





11 gubernatorial races will be decided.

**79%** of legislative seats will be decided.

## Executive and legislative races

While most attention has been focused on the federal elections – with 34 Senate seats, all House seats and the presidency up for election – significant state elections and ballot measures also will be decided. Eleven gubernatorial races will be decided, with at least eight states poised to welcome a new governor due to term limits or an incumbent's decision not to seek re-election. Such changes in state executive leadership are likely to bring new directors of state departments of revenue and economic development, potential shifts in tax and economic policy, and tax reform proposals driven by the executive branch.

Legislative elections will be held in 44 out of 50 states, deciding approximately 5,800 legislators (79%) in 85 of the nation's 99 state legislative chambers. With these elections will come changes in legislative leadership, new chairs of state taxwriting committees, and new lawmakers contributing to tax policy decisions across the country.

## **Ballot measures**

Several states empower their residents to create law directly through ballot initiatives, including decisions on state tax policy. While several important state tax-related measures are on the ballot this election cycle, a few stand out as especially significant. If approved, Oregon Measure 118 would impose a new 3% minimum tax on corporations' Oregon gross sales exceeding \$25 million, beginning in 2025 (see Tax Alert 2024-1250). San Francisco Measure M, if approved, would substantially revise the city's business taxes beginning next year, including rate changes and how several of the taxes are calculated (see Tax Alert 2024-1825).

Other measures would implicate future tax policy decision-making. Measures in Washington would repeal the state's capital gains tax, I-2109, and prohibit the implementation of state carbon cap and trade and carbon tax programs, I-2117, which may reduce current education, transportation and environmental infrastructure spending. Elsewhere, an Illinois advisory question will gauge taxpayer appetite for a 3% surtax on individual income exceeding \$1 million to lower property taxes.<sup>1</sup>

<sup>&</sup>lt;sup>1</sup> For more information on state ballot measures to be decided this election cycle, see Tax Alert 2024-1941 and 2024-1951.



Changes in state executive and legislative leadership will coincide with factors that could lead to a year of substantial state tax policy discussions. All 50 state legislative bodies will be in session in 2025 and must pass new budgets. All those states, except Vermont, have some form of balanced budget requirement enshrined in law, which will require lawmakers to balance spending priorities against revenue raising. Further, both federal policymaking and state fiscal concerns may complicate the state policy landscape moving into next year.

## Tax Cuts and Jobs Act implications

Since the enactment of the Tax Cuts and Jobs Act (TCJA) in 2017, state lawmakers have been refining their policies on federal income tax conformity, selectively choosing which TCJA provisions to adopt or reject for purposes of calculating state income. Several states have also created special tax regimes for pass-through entities, which are largely viewed as a strategic response to the TCJA's limitation on state and local deductions.

## State conformity to key TCJA provisions

#### IRC\* Section 168(k)

Most states decouple from federal "bonus" depreciation provisions.

#### IRC Section 163(j)

Most states **conform** to the TCJA's IRC Section 163(j) business interest expense limitation.

## IRC Section 174

Most states **conform** to the amortization of research and experimentation costs beginning in 2022.

More recently, state lawmakers have been grappling with some of the delayed aspects of the TCJA, including provisions that phase down full expensing and changes to the deductibility of expenses for R&D and interest. With large portions of the TCJA set to sunset in 2025, the results of the 2024 federal elections will determine the path forward for federal tax policy. However, state elections and the ensuing legislative sessions will ultimately shape how states align with or diverge from federal tax policy moving forward.

<sup>\*</sup>Internal Revenue Code

## State fiscal conditions

While most states have seen substantial revenue growth in recent years, fiscal year 2024 – running from July 2023 to June 2024 – saw a 0.7% average increase in inflation-adjusted state revenues, with 33 states reporting declines in revenue.

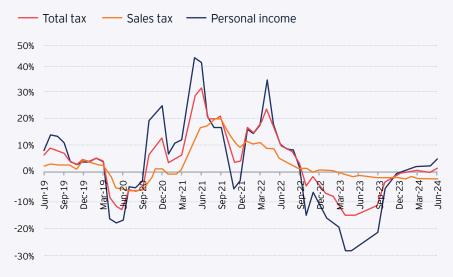
## State Revenue Reporting: June 2024

Source: Monthly State Revenue Highlights, Urban Institute, August 2024.

- June 2024 vs. prior year
  - Overall adjusted state revenue up 4.4%
  - Personal income tax: 10.8%
  - Corporate income tax: 15.7%
  - Sales and use tax decrease: -4.0%
- July-June 2024 vs. prior year
  - Overall adjusted state revenue up 0.7%
    - 33 states showed net declines in inflation-adjusted revenue, four reporting double-digit declines
  - Personal income tax: 2.7%
  - Corporate income tax: 4.9%
  - Sales and use tax decrease: -2.0%

## Percent change in inflation-adjusted state tax revenues

Year-over-year percent change, 6-month moving averages



<sup>&</sup>lt;sup>2</sup> See, Lucy Dadayan, Urban Institute, "Monthly State Revenue Highlights: Income Tax Gains but Sales Tax Losses in July," September 2024.

Several states also continue to face impending revenue shortfalls. California, Illinois, Louisiana, Maryland and New York all face deficits and will be required to make difficult spending reductions or revenue raising decisions in 2025. Federal fund transfers to the states will also continue to dissipate in 2025 following a surge in federal outlays to states over the past four years.

# Due to additional federal funding and unexpected tax receipts, state and local governments increased spending during the pandemic

## Total US state expenditures, FY 2019 to FY 2022 actuals and FY 2023 estimates, in \$b

- In FY 2021, state expenditures were \$2.7 trillion, an 18% or \$412b increase from the FY 2020 actuals of \$2.3t.
- During the pandemic, \$307b of the \$412b increase in the total expenditure was driven by an increase in federal funds associated with COVID-19 aid in FY 2021.
- The estimated total federal fund expenditure was \$1,084b in FY 2022 and estimated to decline by 2% to \$1,060b in FY 2023.



Source: 2023 State Expenditure Report, National Association of State Budget Offices, 2023.



## Conclusion

The 2024 state elections will play a critical role in establishing the state tax policy landscape moving into 2025. All states will be grappling with constrained revenues and reductions in federal funding compared with prior years, all while new executive and legislative leaders and lawmakers navigate the complex tax policy environment. The results of the federal elections are also likely to impact state tax policy, as national leaders make decisions on state funding and federal tax policy. This includes decisions on tax extenders, expiring TCJA provisions and new tax priorities from the next president, such as decisions on international tax provisions and the taxability of tips or overtime – all of which may necessitate state conformity choices.

Provision	2021	2022	2023	2024	2025	2026	Revenue		
TCJA "pre-cliffs"							Through 2025 <sup>1</sup>	2025-2034 <sup>2</sup>	
Interest deduction based on EBITDA		EBIT					-\$18.8b		
R&D expensing		Five-year	amortization	(15-year fo	r foreign R&D)		-\$8.5b		
100% expensing			Phased do	wn in 20% ir	ncrements		-\$3.05b	-\$378b	
TCJA international provisions									
GILTI deduction at 50%						37.5% deduction		-\$120b	
FDII deduction at 37.5%						21.875%	deduction		
BEAT rate: 10% (11% for banks/dealers)						12.5%/13	.5% rate	-\$21b	
TCJA individual provisions									
Income tax rates 10%, 12%, 22%, 24%, 32%, 35%, 37%						10%, 15%, 39.6%	25%, 28%, 33%, 35%,	-\$2.16t	
Standard deduction									
\$12,000/single, \$24,000/married						\$6,350/si	ngle, \$12,700/married	-\$1.25t	
AMT exemption						\$54,300/	cinalo		
\$81,300/single,							-\$1.3		
\$126,500/married						\$84,500/	married		
Child tax credit: \$2,000, refundable to \$1,400						\$1,000,\$	1,000 refundability	-\$748b	
20% pass-through deduction						No deduct	ion	-\$684b	
Estate (currently \$12.92m) and Gift Tax Exemptions						\$5.49m (p adjusted)	ore-2018 \$5m inflation	-\$167b	
SALT deduction cap \$10,000						No SALT d	eduction cap	+\$1.2t <sup>3</sup>	
Other issues			<u>.</u>						
Tax extenders - CFC look-through, WOTC, NMTC, etc.						Extenders	expire	-\$66b	
Expanded ACA Premium Tax Credits							ounts reduced, limited to elow 400% of FPL	-\$335b	

## ■ In effect

Not in effect

These factors in combination will lead to a busy 2025 state legislative cycle teeming with significant and potentially controversial tax policy proposals.

<sup>&</sup>lt;sup>1</sup> Joint Committee on Taxation (JCT), JCX-3-24, Estimated Revenue Effects of H.R. 7024, The Tax Relief For American Families and Workers Act of 2024, January 2024

<sup>&</sup>lt;sup>2</sup> Congressional Budget Office (CBO), Budgetary Outcomes Under Alternative Assumptions About Spending and Revenues, Supplemental Data, May 2024

<sup>&</sup>lt;sup>3</sup> Tax Foundation estimate

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