2022 Tax Policy: Predictions and Outcomes

The verdicts are in

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This is the first in a series of articles produced in partnership between the Senate Presidents' Forum and MultiState.

As taxpayers and accountants wring their hands here in tax season, it's a good time for a reality check on the major trends in state tax policy predicted for 2022.

Going into the year, we knew there would be a few factors impacting the chances of comprehensive tax reform. First, it's a big election year in the states. Out of all 99 state legislative chambers, 88 have elections, covering a whopping 88 percent of legislative seats. Thirty-six states also have gubernatorial elections in November. Historical tax data shows that states are significantly less likely to make major changes to the tax code in an election year. These two factors alone queued up states for a year that was light on comprehensive tax reform measures.

Now, four months of policymaking into the year and with nearly half of states already adjourned, we have perspective on what actually happened with predicted trends and the likelihood of their reemergence next year.

In this article

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Trend Predicted: Tax rate reductions will be widely enacted.
Verdict: True!

Six states have already approved legislation to reduce their income tax rates.

Tax rate cuts were predicted by nearly everyone in the state and local tax policy world. The combination of historic revenue surpluses and election year pressure made tax cuts a popular topic in statehouses around the country. Georgia, Idaho, Indiana, Iowa, Mississippi, and Utah all passed individual income tax cuts this year. Most recently, Nebraska Governor Pete Ricketts signed a bill to reduce both the individual and corporate income tax rates in the coming years by phasing in the reduction through 2027. Additionally, Colorado has a November ballot measure to reduce income

tax rates from 4.55 to 4.4 percent (for both the individual and corporate income tax). The corporate income tax rate has been included in many of the rate reduction bills this year. Tax packages in Idaho, Iowa, and Utah all included a reduction in the corporate income tax.

When considering tax policy in 2022, there were questions about whether progressive legislators would seek to increase tax rates regardless of current revenue surpluses. Colorado, Connecticut, and New York were considered three states to watch due to public comments from legislators and governors in support of additional taxes on higher income or wealthier individuals and targeted large businesses during 2021. However, while there were certainly competing priorities and animated discussions about how to spend surpluses, only two states – Hawaii and Massachusetts – considered proposals increasing tax rates. At this point in the session, the bills have not gained much traction in either state.

Tax Rate Reductions to Date

Georgia
Idaho
Indian
Iowa
Mississippi
Utah
Nebraska

Trend Predicted: Work-From-Home will create tax administration challenges.
Verdict: True!

Challenges continue for employees, employers, and state governments, but there was very little legislative action on the issue.

Before the pandemic, flexible work arrangements were growing in popularity, and COVID-19 sharply accelerated the trend. With changing demographics in the working population and advances in technology, many workers already sought greater flexibility in work arrangements. The increase in remote work has highlighted the many tax challenges for employees, employers, and state and local governments when determining who is subject to tax in the state. It also created tension between states as they battled over who has the right to tax employees working at home.

The increase in remote work has highlighted many challenges in determining who is subject to tax in the state.

New Hampshire sued Massachusetts over a regulation providing that nonresidents working for Massachusetts based companies had to continue to pay Massachusetts income tax when they were working at home (even when they were working from their home office of New Hampshire and not stepping foot in Massachusetts). This is especially contentious as New Hampshire does not have an income tax. The federal government declined to step in when the US Supreme Court did not agree to review the suit.

States have taken different approaches to working from home (WFH), covering everything from tax credits for remote workers to stipulating who is subject to tax. In the 2021 and 2022 sessions we saw a number of bills dealing with a wide range of remote work issues, including:

- Incentives for businesses to recruit employees in a state as remote workers (KY HB 744)

- Addressing economic development incentives with requirements to maintain employment to deal with remote workers (NJ AB 3433)
- Providing earned tax exemptions for work performed remotely (MO HB 1740)
- Prohibiting another state from taxing nonresidents working in their home state (NH HB 1097).

Like many other issue areas this year, while we saw a number of bills, there was very little movement on any of the bills. In part we believe that's because states, businesses, and employees are still struggling to understand all the tax implications and find adequate solutions. In the meantime, individuals are suing states (and some local governments) that attempt to tax their income when they are not working in the state. State tax agencies are auditing employers to make sure they are withholding the proper state tax, with both the resident and nonresident states making claims. WFH and the "digital nomad" lifestyle is here to stay, so these administrative challenges will continue for governments, employers, and employees until the tax challenges are clearly resolved. The question remains whether state governments are able to solve the issue or if the federal government will have to step in.

TREND PREDICTED: Taxes on tech will continue in a new form.
VERDICT: To be determined.

Legislation slowed down significantly this year, but there is still plenty of deliberation coming from the court process as well as from academic and policy wonks.

In 2021 there was a marked increase in the number of bills that would levy novel taxes on the technology sector, with state lawmakers showing particular interest in creating new taxes on digital advertising and aggregated data. Due to a number of political and fiscal factors, however, interest in both of these topics dipped significantly in 2022.

Maryland was the first state to enact a digital advertising tax (HB 732) in February 2021, and the ongoing controversies over that law have chilled other states' efforts to follow a similar path. Maryland policymakers passed the bill in order to raise the money necessary to implement generational education reform, but a lawsuit filed by taxpayers put that new revenue into immediate jeopardy. Opponents of the tax argued, among other things, that the new tax violated the Internet Tax Freedom Act, the Commerce Clause, and the Due Process Clause. One of the two lawsuits is still ongoing, and early rulings from the court (and wide speculation in the tax policy world) suggests that taxpayers' arguments against the new law have merit.

Since the enactment of the Maryland law, the team at MultiState has identified 36 bills that would impose a Maryland-style digital advertising tax. With the legal challenge to Maryland's law pending, however, nearly all of these bills have either died or languished, unheard in committee. The only exception is a group of five Massachusetts bills (HB 2928, HB 2894, HB 3081, HB 4042, & HB 4179) that had introductory hearings, but have not been voted on. Until legal questions around digital advertising taxes are resolved, we do not expect significant action by other states on this topic.

Challenges to Maryland's digital advertising tax have chilled efforts in other states to follow a similar path.

States' interest in taxing aggregated data has a smaller scope, but was also put on pause this year. In 2021 lawmakers introduced 10 bills that would levy some kind of tax on business data, but, unlike with digital advertising taxes, these bills varied in their specifics. For example, one Washington bill (HB 1303) would levy a 1.8% tax on gross income derived from the sale of user data, while a set of New York companions (AB 6199/SB 4959) would levy a data excise tax whose rate would vary based on the number of users at issue. It's also notable that these bills have come from both red states and blue states. While most of this legislation is from solidly Democratic legislatures, West Virginia has also introduced two data-mining tax bills and a few conservative states have introduced legislation that would specifically target social media companies.

These bills burst into legislative debate in 2021, but there has been less discussion in 2022. Only three new bills were introduced this year, and legislators have only held substantive hearings on one Washington bill (HB 1850). This is an area that we believe will be highly affected by the upcoming election. Republicans have tended to show interest in bills focused on social media company practices, while Democrats have tended to support proposals raising taxes more broadly on large technology companies (and in the cases of digital ad taxes, on their customers) One thing that is clear from the myriad discussions on this issue: It's very challenging to draft legislation which affects only the avowed targets without either violating federal law or the U.S. Constitution, let alone fundamental tax policy and economic principles. Nevertheless, we don't expect the political interest in this issue to wane, and experimentation with new concepts and language is likely.

Trend Predicted: The impact of federal changes will linger.
Verdict: Less so than predicted.

After the federal tax bill fell apart in December, states were largely unconcerned with federal impacts.

This issue can be split into two subcategories: the anticipated new federal tax bill, and scheduled changes due to the 2017 Tax Cuts and Jobs Act.

It became clear at the end of December 2021 that the federal tax provisions contained in the Build Back Better Act would not pass as proposed. Nonetheless, President Biden (in his FY '23 budget) and many Democrats are interested in a scaled-back package that will contain some major tax changes. However, as Congress does not currently have a tax package with majority support, state legislatures once again escaped the conformity conversation this year. The midterm elections will of course be hugely influential in whether this trend continues into 2023. If Republicans gain a majority in Congress, it's possible they would try to modify some of the Tax Cuts and Jobs Act (TCJA) provisions that are set to expire in coming years.

The long shadow of the TCJA is the other subcategory of federal change. The TCJA includes several provisions that are scheduled to either change or expire over the course of ten years – and two scheduled TCJA changes did occur this year. Until 2021, corporations were able to deduct 100% of their research and experimentation expenses in the year incurred. However, beginning in 2022, the TCJA requires the expenses to be amortized over five years (15 years for foreign research). This automatically increases the tax base in states with rolling conformity.

The midterm elections will be hugely influential in determining changes to federal tax policy in 2023.

Tennessee was the only state to act on this policy change – the state passed SB 2397, reverting the research and experimental expenditure expensing treatment back to the 2021 policy of allowing full deductibility in the year incurred. Tennessee's action is a benefit for businesses engaged in research activities.

The second change occurring this year is in the calculation of disallowed interest deductions. Prior to 2022, the disallowance of interest in excess of a percentage of income looked to a company's earnings before interest, taxes, depreciation, and amortization. Starting in 2022 the measurement is earnings before interest and taxes. As a result, affected companies will have a larger interest disallowance. In states with rolling conformity that have not already decoupled from the federal limitation, taxpayers will face an increase in state taxes.

A Surprise Trend: "Inflation Relief" Tax Policy

Rising inflation levels have hit consumers, and state legislators spent time trying to provide relief, including indexing income tax brackets, issuing taxpayer rebates, and adopting new sales tax exemptions. Georgia, Idaho, Indiana (an expansion of a refund passed in December 2021), and New Mexico all passed taxpayer rebates this year, with New Mexico having enacted its second round of rebates after the legislation passed in a special session. Governors and legislators are still considering the issue in California, Hawaii, Maine, Minnesota, and Virginia. Depending on if other states follow suit, taxpayer rebates and tax holidays could easily end up being the story of 2022 state tax policy.

State legislators have tried to provide relief to rising inflation.

In a similar vein, fuel tax exemptions and grocery tax exemptions have been popular topics in recent months. Connecticut, Florida (their holiday will take place in October), Georgia, and Maryland have all approved gas tax holidays. Legislators and governors in at least twenty other states have proposed (formally through legislation or informally through expressed interest) in following suit. No state has exempted groceries from the sales tax at this point in the session, but it has been seriously deliberated in Kansas, Oklahoma, Tennessee, and Virginia.

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