

THE POWER OF BEING UNDERSTOOD



DIVIDED GOVERNMENT: IMPACT ON FEDERAL AND STATE TAX POLICY



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Today's agenda

- Introduction
- Election 2022: Tax policy and divided government
- Tax policy: Lame duck, tax policy in 2023 and 2024
- IRS/Treasury: Challenges ahead
- State tax policy impact
- Perspectives

Learning objectives

- Explain the midterm election results
- State how the top federal and state tax legislation efforts will be affected
- Describe the impact on middle market businesses

Election 2022: Tax policy and divided government



HOUSE RESULTS *(as of 11.21.22)*

Republicans gain control of House

218 needed for control



SENATE RESULTS *(as of 11.21.22)*

Democrats retain control of Senate



Election 2022: Deciphering the results

- Short-term, long-term implications on the direction of tax policy and potential legislation
- Overarching theme: legislative gridlock
- Small margins in the House and Senate will require negotiation and compromise across the aisle if much is to get done
- Retention of control in the Senate by Democrats: the story is not over yet



TAX POLICY

Lame duck, tax policy in 2023 and 2024

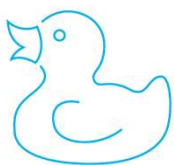
Tax policy – Lame duck

- Continuing resolution and other “must pass” measures
- Possible tax changes
 - R&D capitalization to expensing
 - Interest expense deduction limitation
 - Bonus depreciation
 - Child tax credit
 - Non-TCJA extenders
 - EARN Act (SECURE Act 2.0)



Tax policy in 2023 and 2024

Possible tax changes



Remaining items
from lame duck



Inflation
Reduction Act
changes



Extension of
TCJA



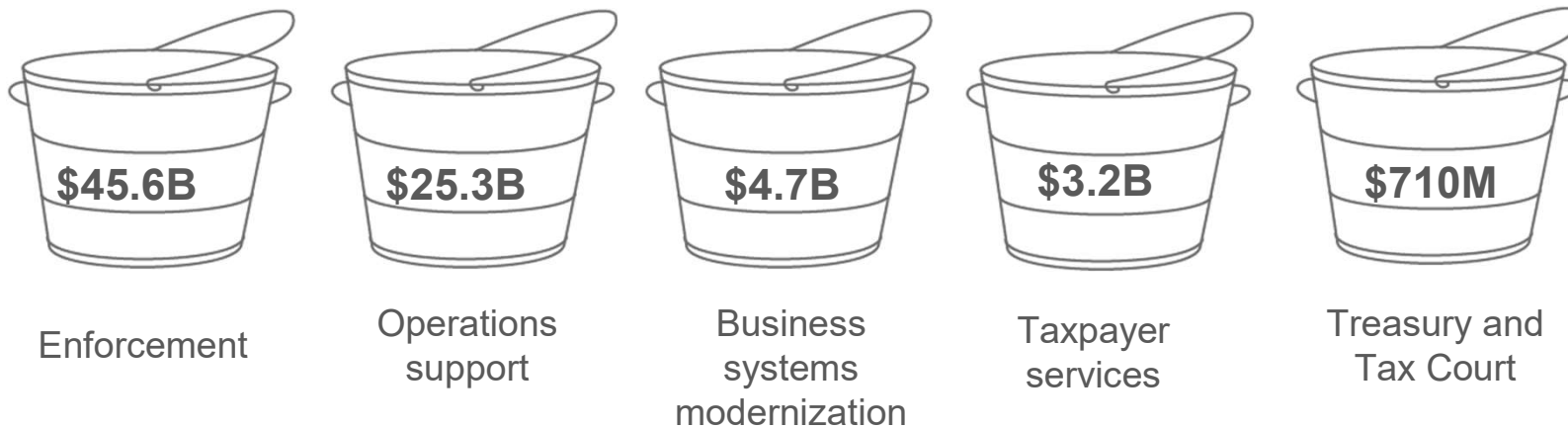
IRS funding

IRS

Oversight, new funding, enforcement

New IRS funding

What are the funding buckets?



- Additional IRS funding (10 years) = \$79.6B
- Average IRS budget 2020-2022 = \$12.9B
- Average increase in IRS annual enforcement budget = 90%

IRS/Treasury: Challenges ahead

- Implementing the Inflation Reduction Act
- Expected IRS enforcement priorities
- Revenue expectations
- Service quality needs
- Increased oversight from a Republican-controlled House



IRS: Areas of enforcement focus with IRA funds

Primary focus of IRS increased enforcement activity

- Households earning more than \$400,000
- Large corporations
- Complex partnerships
- High net-worth individuals

Not a focus

- Households earning \$400,000 per year or less
- Small businesses

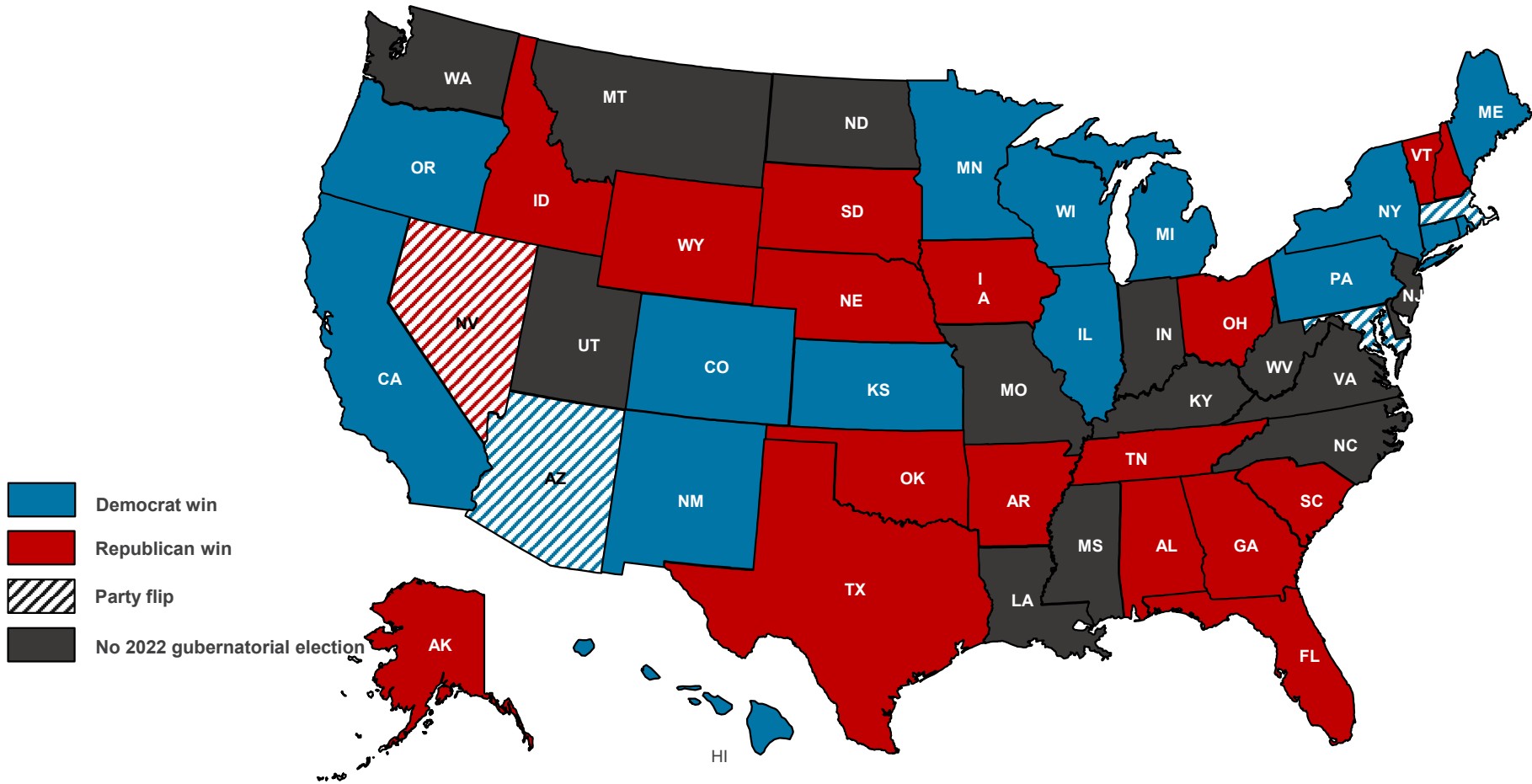
Source: Letters from Treasury Secretary Yellen to IRS Commissioner Rettig dated Aug. 10 and 17, 2022

STATE TAX REFORM IMPLICATIONS

Tax-related ballot initiatives

- Personal income tax
 - ✗ – California 1.75% personal income tax on incomes above \$2M (2023)
 - ✓ – Colorado income tax reduction to 4.40% from 4.55% (2022)
 - ✓ – Massachusetts “millionaire’s tax” of 4% on incomes exceeding \$1M (2023)
- Legalization measures
 - Arkansas, Maryland, Missouri, North Dakota and South Dakota
- Sales tax
 - ✗ – Arizona 0.1% sales tax increase for 20 years for fire districts (2023)
- Others of interest
 - Minimum wage increases in D.C. (tipped employee increase), Nebraska (\$15 by 2026), and Nevada (\$12 by July 2024)

Gubernatorial elections 2022 (36 and D.C.)



Policy takeaways

- State tax collections
 - Tax collections in FY22 resulted in surpluses in almost every state
 - Collections YTD in FY23 mostly remain strong and above projects
- Considerations
 - Vastly different market performance will reduce personal income tax collections
 - Economic uncertainty will begin to impact states in FY23, e.g., California and the tech industry
 - State and local governments beginning to pay more skewing the usefulness of revenue collection data
 - Consumers continue to spend (retail/tourism) in high inflation environment, but for how long?
 - Two consecutive state sessions saw over 20 states with personal and/or corporate income tax cuts, will that focus continue in 2023 sessions?

PERSPECTIVES

QUESTIONS AND ANSWERS

THANK YOU FOR
YOUR TIME AND
ATTENTION

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