

What the States are Watching

Discussion Presentation
MTC Uniformity Committee
April 29, 2025

Federal Tax Policy Developments

Thompson Reuters Institute, Midyear: Corporate tax departments grapple with possible key tax policy changes, Nadya Britton, Mar. 27, 2025 -

- At the Tax Executives Institute 2025 Midyear Conference companies said they are watching.
 - TCJA – expiring provisions
 - Inflation Reduction Act – credits and related regulations
 - US involvement in OECD efforts and DSTs
- And, in their [2025 Corporate Tax Department Technology Report](#) — more than 90% of respondents said they were optimistic about tax technology.

Federal Tax Policy Developments

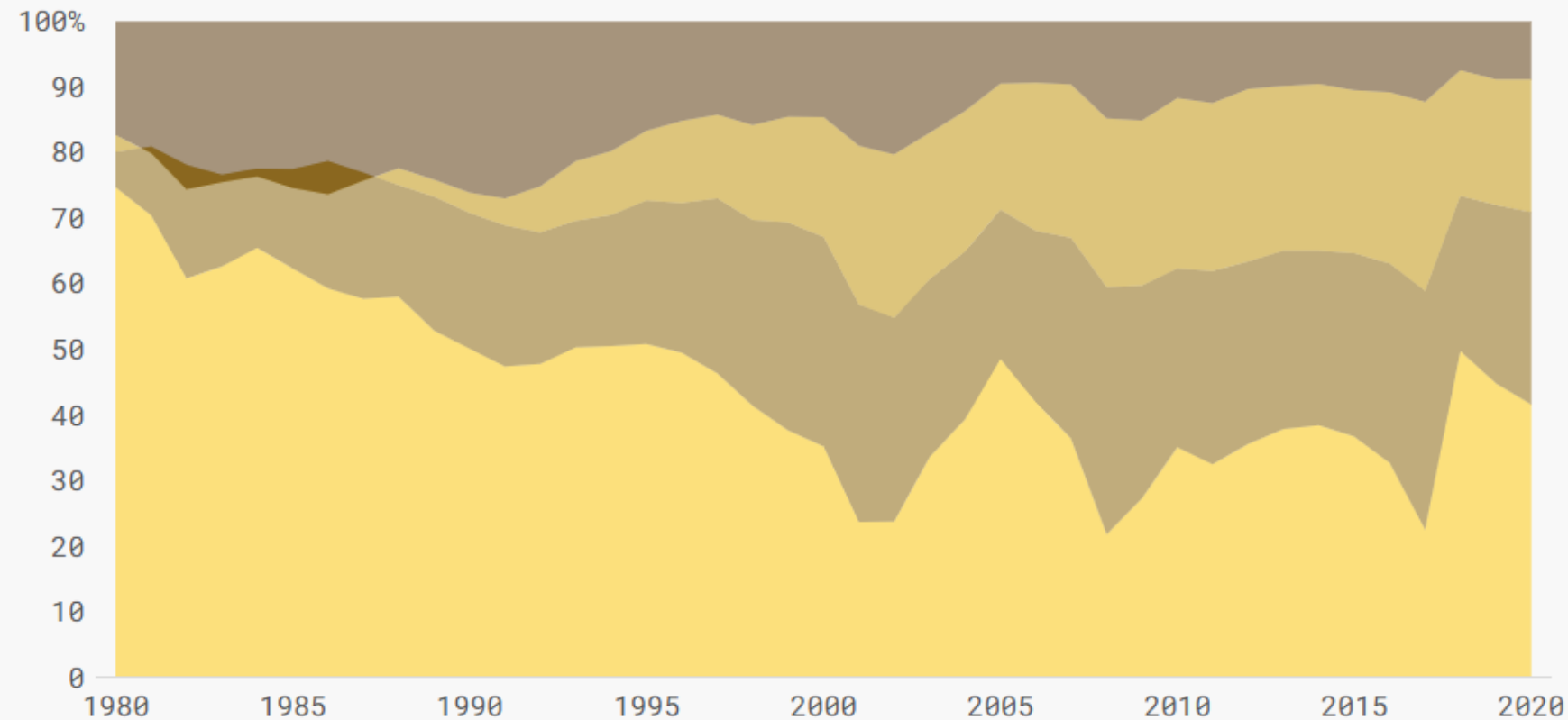
How the TCJA Affected Legal Business Forms, Huaqun Li, Tax Foundation, June 19, 2024

- Tracks the “sharp growth” of the pass-through sector since the 1980’s—from 25% of all net business income to 66% (including partnerships, S corporations, and proprietorships).
- “The sharp growth in the pass-through sector since the 1980s was due in part to a significant improvement in their relative tax treatment.”

Pass-through Profits Surpassed C-corporate Profits in the Mid-1990s and accounted for Two Thirds of All Profits before TCJA

Share of Profits by Major Legal Forms

■ C Corporations ■ Subchapter S ■ Partnerships ■ Nonfarm Sole Proprietorships



Note: The statistics for Subchapter S are calculated using data for all active corporations minus the data for C corporations.
Source: SOI Tax Stats - Corporation tax statistics, Nonfarm Sole Proprietorship Statistics, and Partnership statistics.

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How the TCJA Affected Legal Business Forms, Huaqun Li, Tax Foundation, June 19, 2024

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- TCJA permanently reduced the corporate income tax rate to a flat rate of 21 percent, from a previous top rate of 35 percent.
 - TCJA reduced statutory individual income tax rates and enacted the Section 199A pass-through deduction which was created for “parity” but really just extends the pre-TCJA tax preference for pass-through income.

How the TCJA Affected Legal Business Forms, Huaqun Li, Tax Foundation, June 19, 2024

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- The number of C corporation tax returns has continued to decline since the TCJA.
 - The net income for C corporations shows a turbulent pattern between 2016 and 2020, dropping significantly in 2017 before increasing significantly in 2018.
 - But rather than indicating a real shift in C corporation business activity, the turbulence likely suggests that C corporations timed their income to benefit from the large rate cut, particularly through moving around deductions.

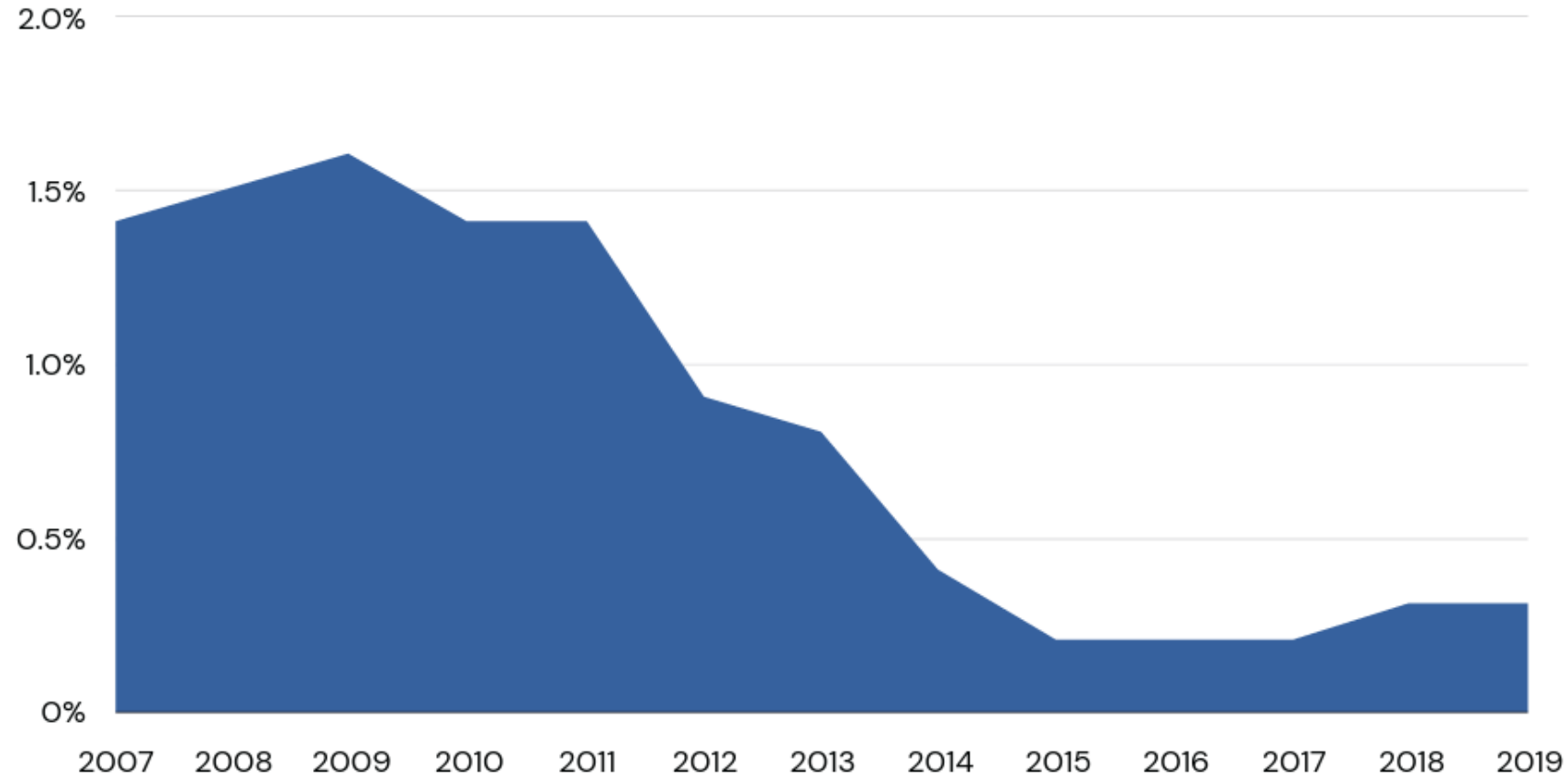
How the TCJA Affected Legal Business Forms, Huaqun Li, Tax Foundation, June 19, 2024

“Ideally, the choice of business form should not be influenced by tax considerations. The current tax treatment of businesses is far from ideal, as it applies two very different tax systems that are very difficult, if not impossible, to bring into parity. As lawmakers debate what to do about the expirations of the 2017 tax law, they should consider more fundamental reforms to integrate business taxation, such as moving to a distributed profits tax. Short of a fundamental reform, moving the tax code in the direction of simplicity, neutrality, and certainty should be the goal.”

Federal Tax Administrative Developments

FIGURE 9

Audit rate for large partnerships



Source: GAO, Tax Enforcement: IRS Audit Processes Can Be Strengthened to Address a Growing Number of Large, Complex Partnerships, 2023.



BROOKINGS

Tax Policy Center - Cuts in Spending and Staff Dim Hopes For Transformational Change At The IRS, Janet Holtzblatt, Apr. 2, 2025

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- The 2022 Inflation Reduction Act (IRA) provided the IRS with almost \$80 billion in new funding over 10 years. Since 2023, Congress has rescinded \$42 billion of that funding.
 - About \$9 billion had been spent as of September 30, 2024, but of that amount, the IRS diverted \$2 billion to pay for routine expenses because the annual Congressional appropriation was insufficient to keep up with inflation.

Tax Policy Center - Cuts in Spending and Staff Dim Hopes For Transformational Change At The IRS, Janet Holtzblatt, Apr. 2, 2025

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- Recently, 11 percent of the IRS workforce accepted buyouts or were laid off in February. (In response to an injunction, the laid-off workers were later reinstated but placed on administrative leave at least temporarily.) Planned staff cuts may be up to 18 percent.

Tax Policy Center - Cuts in Spending and Staff Dim Hopes For Transformational Change At The IRS, Janet Holtzblatt, Apr. 2, 2025

TABLE 2

Planned Reductions in IRS Staff in 2025, Selected Categories of Workers



Category	Beginning of 2025	Probationary Terminations	Deferred Resignations	Projected May Layoffs	Projected Staff Remaining in May 2025	Percent Reductions
Taxpayer Services	42,161	80	2,017	1,150	38,914	7.7%
Compliance	37,075	5,926	1,834	500	28,815	22.3%
Chief Information Officer	8,649	177	312	2,200	5,960	31.1%
Other	14,279	475	570	2,900	10,324	27.6%
Total	102,164	6,658	4,733	6,750	84,023	17.8%

Source: Shannon Najmabadi and Jacob Bogage. "Trump Administration Plans a 25 Percent Staff Cut at IRS Taxpayer Help Office." Washington Post, March 17, 2025.

Note: The categories of employees are those shown in the Washington Post article and may differ from the IRS's categorization of its workforce.

Enforcement has been hit hardest, but the outlook for taxpayer services and modernization is also grim—in part, due to insufficient funds included in IRA for those two accounts.

Tax Policy Center - Cuts in Spending and Staff Dim Hopes For Transformational Change At The IRS, Janet Holtzblatt, Apr. 2, 2025

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- Spending was also constrained by hiring challenges. To increase compliance among high-income taxpayers and big businesses, the IRS sought skilled accountants and tax lawyers in a very competitive job market.
 - But, even though the agency received authority to expedite hiring to meet critical needs, it paused recruitment after the Office of Personnel and Management objected to some IRS promotion procedures. Delays also resulted from an understaffed human resource office, miscommunication, and prolonged security checks.
 - Thus, the IRS hired only 495 full-time equivalent employees to fill enforcement slots in 2023, while it brought in 10,500 for taxpayer services. The agency planned to hire about 3,600 new enforcement staff in 2024 and another 3,150 in 2025.

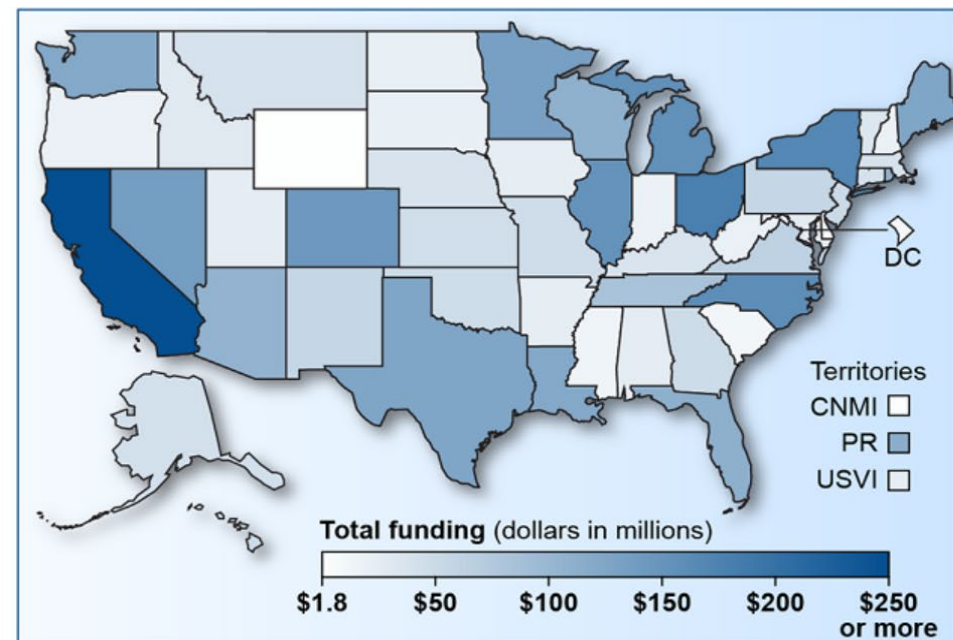
Federal Budget Developments

- Discretionary Grants: DOT Should Improve Clarity and Transparency of Program Management, GAO-24-107264, Apr. 18, 2024.

What GAO's Work Shows

We reported that in fiscal year 2022 (the first year of IIJA funding), DOT awarded about \$3.75 billion through the RAISE and INFRA programs.

Award Totals for RAISE and INFRA Programs, by State and Territory, Fiscal Year 2022

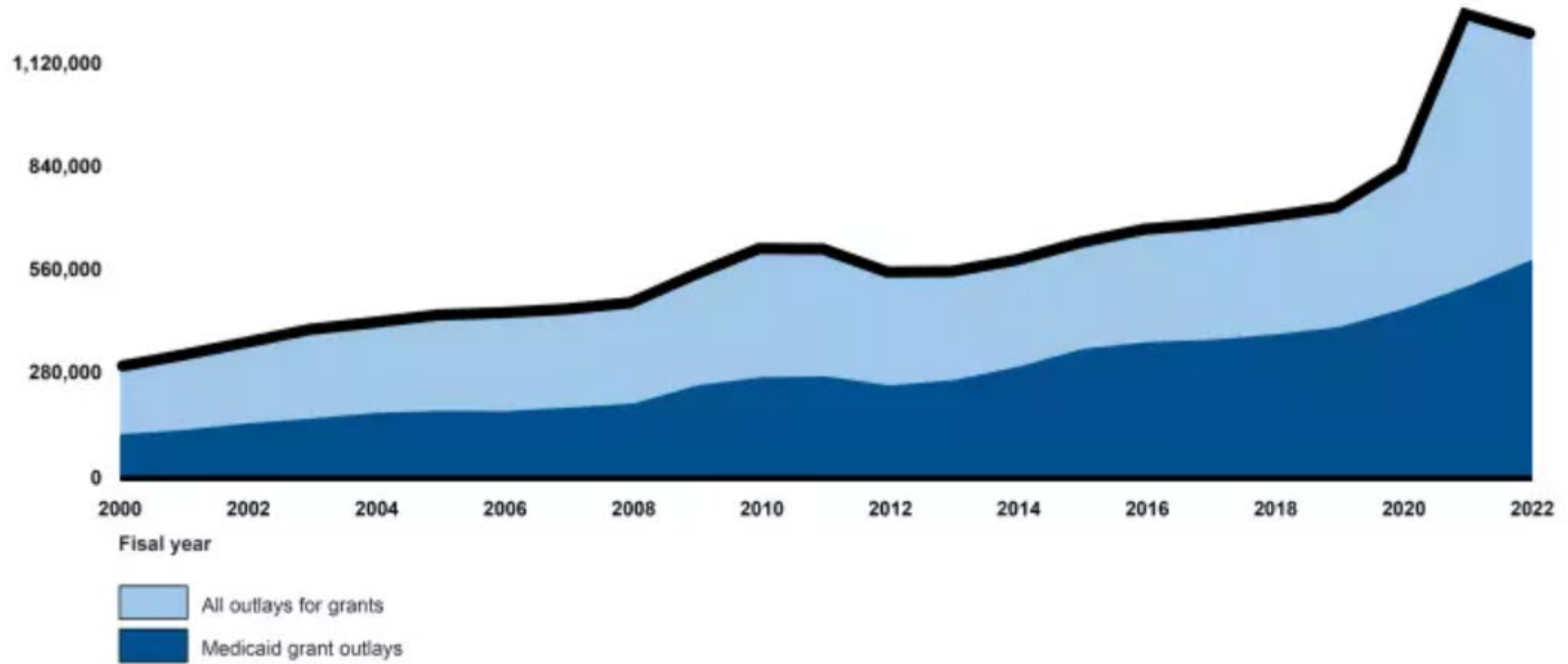


Outlook (new)

Federal Grants to State and Local Governments and Medicaid, FYs 2010-2022

In millions of dollars

\$1,400,000



Source: GAO analysis of OMB data and Historical Table 12.3. | GAO-24

Grants Management: Action Needed to Ensure Consistency and Usefulness of New Data Standards, GAO-24-106164, Released: Jan 25, 2024.

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- In 2022, federal aid to tribal, state, local, and territorial governments—primarily through grants—totaled roughly \$1.2 trillion. Tracking federal grants spending can be difficult because data are sometimes not consistent government-wide. The GREAT Act seeks to strengthen management and oversight of federal grants through the establishment of governmentwide data standards.

The Tax Policy Center - What types of federal grants are made to state and local governments and how do they work?

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- The federal government directly transferred \$988 billion to state governments and \$133 billion to local governments in 2021. These funds accounted for 18 percent of the federal government's budget in fiscal year 2021, and 27 percent of combined state and local governments' general revenues. The total amount transferred directly to state governments was significantly higher than the amount transferred directly to local governments because the state total includes "pass-through" grants, which are federal dollars sent directly to states but ultimately intended for local governments.

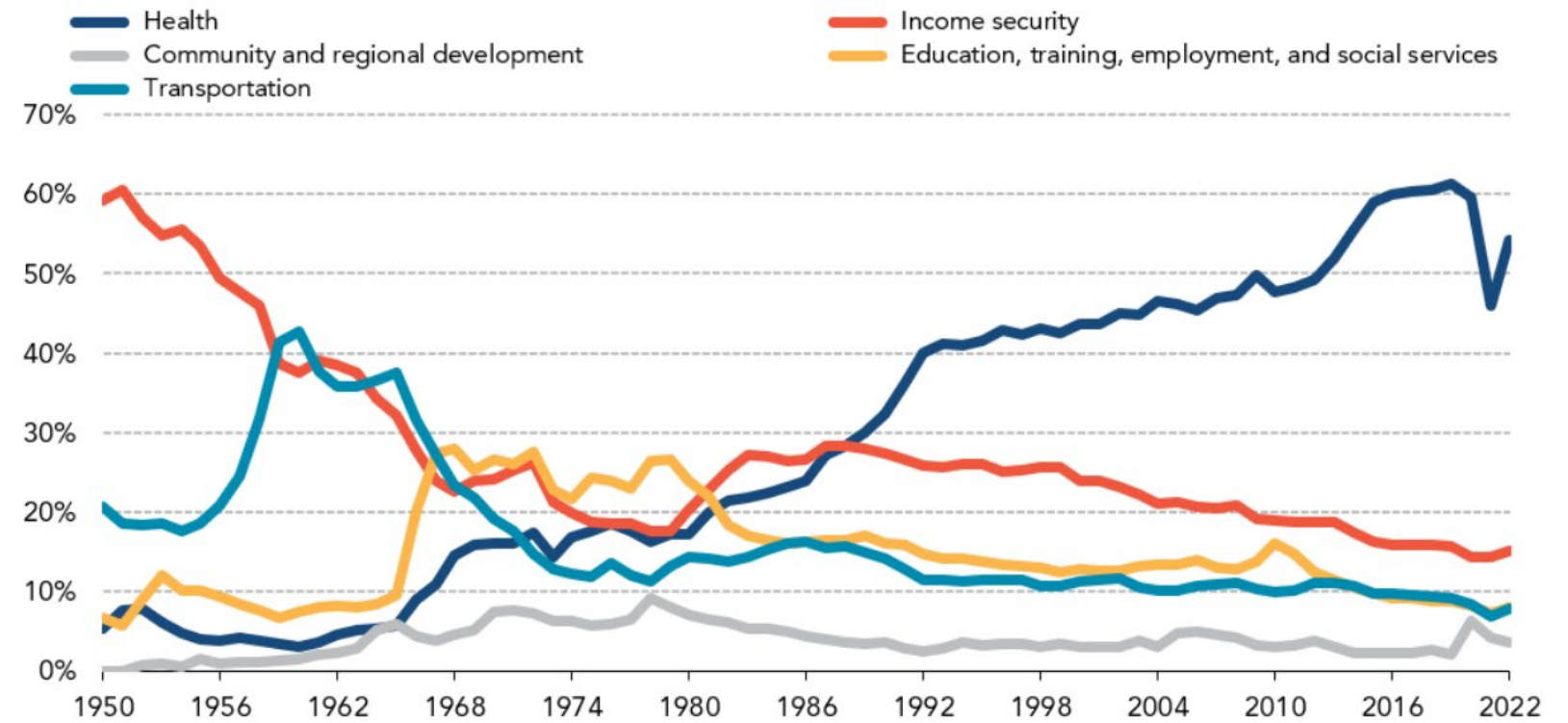
Federal Budget Developments

- The Tax Policy Center - What types of federal grants are made to state and local governments and how do they work?

FIGURE 1

Federal Grants to State and Local Governments

Share of total, by category, fiscal years 1950 to 2022



Source: Office of Management and Budget. 2023. Historical Tables. Table 12.2. Total Outlays for Grants to State and Local Governments by Function and Fund Group: 1940–2028.



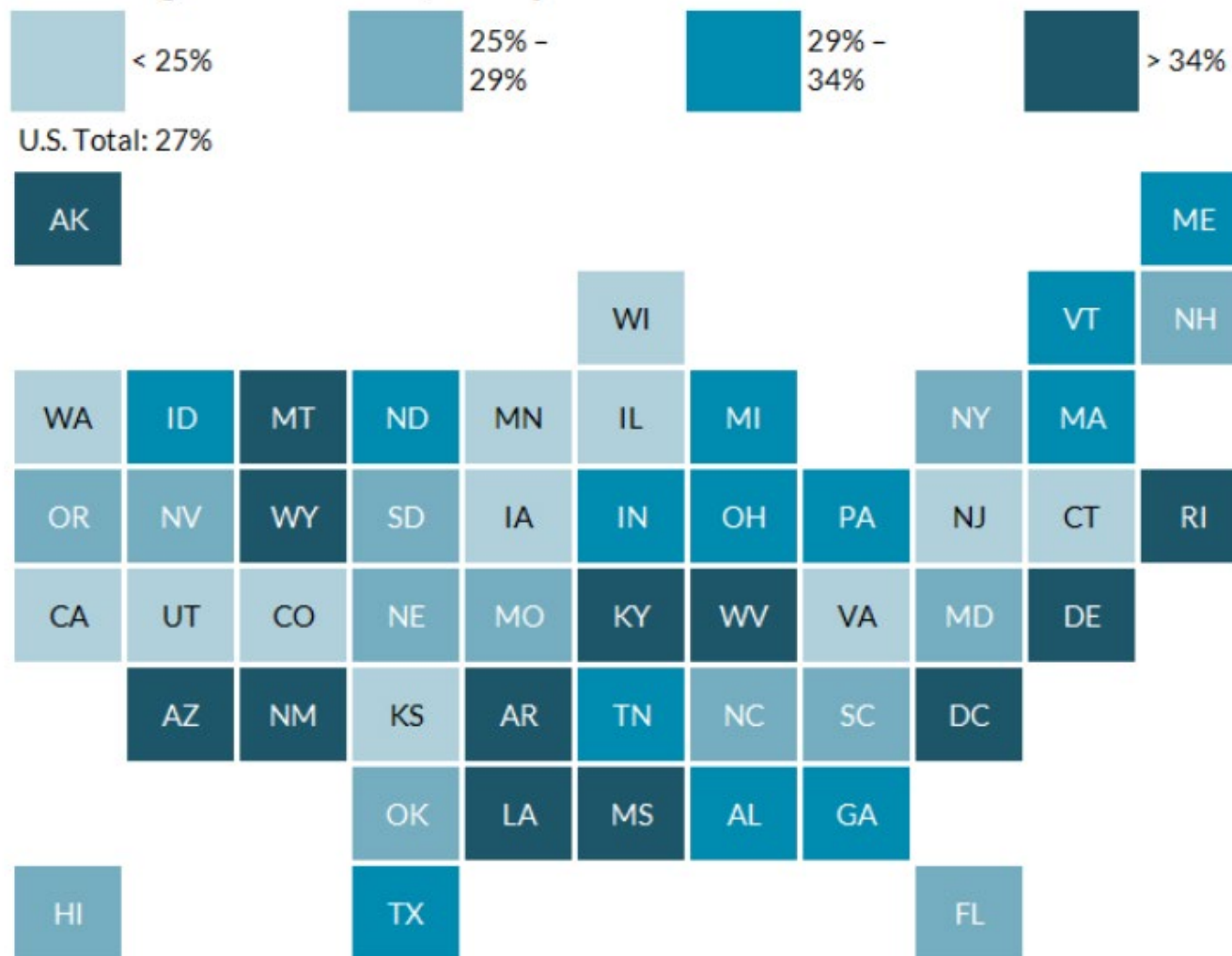
Federal Budget Developments

- The Tax Policy Center - What types of federal grants are made to state and local governments and how do they work?

FIGURE 3

State and Local Intergovernmental Revenue from Federal Government

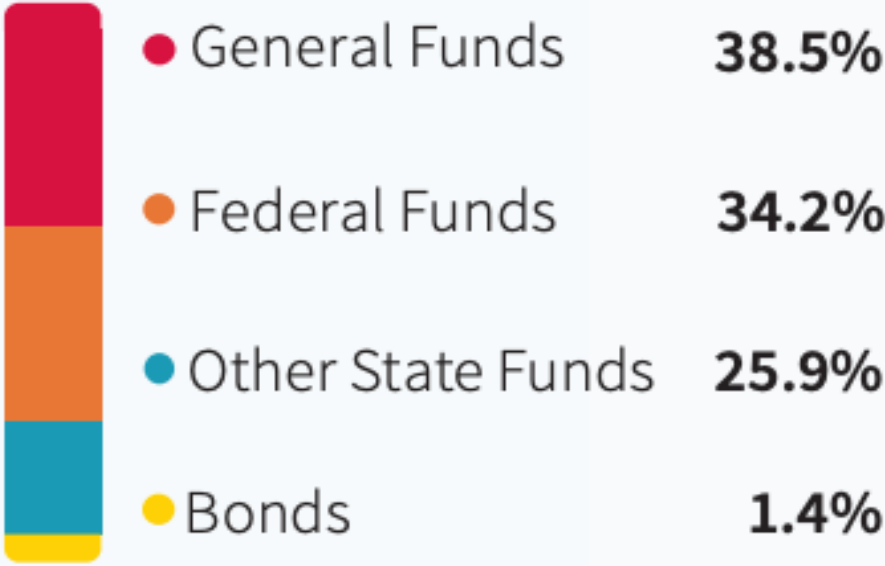
Share of general revenues, fiscal year 2021



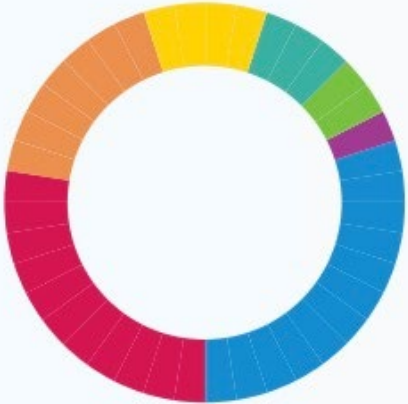
Source: US Census Bureau Annual Survey of State and Local Government Finances, 1977-2021 (compiled by the Urban Institute via State and Local Finance Data: Exploring the Census of Governments; accessed 08-Aug-2023 12:45), <https://state-local-finance-data.taxpolicycenter.org>.

States and Federal Funds Decline

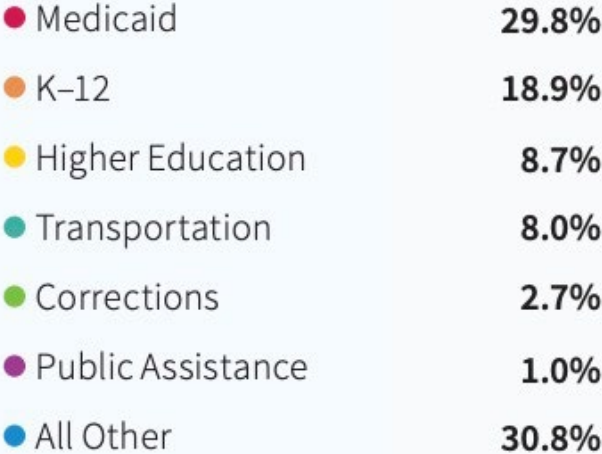
Total State Expenditures by Fund Source, FY 2024



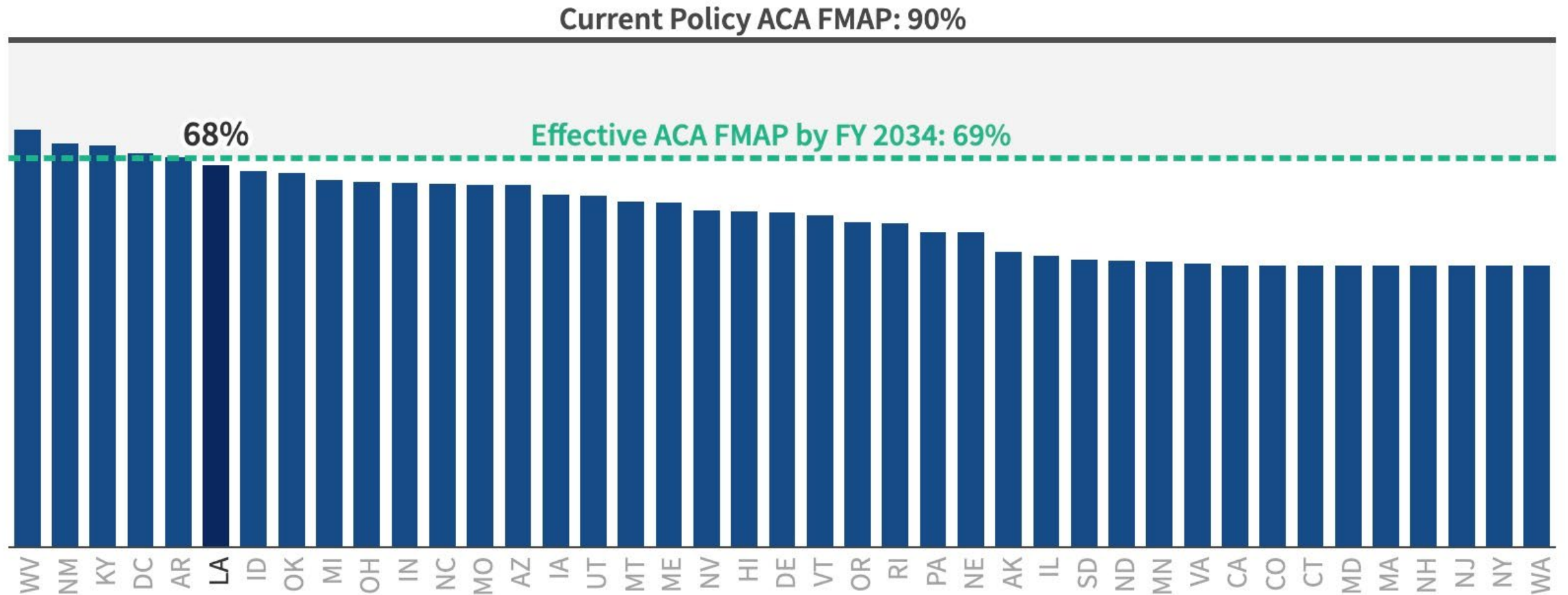
Total State Expenditures by Function, FY 2024



\$3,064 Billion



Medicaid \$246 Billion Loss



State Revenue Forecasters Watching...

Impacts on State Revenues

Interest Rates/Inflation

Impact of Tariffs

Medicaid Cuts

Markets – Equities – Bonds

Munis

Dollar

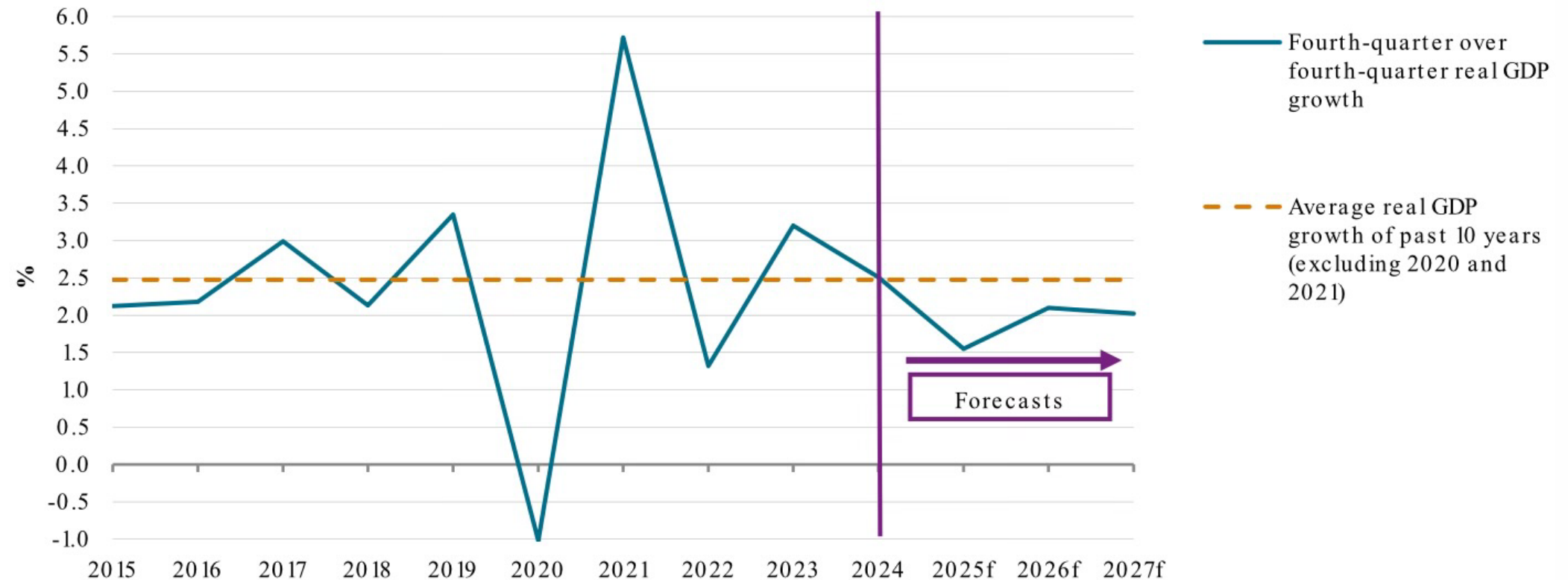
Energy

Labor

Consumers

Economic Developments - Slowing Growth

U.S. economic expansion will slow sharply in 2025 and remain below the long-term average



f--Forecast. Source: S&P Global Ratings Economics.

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Economic Developments

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