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Fitch: State Tax Cut Wave Has Peaked with Modest Revenue Effects for Most States

Fitch Ratings-New York-17 August 2023: Tax cuts enacted by US states in 2023 are not likely to have a meaningful effect on most states' revenues or affect credit ratings in the short term, says Fitch Ratings. We expect that states implementing the largest structural tax changes will adjust spending accordingly, though states that have underestimated the potential revenue impact of cuts made near the peak of the economic cycle may face fiscal deterioration and credit challenges.

The wave of tax cuts passed by U.S. states beginning in 2021 appears to have crested. Although 24 states adopted tax reduction measures of some kind in their fiscal 2024-25 budgets, the scope of changes narrowed versus prior years, with fewer states opting for major restructurings of tax brackets or deep cuts to tax rates.

For the most part, tax cuts enacted in 2023 will have more modest effects on revenues than cuts made in prior years, as most 2023 changes took the form of temporary rate reductions, tax holidays, or expanded tax credits. Tennessee's four-month sales tax holiday will reduce fiscal 2024 collections by $400 million, equal to 1.3% of state-source revenues. Wisconsin's permanent cuts to its two lower personal income tax (PIT) rates will reduce biennial general fund revenues by only 0.8% ($175 million). However, when combined with larger PIT cuts enacted in the last biennium, this will reduce collections by $2.2 billion, or about 2.5% of state revenues.

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