes at a tricky time for state governments, when the November elections are beginning to loom.

Business groups are mounting a lobbying fight, emphasizing that, though the money may be washing into states without legislators having to do anything, they are nevertheless tax increases.

"Because it's automatic, it's not recognized [as a tax increase], and that's the biggest challenge," said Ferdinand Hogroian, senior tax and legislative counsel at the Council on State Taxation, which represents large corporations.

The issue highlights the little-noticed links between state and federal tax codes. Most states sync their tax systems to the federal one, to varying degrees.

Piggybacking on the federal code eases the administrative burden on states, which can rely on the IRS to explain and enforce the provisions, while also making life easier for taxpayers navigating the systems.

But that syncing does not extend to individual and business tax rates — states keep tight control over those. That's a big deal now because the federal Tax Cuts and Jobs Act squeezed narrow tax provisions in exchange for lowering rates. Only the changes in those breaks are now flowing through to state codes, not the changes in rates.

So even if state tax rates go untouched, they nevertheless now raise more money because they apply to more types of income.

"If you expand the base, but don't decrease the rate, what's going to happen? Tax revenues are going to go up," said Steve Wlodychak, an expert on state taxes at Ernst & Young.

Individuals and businesses alike would be hit by increases, though to varying degrees in different states, and many legislators will surely prioritize protecting average citizens. That leaves businesses fearful legislators will cherry-pick the hard-to-understand corporate revenue raises in the new tax law to prevent tax hikes on individuals or to fill other funding gaps.

"Most of the policymaker discussion is focused on the individual income tax side — what are states going to do to protect their individuals from tax increases," said Steve Kranz, who represents the STAR (State Taxes After Reform) Partnership, a coalition of businesses fighting the increases.

"The corporate tax discussion is really just beginning."

Anti-tax guru Grover Norquist is urging legislators to reject the windfalls.

"There's always a temptation to keep the cash — the Democrats will all want to keep the cash, and there may be some Republicans who will be tempted," said Norquist. "But we would just urge everyone to work to reduce the tax burden, and one of the ways you do that is by not accepting windfall tax increases."

On the other side are groups like the left-leaning Center on Budget and Policy Priorities, which is urging states to raise taxes on corporations, arguing the cuts at the federal level went too far.

That's what Democrats like Minnesota Gov. Mark Dayton want to do. He proposed last month raising $500 million, in part by incorporating in the state's tax code federal provisions taxing multinationals' repatriated earnings and also imposing a new "GILTI" minimum tax on a type of companies' overseas income. He wants to use much of that money to finance a new personal and dependent credit projected to benefit 2 million Minnesotans.

"One of the reasons that the governor has been focusing on individuals at the state level is because the focus at the federal level was on businesses," said Cynthia Bauerly, the state's revenue commissioner. "The governor has really been focused on providing permanent tax cuts for individuals and families and balancing that [Tax Cuts and Jobs Act] at the state level."

In New York, legislators are battling the federal law's new SALT cap even as they want to adopt other tax increases in the law, such as one limiting companies' ability to take interest deductions.

In Colorado, the debate between Democrats and Republicans over what to do with its windfall has focused mostly on how to spend it.

Efforts by states to impose their own taxes on companies' foreign earnings will likely end up in court, said Wlodychak, pointing to a 1992 Supreme Court decision restricting states' ability to tax international income.

“There are some very, very serious constitutional questions that have to be determined,” he said.

So far, only a handful of states, including Georgia and Idaho, have rejected the windfall by cutting their own tax rates.

“Eliminating the windfall will keep more of Georgians’ hard-earned money in their pockets while keeping our state competitive and business friendly,” said Jen Ryan, a spokeswoman for Georgia Gov. Nathan Deal.

Many other states have barely begun engaging with the issue, with some planning special legislative sessions on the new law.

Said Wlodychak: “Tax reform isn’t over — we still have to worry about what’s going to happen at the state level.”

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