



State of the States: What to Watch

October 2022

Notice

The following information is not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

Agenda

- **Fiscal update: Revenues and ending balances**
- **Recent legislative activity**
- **American Rescue Plan**
- **Pass-through entity work arounds**
- **Work from anywhere**



Fiscal Summary

State fiscal summary

Revenue growth and other factors have largely offset COVID-related fiscal impacts

- Revenue growth has offset COVID-induced declines and exceeded projected growth in nearly all states
- Income tax collections (corporate and individual) remained strong in most states as higher earning individuals have remained employed and stock market gains have led to outsized increases in non-withheld income
- Sales tax revenues have remained strong with shift to online buying, *Wayfair*, and inflation
- Federal ARPA funding supplemented state resources and contributed to increased fiscal flexibility for states

Ending balances (aka surpluses)

- Both rainy day funds and total ending balances reached all-time highs at the close of FY 2022
- Governors' budgets for FY 2023 projected some decline based on submitted budgets
- Legislatures likely outdid Governors in some cases

For those of a certain age...

Various yellow caution lights

- Near-term economic outlook is not great
- Stock market down substantially
- Number of states not at pre-COVID job levels
- Significant tax reductions enacted in 2022; several phased-in over near term
- ARPA/COVID funding is time-limited
- Property taxes not increasing at nearly same pace; local governments generally more limited in fiscal tools

Punchline

- All is not as rosy as FY 2021 and FY 2022
- Some caution, or at least vigilance, seems in order



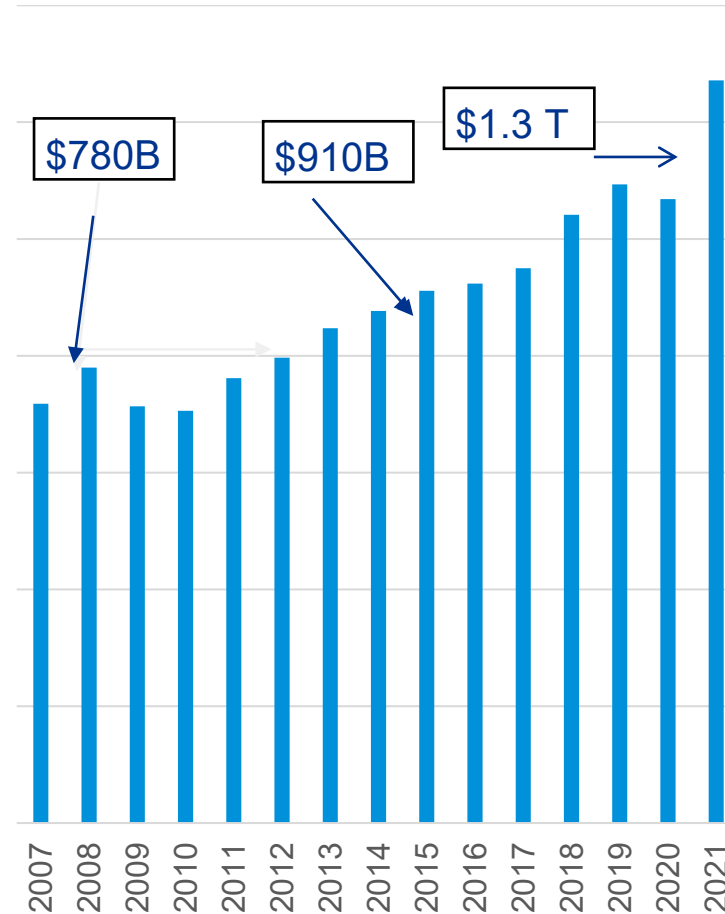
Nominal state tax revenue FY 2007 – FY 2021

Growth in 2018-2019 was “out of the norm” - about 15 percent over two years or about double the norm since 2011

COVID impact was to make FY 2020 a negative year; first since 2010

FY 2021 was an “enormous” year with nearly 20 percent growth

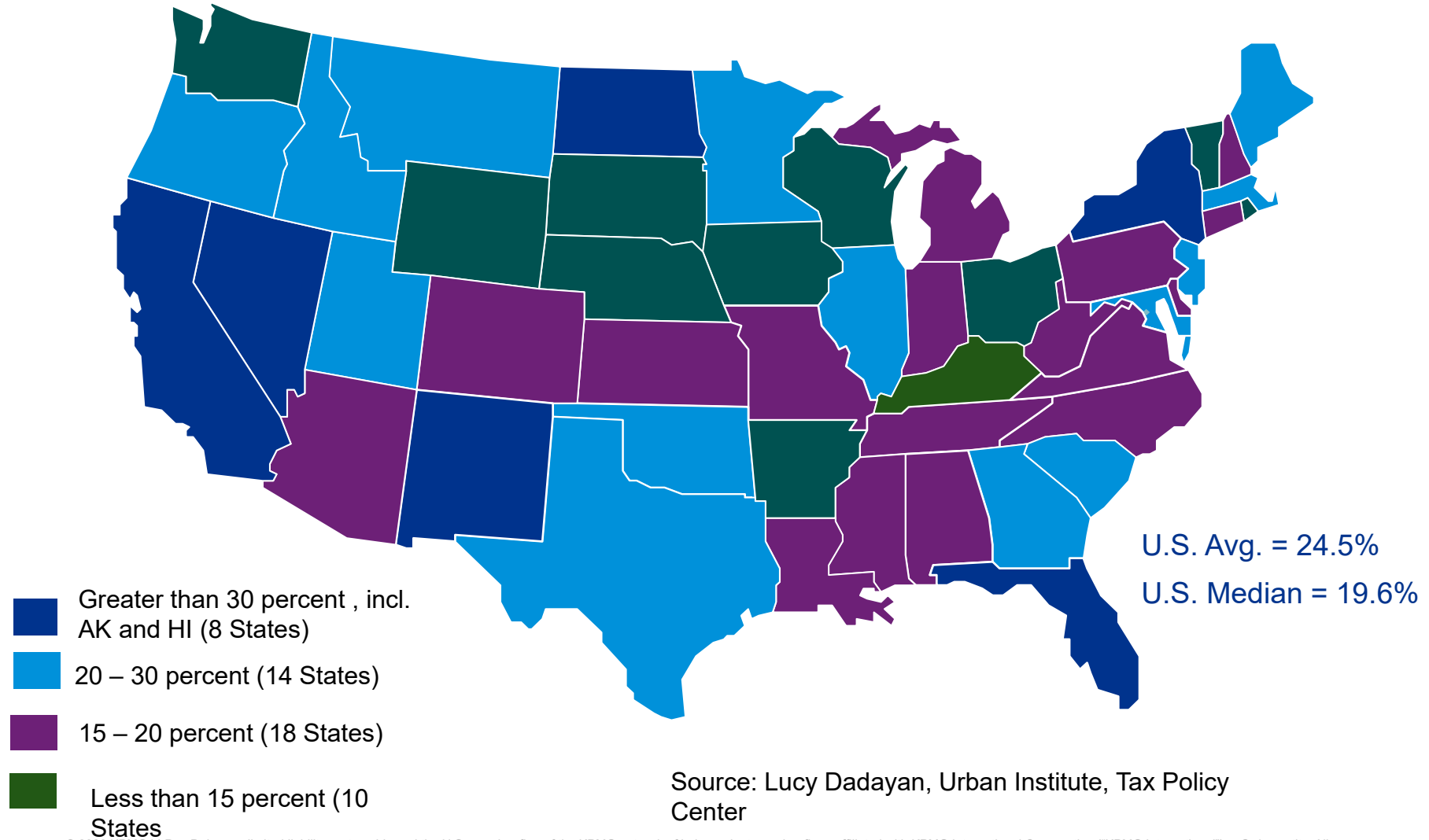
FY 2022, to all appearances, will be similar to 2021



Source: U.S. Bureau of the Census

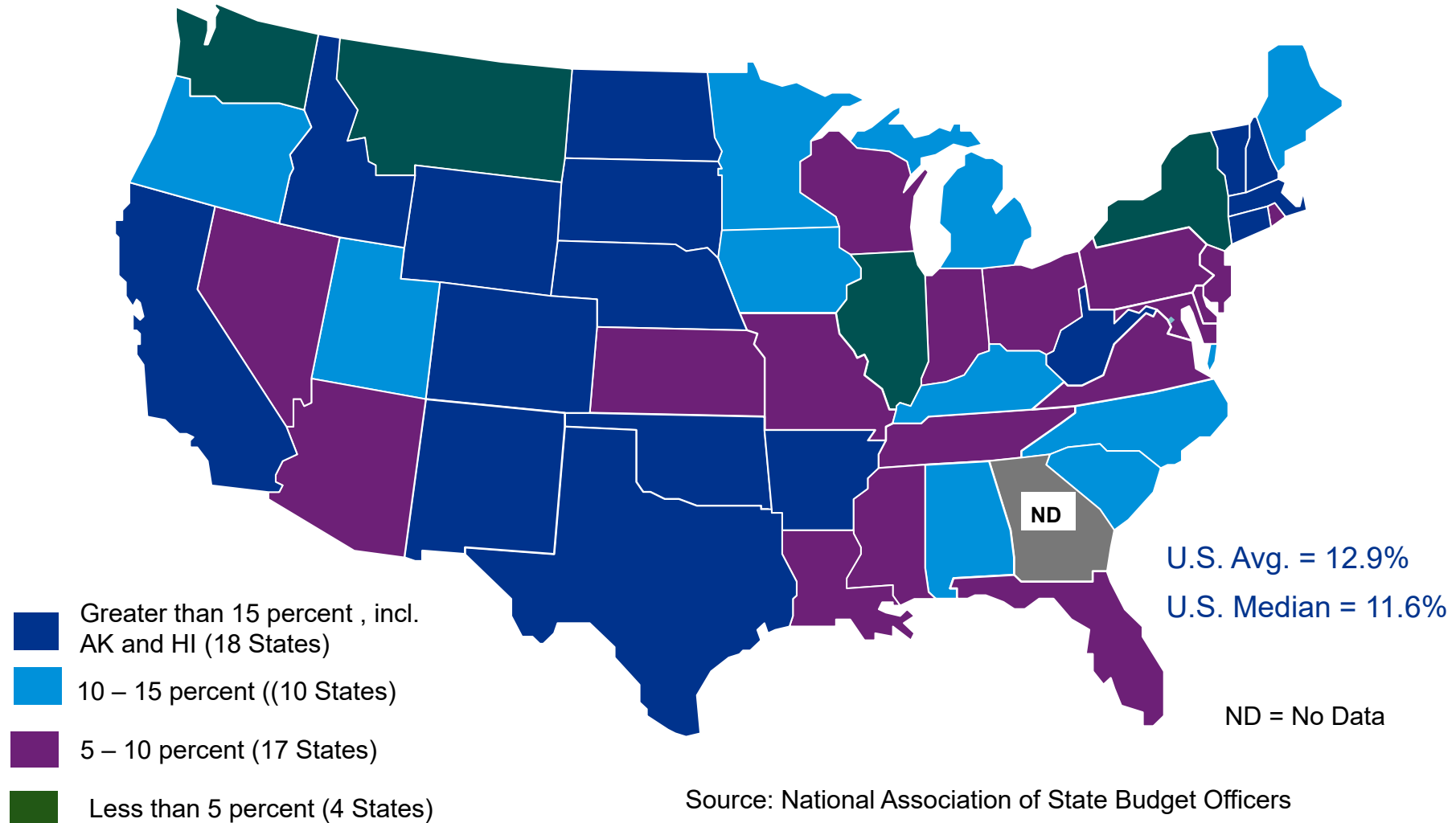
State revenue collections

Nominal percent change from 12 months March 2021 v. March 2022



State rainy day funds – Est. year-end FY 2022

Percent of General Fund expenditures



Rainy day and total ending balances

FY 2000 to FY 2023

FIGURE 4:
Rainy Day Fund Balances as a Percentage of Expenditures Fiscal 2000 to Fiscal 2023

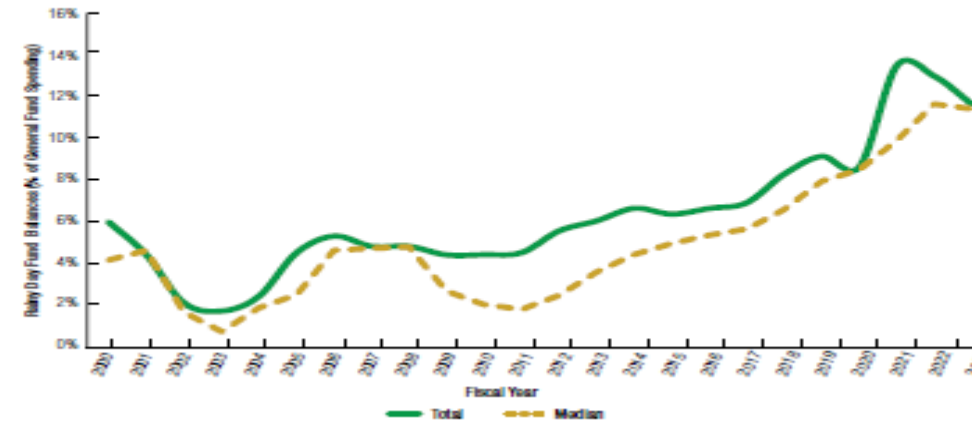
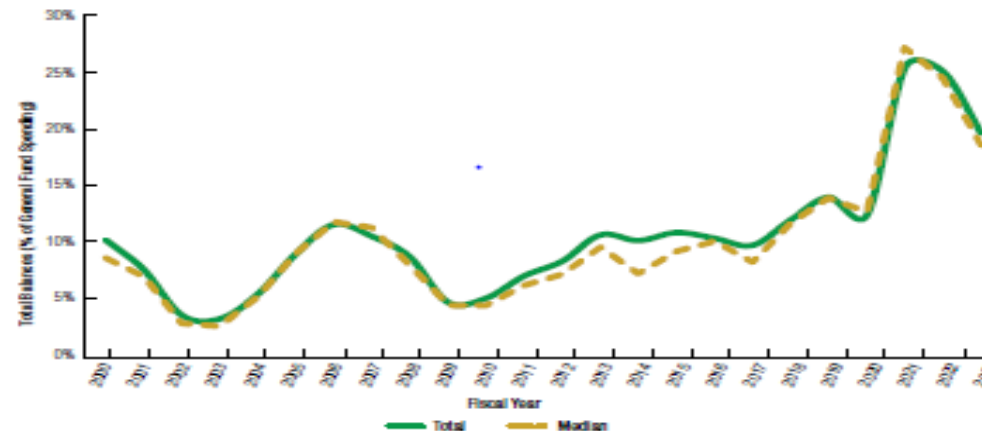


FIGURE 5:
Total Balances as a Percentage of Expenditures, Fiscal 2000 to Fiscal 2023

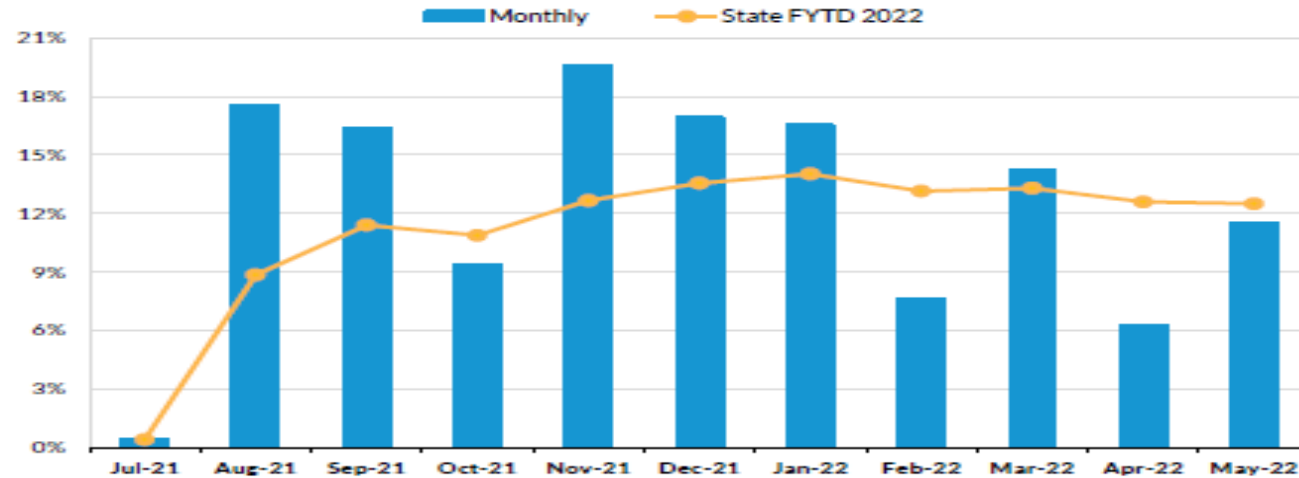


Source:
Nat'l. Assoc.
of State
Budget
Offices

Some income tax data

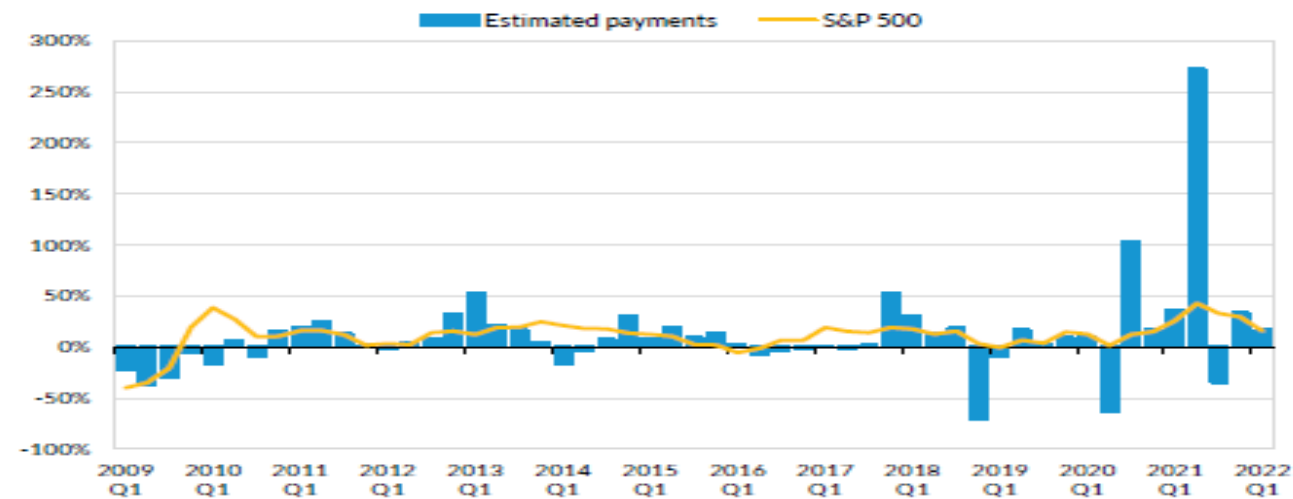
Withholding Is Strong, Fueled by Inflation

Nominal percentage change in withholding tax collections compared with the previous year, monthly and year-to-date for state fiscal year 2022



Large Volatility in Estimated Payments

Year-over-year nominal percentage change in estimated payments and S&P 500 Index

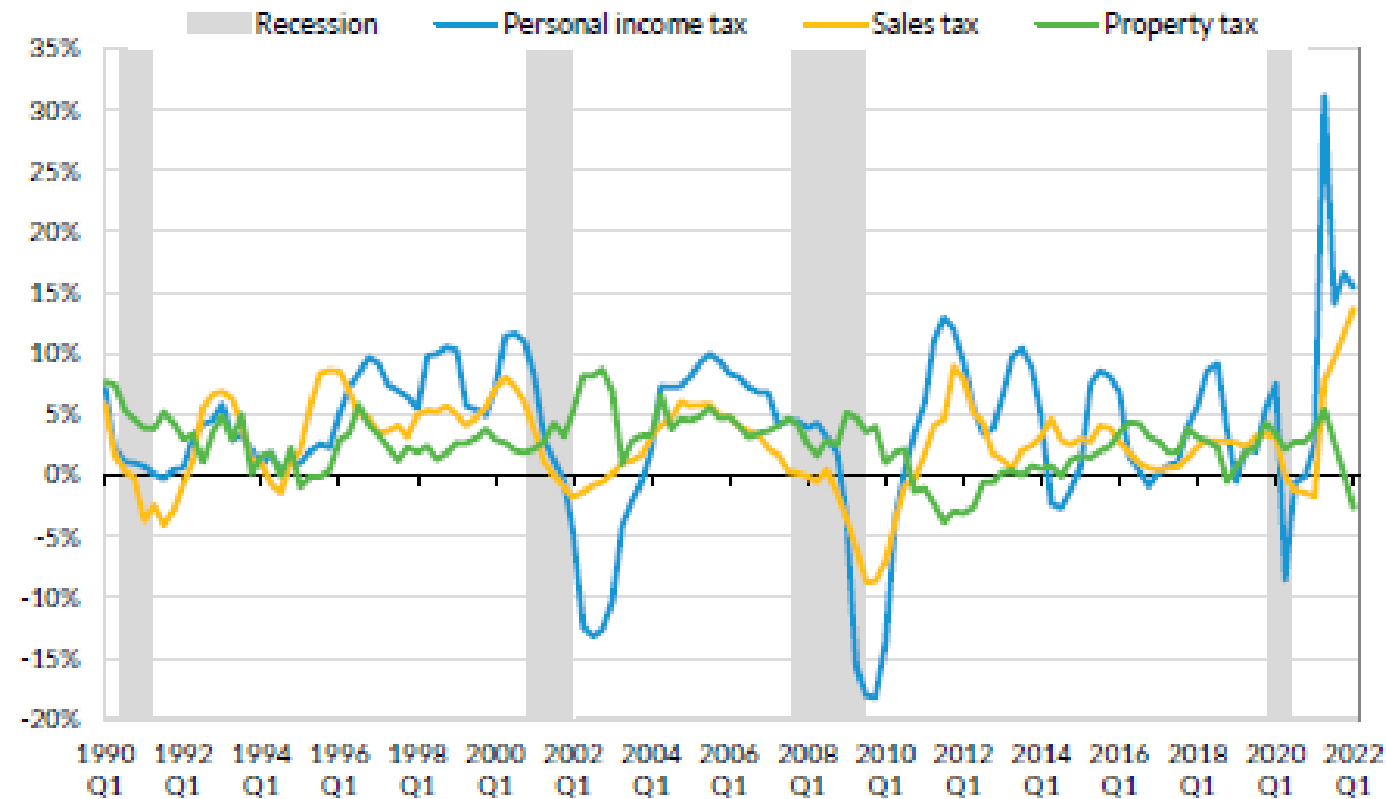


Source:
Urban
Institute,
State Tax
and
Economic
Review,
2022Q1

Cloudy local outlook

State and Local Property Tax Revenues Weakened Substantially

Year-over-year inflation-adjusted percentage change in major state-local taxes



URBAN INSTITUTE

Source: US Census Bureau (tax revenue) and Bureau of Economic Analysis (GDP), analysis by the author.

Notes: Year-over-year change is the percentage change of four-quarter moving averages. Data are adjusted for inflation.

Source:
Urban
Institute,
State Tax &
Economic
Review,
2022Q1

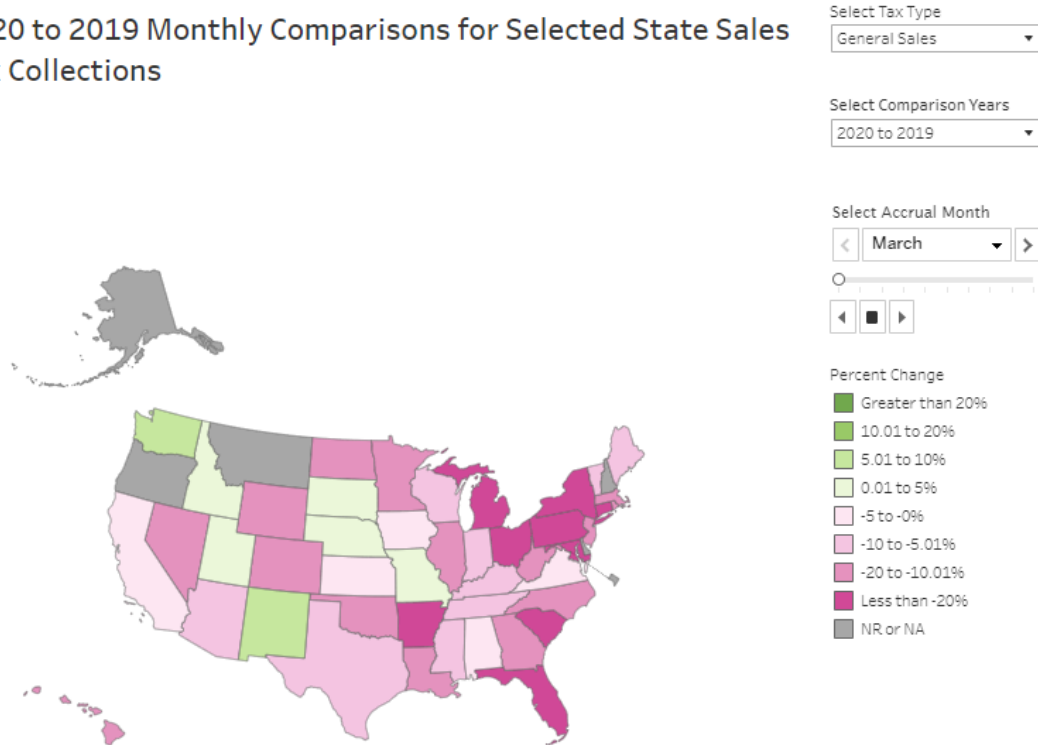
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Sales Taxes

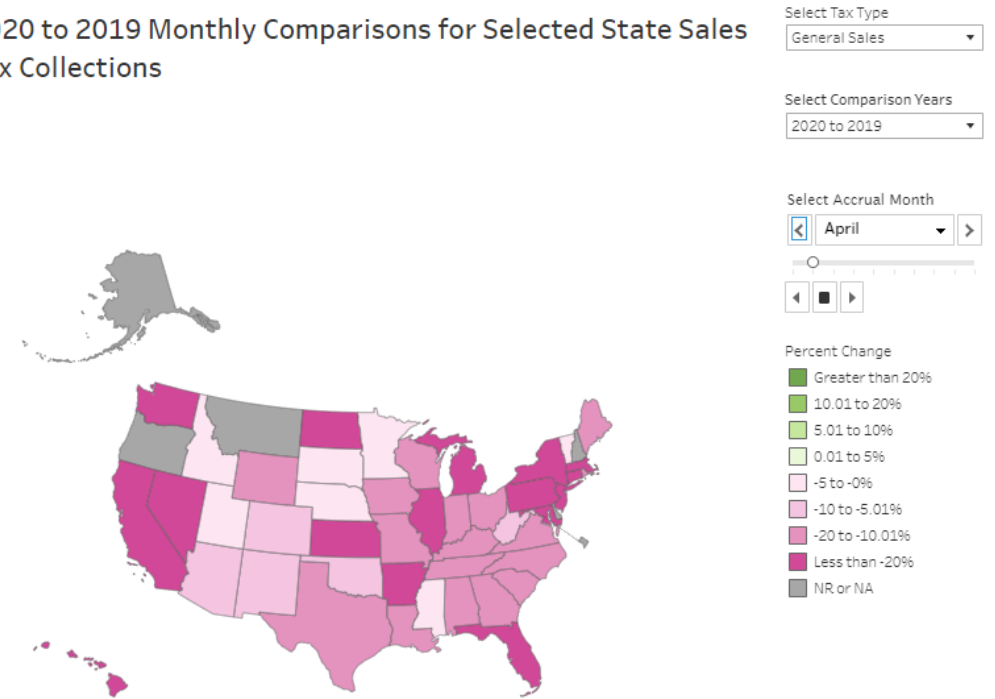
Sales Taxes: Start of the Pandemic

YOY CHANGE BETWEEN FY19 & FY20 FOR MARCH & APRIL

2020 to 2019 Monthly Comparisons for Selected State Sales Tax Collections



2020 to 2019 Monthly Comparisons for Selected State Sales Tax Collections

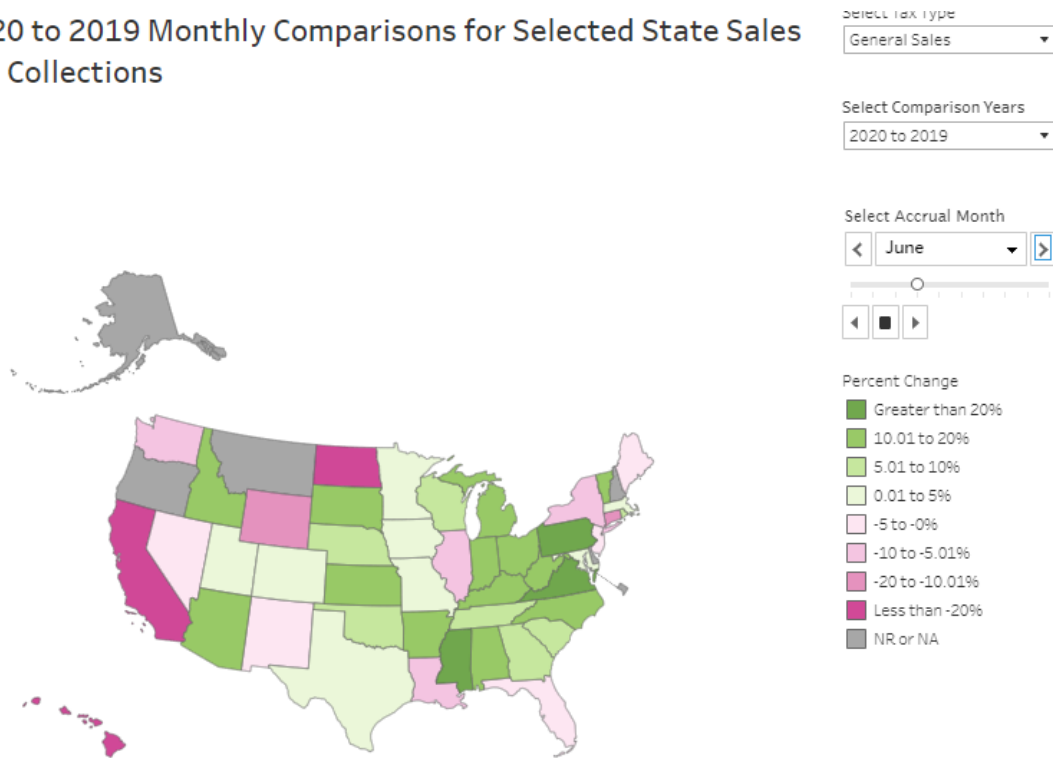


NR Not reported.
NA Not applicable.

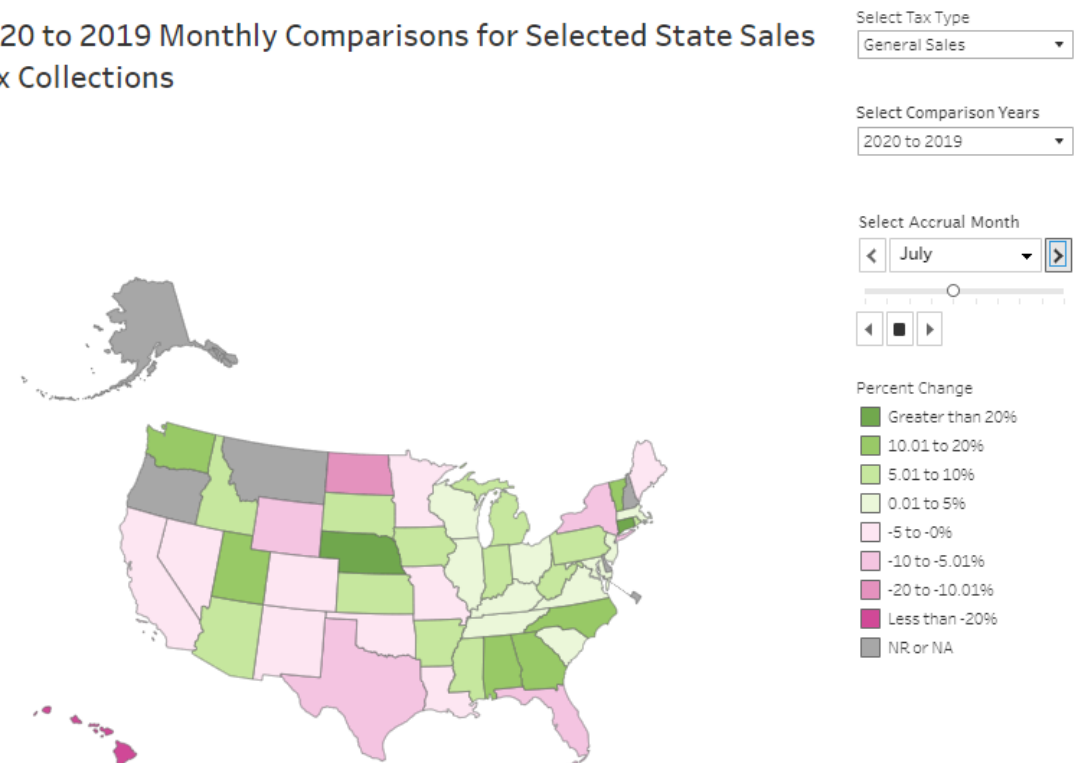
Sales Taxes: Quickly Rebounded in Most States

YOY CHANGE BETWEEN FY19 & FY20 FOR JUNE & JULY

2020 to 2019 Monthly Comparisons for Selected State Sales Tax Collections



2020 to 2019 Monthly Comparisons for Selected State Sales Tax Collections

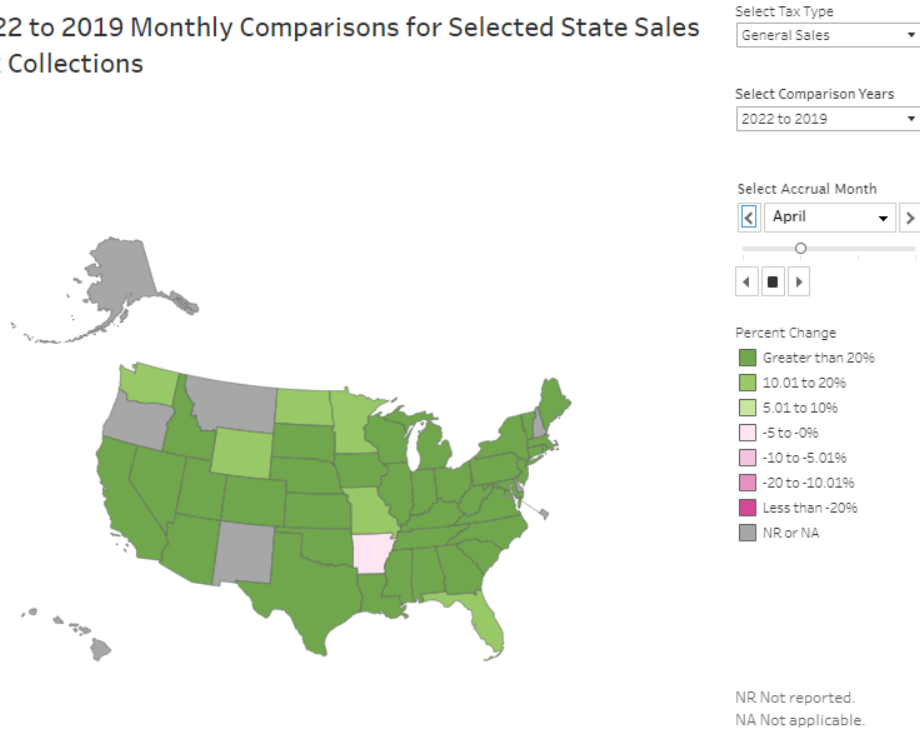


Sales Taxes: Astronomical Growth

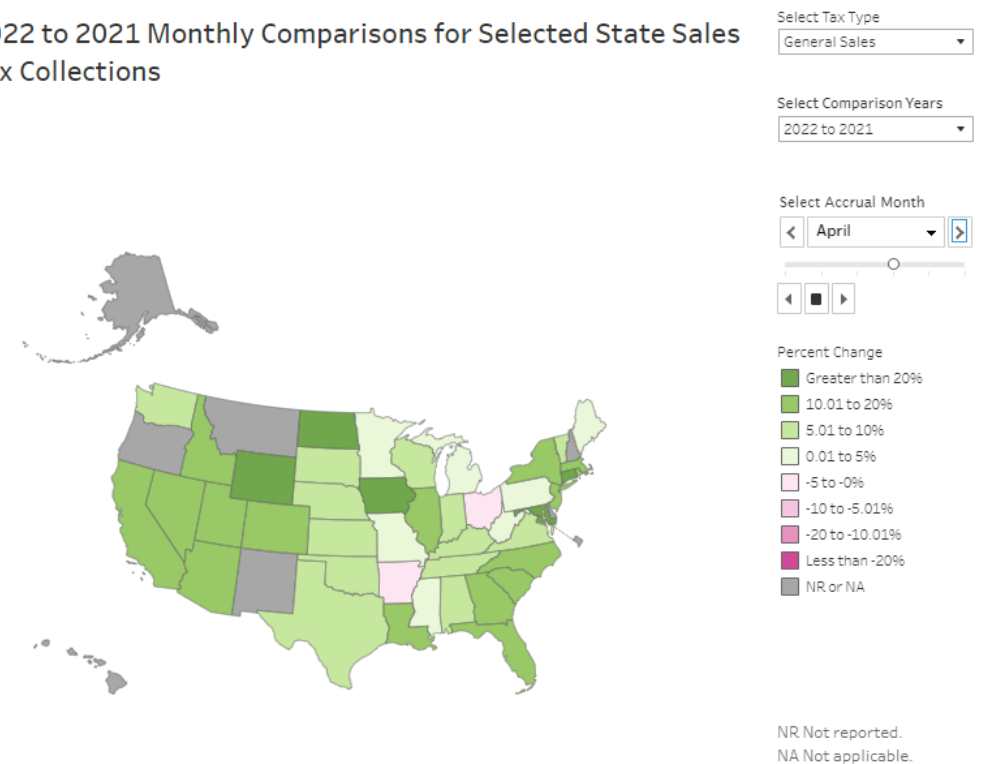
GROWTH BETWEEN FY19 & FY22: APRIL

YOY CHANGE BETWEEN FY21 & FY22:
APRIL

2022 to 2019 Monthly Comparisons for Selected State Sales
Tax Collections



2022 to 2021 Monthly Comparisons for Selected State Sales
Tax Collections



North Carolina Trends

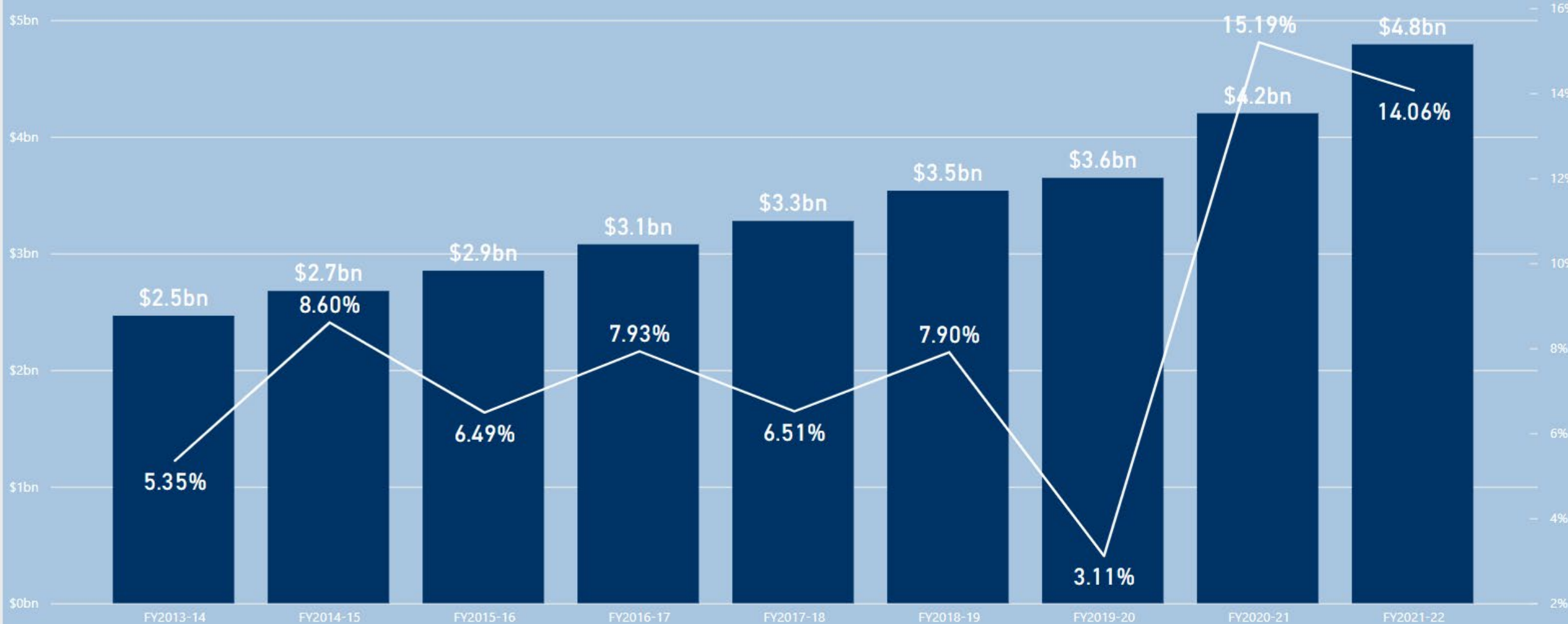
Unprecedented growth in sales tax collections

Sales Taxes: The Wild Ride



Gross Collections and Gross Collections YOY% by FY

● Gross Collections ● Gross Collections YOY%



By Quarter: Q2 FY20



By Quarter: Q3 FY20



By Quarter: Q4 FY20



By Quarter: Q1 FY21



By Quarter: Q2 FY21

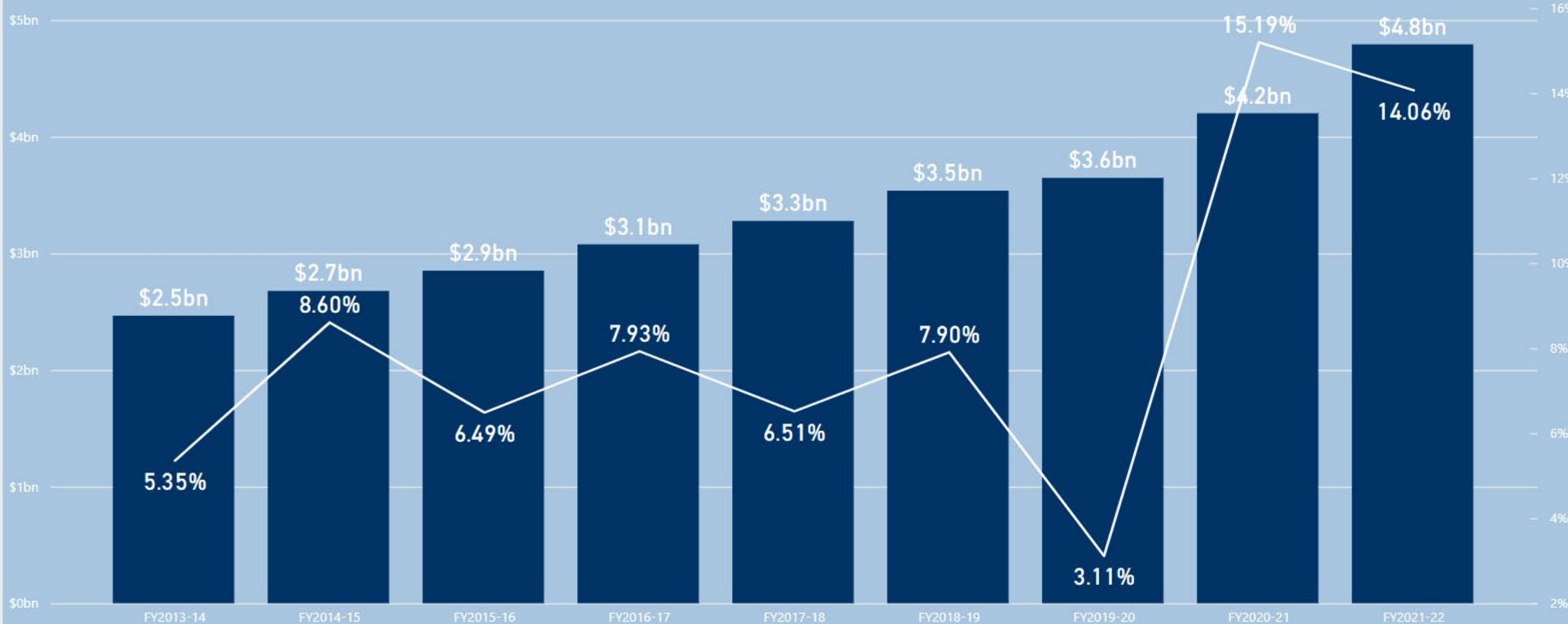


Sales Taxes: The Wild Ride



Gross Collections and Gross Collections YOY% by FY

● Gross Collections ● Gross Collections YOY%



Sales Taxes: The Wild Ride

- Local sales tax reduction during the pandemic was swift
- However, the rebound has been astronomical
 - Why?



Things to Note

- Multiple drivers of growth
 - Early shift in consumption patterns
 - Inflation, of course
- Breadth of taxes still dwindling
 - *Wayfair* & third-party vendors
 - 50% coverage to 36% coverage since 2000
- Most states considering reductions to tax base, rather than expansions



Examples of Base Reductions

- Last month, Gov. DeSantis proposed a whole host of exemptions
 - Diapers, wipes, & toddler shoes
 - Strollers and cribs
 - Children's books
 - Laundry detergent & other household items
 - Bicycles, footballs, & rollerblades
 - Dog food & flea medicine
 - Medical supplies & equipment
 - 5 weeks of sales tax holidays
 - And more
 - *Some are permanent and some are temporary*





Other examples

- Kansas: diapers & feminine hygiene products
- Colorado, Iowa, and Nebraska: all in process or just eliminated sales tax on feminine hygiene products
- California Governor just vetoed bill to remove manufacturing equipment from the local sales tax base
 - Already excluded from state sales tax
 - Increase sales tax exclusion limit by \$50 million for eligible alternative energy & advanced manufacturing
- New York Proposals include:
 - Expand single item exemption from \$110 to \$250
 - Month long sales tax holiday on back-to-school supplies including computers under \$3,000



State Activity - 2021-2022

State tax activity summary

Strong revenue and ending balances led to significant tax activity in 2021 and 2022

- Addressed all major tax sources
- Mix of permanent and one-time relief

Permanent relief

- Primary focus on individual rate reductions (12 states)
- Some attention to corporate rates (7 states)
- Little corporate base activity
- Sales tax
 - Exemption of food for home consumption (2 states)
 - Other limited exemptions (several)

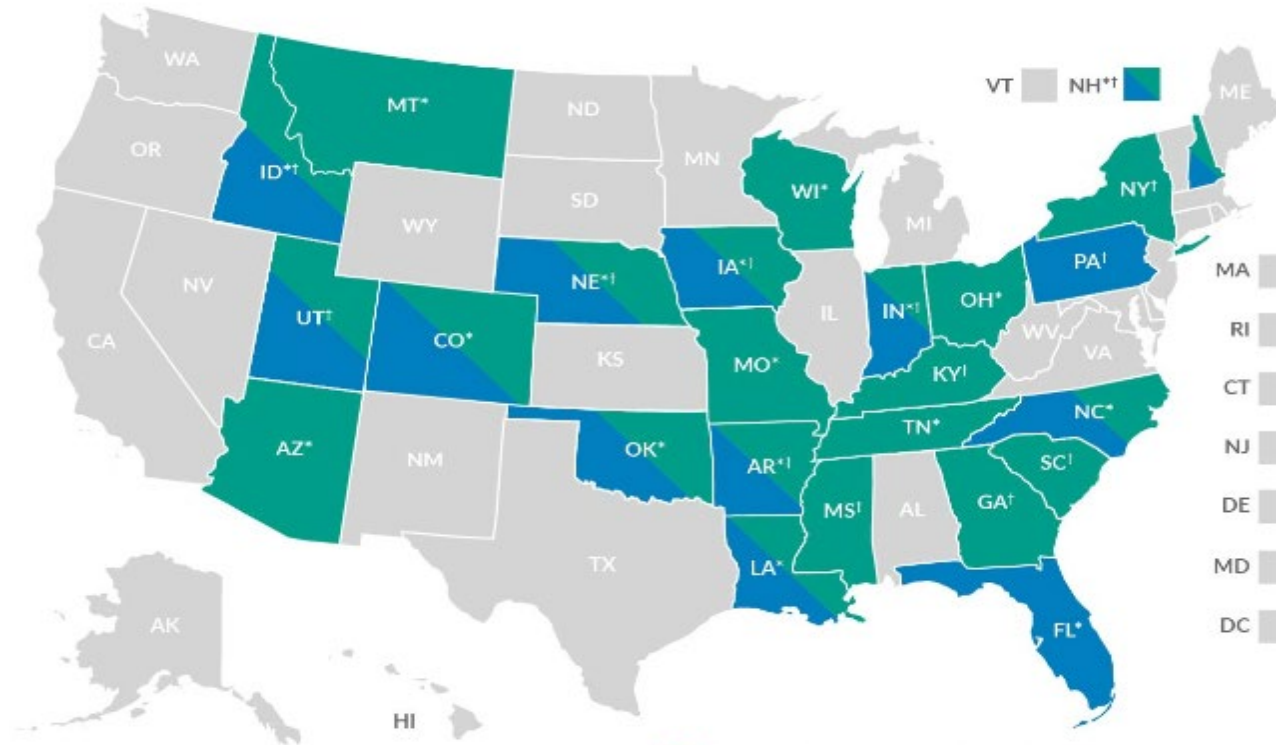
Temporary or One-time relief

- Tax rebates (11 states)
- Sales tax holidays (multiple)
- Fuel tax suspensions(6 states)

Income tax rate reductions

Income Tax Rate Reductions Enacted or Implemented in 2021 and 2022

As of July 13, 2022

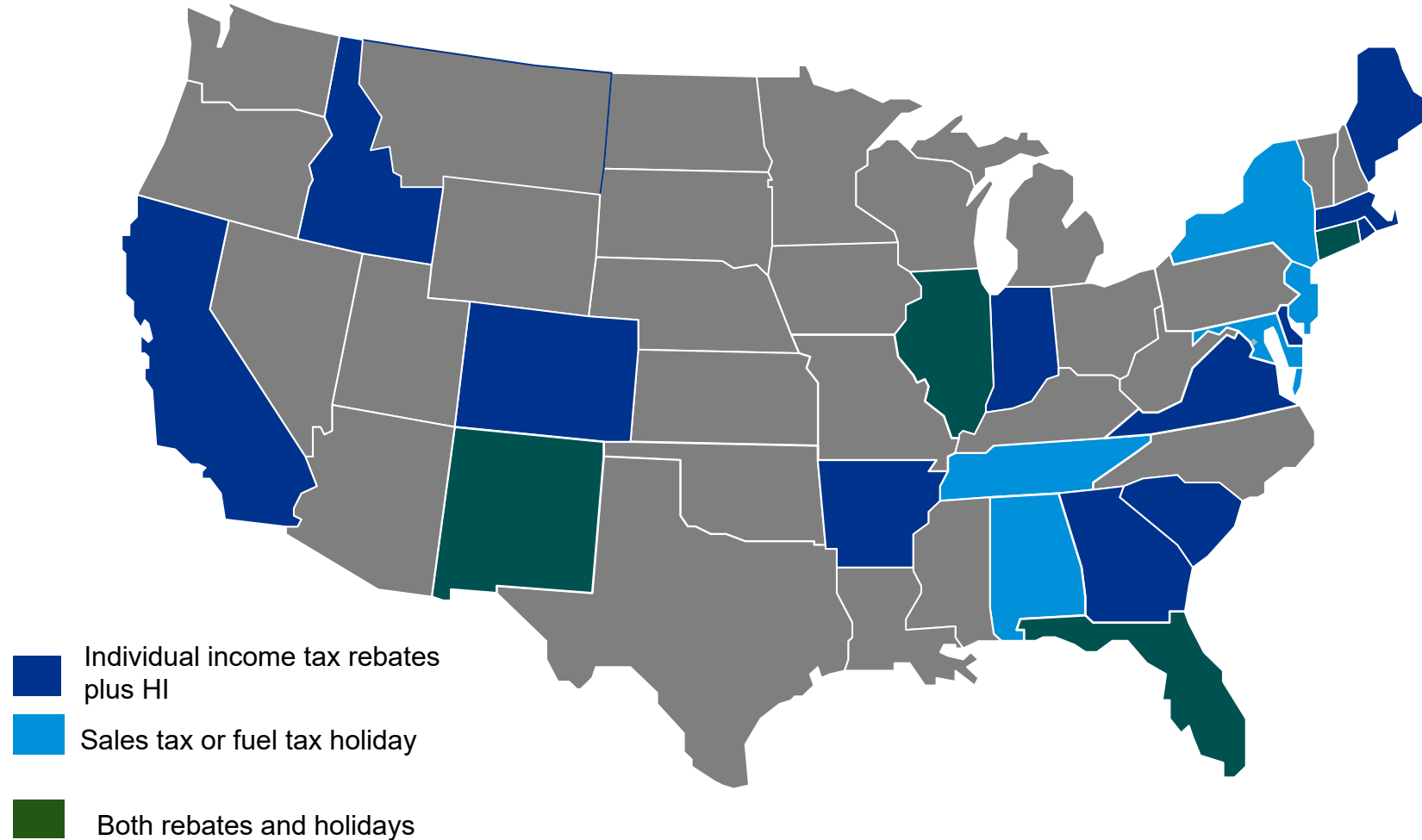


Note: In Florida, a corporate income tax rate reduction was automatically triggered for 2021 only. Colorado's taxpayer's Bill of Rights (IABOR) triggered a temporary individual and corporate income tax rate reduction for 2021. New Hampshire does not tax wage and salary income, but its tax on individual interests and dividends income is phasing out over time. Tennessee's tax on interests and dividends income, the Hall Tax, was eliminated effective January 1, 2021.

Source: Tax Foundation.

- Individual Income Tax Reduction
- Corporate Income Tax Reduction
- * Rate reduction enacted/implemented in 2021
- † Rate reduction enacted/implemented in 2022

Temporary tax relief - 2022



Source: Tax Foundation supplemented by KPMG

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Federal Relief Funds

CARES, CRF, & ARP, Oh My!

CRF (CARES dollars directly to states) \$150 billion

SFRF (ARP dollars directly to states) \$195.3 billion

Who is Getting the Most?

Estimated Federal Disbursement to States



State	Sum of Total Funding (in millions)	Sum of Funding Based on Average Number of Unemployed (in millions)	Sum of Funding from Even Distribution (in millions)
Alabama	\$2,120	\$1,620	\$500
Alaska	\$1,012	\$512	\$500
Arizona	\$4,183	\$3,683	\$500
Arkansas	\$1,573	\$1,073	\$500
California	\$27,017	\$26,517	\$500
Colorado	\$3,829	\$3,329	\$500
Connecticut	\$2,812	\$2,312	\$500
Delaware	\$925	\$425	\$500
District of Columbia	\$1,802	\$548	\$500
Florida	\$8,817	\$8,317	\$500
Georgia	\$4,854	\$4,354	\$500
Hawaii	\$1,642	\$1,142	\$500
Idaho	\$1,094	\$594	\$500
Illinois	\$8,128	\$7,628	\$500
Indiana	\$3,072	\$2,572	\$500
Iowa	\$1,481	\$981	\$500
Kansas	\$1,584	\$1,084	\$500
Kentucky	\$2,183	\$1,683	\$500
Louisiana	\$3,011	\$2,511	\$500
Maine	\$997	\$497	\$500
Maryland	\$3,717	\$3,217	\$500
Massachusetts	\$5,286	\$4,786	\$500
Michigan	\$6,540	\$6,040	\$500
Minnesota	\$2,833	\$2,333	\$500
Mississippi	\$1,806	\$1,306	\$500
Missouri	\$2,685	\$2,185	\$500

Source: U.S. Department of Treasury

NC #9

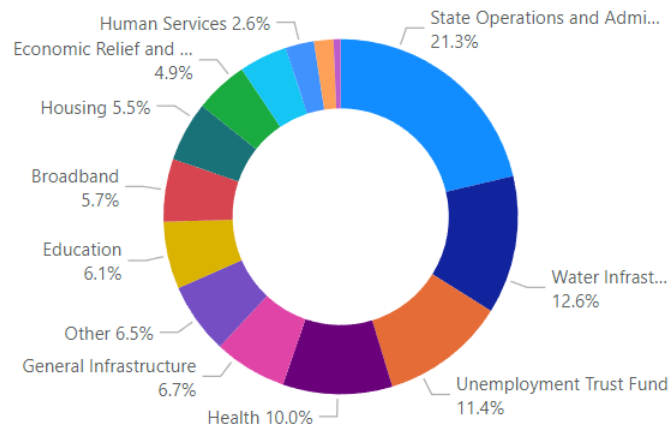
Where is the Money Being Spent?

Allocations by Category



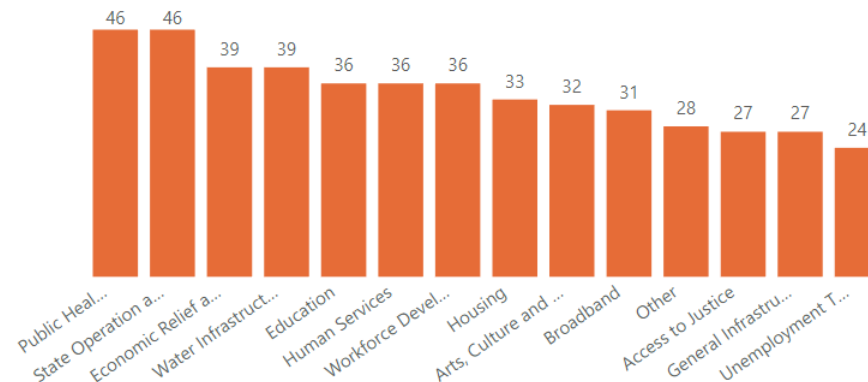
Category

- State Operations and A...
- Water Infrastructure
- Unemployment Trust F...
- Health
- General Infrastructure
- Other
- Education
- Broadband
- Housing
- Economic Relief and De...
- Workforce Development
- Human Services
- Arts, Culture & Tourism
- Access to Justice



Category	Percentage	Total Amount Allocated (in millions)
State Operations and Administration	21.3%	\$31,634
Water Infrastructure	12.6%	\$18,660
Unemployment Trust Fund	11.4%	\$16,894
Health	10.0%	\$14,812
General Infrastructure	6.7%	\$9,888
Other	6.5%	\$9,603
Education	6.1%	\$9,091
Broadband	5.7%	\$8,493
Housing	5.5%	\$8,084

Number of States by Category



In North Carolina

"North Carolina is drowning in money." -State Treasurer Dale Folwell

Money is being spent on everything from broadband, childcare, higher education tuition subsidies, and water and sewer infrastructure

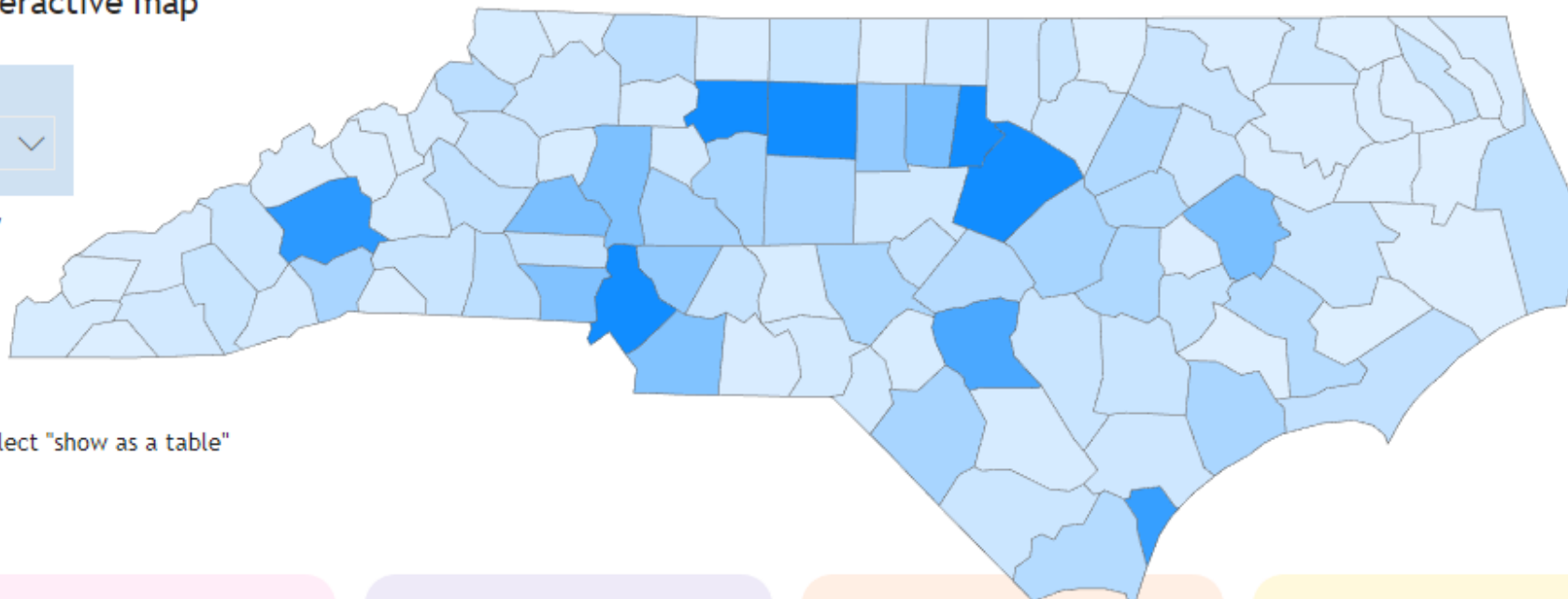
Relief Funds by County

A non-exhaustive, interactive map

Select county (or multiple)

All

Use eraser to reset view



To view the full data:
Right click on the map and select "show as a table"

\$17,045,243,249

Business Aid Total

[Paycheck Protection Program \(PPP\)](#), administered by the U.S. Small Business Administration (SBA). Note that awards greater than \$150K are estimated based on median award amounts.

[Economic Injury Disaster Loan \(EIDL\)](#), administered by SBA. EIDL A are automatically forgiven advances.

[Job Retention Grant \(JRG\)](#), administered by NC Department of Commerce using [CRF](#).

[Rapid Recovery Loans \(RRL\)](#), administered by Golden LEAF using [CRF](#).

\$786,819,001

Local Government Total

Includes [CRF](#) allocated to counties and municipalities by NC General Assembly, as well as direct allocations from the US Treasury.

\$351,540,625

Payments to Families

Includes [Extra Credit Grants](#), administered by NC Department of Revenue using [CRF](#).

\$3,610,414,752

Education Total

Public K12 schools includes [CRF](#), [Governor's Emergency Education Relief \(GEER\) I](#), and [Elementary and Secondary School Emergency Relief \(ESSER\) I & II](#).

Higher education includes [CRF](#), [GEER I](#), and [Higher Education Emergency Relief Funds \(HEERF\) I & II](#).

\$2,711,342,823

Health Provider Total

Includes [CRF](#) allocated to hospitals by NC General Assembly, and [Provider Relief Funds \(PRF\)](#) distributed to providers by U.S. HHS. Providers were attributed to their corresponding counties.

Notes: Map represents \$24.1 billion out of over \$50 billion in federal COVID relief funds allocated to NC in 2020 (does not include American Rescue Plan funds). Amounts do not reflect expenditures. Of the funds listed, NCPRO administers CRF and GEER.

Updated: 6/8/2021



Contact us at NCPRO@osbm.nc.gov

Concerns

- Greater inflation
- Shovel ready vs strategic investments
 - Trade-offs between timing & optimal choices
- Long term costs associated with these investments





Pass-through entity “work-arounds”

Background on Elective State PTETs

What is the individual income tax limitation (the “SALT Cap”)?

- I.R.C. Section 164
 - Schedule A (itemized deduction) versus a part of net income from a passthrough entity
- Tax Cuts and Jobs Act: I.R.C. Section 164(b)(6)
 - Deductibility follows present law. H.R. Conf. Rep. No. 115-466, n. 172 (December 15, 2017).
 - Sunsets after 2025 - future of limitation?
- Notice 2020-75 (November 2020)
 - Noted awareness of elective passthrough taxes and owner state tax credit / income backout
 - Regulation shall generally provide that a “Specified Income Tax Payment”:
 - Means any amount paid by a domestic partnership or an S corporation to a Domestic Jurisdiction pursuant to a direct imposition of income tax by the Domestic Jurisdiction,
 - Is deductible by the partnership or S corporation in computing its taxable income,
 - Deduction does not constitute an item of deduction that a partner or shareholder takes into account separately under sections 702 or 1366 and that the Specified Income Tax Payment will be reflected in the “distributive or pro-rata share of non-separately stated income or loss reported on a Schedule K-1,” and
 - Will not be taken into account in applying the SALT Cap to any partner or shareholder.

Post-TCJA Passthrough Entity Taxes

Post-TCJA elective PTE Taxes before Notice 2020-75:

— Elective

- *Starting with TY2018*
 - Wisconsin for S corporations
- *Starting with TY2019*
 - Oklahoma
 - Louisiana
 - Rhode Island
 - Wisconsin for partnerships
- *Starting with TY2020*
 - New Jersey
 - Maryland

— Mandatory

- *Starting with TY2018*
 - Connecticut

Post-TCJA PTE Taxes

Post-TCJA elective PTETs after Notice 2020-75:

— Elective

- *Starting for TY2018 (Retroactive)*
 - Colorado
- *Starting for TY2021*
 - Alabama
 - California
 - Illinois
 - Idaho
 - Massachusetts
 - Michigan
 - Minnesota
 - New York
 - South Carolina
 - Virginia

• Elective

- *Starting for TY2022*
 - Arkansas
 - Arizona
 - Colorado (also retroactive to TY2018)
 - Georgia
 - Kansas
 - Mississippi
 - Missouri
 - New Mexico
 - New York City
 - North Carolina
 - Ohio
 - Oregon (applies for only TY2022 and TY2023)
 - Utah

31
Total

Challenges with PTETs

Credit for taxes paid in resident state

Differences in sourcing rules

Timing of the election

Interaction with composite elections

Subsequent audits with differing state rules



Remote work or 'work from anywhere' – What's the status?

Remote work – the challenges

State personal income taxes

- Wage income generally considered taxable “where the services are performed”
- Some states (MA and NYS) and cities (MO and OH) use a ‘convenience of employer’ test
 - Income taxable where employee’s place of employment regardless of where service is performed
 - City challenges are largely inter-city, not interstate
- Remote work/work from anywhere presents challenges for employers and employees

Employer challenges

- Income tax withholding and employment tax obligation footprint
 - Readiness for collection; monitoring location and gathering data; possible limitation on movement
- Expense reimbursement
- Change in sales/corporate tax nexus footprint
- Possible impact on P.L. 86-2672 footprint

Remote work (cont.)

Employee challenges

- Income tax filing obligations
- Availability of data
- LARGE potential for “whipsaw” with differing rules and new situation of regular remote work v. intermittent remote work

Potential remedies

- Improved employer systems
- Revised employer policies
- More harmonious state laws (good luck)
- Federal legislation (more good luck)
- Continued forbearance on part of some states



Questions?



Thank you



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