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3 Tax Trends Emerging In State Legislative Sessions

By **Maria Koklanaris**

Law360 (January 27, 2023, 7:33 PM EST) -- As the 2023 state legislative sessions produce a slew of tax-related bills, with more than 2,500 introduced and up to 4,000 expected, three prominent trends have emerged.

One significant trend is a slate of bills that would either create a wealth tax or tax higher earners in some way, with eight states banding together in a kind of pact to create such legislation.

Another trend is a move in the opposite direction, with some states seeing a deluge of bills to continue to cut taxes, as many states did in 2022, or to simplify the tax code with a flat tax. Finally, even though the fate of Maryland's tax on digital advertising is mired in litigation, some states are proposing similar taxes on digital services, including taxes on data collected by big technology companies.

Here, Law360 looks at these three areas of legislation.

Taxes on Higher Earners

In the last half of January, lawmakers in Oregon, Hawaii, New York, Minnesota and Massachusetts have proposed increasing taxes on higher earners. A legislator in Hawaii has also proposed a wealth tax of 1% of an individual's state net worth over $20 million.

And in California, a proposal would impose a 1.5% tax on residents with a net worth greater than $1 billion, or greater than $500 million for a married taxpayer filing separately, for tax years 2024 and 2025. For 2026 and beyond, that California bill says, a 1% tax would be imposed on residents with a net worth greater than $50 million, or greater than $25 million for a married taxpayer filing separately. An additional 0.5% would be assessed for residents with a net worth greater than $1 billion, or greater than $500 million for a married taxpayer filing separately.

Those are just some of the proposals, and there is a coordinated effort among some states to promote higher taxes on the rich. In a campaign launched Jan. 19 and titled "Fund Our Future," California, Connecticut, Illinois, Hawaii, Maryland, Minnesota, New York and Washington have joined together to advocate increasing income tax rates, creating dedicated wealth taxes, and boosting the rates investors pay when they realize capital gains.

Richard Auxier, a senior policy associate at the Urban-Brookings Tax Policy Center, said the proposals have become more numerous as progressive lawmakers in particular are increasingly concerned that states suffer when individuals hold too much wealth.

"They say, 'If we had more money from the highest percentage of households, we could benefit education, we could benefit housing,'" Auxier said. "But what do we mean by a wealth tax?"

Auxier said he draws a distinction between proposing higher tax rates and creating special wealth taxes.

"A small increase is nothing out of the norm," Auxier said. "Then there is this idea that we need a new tax on a new concentration of wealth. But how are you going to do it? And how does it affect relocation decisions?"

David Pope, a tax partner in the New York office of Baker McKenzie, noted that New York is one of the top three states for out-migration, and Democratic Gov. Kathy Hochul pledged in her State of the State speech that the state was not going to increase income tax. But New York still has seen an increase in bills proposing taxes on higher earners, Pope said.

"I haven't seen that many tax proposals come through in quite a while," Pope said. He said the proposals include a capital gains tax of up to 15% for the highest earners and a bill to reinstate the stock transfer tax.

Another bill would raise the top income tax rate from 10.9% to 24% for individuals with income of more than $20 million.

"Granted, it's on income of more than $20 million," Pope said. "But to see a 24% tax rate is astounding."

Tax Cuts and Flat Taxes

On the other end of the spectrum, some states are continuing a trend seen in 2021 and 2022. In those years, flush with cash from strong capital gains receipts and a huge infusion of federal money, many states moved to reduce taxes. This year, it's more of a mixed bag for state revenues, as some states are still expecting significant surpluses and others are tipping back into deficit. But the tax cuts are ongoing. Meanwhile, other bills have been proposed to simplify tax structures by creating a flat tax.

Kansas and North Dakota are among states with bills to switch their progressive tax structures to a flat tax. In Wisconsin, a bill would adopt a flat tax in 2026 but would first cut income tax rates in 2023, 2024 and 2025. Colorado and Kentucky already have a flat tax, but there are proposals to cut it. Democratic Gov. Jared Polis of Colorado has again renewed his call to end the income tax entirely.

In Virginia, the Republican-controlled House of Delegates on Tuesday passed Republican Gov. Glenn Youngkin's proposals for an additional $1 billion in tax cuts, but the package faces an uncertain path in the Democratic-controlled Senate. The package would be on top of $4 billion in cuts the General Assembly passed in 2022.

Some of Youngkin's proposals for tax cuts are on triggers, meaning they will take place only if the state meets revenue targets. Morgan Scarboro, a vice president for tax policy at the governmental affairs firm MultiState Associates, said states are mindful of the potential for an economic downturn. When planning tax cuts, they're doing so in a more deliberate manner, she said.

"They want to pare down rates, but they want to do it in a way that is very cognizant of their state's revenue situation," Scarboro said. "Nobody wants to be in a situation where they've cut, cut, cut really quickly and then they are facing a problem in two or three years if we're in recession or one is about to hit."

Digital Services Taxes

State digital services taxes have become almost synonymous with Maryland's first-in-the-nation tax on the large corporations that sell digital advertising. That tax is about to be reviewed by the Maryland Supreme Court, but even though it is in litigation, some states are still enthusiastic about digital services tax proposals. However, many of the proposals are structured differently from Maryland's.

Scott Roberti, state policy services leader with EY's national tax team, noted that New York and Massachusetts, for example, have bills that would levy taxes on companies that collect consumer data.

"Now you're taxing the collection of data, a little different than an advertising tax, but those are the two buckets [of digital services taxes] we're watching," Roberti said. He said he finds both kinds of taxes complex and difficult to administer, but expects more states to introduce them.

Charlie Kearns, tax partner at Eversheds Sutherland, which is representing telecommunications companies fighting Maryland's tax at the state high court, agreed with Roberti. Even with the litigation, he said, he is not surprised that digital services taxes have taken hold, noting that some lawmakers are increasingly expressing a belief that companies should pay if they collect or use consumer data.

"All of these taxes in general would, I guess, tend to address a perceived problem by the sponsors," Kearns said, that "some folks aren't paying what they should be paying."

--Editing by Aaron Pelc and Khalid Adad.