

# Legislative Solutions

## ★ Report from the Capitols ★

**S**low Growth Continues For Second Straight Quarter - Despite stronger numbers than the previous quarter, adjusted tax growth is the second slowest in five years. This finding was part of the most recent "State Revenue Report" released by the Nelson A. Rockefeller Institute of Government.

According to the study, the reduction in tax growth was attributed to legislative changes (tax cuts, etc.), combined with inflation. The first quarter of 2001 saw national adjusted tax growth of only 2.8% over the same quarter last year. Relatively strong growth of 11.5% in the Far West (AK, CA, HI, NV, OR and WA) couldn't offset slow growth in other areas. The Great Lakes region (IL, IN, MI, OH, and WI) was the hardest hit with an adjusted revenue *decline* of 5.1%.

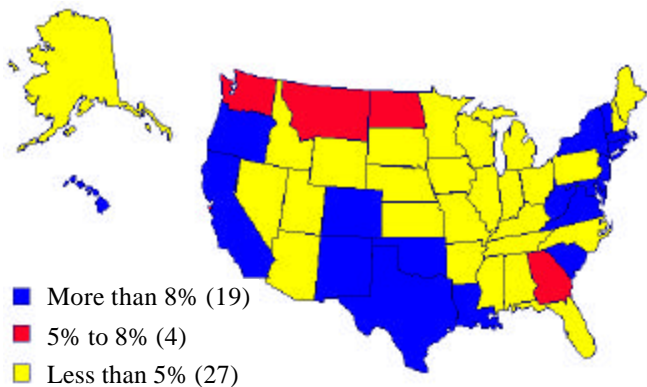
The slowdown which began in the Midwest has recently spread to the Northeast. MA, NJ, PA and NY recently reported softening tax receipts indicating that the slowdown is spreading.

While some states are considering tax increases, slower tax revenue growth has not deterred some states from considering further tax cuts. The Rockefeller Institute cites Minnesota as one example of this because they are close to enacting a sizable sales tax rebate (nearly \$856 million).

➡ (Cont.)

### Change in Quarterly Tax Revenue

First Quarter 2000 vs. First Quarter 2001<sup>i</sup>



<sup>i</sup> "State Revenue Report", Fiscal Studies Program, *The Nelson A. Rockefeller Institute of Government*, June 2001.

**F**ederal Tax Cut Will Have Unintended Consequences - The \$1.35 trillion federal tax-cut bill signed into law by President Bush is certainly good news for most taxpayers...or is it? The refund checks, which are expected to begin rolling out of Washington this summer, provide an interesting dilemma for state government on several fronts.

### Taxes on your tax refund

Since several states allow taxpayers a deduction for federal income taxes, a refund means that taxpayers may owe additional income tax to the state. State Governments are in a precarious situation, it will certainly be unpopular with residents if states tax the federal refunds, but in order to exempt the refund checks, specific legislative action must be taken.

According to the Federation of Tax Administrators, eight states allow a deduction for federal income taxes, and therefore will collect tax on the refunds: Louisiana, Missouri, Montana, North Dakota, Oklahoma, Oregon and Utah. Oklahoma's Gov. Frank Keating (R) has already gone on record to ask the legislature to work to exempt the refund from tax.<sup>ii</sup> The challenge is that they need a legislative change to the tax laws. The Governor has promised to make it an issue for an expected special session this year. His effort may meet some opposition. State Rep. Clay Pope (D), chairman of the House Revenue and Taxation Committee, has already expressed concern with the chaos a change could have on the tax code.<sup>iii</sup>

Missouri also needs legislative action to allow the refunds to be exempt. Gov. Bob Holden (D) announced a plan for a one-time change in state tax law to exempt the federal rebate. The Governor will put his proposal before the state legislature during the veto session in September.<sup>iv</sup>

➡ (Cont.)

<sup>ii</sup> "Keating wants rebate untaxed", *The Oklahoman*, by Diane Plumberg, 6/7/2001.

<sup>iii</sup> "Keating wants rebate untaxed".

<sup>iv</sup> "Holden plans to seek state tax exemption for federal rebates," *St. Louis Post-Dispatch*, By Terry Ganey, 06/19/2001.

**Second Quarter of Slow Growth (Cont.)** - Other states (MA, NJ, NY, OR, PA, RI, and UT) may follow Minnesota's lead by enacting tax cuts of their own. Virginia must also face the loss of tax revenue, as the car tax will be phased out completely this coming year.



As the economy's torrid pace begins to ease, slowing tax revenue growth is not entirely surprising. Despite this, states haven't seen the repeated quarterly declines common in past recessions, but if the slowdown continues or spreads, many states could be faced with difficult decisions in order to keep the budget balanced. ■

**Off Year Elections** - 2001 elections in Kentucky, Louisiana, Mississippi, New Jersey and Virginia are not particularly exciting to outsiders, but the results are typically a preview to next year's elections. New Jersey and Virginia are particularly important since they are electing new governors and the race for the state executive's office is heating up.



In New Jersey, Christine Todd Whitman's departure for Washington has left a void in the state's Republican party. Jersey City Mayor Bret Schundler (R) seized the Republican nomination for governor from former Congressman Bob Franks, the handpicked candidate of party leaders. The stage is now set for November's contest with the Democratic nominee, Woodbridge's Mayor Jim McGreevey.

Virginia's Gov. Jim Gilmore (R) has reached the end of his term and hopes that the state's Attorney General Mark Earley (R) will continue the party's dominance in the state. However, Gubernatorial candidate Mark Warner (D) has portrayed himself as a moderate and has gained the support of many conservatives in the business community. He's hoping to use that support to take the governor's mansion in November.



In 1999, the Republicans won control of the House of Delegates for the first time since reconstruction, giving them complete control of state government, but Warner is working to win back control. This year's battle over the budget has hurt the Republicans' image and Democrats see an opportunity. November's outcome will surely set an early tone for the 2002 elections. ■

**Federal Tax Cut (Cont.)** - Utah officials do not expect to address the issue. Current tax law would require the refund to be taxed and there is little time for the state legislature to act. Observers feel that even though a special session is expected this summer, the agenda will likely be full with no time to address this issue.<sup>v</sup>



### Revenue Loss

States' revenue collections are down for the first time in many years and, unfortunately, the federal tax cut may unintentionally reduce state revenues even further. The largest impact on state revenues will likely be the elimination of the death tax. According to the National Governor's Association, elimination of the death tax will mean a revenue loss of \$69 billion over the next ten years. Florida Gov. Jeb Bush (R), not surprisingly, supports the plan despite the revenue impact on Florida, "Some people might call it a hit, but I call it tax relief...we'll live with it," he said.



Several states that link their state income taxes to the federal income tax will obviously feel a direct hit. Vermont expects to see a \$21 million loss in fiscal year 2002, or 2.5 percent of the state's budget, according to Susan Allen, spokesperson for Gov. Howard Dean (D). These states are considering proposals including decoupling the state income tax from federal liability or simply raising the income tax rate.



So while individual taxpayers may enjoy their rebate check from the federal government, many states have been left scrambling to deal with this unforeseen challenge. ■

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<sup>v</sup> "Tax Rebate Will Suffer State Bite", *The Salt Lake Tribune*, by Shia Kapos, 6/11/2001.