

## GeTtin' SALTy Podcast – Episode 48

Nikki Dolby ([00:00](#)):

Hello and welcome to GeTtin' SALTy, a state and local tax policy podcast hosted by Greenberg Traurig. My name is Nikki Dobay, shareholder in the Portland, Oregon and Sacramento, California offices. I'm very pleased to be joined once again by Lucy Dadayan, principal Research Associate with the Urban-Brookings Tax Policy Center. Lucy, thank you so much for being here today.

Lucy Dadayan ([00:25](#)):

Thank you so much for having me.

Nikki Dolby ([00:27](#)):

So Lucy, you are an expert on all things state revenue. So you've recently in the tax policy center have done some reports on 2024 state tax revenues. So I thought today you could get us caught up on what happened with the states last year and what we know, and then we'll get into a conversation about maybe what to expect this next year. So looking back on 2024, how did the states do generally?

Lucy Dadayan ([00:59](#)):

So looking back at 2024, most states experienced moderate economic growth where the pace varied based on industry composition, on state policy decisions and specific regional factors. Many states benefited from strong labor markets and steady consumer spending, but of course, inflationary pressures and rising interest rates posed significant challenges for housing and business investments. Now if we look at the overall revenue growth in nominal terms, we have seen that personal income tax revenues have seen actually some decline in the median state, whereas for sales tax revenues as well as overall tax revenues increased by 2% in nominal terms in the median state and growth state tax revenues was moderate for fiscal year 2024. And if we look at all states, about 2/3 of the states have actually seen declines in 2024. And states that have enacted substantial tax cuts have seen declines, whereas the states that have high reliance on high income taxpayers have seen growth largely because of the good stock market performance.

Nikki Dolby ([02:31](#)):

And I know you all just wrapped up a report, I think you got through Q3 of 2024 and now are working on or getting into Q4 of 2024. Any particular highlights that you're seeing from those specific quarters or just other items of note that you think are interesting?

Lucy Dadayan ([02:52](#)):

So yeah, the Q4 of 2024 combined with Q3 2024 would represent the first six months of state fiscal year 2025 in 46 states., And we are seeing mixed economic conditions. Again, we have complete data for the first six months of fiscal year 2025, and overall, states have experienced declines in overall tax revenues in inflation-adjusted terms, despite the growth in the stock market as well as despite having the months of November and December being the holiday shopping season, and we start the months where we usually see some boost in sales tax revenues. But when we look at the revenues, we see that personal income tax revenues have seen growth with an average increase of 2.1% and a median increase of 4.7%. That's in inflation-adjusted terms. As we look at the corporate income tax revenues, we have been declining both in nominal and in inflation-adjusted terms. And sales tax revenue performance has been really disappointing with an average decline of 1.7% for the nation as a whole and a median decline of 1.0% decline.

[\(04:30\)](#):

Given the strong stock market performance in calendar year 2024. On average, the stock market increased by nearly 27%, which is rather strong. We expect that actually income tax revenues will see strong boosts this April when taxpayers file their income tax returns for calendar year 2024. So this boost in income tax revenues will help the states, particularly for the states that have high reliance on high income taxpayers. Of course, it's also possible that some of the taxpayers might be delaying their capital gains realizations because they might be anticipating lower tax rates under the new federal administration. But so far, if we look at different components of income tax revenues, the estimated payments are up by 10% in inflation-adjusted terms, which is good news. However, moving forward, the revenue forecast for fiscal year 2026, so far, all things being equal are showing nominal growth about 3% for personal income tax revenues and around 3.3% for sales tax revenue. And what happens next? It depends a lot on both federal and state policy decisions.

Nikki Dolby [\(06:18\)](#):

Yeah. Let's put a pin in what happens next 'cause I think we've got some things to discuss. But the decline in sales tax revenue, is that something that was expected or was this really an unexpected trend that started to emerge mid to late last year?

Lucy Dadayan [\(06:39\)](#):

As a matter of fact, though, sales tax revenues have not been performing well in the last two years.

Nikki Dolby [\(06:48\)](#):

Okay.

Lucy Dadayan [\(06:50\)](#):

We've seen steady decline in sales tax revenues in inflation-adjusted terms, and that's pretty much true across the board. Nearly every single state is seeing either very weak growth in sales tax revenue performance or decline in inflation-adjusted terms. And that was expected for different reasons, right? Because sales tax revenues saw a boost during the pandemic because of all the consumer spending behavior, people were spending more on goods rather than on services. But that has been reverted back as consumers are back to where normal spending behavior patterns, we are spending more on services and these services are quite often not subject to sales tax. Another thing is the high inflation has increased the living costs, the prices and consumers just don't have that much discretionary spending. And that has also impacted on sales tax revenues.

Nikki Dolby [\(08:02\)](#):

I was thinking also that inflation must have a significant impact because just thinking about when consumers are spending more on food, things like food and necessities that are also often exempt from sales tax for various reasons and then they have less discretionary income to spend on those items subject to sales tax. So that, I think, will be one really to watch at the state level to see if we see any state legislatures take action and make changes to their sales tax base to try to adjust for that, so a really interesting one. So now getting into 2025, it's sounding like things are not looking as rosy as they had been for the past several years. Are there specific things, I know you mentioned impact of federal changes and we've talked a little bit about inflation, but what else is really impacting... or if you want to just get deeper into any of those issues, the weak growth that is expected?

Lucy Dadayan ([09:15](#)):

So uncertainty is one of the major issues. This is the time when states are proposing the budgets for fiscal year 2026, finalizing the budgets for fiscal year 2026. And with all the potential changes at the federal level, which will have direct impact on state and local budgets are putting clouds on state budgets. Some states have already been projecting budget deficits for fiscal year 2026, and now with the prospect of cuts in federal funds, that will make things even more complicated for the states. And there are states that have much higher reliance on federal funding rather than other states.

([10:09](#)):

For example, in Louisiana, nearly 50% of the funds are coming from federal sources, and places like that will have to deal with potential impact of the potential federal funding cuts. Another thing to watch is the cuts in federal workforce. This is particularly true for the District of Columbia, Maryland, and Virginia, DMV area because federal workers are highly concentrated in the DMV area, of course. And any cuts will have direct impact on the economies of these states that are dependent on government employees as well as government contractors. So there will be ripple effects for sure of the federal workforce cuts.

Nikki Dolby ([11:06](#)):

And from your perspective, is there anything the states can do to deal with this uncertainty and with everything that we don't know right now, or is it really just a wait-and-see environment where the states should perhaps be a little conservative in maybe their spending and their thoughts on what growth will be and try to weather the storm a little bit?

Lucy Dadayan ([11:33](#)):

Sure. Well, to start with, I think it'll be prudent for the states to postpone any cuts in tax rates. Between 2021 and 2024, overall, 24 have enacted cuts in personal income tax rates, and of course, other states have also enacted cuts in other sources of revenues including sales tax and corporate income tax. And these cuts were estimated to decrease the net revenues by \$15.5 billion in 2023 and by \$13.3 billion in 2024. Now, this is really large impact and unprecedented. And just to give you an idea, the opposite was true in post-Great Recession period when states actually increased the tax rates and the net impact was estimated to be a revenue gain of around \$24 billion. So fortunately, some of these cuts and some of these losses because of the state policy decisions was only one-time cuts, but of course, there were also permanent cuts.

([13:19](#)):

And at this point, because of all the uncertainty around federal funding, around cuts in federal jobs, which will certainly have larger impact on not only on the DMV area, but also on all states because federal employees are in every single state, not as substantially... the rest of the states are not that much reliant on federal workforce, but there are still Federal workers in every single state. And as I said, there will be ripple effects of the federal employee workforce cuts, and states should think about diversifying their revenue sources. They should be thinking about expanding the sales tax space, including more services into the sales tax space, whether it's your beauty salons, gym memberships or anything else. And one area that I think would be important to look into is for the states and localities to look into some partnerships, regional partnerships, to share resources, to share knowledge, and to tackle any potential changes at the federal level together.

Nikki Dolby ([14:48](#)):

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That's a great point, and that's something I'd never really thought of. Are there examples of that that we have seen where the states have worked together through these regional partnerships, or is this really a new area that really the states just should add to their list of ways to manage this uncertainty?

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

There are some examples. However, those examples that I can think of have been federally-funded regional partnerships.

Nikki Dolby ([15:25](#)):

Okay. Right. Right. Right.

Lucy Dadayan ([15:26](#)):

But it's important for the states to find some other forms of funding and whether it's private partnerships or anything that could make it work.

Nikki Dolby ([15:39](#)):

So it sounds like it's time for the states to get creative in thinking about ways to manage to try to navigate these uncertain waters. A couple more questions on federal policy changes a little more specific. We've got the Tax Cuts and Jobs Act provisions mostly on the personal side that were set to expire this year. It's looking like at least the house has passed a bill to extend those. Do you have a sense of how these extensions or lapses in extensions may impact the states at this point? I know we often focus on the corporate side, so we were very involved with the corporate changes for the TCJA, and this is mostly personal, but will the extension or lapse have a big impact on the states, depending on what happens?

Lucy Dadayan ([16:37](#)):

I think pretty much depends where you are actually, because, and I guess one of the most important provisions is the \$10,000 cap on state and local tax deductions that are set to expire at the end of 2025. So of course, states have enacted pass-through entity taxes to address this issue. And if it expires, the salt cap expires, then one thing that we'll see is probably the law tax states will no longer be so attractive for the taxpayers with high income, so we might see some migration patterns between the states. And it'll also make states to rethink their pass-through entity taxes, whether it makes sense to continue administering these pass-through entity taxes or not. So it really depends on what the final outcome is for this salt cap and other provisions, whether they are set to expire or not. But states have been good in being creative to come up with solutions to address the federal policy changes at the state level.

Nikki Dolby ([18:04](#)):

And then one other big question before your final thoughts for federal policy tariffs, we've been hearing a lot about tariffs. We've seen some, not as many as we've been hearing about, but if the tariffs are enacted the way that as vastly as we've been hearing about them, how is that going to impact the states and their revenue streams?

Lucy Dadayan ([18:30](#)):

So depends where the tariffs are being imposed, but the most significant impact will be there is any new tariffs on Canadian or Mexican goods because particularly Canada is one of the largest trading partner of United States, and there are many states that are highly reliant on Canadian goods. And of course, the tariffs are not going to be just one way street. There will definitely be retaliatory tariffs from the other countries that would really hinder the exports of American goods to the other countries, whether it's Canada or Mexico, affecting states that have significant reliance on exporting fair goods to these countries. So tariffs can disrupt the state economies and it'll alter the trade balances. It will increase the costs. It'll affect the employment in some key industries. But again, there has been an attempt to impose the tariff. During this new federal administration, it's on the pulse for the moment. And apart from certain goods, whether it's aluminum or other goods, a lot has to be seen. However, it'll have a negative impact on state economies, particularly for the states that have high reliance on goods imported from Canada or Mexico or China.

Nikki Dolby ([20:24](#)):

Well, Lucy, I'm not going to lie, this has been a little bit of a downer for what's going on with state revenues. But before we go, any final thoughts on what to expect as the states are in legislative session and maybe what the listeners of this podcast, so big companies working on a multi-state basis, anything they can be thinking about to navigate these uncertainties as the states move through this fiscal year?

Lucy Dadayan ([20:53](#)):

I think the best thing is to be prepared for the worst and to hope for the best.

Nikki Dolby ([20:58](#)):

Okay. I love that.

Lucy Dadayan ([21:00](#)):

We know that there are some ambitious talks and there are actions that needs to be taken. One thing is definitely to be proactive, to think how you are going to address any potential shortfalls. And the good news is that states are in a good place in terms of rainy day funds, but most rainy day funds are good for the economic downturns. And we are not having economic downturn, at least not yet. And we are just having uncertainty around federal policy decisions, which will have direct impact on state and local budgets. So it's much prudent to keep the rainy day fund for rainy days, for economic downturns-

Nikki Dolby ([21:58](#)):

Yes. Yes.

Lucy Dadayan ([21:59](#)):

... and to be prepared to navigate this fiscal uncertainty to come up with some joint solutions with their neighboring states. As I said, it's time for the states and localities to think collectively, to talk to their neighbors, to come up with solutions that will benefit the regional partnerships.

Nikki Dolby ([22:26](#)):

It seems to me that the states are really juggling a couple of things 'cause they've got to be prudent with their spending. And I do see states that traditionally on the West Coast where I sit, where often they're often thinking about all the different ways they could spend money and they're being a little more

mindful. But then it's also seeming like with other uncertainty at the federal level is they may have to boost those programs that are going to be shrunk or go by the wayside that the federal government was providing. So it's a really tough spot for the states, and I love this idea of preparing for the worst and hoping for the best. Well, Lucy, thank you so much for filling us in on all this. Lucy has a great article in State Tax Notes that talks about Q3 and provide some insights in Q4 and 2024, so I would encourage you to check that out. Lucy, if folks reading the article or listening to the podcast, want to get more information about the items that you report on, what should they do or where should they go?

Lucy Dadayan ([23:31](#)):

Sure. So I have to mention that we closely monitor the state tax revenue trends and we provide timely insights into evolving state fiscal conditions. And we produce monthly state revenue highlights as well as quarterly state tax and economic review reports for which we collect and analyze real-time state tax revenue data on a monthly basis. And we have a comprehensive data set. Listeners to this podcast are more than welcome to contact me for more information or to gain access to real-time state tax revenue databases. And I will also be happy to provide you with the link for the databases.

Nikki Dolby ([24:17](#)):

Awesome. We'll be sure to put that in the show notes. But Lucy, before we go, I have to ask a surprise non-tax question. And so this one, I've been scrolling through my handy dandy internet list of questions and this one just popped up and I thought it's a great one. Is a hot dog a sandwich? I'll go first. I don't think so. It doesn't seem like a sandwich. A sandwich really seems to have bread on top and bottom. That's going to be my definition of a sandwich, and the bun really goes all the way, well around three-quarters of the hot dog. So I don't know. What are your thoughts on this? Is a hot dog a sandwich?

Lucy Dadayan ([25:00](#)):

That's an interesting question because you're asking it to someone who doesn't eat red meat or any meat.

Nikki Dolby ([25:08](#)):

All right, we'll go with a vegan, your favorite meat alternative in the shape of a hot dog?

Lucy Dadayan ([25:17](#)):

When you say hot dog you usually think of it as a sandwich. But I can totally see your point, so I'm inclined to agree with you-

Nikki Dolby ([25:27](#)):

Okay.

Lucy Dadayan ([25:27](#)):

... that's not really a sandwich.

Nikki Dolby ([25:32](#)):

All right. Well, I think we've authoritatively put our stamp on that question. So thank you so much again for joining me and talking about where the states are this fiscal year with their revenues. I'm sure you'll be back again to catch us up in the near future. And thank you to the listeners for tuning in. There will be

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information for Lucy and I in the show notes. As always, if you have any questions or comments, please leave those in the show notes, and I will be with you again in a few weeks on the next GeTin' SALTy.