Revenue Trends and Performance in Post-Wayfair and TCJA era

NCSL Capitol Forum, 2019
Phoenix, Arizona

December 11, 2019
Lucy Dadayan
States continue facing fiscal challenges and uncertainties

- Currently in the longest economic expansion, but 11+ years later states still feeling the pain of the Great Recession
- Both economic and revenue growth in the current expansion has been weaker than in previous expansions
- Variables that drive revenue were hit harder than broader economy, harder than before
- State tax revenue recovery has been very slow and prolonged
- Employment and wage recovery has been very slow, particularly for the public sector
- Demographic changes and aging population are a major concern
- International trade uncertainty has a negative impact on both state trade and overall state economic stability
- State revenue forecasters stand on shifting sands due to changing federal and state policies
State taxes and the economy: States taxes are far more volatile

Real GDP vs. Real state tax revenue over time.
Growing reliance on personal income tax; Declining reliance on sales tax & corporate income tax

Personal income, corporate income, and sales taxes as share of total taxes, 1970-2018

Source: U.S. Census Bureau.
Current state of the state and local tax revenues

- Sales taxes
  - Weak growth in post-Great Recession period
  - Hopes for sales tax boost in post-Wayfair; but it will take a long time before full implementation

- Personal income taxes
  - Steep declines during the Great Recession period and strong growth in post-TCJA
  - Increased income tax revenue volatility and uncertainty due to TCJA and other federal and state policy changes

- Corporate income taxes
  - Still below prerecession levels but soaring in post-TCJA

- Local property taxes
  - Continued but soft growth
State & local government tax revenues: Now 18% above prior peak

Percent change in state & local government major tax revenue since start of recession (PIT + CIT + Sales + Property) Four-quarter moving average, adjusted for inflation

Cumulative percent change since start of recession

# of years since start of recession

Sources: U.S. Census Bureau (taxes) and Bureau of Economic Analysis (GDP).
Notes: Data are shown only until the start of the next recession; 1980 & 1981 recessions are treated as single recession.
Tax revenue recovery varied by source; Corporate incomes taxes still below prior peak

Major tax revenues since the start of the 2007 recession
Four-quarter moving average, adjusted for inflation

Sales tax (state)  | PIT (state)  | CIT (state)  | Other (state) | Property (local)

Cumulative % change since start of recession

Sources: U.S. Census Bureau (taxes) and Bureau of Economic Analysis (GDP).
Notes: (1) 4-quarter moving average of inflation-adjusted tax revenue; (2) No adjustments for legislative changes.
State taxes returned to normal levels in July-September 2019 quarter

Year-over-year nominal percent change, July-Sep 2019 vs July-Sep 2018

<table>
<thead>
<tr>
<th>Category</th>
<th>US Average</th>
<th>US Median</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>5.6%</td>
<td>4.5%</td>
</tr>
<tr>
<td>Sales</td>
<td>7.4%</td>
<td>5.8%</td>
</tr>
<tr>
<td>PIT</td>
<td>4.4%</td>
<td>5.1%</td>
</tr>
<tr>
<td>CIT</td>
<td>10.5%</td>
<td>3.5%</td>
</tr>
</tbody>
</table>

Source: Urban Institute’s compilation of data from individual states.
Growth in total state tax revenues was over 5% in 20 states in July-September 2019 quarter
June 21, 2018: The US Supreme Court issued its decision in the South Dakota v. Wayfair case
States responded fast: Economic Nexus
State sales tax complexity

- **Origin- vs. destination-based sales tax for in-state sellers**
  - 12 states have origin-based sales tax rule for in-state sellers
    - Sales taxes are collected based on where the **seller is located**
    - California is mixed: City, county, and state sales taxes are origin-based, while district sales taxes (supplementary local taxes) are destination-based
  - 33 states have destination-based sales tax rule for in-state sellers
    - Sales taxes are collected based on where **the customer is located**

- **Origin- vs. destination-based sales tax for remote sellers**
  - Sales are generally destination-based
State actions in response to Wayfair and challenges

- States implemented two sets of legislations in response to Wayfair decision
  - Remote seller laws
  - Marketplace facilitator laws
- States implemented various dollar value and transactions value thresholds; and some states already revised those thresholds
  - Some remote sellers may sale few items of higher value
  - Some remote sellers may sale large number of items of lower value
- Foreign vendors must comply with US laws
Local sales tax rate, base, and administration complexity

- 37 states (including Alaska, which has no state tax) allow general sales taxes at the local level

- Large variation across and within the states in terms of local sales tax base: the structure of sales taxes, defining what is taxable and nontaxable

- Large variation across and within the states in terms of local sales tax rates and administration
  - Fixed local sales tax rates and/or low rate setting autonomy
  - Varied local sales tax rates and/or higher rate setting autonomy

- Overlapping local jurisdictions
  - For example, Oklahoma city spreads out over 4 counties with various sales tax rates: Canadian (0.35%), Pottawatomie (1.495%), Cleveland (0.25%), and Oklahoma (0%)
  - It will take long time until full implementation down to the level of localities is in effect
Local governments in 16 states raise over 25% of total state-local general sales tax revenues
State government sales taxes: Recovery is extremely weak

State sales tax revenue since the start of the recession
Four-quarter moving average, adjusted for inflation

Cumulative % change since start of recession

Years since start of recession

Sources: U.S. Census Bureau (taxes) and Bureau of Economic Analysis (GDP).
Notes: 4-quarter moving average of inflation-adjusted tax revenue. Data are shown only until the start of the next recession.
Sales tax base and collections: Shift to services

Goods and services as percentage of personal consumption expenditures

Source: U.S. Bureau of Economic Analysis, National Income and Product Accounts, Table 2.3.5.
Sales tax base and collections: Shift to services

Goods and services as percentage of personal consumption expenditures

Source: U.S. Bureau of Economic Analysis, National Income and Product Accounts, Table 2.3.5.
Consumption of durable & non-durable goods was hit hard

Source: U.S. Bureau of Economic Analysis, National Income and Product Accounts, Table 2.3.5.
E-commerce sales are growing rapidly; Now represent >11% of total sales

Source: U.S. Census Bureau, Quarterly e-commerce report.
Total retail sales vs. e-commerce sales

US total retail sales vs e-commerce sales

Source: U.S. Census Bureau, Quarterly e-commerce report.
Total retail sales vs. e-commerce sales: Similar growth patterns

Year-over-year nominal growth in total retail sales vs e-commerce sales

Source: U.S. Census Bureau, Quarterly e-commerce report.
Growth in sales tax revenues was over 5% in 27 states in July-September 2019 quarter
State income taxes before and after the Tax Cuts and Jobs Act: Joy, Sorrow, and Uncertainty
TCJA: Brief summary

- Didn’t apply to 2017 income tax
- Most provisions began on January 1, 2018 (tax brackets, tax rates, etc.)
- Few provisions started later on
- Tax cuts for individuals & small businesses expire on 2025
- Corporate tax cuts are “permanent”
- Elimination of unlimited deductions for state and local taxes (SALT)
  - $10K cap per year
  - Big deal for high-tax, high-income states (CA, NY, NJ, IL, etc.)
- Lower cap on the mortgage interest deduction for new buyers
- Challenges: Determining short-term intertemporal behavior compared to long-term structural changes
State government personal income taxes: Stronger recovery, but volatile

State personal income tax revenue since the start of the recession
Four-quarter moving average, adjusted for inflation

Sources: U.S. Census Bureau (taxes) and Bureau of Economic Analysis (GDP).
Notes: 4-quarter moving average of inflation-adjusted tax revenue. Data are shown only until the start of the next recession.
April-June personal income tax collections are very volatile

**Year-Over-Year Nominal Percentage Change for April-June Quarters**

- **Source:** Individual state data, analysis by the author.
Estimated / final payments in California and New York vs the rest of the nation

Estimated and final payments, FYs 2009-2019

Source: Individual state government data, analysis by the author.
TCJA caused large volatility in estimated/final payments

Year-over-year percentage change in estimated & final payments

Source: Individual state government data, analysis by the author.
Growth in estimated and final payments
Monthly vs state fiscal year-to-date

<table>
<thead>
<tr>
<th>Month</th>
<th>Monthly</th>
<th>State FYTD 2019</th>
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<tbody>
<tr>
<td>Jul-18</td>
<td>20.5%</td>
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<tr>
<td>Aug-18</td>
<td>18.0%</td>
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<td>Sep-18</td>
<td>17.4%</td>
<td></td>
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<td>Oct-18</td>
<td>17.3%</td>
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<tr>
<td>Nov-18</td>
<td>15.9%</td>
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<tr>
<td>Dec-18</td>
<td>-21.6%</td>
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<td>Jan-19</td>
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<tr>
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<tr>
<td>Mar-19</td>
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<tr>
<td>Apr-19</td>
<td>2.4%</td>
<td></td>
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<tr>
<td>May-19</td>
<td>2.8%</td>
<td></td>
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<tr>
<td>Jun-19</td>
<td>2.7%</td>
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TCJA also caused volatility in withholding, particularly in California and New York

Source: Individual state government data, analysis by the author.
Growth in withholding
Monthly vs state fiscal year-to-date

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<th>Month</th>
<th>Monthly</th>
<th>State FYTD 2019</th>
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<td>Jul-18</td>
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<td>8.0%</td>
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<td>Aug-18</td>
<td>7.3%</td>
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<td>Apr-19</td>
<td>2%</td>
<td>4.7%</td>
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<tr>
<td>May-19</td>
<td>4%</td>
<td>4.7%</td>
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<tr>
<td>Jun-19</td>
<td>6%</td>
<td>4.6%</td>
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# Actual vs. projected personal income tax revenues in post-TCJA period ($ in millions)

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<tr>
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<td>1,024</td>
<td>1,152</td>
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<td>933</td>
<td>1,342</td>
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<td>647</td>
<td>637</td>
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<td>563</td>
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<td>6.3</td>
<td>18,993</td>
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<td>441</td>
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<td>830</td>
<td>1,086</td>
<td>948</td>
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<td>369</td>
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<td>356</td>
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<td>375</td>
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<td>136</td>
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<td>(13.6)</td>
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<td>578</td>
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<td>RI</td>
<td>319</td>
<td>287</td>
<td>309</td>
<td>(9.8)</td>
<td>7.7</td>
<td>270</td>
<td>317</td>
<td>290</td>
<td>17.4</td>
<td>(8.6)</td>
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<tr>
<td>SC</td>
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<td>676</td>
<td>854</td>
<td>675</td>
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<td>VT</td>
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<td>179</td>
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<td>5.1</td>
<td>210</td>
<td>239</td>
<td>201</td>
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<td>(15.8)</td>
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<td>WV</td>
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<td>425</td>
<td>489</td>
<td>438</td>
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<td>WI</td>
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<td>9.1</td>
<td>1,523</td>
<td>1,819</td>
<td>1,588</td>
<td>19.4</td>
<td>(12.7)</td>
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<tr>
<td><strong>Median</strong></td>
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<td></td>
<td><strong>(9.2)</strong></td>
<td><strong>7.7</strong></td>
<td></td>
<td><strong>21.3</strong></td>
<td>(<strong>11.8</strong>)</td>
<td></td>
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</table>
April windfalls: Celebration or prudent fiscal planning?
Income shifting and capital gains

- In concept, taxpayers can shift many kinds of income, but…:
  - **“Regular” wages** – not so easy - work less now, more later
  - **Bonus wages** – easier – firms could shift out of q4 into q1 or vice versa
  - **IRA distributions** – maybe not so hard
  - **Dividends** - boards of closely held firms could delay payouts
  - **Capital gains** - easiest - defer stock sales (rearrange assets); concentrated – 70% of cap gains claimed by just 0.7% of taxpayers
Capital gains: Big contributor to income tax volatility

Capital Gains as Percentage of GDP

Capital gains are loosely related to the stock market

Percent Change in Capital Gains Realizations vs S&P 500, by Tax Year

- 2012: Fiscal cliff acceleration of capital gains
- 2013: Capital gains trough after acceleration
- 2014: Rebound from trough
- 2017: TCJA
Growth in personal income tax revenues was over 5% in 21 states in July-September 2019 quarter

Year-over-year nominal percent change in state sales tax revenues, July-Sep. 2019 vs July-Sep 2018
US average growth = 4.4%, US median growth = 5.1%
State government corporate income taxes: Still below prerecession levels

State corporate income tax revenue since the start of the recession
Four-quarter moving average, adjusted for inflation

Cumulative % change since start of recession

Years since start of recession

Sources: U.S. Census Bureau (taxes) and Bureau of Economic Analysis (GDP).
Notes: 4-quarter moving average of inflation-adjusted tax revenue. Data are shown only until the start of the next recession.
Local government property taxes: Continued growth

Local government property tax revenue since the start of the recession
Four-quarter moving average, adjusted for inflation

Sources: U.S. Census Bureau (taxes) and Bureau of Economic Analysis (GDP).
Notes: 4-quarter moving average of inflation-adjusted tax revenue. Data are shown only until the start of the next recession.
2018 property tax pre-payment rush and chaos

- The TCJA was vague about state and local property tax pre-payments
- Governors in NY and NJ issued orders encouraging people to pre-pay and deduct their 2018 taxes in December 2017
- Homeowners in some high-property tax states rushed into paying 2018 property taxes
- Taxpayers hoped they can deduct pre-payments from 2017 taxes
- Example: Montgomery County, Maryland
  - Hold a special session and passed a bill allowing residents to pre-pay 2018 property tax bills
- On December 27th (after many taxpayers rushed to prepay), the IRS released an advisory:
  - Prepaid real property taxes may be deductible in 2017 if assessed and paid in 2017
Continued Growth in Housing Prices and in Local Property Taxes

![Graph showing housing price index and local property taxes over time with recession periods highlighted.](image-url)
Recap: States face fiscal and economic uncertainties

- Expansions don’t die of old age; next recession likely around the corner
- Differing fiscal, tax, and economic structures play important roles
- State tax revenues increasingly more reliant on economically sensitive taxes
- Income taxes will likely fluctuate further in light of the TCJA and because of reliance on volatile income (i.e. capital gains, bonuses)
- *Dynamic* nature is crucial – impacts and responses roll out over time
- States expanded sales tax bases in response to Wayfair; but many services remain untaxed and are hard to tax: politically, legally, administratively
- Demographic changes pose major concern for future workforce and for state budgets
- Annual budget balance requirements lead to “stretching out” fiscal problems
- Time to adjust to the new reality (gig economy, digital world, older population) and implement multi-year financial planning
Need more information and detailed 50-state tax data?

- Visit Urban Institute’s State and Local Finance Initiative [webpage](#)
- Read our *State Tax and Economic Review* Quarterly Reports, which cover the current status of state tax revenue performance
- Contact me to receive our monthly state fiscal highlights by email
- Subscribe and get real-time state tax data for one of our 6 [databases](#)
  - Monthly State Government Tax Revenue Data
  - Monthly State Government Personal Income Tax Data
  - Quarterly State Government Tax Revenue Data
  - Annual State Government Tax Revenue Collections versus Official Forecasts
  - Annual State and Local Government Gambling Revenue Data
  - Monthly State Government Marijuana Tax Revenue Data
Thank you!

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December 11, 2019