GeTtin' SALTy Podcast – Episode 68

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. We are kicking off 2026 with a bang, and I am very pleased today to be joined once again by Lucy Dadayan. She is a Principal Research Associate for tax and income support division at the Urban-Brookings Tax Policy [00:00:30] Center. Lucy, thank you so much for being here once again.

Lucy Dadayan: Thank you for having me, Nikki. Always a great pleasure to have a conversation with you.

Nikki Dobay: Well, thank you. And as I said, we are kicking off the 2026 GeTtin' SALTy podcast, and you have traditionally joined us in January. I'm not sure if it was on the first podcast of the year, but I thought a conversation with you would be a great way for the listeners to kind of level set [00:01:00] with where the states are on the revenue side because as we know on the tax policy side, often those conversations are triggered by what's going on on the revenue side. So lets kind of jump in and talk about that. And maybe we'll start with a bit of a recap of 2025 and where did the states end up? I know you guys put out a report. You [00:01:30] also have a new report that's hot off the presses, so hopefully you'll talk about that, but kind of give us your thoughts on 2025 and where the states were and where they landed.

Lucy Dadayan: Sure. So in fiscal year 2025, state revenues grew modestly on a nominal basis, but that strength varied from place to place, and it all depends on the tax revenue structures. And overall, we saw solid growth [00:02:00] in personal income tax revenues, the median states of 6.7% growth in nominal terms. However, we have seen declines in corporate income tax revenues and the growth in sales tax revenues was very modest at 2.3%, and those are in nominal terms. Now, it's also that income taxes were the main driver of the growth, [00:02:30] while the other big source of revenue were much softer. And the headline numbers, however mask the real valuation beneath the surface about seven to eight states actually saw declines in personal income tax revenues. And those are the states that have enacted income tax rate cuts. Also, 10 states are declined in total nominal tax revenue collections in fiscal year 2025, [00:03:00] which is a sign that some states are struggling with the combined effects of slowing economic growth and as well as prior tax cuts.

That mixed picture was reinforced in state debates for 2025. The lawmakers are already grappling with tightening budget conditions because pandemic aid has dried [00:03:30] up and revenue growth has slowed even in states with strong fiscal histories. So many states are grappling with [inaudible 00:03:42] pressures of slow revenue growth and rising demands on spending in a much tighter fiscal space.

Nikki Dobay: All right. So a couple things to unpack, it seems like. You mentioned that the states where you were seeing the decline in personal [00:04:00] income tax were generally those states where they had cut rates. So is it fair to say that in the states where they've kind of held the party line or held the rates, those revenues are continuing to increase because there is a greater income on the personal income side that states can tax?

Lucy Dadayan: In fact, states that have seen growth in personal income tax revenues are states that have progressive [00:04:30] income tax structures have not enacted any income tax rate cuts and have high reliance on high income taxpayers. And that's predominantly because the stock market performed so well in the past year or so. And that's also true for calendar year 2025, the stock market increased on average by 15%, which means that we are going to see another strong April [00:05:00] this April. So places that have seen strong growth are California, New York, your states that have high reliance on high income taxpayers and have progressive income tax structures. Whereas places that have cut taxes, tax rates on income for income have seen declines. And what we have seen in the post-pandemic period is many states moving towards having [00:05:30] flat income tax structures.

Nikki Dobay: Okay. Yes. And can you tell if the decline in the states that have cut their rates essentially, and I don't know what the proper economic term is, but it's kind of equal to or it's kind of aligned with the actual rate cuts or do you see other forces at play there? Or is that client just kind of apples to apples, they cut rates and so the revenue's going [00:06:00] down because the rates were cut? Or just wondering if there's other factors at play or just that's just revenues are going down because those rates went down or they're moving towards this flat tax?

Lucy Dadayan: Well, I wouldn't say that the tax cut of X percentage leads to tax revenue declines of the same percentage, but there is definitely a correlation between the tax rate cut and tax revenue slowdown. [00:06:30] And of course there are lots of other forces in play, whether it's economic conditions of the state, whether it is the other state and federal policy decisions. And also one other major area moving forward is the impact of federal policy changes on particularly the One Big Beautiful Act. And it has many provisions that has a direct impact on state [00:07:00] tax revenues and whether the states are conforming or not will have a play in state tax revenue collections.

Nikki Dobay: All right. Thank you. That's so helpful because we are continuing to hear the conversation in many states that they want to cut rates or move towards a flat tax rate, or we've even seen proposals of complete phase outs of the personal income tax. So I think watching those [00:07:30] trends is going to be really key for policymakers. I assume if I'm putting my legislator hat on as to why you would want to continue to move forward with those policies despite seeing potential declines and maybe they're significant for your state, I assume it's because you think it's going to help with growth. You're going to bring more folks into your state, which will boost revenues, tax revenues in other areas. So just a really [00:08:00] fascinating area to watch. So thanks for unpacking that for me.

	You mentioned sales tax and from your perspective or kind of watching these trends, do you see that as kind of just the culmination of... Wayfair is now almost, I guess they're eight, nine years behind us. So the states have really kind of pulled in those sellers that should be collecting. And so [00:08:30] we're kind of chugging along on that front. We aren't having the pandemic spending levels that we were, and also just the general affordability issues that are impacting folks are cutting their spending that would lead to greater revenues in that area. So any kind of highlights there that you're seeing in that space?
Lucy Dadayan:	Well, we have been saying for a while now [00:09:00] that sales tax revenues are actually very weak and even declining in many states. I mean, it's a question whether you are looking at the numbers in nominal terms or inflation adjusted terms. And when you look at the numbers in inflation adjusted terms, it's actually the same story across the board. In most states are seeing very weak nominal revenue growth in sales tax collections. And there are different fiscal [00:09:30] pressures related to that. One is inflation, which has driven the costs up and the prices up. And on the surface, it might seem to be a good news for the states because higher prices means higher sales tax revenue collections. However, that's only true for so long because the consumers haven't seen that strong bump in their wages [00:10:00] and they are adjusting to the new environment and tightening their wallets and spending less. At the same time, as you mentioned, the Wayfair is behind us, the pandemic spending is also behind us and people are bad consumers are back spending on services rather than on goods. And as you know, in most states, most services [00:10:30] remain on taxed and that creates an environment that states particularly with high reliance on sales tax revenues are seeing fiscal pressures.
Nikki Dobay:	Thank you for that. And I guess before we move into 2026 and what we're expecting there, the other category where you said revenues were slow or lower was corporate income tax. And we definitely saw the latter half [00:11:00] of the year, a lot of large companies doing layoffs. So it does just seem like corporate income levels are lower than they have been. To me, lower revenues in the corporate income tax space kind of correlates with companies aren't doing as well, the income tax is doing what it should be doing. Is that true? And are there other headlines there, or is it just that companies are not as well off as they have been in prior [00:11:30] years, and so corporate income revenues are down?
Lucy Dadayan:	Well, corporate income tax revenues have been wildcard. There is always a large volatility in corporate income tax revenues, and that has been the case for so long. Thankfully, most states have not relying that much on corporate income tax revenues. On average, corporate income tax revenues make up around 10% [00:12:00] of overall estate tax revenues, but corporate profits are down and there are many different forces. As you said, there have been a lot of layoffs and we have also the impact of tariffs on corporate profits, which has been a little bit muted for all different reasons, but moving forward, we do not anticipate significant growth in corporate income tax revenue [00:12:30] collections. And

that's also partly due to various [inaudible 00:12:36] provisions on corporate income tax revenue. So there is a lot of things happening in that area, which is making projecting corporate income tax revenues very hard for state forecasters.

Nikki Dobay: So now let's shift into 2026 and based on the information you've been looking at and analyzing, [00:13:00] what are the expectations as we move into this new year?

Lucy Dadayan: So for state fiscal year 2026, we are mid-year of fiscal year 2026. And what we see is some modest overall growth in revenues. And we have also tracked the state's recent revenue forecasts in the post [inaudible 00:13:28], about 31, [00:13:30] 32 states have already released their revised revenues forecasts for fiscal year 2026 and beyond for fiscal year 2027. And so we see the only clear bright spot in that budgets being personal income tax collections again. And once again, it's tied to the stock market performance. However, [00:14:00] states are expecting modest revenue growth in nominal terms under 2% for overall total tax revenue collections around 1.7%. That's the median revenue growth from 31 states. And that growth is driven by stronger growth in income tax revenue collections, but much bigger growth is sales tax revenue collections.

Nikki Dobay: Okay. And [00:14:30] I guess I'll ask a scary question. So we're seeing the slowdown in these revenues, but we haven't heard much lately about any sort of economic downturn or things, I will say, I don't want to say things getting worse or something like that, but is there any chatter about how the economy's doing and how that could impact the state? At this point, if I'm hearing everything, it seems [00:15:00] like we're kind of in a slow growth time, but that seems to me to be a better place than a no growth or downturn time.

Lucy Dadayan: Right. We had heard more chatter about potential inflation in 2023, 2024, and partly in 2025, but now we are talking about more like stagnation, [00:15:30] slow revenue growth, and that's exactly what we have been seeing in the past year. And that's how states have been forecasting their revenues for fiscal year 2025 and 2026. One, I want to point out that actually fiscal year 2025 revenues were stronger than expected, [00:16:00] and that's exactly because states were expecting recession for fiscal year 2025, but we didn't enter into recession and they were forecasting their revenues conservatively, but in any given year, revenue forecasters always try to be more conservative in their revenue forecasts. So yes, we are in a more weak revenue growth period, weak economic condition period. [00:16:30] We are seeing still low unemployment rates, but that unemployment rate is increasing very slowly by 0.1% each month. So things are moving slow in terms of economy weakening as well as revenues weakening.

Nikki Dobay: Okay. Which is kind of fascinating because everything else seems to be moving so quickly. [00:17:00] But if I'm kind of thinking about this again from the state policymakers' perspective, it's good to be conservative, but there's nothing that seems to be on the horizon that would require drastic measures. So it's a lot of watching and seeing and just being very fiscally responsible and kind of conservative in any actions that are being taken.

You mentioned tariffs a bit ago, and it sounds [00:17:30] like tariffs should boost some of the revenue collections because they'll increase prices, but maybe we're not seeing that so much. So are tariffs having much of an impact on state revenues from... Can we tell that?

Lucy Dadayan: Not really. And actually tariffs do not happen in isolation. There are retaliatory tariffs. [00:18:00] And one reason we are not seeing an immediate dramatic tariff shock in set revenue data is because a lot of businesses anticipated higher tariffs and they planned ahead and front loaded the purchases. And in other words, importers accelerated shipments and brought inventory early to log on lower tariff rates. [00:18:30] So that kind of front loading head temporarily cushioned the economy and state revenues. And the inventories are already on shelves, pricing pressures have been delayed as a result, and we haven't seen that immediate hit of high tariff rates. But in the longer run, the tariffs are still likely to be a headwind, especially for states [00:19:00] with high reliance on imports and important sensitive supply chains. And once that front loaded inventory burns off, higher input costs tend to get passed through gradually, which can [inaudible 00:19:20] consumer purchasing power, which can reduce taxable goods consumption, and which can compress corporate margins actually. [00:19:30] So that would have an impact both on sales tax revenue collections as well as on corporate income tax revenue collections.

Nikki Dobay: Right. That's really fascinating. And there's also just so much uncertainty with respect to the tariffs and the Supreme Court decision and what will happen there. And so it's going to be really interesting to watch this area. And I'm sure from the business's perspective, it's very challenging [00:20:00] to navigate as well. So we'll continue to watch it from our side as it unfolds. So Lucy, are there any states that you're focused on, really watching, really worried about, think are just knocking it out of the park? So what are some states to watch from your perspective?

Lucy Dadayan: Every single state is important. Every single state is-

Nikki Dobay: So diplomatic.

Lucy Dadayan: No, seriously, [00:20:30] I mean, states that have high reliance on severance taxes and on oil industry, they have their own story. The volatile oil prices have an impact on these states. And we have already seen which states are seeing the most weakness in revenue collections, places like Alaska, South Dakota, et cetera. And these states tend [00:21:00] to have much volatile revenues than other states. But also that same thing is true for states that have high reliance on income tax revenue collections because the capital gains can have a significant impact on overall personal income tax revenue collections and the stock market volatility translates into more volatility in capital [00:21:30] gains realizations and volatility in personal income tax revenue collection. So the states that have more diversified tax revenue structures will be better off rather than the states that have high reliance on one or another type of just single type of tax source.

Nikki Dobay: So I'm going to be in a meeting this afternoon and we, at the National Conference of State Legislators, and one of the topics that we'll be talking [00:22:00] about that's going to be part of the discussion for 2026 is the three-legged stool because we see so many states potentially shifting away from generally the personal income tax. So I am very appreciative of your thoughts on diversity in the revenue streams that the states have because I think that's a really important message.

Well, Lucy, again, thank you so much for this conversation. Sitting on the tax side, we often [00:22:30] try not to think too much about what the revenues are coming in, but it's a very, very important part of the conversation when we have to go talk with policymakers to understand what their needs are. Before the final surprise non-tax question or the surprise non-tax question, any final thoughts or predictions you'd like to share or comments about your new study that's coming out?

Lucy Dadayan: So I guess the biggest takeaway is that now we are living [00:23:00] in an environment where uncertainty is the baseline. And so we are living through, at the same time, we are living through period of fast moving change across the economy, technology, whether it's the AI, geopolitics or the environment, the major disasters happening. And in that environment, it makes sense that state fiscal planning is less about [00:23:30] thinking or predicting the next shock, the next recession, and more about building flexibility and tools and disciplines to adapt to the new environment and in the environment where we are seeing with weakness in revenue collections and the economy that is growing, but not really growing at every trade, [00:24:00] but below every trade.

Nikki Dobay: All right. Well, thank you again for all that. But before we sign off here, the surprise non-tax question. So we're in a new year, in January, coming into the new year, many people make new year's resolutions. So my question for you is, are you a person that makes new year's resolutions? My husband was asking me about this, and we were in Cabo for the New [00:24:30] Year's, and he's like, "Do you have any New Year's resolutions?" And I was like, "Yeah, I don't really think of myself as a New Year resolution type person." But then a couple days later I was like, "Well, we're going to start running again and we're going to start doing this." And he's like, "Wait, did you make New Year's resolutions?" So I think that I've come to realize that I'm kind of a soft resolution maker. I don't want to put it out there that this is my resolution because that, again, seems [00:25:00] very definitive, but whenever it's a new time, it's like, okay, it'd be good to do some of these things again. So where are you at on the spectrum of New Year's resolutions?

Lucy Dadayan: Funny you ask, I have a resolution that has been New Year's resolution for the past decade, which never materializes.

Nikki Dobay: See, this is why I like the soft approach.

Lucy Dadayan: Which is learning French. [00:25:30] My French is in progress, but otherwise I'm not really the type who makes resolutions, but more like I can make resolutions in the middle of year and try to stick with it, but the French has been a resolution that has never materialized.

Nikki Dobay: All right. Well, maybe saying it out loud on this podcast, this will be the year that you work on your French. Well, thank you [00:26:00] again, Lucy, for a great conversation about state tax revenues and where the states are at currently. Please check out the studies that Lucy puts out. They are really incredible resources. We'll be sure to link those in the show notes. Lucy and I's contact information will also be in the show notes, and I will be with you again soon on the next GeTtin' SALTy.