

GeTtin' SALTy Podcast – Episode 54

- Nikki Dobay: 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 Sacramento, California, and Portland, Oregon offices. It has been a while, but I am so pleased to have Morgan Scarborough back from Multistate Associates. Morgan, I've completely forgot your title, so please make it up when you say thank you. Thank you so much for joining me today.
- Morgan Scarboro...: Thank you, Nikki. I was looking [00:00:30] for... You give me a new title every time I'm on this podcast, so I was looking forward to that. But no, I'm Vice President of Multistate and lead our tax team on the day-to-day stuff, so really excited to be back. It's been a couple of months.
- Nikki Dobay: All right, so Morgan, we have missed you. You've been doing much more important things than monitoring state and local tax legislation.
- Morgan Scarboro...: What could possibly be more important than that, Nikki? Please.
- Nikki Dobay: I don't know, making life, something like that. But we are very glad to have you back and I thought I would take this opportunity to [00:01:00] catch up with you on your reentry into the state and local tax legislative world. But today we're going to actually start with a piece of federal legislation, a big piece of federal legislation. Would you like to give the name of this bill? I'm going to be workshopping some acronyms today, but I just can't say it out loud. So what are we talking about first?
- Morgan Scarboro...: Are you talking about one big, beautiful bill, Nikki? Imagine my surprise and excitement when I returned from [00:01:30] maternity leave and found that no state had done anything noteworthy. The federal government was just quiet as a little church mouse, nothing for me to catch up on whatsoever for over the last four months.
- Nikki Dobay: And then like a flash, like a vision, something happened. So again, I'm having a hard time with the name of this bill, so I'm going to workshop some things. So I'm going to start with the OBBBA, the O-B-B-B-A.
- Morgan Scarboro...: Not a crowd favorite, but okay.
- Nikki Dobay: [00:02:00] Okay. I'll keep working on it. So tell us what you've been thinking about with this big thing and how you think this might impact the states.
- Morgan Scarboro...: Yeah, I think the first thing to remember is that we all have still a Tax Cuts and Jobs Act hangover, so to speak, where there is this perception that anytime there's a big federal tax bill, states are going to have to tackle a bunch of new really comprehensive [00:02:30] principled questions about how they're going to incorporate pieces of this into the tax code, right? In the Tax Cuts and Jobs Act, there were a lot of conversations about if states were going to incorporate any foreign income provisions from the TCJA, that was really a departure, that

was really a conversation about tax principles. This bill to me doesn't have that same standing. So when I'm thinking about federal impacts on states, I think there's a potential [00:03:00] for huge impacts on states. I don't think that it is constrained to this one big, beautiful bill. The revenue impact for states if they adopted most of these provisions is not huge.

Where I think you could run into issues is some of the other pieces of this. So some of the changes to Medicaid matching will have really big impacts on state budgets. Some of the changes in terms of shifting responsibility from the federal government to states [00:03:30] when it comes to SNAP benefits, nutritional benefits, that will have big impacts on state budgets. And then outside of this bill, things like are they really going to cut a bunch of grants to states? How is that going to continue moving forward? Is FEMA really going to roll back their monetary support in states? That's going to have a big impact on them. So I think about this twofold, yes, there is a lot going on at the federal level that will impact state budgets, but [00:04:00] no, it's not totally, or really even majority from this one big beautiful bill. You're right, we do need an acronym. I don't really love what you came up with so far, but it is a mouthful. So we need to work on it.

Nikki Dobay: We need to work on it. But let's go back to the pure tax piece and talk conformity. And I think saying we have a TCJA hangover is a good way to describe our lives in December of 2017, when all of a sudden... We had always thought about [00:04:30] how do states conform to the federal code, but with the TCJA, there were so many significant and really complicated code changes we had to dive into conformity, at least in a way I had never done in my career.

Morgan Scarboro...: I think it would be fair to say it was transformative for the federal government and for states.

Nikki Dobay: Yeah. And so now when we think about this, what was interesting from my perspective, and let me catch you up on a few conversations you missed while you were out, [00:05:00] but so conformity has been on everybody's mind this year. We've seen, and maybe this is just because I've been in Oregon and it's been a really big conversation here, but the question really in the legislature here in Oregon was they were so afraid about what this potential thing could look like at the federal level that they were taking preemptive steps to decouple from our general ruling conformity. [00:05:30] And so I think that's been an interesting conversation this year because it's been more of a political conversation about conformity as opposed to a technical conversation. And so that's definitely been a conversation here. I haven't heard it too much in many other states, quite as politicized as it has been in Oregon, but I do wonder if we will start seeing more decoupling or backing away from rolling conformity [00:06:00] for political rather than technical reasons.

Morgan Scarboro...: Yeah, I think that's a really important point, and I think I want to briefly talk about what the actual monetary value of this is because I think it loops back into this. Jared, who I know you've had on your podcast before at Tax Foundation,

they've released it, but a really excellent overview on what the state revenue impacts of this would be. And from their calculations, for [00:06:30] states with rolling conformity, it will cost them an aggregate about \$3.7 billion which, would you like to guess what percentage of revenue collections that is in the aggregate?

Nikki Dobay: Oh, dear.

Morgan Scarboro...: This is kind of a trick question.

Nikki Dobay: Oh, dear. Just tell me. Go for it.

Morgan Scarboro...: That is 0.8% of income tax collections in the aggregate. So that is a fairly small amount.

Nikki Dobay: Wow. Okay.

Morgan Scarboro...: Very small, reported here. And then if you look at states that [00:07:00] would have to proactively conform if they conform to all these provisions, which every state is not going to conform to all of these provisions, you end up somewhere around 4.2% of state income tax collections. So really we're talking very small dollars in comparison to prior bills. And why I think that's related is because right now if you read a state revenue forecast that's coming out it's, "Here's the position that we're currently in, but because of X, Y, and Z going onto the federal level, [00:07:30] this is what we're planning for because anticipating some negative changes." And I think that that is a correct way to go about it. But you also I think do have to factor in that some of this is political.

If you are a governor in a blue state and your economy is not doing as well as you had hoped, or your revenue collections aren't as strong as you wanted them to be, or your spending is continuing to outpace revenue collections, it is an easy [00:08:00] point to make to say, "We're not doing well, but it's because of these federal government changes," because I would say a lot of them have not actually gone into effect yet, so have a little bit of maybe some funding money stuff going on there. And I don't mean to be critical of that, I'm just saying you look at these and I think to myself, well, a lot of this stuff hasn't actually come to fruition yet, so I don't think it's fully impacting your economy. That being said, of course, tariff conversations [00:08:30] in states that are really dependent on sales taxes and manufacturing, et cetera and imports, that is true, but it's just a caveat that I keep in mind as I'm reading revenue forecasts right now.

Nikki Dobay: Let's pivot to maybe just some broader themes on revenues and where the states are at mid-year. But I think the two takeaways from, I'm trying to come up with a different acronym, but OBBBA is [00:09:00] sticking in my head, so maybe I've gone too far. So if others have ideas, please, please send them our way. So the actual impact from conforming to the federal tax change is quite small, according to the Tax Foundation study, which I agree.

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- Morgan Scarboro...: If it's wrong, blame it on Jared. Yes, that's what I'm saying.
- Nikki Dobay: I do not think Jared is wrong on this front. I agree. This is a very robust, helpful study. So really where we're going to see the potential issues [00:09:30] for states or bigger issues for states is on the spending side and what the states are going to have to absorb with some of these spending changes. Are those the takeaways from your perspective?
- Morgan Scarboro...: Yes, I think that's totally right. And I'm sorry you had the two takeaways me, because that meant I talked too long. So yes, those were my two main points that I was trying to get across.
- Nikki Dobay: No, awesome. So we got those. So now, okay, we're mid-year, we've had a lot of states work on past their [00:10:00] budgets. I mean, is the sky still falling? Are we doing okay? Where are these states at with respect to revenue?
- Morgan Scarboro...: We're in the same place that we've been, which is an interesting one.
- Nikki Dobay: We're in another loop. Great.
- Morgan Scarboro...: Yeah, exactly. The simulation continues. I would categorize this as saying most states are in stable fiscal positions. However, the states that are not are California, Washington, [00:10:30] Illinois, New York, New Jersey, Maryland, states that a lot of people care about. If you are interested in corporate tax policy, you care a lot about those states. So it's easy for me to be like, "Cheer up guys, New Hampshire is fine."
- Nikki Dobay: Right.
- Morgan Scarboro...: That is not as big of a state for most people as California, I think we could confidently say.
- Nikki Dobay: Yeah.
- Morgan Scarboro...: So we have some recent figures here. Governor Newsom came [00:11:00] out in California recently and has made revise. He said the state's going to be facing a \$12 billion shortfall. He's calling for, "difficult but necessary changes in the state's budget." He really focused a lot on expenditures and spending. But that's a good example of a state where things are going south, so to speak. In Illinois, you keep seeing revenue forecasts drop from the prior forecast. Maryland obviously is dealing with the same structural deficit [00:11:30] issues they've been dealing with for several years at this point. New York and New Jersey. New York actually is an interesting one because they're looking at now about a \$14 billion budget gap, which sounds and is large. Some folks there are celebrating though, because that's lower than it was. It previously was a \$27 billion gap, so it's less bad than it was, but that's really the overall picture is a lot of states are

fiscally stable. They're doing well, states have good rainy [00:12:00] day funds, et cetera, but those big states of concern are concerning.

Nikki Dobay: I think Washington is another state that's on that list where they are facing some significant headwinds, and we saw a lot of changes come out of Washington, and now we're dealing with the fallout of that. So let's now get into some of these individual states. So Illinois, this one's hat off the presses. I think you sent out your newsletter [00:12:30] over the weekend, Morgan, and what was the headline?

Morgan Scarboro...: "Illinois passed a thousand-page budget in about 20 hours," was the headline.

Nikki Dobay: I loved that it was in Illinois fashion, the budget came out.

Morgan Scarboro...: True fashion. It was in a bill that previously was about commemorative dates, and they put a thousand plus page amendment into there to do the revenue omnibus bill essentially. I think the top line for me was it taxes 50% of GILTI, which [00:13:00] there had been rumors about, but I don't know. It's hard to say. It was a package that people were saying nobody knows what's going to be in it. It was a very closed door discussion. I was somewhat surprised still to see that in the bill.

Nikki Dobay: Right. Yeah, same. I would agree with that.

Morgan Scarboro...: They originally, in the first amendment that they had to this bill, they did include a digital advertising tax. They had been... Legislators had been in the press saying, "We have figured out a way to do the digital advertising tax bill, it's legal. We're not going to have challenges." They did still expect challenges, but they expected that they could prevail [00:13:30] over these challenges, that they had structured it differently than other states. That was amended out at the last minute before it was passed. So there's no digital advertising tax in there. They make some problematic changes to add back provisions the folks are concerned about, and then a whole host of other things. So a lot of changes to tobacco taxes, gaming taxes, et cetera, some of that more excise tax area, but it was very large. That was truly a one big, I don't know that you'd call it a beautiful bill, but it was. It was a big bill.

Nikki Dobay: It was a big one.

Morgan Scarboro...: It was passed [00:14:00] very quickly.

Nikki Dobay: Yeah, it's interesting because I had also... The rumors ahead of the weekend last week were that it was going to be something in the digital advertising space. And I had heard that they were really looking at what Washington had passed because Washington thinks they've cracked this nut. I tend to think that's not true, but we'll get into that in a minute. So it was interesting to see that came out and yes, I was also surprised to see [00:14:30] the GILTI piece in. So I think

we'll be digesting that a little bit more. What's your next favorite state that you've been pleased, displeased?

Morgan Scarboro...: This is not my favorite.

Nikki Dobay: Okay.

Morgan Scarboro...: Florida. They're on my list right now because we sent out to most state clients monthly recap of what's gone on and what's coming up over the next month. And we had talked about Florida because they were in this really bitter debate about whether they should do property tax [00:15:00] relief or sales tax relief. And on Friday, I literally sent an email saying, "Oh, I think it's probably going to be a couple of weeks before we see anything come out." And then of course, on Saturday it was announced that they had come to an agreement. So I think they did that just to embarrass me about my newsletter.

Nikki Dobay: So what was the agreement that they-

Morgan Scarboro...: The agreement seems to be, I have not finished going through it yet, but the agreement seems to be that nobody won in the sales tax versus property tax relief discussion.

Nikki Dobay: Okay.

Morgan Scarboro...: My big grain of salt here is that I do not know if the governor yet has said [00:15:30] he agrees and that he will sign this compromise between the House and the Senate. It's a very interesting dynamic and very red Florida. The legislature and the legislative leaders are not getting along with Governor DeSantis. I mean, it has turned nasty publicly, and the speaker really wanted to do a big sales tax reform in Florida, wanted to cut the sales tax. A number of folks were confused, I think, about [00:16:00] why he would want to do that. The perception in Florida, and I don't know what the numbers are, but the perception is that their sales tax is funded largely by tourism in the state.

So Governor DeSantis took this as an opportunity to say, "No, we should be doing property tax reform and in fact, we should eliminate the property tax." I don't know that he had the technical details of how they would do that.

Nikki Dobay: Or what that would entail.

Morgan Scarboro...: [inaudible 00:16:25] backfill any of that revenue, but it is an extremely popular political talking point to [00:16:30] do so. And so there was really a lot of back and forth there. But it looks like from what I've seen in their budget agreement, they're doing a little bit of sales tax exemption relief and maybe some homestead stuff, but nothing transformative.

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- Nikki Dobay: Nothing like they were thinking of. So, all right, well, is Florida still in session or do they need to come back?
- Morgan Scarboro...: No, Florida is not in session. They were in, I don't know if they were already in a special or the governor's going to call them back into special to pass [00:17:00] this legislation, but I think they have until June 30th to do so.
- Nikki Dobay: All right. So Florida's one to watch. Minnesota. Some things are happening there.
- Morgan Scarboro...: Where you have an interesting political dynamic. I really don't know that there are many states left though that you don't have an interesting political dynamic. But in Minnesota, they have a power-sharing agreement in the house so they have an even split in the house. And in Minnesota, the Democrats control the Senate by one vote. They have to do a lot of compromising [00:17:30] is what I'm getting at here. So they have been in conference committee to try to work out differences between the two chambers' tax bills. It also has turned a little bit unfriendly with the Senate saying the house can't even pass their own conference committee report. There was a lot of back and forth. There was a lot of discussion about whether the governor needs to pull in other folks outside of the conference committee to iron this out for them.
- Where we're at right now from [00:18:00] my understanding is that the focus really is on data center stuff. So eliminating the electricity credit for data centers, looking at some cannabis taxation stuff and expanding the R&D credit. Minnesota previously had talked about doing a digital advertising tax. That has not resurfaced in the conference committee discussions. That's not to say that it couldn't come back. Minnesota is another state where they often release this omnibus bill and then pass it very, [00:18:30] very quickly. So if folks are concerned about Minnesota, it's definitely one to keep a very close eye on as they work through this.
- Nikki Dobay: Any other states on the eastern side of the country? It seems like everything since... Maryland really took a lot of air out of the room, you missed all that. Don't worry about it. Nobody can blame you, but it seems like it's been pretty calm there. Texas wrapped up their session, the good news [00:19:00] is the R&D credit was extended, so it's going to be in a little bit of a different form. They're going to much more closely follow federal, and they also did a little bit of property tax relief, but I would not describe what they did as transformative either. And then we've got a few West coast states to talk about, but.
- Morgan Scarboro...: I think everybody else on the East Coast is relatively well-behaved, or at least predictably behaved at the moment. So we could move to your side of the world, Nikki.
- Nikki Dobay: All right. It's been crazy. [00:19:30] So we'll start with Washington. Washington is wrapped the 20th, 21st.

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- Morgan Scarboro...: I heard nothing happened there either this year.
- Nikki Dobay: Oh, it was [inaudible 00:19:42]. Yeah, it was one of those sessions where it ended. It was, I will describe it as a bloodbath for all the changes that were made. A lot of increases in BNO tax rates, some temporary, some permanent. The big battle was Senate Bill [00:20:00] 5814 I believe, where they included in the sales tax advertising services carved out most non-digital advertising services. So it really is focused on digital advertising and lots of issues there. There was a big push to get the governor to veto that bill and he did not do that. So I think there will be some additional work there. But yeah, lots of fun up in Washington. So you missed all that too.
- Morgan Scarboro...: [00:20:30] So will there be litigation about the digital piece?
- Nikki Dobay: Yes. I think it still has serious thought issues based on the carve outs that were created. So I do anticipate litigation, but there have also been conversations with key legislators about coming back to the table to work on the technical issues to see if there is a path forward that can address the technical pieces of this. So [00:21:00] I think the threat of litigation will hopefully push those conversations along because I think there's a lot of technical pieces that need to be sorted out.
- Morgan Scarboro...: Do you think... I had read something in Illinois saying when they were originally going to do a digital advertising tax, that in order to prepare for litigation, they were not going to actually count on this revenue for a couple of years because they thought it would have to go through the court process first. In Washington, or they immediately appropriating that revenue, counting on it to cover any budget shortfall, do you know?
- Nikki Dobay: [00:21:30] Well, I mean, the provisions go into effect in October. I will say when Washington passed its capital gains tax, and it was litigated, the Department of Revenue put a pause on it and basically said, "Don't pay this yet because we don't want to have all this money that we might have to give back to you." So I would anticipate that [00:22:00] because some of Washington's problems weren't as immediate as maybe they had indicated. So my sense is they potentially built in some of that, but that's not what they're saying publicly. But if we're looking at things through the lens of what the state has done before, I think they will, if there is litigation, the Department of Revenue will pause the tax until the issue is decided.
- [00:22:30] So that's what they did with capital gains. Now I will say as soon as the Supreme Court in Washington said capital gains was okay, it was back on in about five seconds.
- Morgan Scarboro...: Okay, give us the money, we were just joking.

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- Nikki Dobay: Right, right, right. So we'll see. I mean, I just think there's going to be a lot more work to be done in addition to the litigation, because even if this thing was constitutional and didn't have IPFA problems, it's got a whole bunch of technical issues [00:23:00] that need to be sorted out. So all right, let's end with California. So California, I'll just say it's been a little bit of a like, something's happening. No, it's not. Something's happening. No, it's not. That's what you missed.
- Morgan Scarboro...: You know what? That's okay. My least favorite thing in the world is hurry up and wait. So, that's okay.
- Nikki Dobay: So the thing in California that seems to have the most momentum right now is the conformity bill, which does [00:23:30] have me shaking my head a little bit because I just feel like if they're going to conform, why are they conforming ahead of a year where there's going to be some additional significant changes.
- Morgan Scarboro...: For the first time in a decade, right? I think that they're still conformed to 2015, is that right?
- Nikki Dobay: Correct. Correct. So I mean, again, this is one, it seems to have support from many folks in California, but it seems like maybe doing it 11/25 [00:24:00] isn't the best thing, but we'll see.
- Morgan Scarboro...: Well then they can just address the one big beautiful bill in 2035, right?
- Nikki Dobay: Yeah, they're going to OBBBA it in 2035, something like that.
- Morgan Scarboro...: I'd like to be back on the podcast for that.
- Nikki Dobay: Okay. Well, any other thoughts on California before we get to the fun part, Morgan? I know the part you've been missing.
- Morgan Scarboro...: No, I don't [00:24:30] think so. I do think it's going to be interesting to watch, once again, the battle between the governor saying, "We need to look at our spending," and the legislature saying, "Hold on a second. Maybe we want to look at tax increases." So that'll be another test of governor's power over the legislature.
- Nikki Dobay: Yeah. I think the budget this month will be interesting. So we'll see where it all shakes out. But the governor's been pretty strong on no new taxes [00:25:00] now. A significant retroactive tax increase, that was totally fine.
- Morgan Scarboro...: I do like the creative interpretation there and in Illinois where Governor Pritzker is like, "We're not going to do any broad based tax increases except we're going to tax 50% of GILTI and we're going to do this add back change and all these other things." So that is... But nobody brings that up on the campaign trail,

right? Nobody's like, "Hey, wait a second, you taxed 50% of global intangible low tax income. What are you talking [00:25:30] about?"

Nikki Dobay: Yeah, I know. They don't get called out for that stuff, so we'll keep them on their toes. How about that? All right, well thank you so much, Morgan, for getting us caught up on some of these issues across the states. But before you go, I've got a surprise non-tax question for you. And this list came out today in Rolling Stone, which was the 50 one- [00:26:00] hit wonders from the two thousands. And so I was listening to the radio this morning and they were talking about it, and I was having a little bit of PTSD for some really bad songs in the early two thousands. So here's my question, here's my surprise non-tax question. Were you familiar with many of these songs and do you have a favorite on this list? And if not, what else were you listening to? So I'll start [00:26:30] with you this time, because you're prepared.

Morgan Scarboro...: Thank you. First of all, these were a little bit too mainstream for my music taste, and I was really in my emo music era, but there are a few on the list that I recall as being my favorite. Number one probably was Lips of an Angel by Hinder, because I remember listening to that with my sixth grade best friend on repeat after her sixth grade boyfriend cheated on her and that was an anthem for a year, [00:27:00] so yes.

Nikki Dobay: Wow. Cheating at sixth grade. Okay.

Morgan Scarboro...: I know. What can you do?

Nikki Dobay: What can I say? That guy, that guy. I'm glad she got on her-

Morgan Scarboro...: Hinder understood our pain. Hinder understood our pain and put it into words.

Nikki Dobay: All right, that's the one?

Morgan Scarboro...: Yes. What was yours?

Nikki Dobay: Well, I did not recognize a ton of these songs because I was much more in an Ani DeFranco phase during this time. But [00:27:30] I will say the two that brought me back to something fun was Butterfly by, what is it? Crazy Town. And then I Believe in a Thing Called Love by The Darkness. And I watched part of that video as I was going through the list and that is just a really ridiculous video.

Morgan Scarboro...: My strongest, I don't know the music video, but my strongest correlation with that is that it appears in the movie Shrek, the critically acclaimed movie Shrek. [00:28:00] I believe Donkey does a rendition of that.

Nikki Dobay: All right, I may have to go find that and I'll watch the video and then I'll watch the Donkey and next time we'll debate which is better.

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Morgan Scarboro...: I will watch the three-minute music video. You have to watch all hundred something minutes of Shrek and then we'll talk about it next [inaudible 00:28:19].

Nikki Dobay: All right, well we're lining up our next debate. Well, Morgan, thank you so much for being back. Super excited to have you back and thank you to the listeners for following [00:28:30] along with our conversation about where we're at in the middle of the year here in the state and local tax world. If you have any questions or comments, please leave them in the show notes information. Contact information for Morgan and I will also be in the show notes and I will be back in a few weeks on the next GeTtin' SALTy.