

Speaker 1 ([00:00](#)):

This podcast episode reflects the opinions of the hosts and guests and not of Greenberg Traurig, LLP. This episode is presented for informational purposes only, and it is not intended to be construed or used as general legal advice, nor a solicitation of any type.

Lucy Dadayan ([00:15](#)):

I would say that there is a much variation across the local governments because the pandemic has changed lots of normal trends.

Nikki Dobay ([00:26](#)):

Hello, and welcome to GeTtin' SALTy, a state and local tax policy podcast hosted by Greenberg Traurig. My name is Nikki Dobay, a partner in the Sacramento, California and Portland, Oregon offices.

([00:39](#)):

I am very pleased to be joined today by Lucy Dadayan, who is a principal research associate with the Urbans-Brookings Tax Policy Center at the Urban Institute. That's a mouthful, Lucy, so hopefully you don't have to introduce yourself with that every time. But Lucy and I have spoken before on the podcast, so I'm very pleased that she was able to join me today. Thanks so much for being here, Lucy.

Lucy Dadayan ([01:04](#)):

Thank you so much for having me. Always a pleasure to talk to you.

Nikki Dobay ([01:10](#)):

Lucy, you recently put out a very lengthy report, the Q4 2022 report, and then you've had some blog posts on how things are looking in 2023. So I thought what we would do today is really get caught up since we last spoke, which was early in 2022. And I went back and listened to our podcast again, and what we really talked about then was how going into the pandemic things were very uncertain for the States and we were probably on the brink of a potential recession then. And then the pandemic hit, there was a free fall, but then everything kind of rebounded with the government money and a lot of additional consumer spending. And so the States were doing fairly well going into 2022.

([02:02](#)):

So catch us up and tell us how the rest of 2022 panned out, and then we'll really dig into the specifics of the report. But just high level, how did 2022 end up going on the state revenue side?

Lucy Dadayan ([02:20](#)):

Sure. When we talked, the state tax revenues were in a healthy position and it was mid-fiscal year 2022. And for sure states were going to end the fiscal year 2022 in a very good note, and that's exactly what happened. Most states have seen double-digit revenue growth.

([02:44](#)):

However, shortly after we talked actually, and because of the conversation we had, I went back and wrote up a blog post which was titled Five Reasons Why a State Should Proceed with Caution Despite Soaring Revenues. And the five reasons were the inflation, the second reason was because of the pandemic, the spending on taxable goods has increased sharply and we were expecting that consumers will revert back to their normal spending behavior, which is spending more on services rather than on goods.

[\(03:24\)](#):

Well, the other reason of caution was the stock market, in 2021, calendar year 2021, the stock market performed extremely well. On average the stock market increased by 33%, which was the highest growth observed in the last six years. So it was obvious that that could not be sustainable, that the stock market performance is going to weaken. And then other reason was the fact that in 2021 we have seen a skyrocketing number of initial public offerings. And again, it was clear that it wasn't going to be repeated in 2022 calendar year, 2022.

[\(04:16\)](#):

When we talked it was early January I believe, and so we haven't had the geopolitical crisis going on yet. That added up to the uncertainties as well. So fast-forward, states have closed their fiscal year 2022 in a very positive note, but we have already seen weakness starting from July of 2022, which is the first month of fiscal year 2023. And if we look at the revenues for fiscal year 2023, revenues have been declining in nominal terms for six, seven consecutive months. So fiscal year 2023 was not a repeat of fiscal year 2022 or 2021 in many states. As a matter of fact, in several states, revenues were declined in comparison to fiscal year 2022, but there is large variation across the states and I'm sure we're going to talk about it.

Nikki Dobay [\(05:35\)](#):

Yeah. Okay, so that was a lot to get caught up on. It sounds like it's been a busy year for you, watching all of the information come in. So let's get into some of the details about the report on Q4 2022 and then the beginning of 2023. And so as you mentioned, we are at the end of the 2023 fiscal year, and so how things really did play out.

[\(06:05\)](#):

I think I was reading in your last blog post that overall revenues have declined just above 5%. Can you unpack that and talk about how that really looks across the board? I mean, at a high level, but also any specific state outliers. I noticed Oregon was one you pointed out in your blog post, which made me chuckle a little bit because of our kicker, but just, what's the impact of that number and what does it all mean?

Lucy Dadayan [\(06:37\)](#):

Yeah. Actually now we have preliminary data from 42 states for fiscal year 2023. And at the moment, average nominal percentage is about 6% on average. Whereas if we look at the median state, among all those 42 states the average revenues nominal change is about 1% growth. So that is indicated that there is large variation across the states.

[\(07:12\)](#):

But decline or weakness is predominantly caused by the declines in income tax revenues. And income tax revenues have declined for multiple reasons. As I mentioned earlier, one of the reasons is the performance of the stock market, which on average declined in calendar year 2022 compared to 2021. And when taxpayers make their final payments in April, they make payments based on the calendar year 2022. So the weakness in stock market is one of the reason.

[\(07:53\)](#):

But another big reason is the income tax rate cuts among many states. In general states enacted tax cuts that was expected to decrease the overall state budgets by \$16 billion. That was just enormous and

unprecedented single year tax cuts. That's the second reason for weakness in revenues, particularly for income tax revenues.

[\(08:30\)](#):

Other reasons are many states have moved forward to enact new tax, which is the pass-through entity taxes, which is supposed to be revenue-neutral for the states, but it kind of shifted revenue from personal income tax to corporate income tax in several states. It depends on how we account that revenue from the newly enacted taxes. So depending on that, that's another reason why we have seen declines in income tax revenues, personal income tax revenues.

[\(09:08\)](#):

Overall, the personal income tax revenues has seen double-digit declines in fiscal year 2023 on average, whereas if we look at the sales tax revenues we have seen nominal growth of around 6%. I mean, if you adjust for inflation, it's almost like negative or unchanged compared to fiscal year 2022. So that's where we stand at the moment.

Nikki Dobay [\(09:41\)](#):

The observations on the income tax side are really interesting, because with the rate cuts I assume the state's expected to see those revenue declines. I mean, in fact, that was the purpose for those rate cuts. So in that sense, is there any worry about that decline from your end or maybe the circles that you run in, or is everybody saying, "Yep, those rate cuts did what they were supposed to."

Lucy Dadayan [\(10:15\)](#):

I mean, most states have really healthy rainy day funds, and they thought that it's okay to move forward and have tax cuts. But in a more prudent fiscal policy environment, when you make any tax cuts, you should also propose how you are going to replace lost revenues from those tax cuts. Unfortunately, it's often the case that such revenue cuts are not replaced with new revenue sources.

[\(10:53\)](#):

And another thing to remember is that tax cuts were also structured in a way that we're going to benefit more the wealthy taxpayers, benefit more on high-income taxpayers, which is reason for concern because in most states where we have progressive income tax structures, or even if they don't have progressive income tax structures, they rely highly on high-income taxpayers. So it's not even benefiting everyone, and unfortunately it's costing the states.

Nikki Dobay [\(11:39\)](#):

Yeah, yeah. I mean, your point is well taken that right now the rainy day funds can sustain the rate cuts, but I think this has been one of the questions as we've watched the States, especially on the personal income tax side cut rates, is I think proceeding with caution because we don't know what the future holds. And those are very good campaign points I'm sure, but we will have to see how they play out in the future.

[\(12:15\)](#):

And the other thing that I will say is very interesting to hear, and I was very interested in reading in the report, was the point about the pass-through entity taxes because they ... So this explanation is very helpful because it sounds like they probably are revenue-neutral ultimately, but it's really a shift of the money going from one bucket, the personal income tax bucket, into another. Because when I read the

report that wasn't crystal clear and I was like, "Wait a minute, this was not supposed to have this impact." But that makes a lot of sense.

[\(12:50\)](#):

On the corporate income tax side it seems like there there's been some softening as well, but again, we all know the corporate income tax is kind of a small piece of the budget, so maybe not that impactful overall. But any insights on that front?

Lucy Dadayan [\(13:10\)](#):

I mean, there has been a bit of gap between the growth in corporate profits and the growth in corporate income tax revenues. And if we have to forecast what's going to happen to corporate income tax revenues, we should look into corporate profits, which have been softening a lot in the last few quarters. And that data comes from the Bureau of Economic Analysis. Of course there is large variation across the industries, but the financial sector industry's suffering the most, and which means it is having much larger impact in places like New York and California which have high reliance on financial industries.

Nikki Dobay [\(13:57\)](#):

Yeah. And then on the sales tax side, I think this is going to be an interesting area to watch because there's always a lot of discussion at the state level and there's a lot of discussion amongst the administrators on broadening sales tax bases. And it seems like, if I'm kind of taking a step back and trying to get some of the themes from the report and what's happening, and these are probably obvious observations for you because you live in this space, but income taxes are very volatile, whereas the consumption-based taxes are fairly steady. And so there is something to states gravitating towards those types of taxes to try to stabilize their revenue streams.

Lucy Dadayan [\(14:52\)](#):

Sales tax revenue trends are really interesting. In general, sales tax revenues tend to be much less volatile compared to income tax revenues. And when we look at the trends, we do expect continued but weak growth in sales tax revenues.

[\(15:15\)](#):

Now there are few things that happened to sales tax revenues. First of all, they have seen a significant increase during the pandemic because many consumers were spending a lot on goods rather than on services because they couldn't be spending on services because of the lockdowns, travel restrictions, and everything else happening. And the other thing is, just by luck, most states had moved forward to enact internet taxation. In the post-Wayfair world we have seen that. And just before the pandemic in many states had rules and regulations in place to tax online sales, which helped a lot during the pandemic.

[\(16:15\)](#):

The other reason why we have seen strong growth in sales tax revenues in the last year or so is largely because of the inflation. Of course the high inflation means higher prices and the sales tax, is the rate is the percentage of the price. So obviously sales tax revenues increased because of inflation. But moving forward, consumers have much less savings than they had during the pandemic, whether it was because of the injected trillions of dollars into the economy, or rebates, et cetera. And a lot of consumers are struggling to face the inflation, the increased cost of living, the increased cost of interest rates, and increased cost of mortgage because of the higher interest rates, et cetera.

[\(17:16\)](#):

So we think that the spending is softening, and actually, if you look at the Bureau of Economic Analysis data, spending on durable goods, as well as on nondurable goods, has gone down substantially, which is going to translate into weaker sales tax revenues. And also, those who have higher income and have savings and money to spend in the economy, they shifted back to spending on services rather than on goods. And as you know, in most states, most services are not taxed or are taxed at a much lower rate.

Nikki Dobay [\(18:04\)](#):

Yeah, yeah, that's all really helpful to ... I mean, when you say it all it makes complete sense, but when you don't think about things in these terms, there's a lot of question marks.

[\(18:18\)](#):

But how about on the local front. Are the localities in a fairly good fiscal place right now, or should we expect that the localities will be facing some challenges ahead and maybe getting creative and looking for new revenue sources?

Lucy Dadayan [\(18:41\)](#):

As you know, unfortunately there isn't timely data for local governments, but I do try to monitor a few larger local governments' budgets. And I will say that there is much variation across the local governments because the pandemic has changed lots of normal trends. We know that during the pandemic a lot of people moved from superstar cities to more suburban areas, and we have seen the housing prices increasing in suburban areas much more than in cities, in urban areas. And we know that a lot of commercial properties are having large vacancy rate, which means that commercial property values are going down, which means that we will see less property tax revenues from the commercial properties.

[\(19:44\)](#):

It's true that residential property values have gone up a lot during the pandemic, double-digit in most places. But again, there is large variation across local governments so it really depends on which local government we are talking about. Looking at New York City budget, for example, which is the largest local government in the nation of course, representing around 10% of the total nationwide local government revenues, it's forecasting less than 0.1 or 0.2% growth in fiscal year 2024. So it's almost the same expected revenues in fiscal year 2024 as in fiscal year 2023.

[\(20:35\)](#):

But moving forward, I think if things continue the way they are, which is softening economic indicators and weakening house prices and continuous remote work, then we will see that property tax revenues are going to start to weaken substantially or even decline. And there is usually two to four years of lag until local governments do reassessments of the properties and until we see end result in property tax revenue collections.

Nikki Dobay [\(21:16\)](#):

That's really helpful. And I think something we've been seeing some activity on, especially in some of the Western states is, and Texas of course, is property tax reform. So I think it will be interesting to see how those reform efforts in some of the various states trickle down on this front too.

[\(21:36\)](#):

It seems like, from my perspective, and I follow these, but I can't say I follow all the specific details, that the States have at least been mindful that if they're going to do something that could decrease property tax revenues coming in at the local level, that the state is going to need to backfill those holes to provide that property tax relief for the individual. So I am hopeful that on the property tax front we don't, other than valuation issues and how that will translate, that we won't see any significant shifts. The states out here in the West also get very creative on other local tax revenue streams, which always has its challenges on the taxpayer side.

[\(22:25\)](#):

Lucy, are there any other ... As we move into the ... We're headed into Q4 of ... Summer's coming to an end, unfortunately, probably sooner than I know I would like, and then we're going to be moving into Q4 of 2023. Anything that the data's telling us at this point or anything you are watching for in the more near term?

Lucy Dadayan [\(22:49\)](#):

More in, I call it the near term, is the elections of 2024, presidential elections. And I think it's going to be one of the cases where the election results are going to be highly unpredictable. And depending on which political party holds the office, there might be big policy changes again, because if we end up having a Republican president, then definitely there will be much larger tax policy changes.

[\(23:27\)](#):

And also, the other thing is that some of the TCJA provisions are coming to an end, and it's also interesting to see if those provisions are going to be extended or not, or sunset. So all of those will have definitely an impact on certain local government budgets.

Nikki Dobay [\(23:53\)](#):

Oh, you're reminding me of the two things that I hadn't even contemplated coming into play on the state and local tax side, but you are spot on, the TCJA expirations and then potential broader federal tax reform will get us back in the weeds on conformity and how all that works. So great things to look forward to.

[\(24:16\)](#):

Anything else into 2024 trends that we're seeing? And maybe this might be, I know you started out by talking about the blog post where you told the states to be cautious for those five reasons, is that what you're still communicating to the states is that they need to be cautious? And what are those big issues that really are looming that are going to impact the state revenues in 2024, and potentially what type of legislation we might see in 2024?

Lucy Dadayan [\(24:54\)](#):

Yeah, I mean, as you know, all states have now passed fiscal year 2024 budgets. And looking at the states, there is large variation, and big states like California and New York have already proposed spending cuts. In California that cut is around 7%, 6.9%, and in New York the cut is 4.6%. Whereas other states have budgets that are calling for spending increases. For example, in Florida the budget is calling for 3.5% increase in spending.

[\(25:35\)](#):

So there is large variation across the states. And depending on their revenue structures, on their industry reliance, on their environmental conditions, because we're also seeing lots of natural disasters

which cost the states tons of money to handle, to weather, and so it's really ... And also depending on the state tax policy actions, we might see a large variation in the coming year, for fiscal year 2024. But overall, overall, I do not expect any state to see double-digit growth in revenues as we have seen in fiscal years 2021 and 2022. And I expect that a lot of states are actually going to see declines in revenues.

Nikki Dobay ([26:36](#)):

All right, so that's a rosy picture to take us into the end of the year. Lucy, thank you so much again. Any final thoughts or observations you want to leave the listeners in before we get to our favorite part of the podcast, the surprise non-tax question?

Lucy Dadayan ([26:54](#)):

Well, in general, I think the policymakers should be thinking in a longer term and have prudent fiscal planning because there are so many challenges ahead of us, whether it's artificial intelligence taking over the jobs, whether it's the demographic changes, aging population, which means less labor force, which means less income tax revenues and less sales tax revenues, I mean, as well as the growing number of natural disasters. So I think states should be not looking for having a balanced budget for the current year, but to be prepared to have balanced budgets in the next few years. Just fiscal planning.

Nikki Dobay ([27:55](#)):

What we all have to do. Well, thank you for all that. This is very helpful information to understand where the States are at and where the revenue trends are going.

([28:06](#)):

All right, before I let you go we have to do a surprise non-tax question. And as I was thinking about this this week, we have this condo in Portland and we often rent it out. And one of my recent inquiries, which I declined, was from a person that was traveling with at least 15 animals as part of an exotic pet show. So I thought, let's talk about our favorite exotic animals. And I don't really have a specific definition of that, so I'll pick my favorite exotic animal while you think about that. But I think probably my favorite, which is it's not really known to be a very nice animal, but I really think they're pretty fun, is hippos. I know I'm not supposed to go talk to one or befriend one out in the wild, but I think they're very cool animals. And my favorite hippo is this hippo in Cincinnati, who was born right before the pandemic, named Fiona. And so I think she's great.

([29:09](#)):

I'm going to go with hippos on this, but do you have a favorite exotic animal?

Lucy Dadayan ([29:15](#)):

Well, I'm not sure if it's exotic animal, and mine is also not popular among many people, and my favorite animal is actually snake.

Nikki Dobay ([29:27](#)):

Oh my God. Wow.

Lucy Dadayan ([29:30](#)):

This transcript was exported on Aug 14, 2023 - view latest version [here](#).

I just feel they have beautiful skin, and I have hold snakes several times. I think they're smart enough not to touch you, not to harm you, unless you trigger them.

Nikki Dobay ([29:47](#)):

Okay. All right. This is good information. I have an irrational fear of snakes, so I'm happy to hear they're smart enough to just ... As long as I don't go in their space, they'll leave me alone. That you don't hear that much, so I'm really happy that the snakes have someone, I know there's more than just you, that think they're great.

([30:11](#)):

Well, thank you so much for sharing that insight and for all these insights. Again, it's really great to have you here and I'm sure we'll be catching up again. And thank you to the listeners for tuning in. Information for Lucy and my contact information will be in the show notes, and we will be sure to include this most recent blog post that Lucy put out on this great information. So thanks for being with us, and I'll be with you again in a few weeks.

Lucy Dadayan ([30:37](#)):

Thank you for having me.