

While States Debate New Trump Tax Changes, Equity Must Be at the Core

By Brakeyshia Samms

States continue to debate whether and how to link their state tax codes to the 2025 federal tax law. This is not just a technical debate. The newly enacted provisions that states are considering incorporating into their own tax codes have profound implications for economic and racial equity.

Sound policies can undo some of the harms embedded in tax laws – whether intentional or not – and ensure **state tax systems** reduce racial and wealth gaps and generate revenue to invest in public services that strengthen families and communities. Conformity to federal tax law – especially in the face of recent changes – can play an important role in determining whether states improve economic and racial equity in their tax codes.

Last year, President Trump and his allies in Congress **passed a sweeping new tax law** that resulted in a **massive giveaway** to the wealthy with far smaller tax cuts for everyone else. The “**One Big Beautiful Bill Act**” (OBBBA) extended and made permanent several of the highly inequitable 2017 Trump tax cuts and created new tax breaks.

Some of these alterations to the federal tax code could impact state revenues, depending on how states mirror them in their own state tax laws. This has important economic and racial equity implications. **Most states already have a regressive tax code**. Linking to certain components of the new federal tax law could worsen that inequality while reducing states’ ability to fund programs that support racial and economic justice.

How State Tax Codes Conform to Federal Law

The reason states are debating this issue now is that state income tax codes are nearly always based, to varying extents, on federal law – an approach known as **conformity**. This keeps federal and state tax policies aligned but can disrupt the budget process for state policymakers and cause chaos for their revenue decisions when federal tax laws change. When federal lawmakers make major structural changes to the income tax, states have an opportunity to decide which, if any, of those changes to mirror in their own tax codes. They must carefully evaluate the cost, the benefits to the state and residents, and the racial and economic equity implications of each federal tax provision before deciding whether to incorporate it into their own tax code.

Linking to Some OBBBA Provisions Will Reduce Vital Revenue for Programs that Support Racial Equity

A number of the OBBBA provisions will result in reduced revenue for states if policymakers decide to link to them because they narrow the federal definition of income, which is the starting point for state tax calculations. This would leave states with fewer resources to work with to invest in public programs that provide a path toward racial equity.

This is at a time when unprecedented amounts of spending on public services like nutrition assistance and health care are shifting from the federal government to the states. OBBBA reduces the amount of federal spending on Medicaid and SNAP through programmatic changes. It asks states to backstop the funding gap, but if states have less revenue, they may ultimately have to cut services for low-income households, who are disproportionately people of color.

Because wealth in the U.S. is still deeply shaped by a history of racial discrimination in housing, employment, and taxation, the households at the very top of the income distribution are disproportionately white. Policies that deliver large tax cuts to the wealthiest households while draining state resources risk widening racial inequities rather than helping states build a more equitable tax code.



One example is the qualified small business stock (QSBS) exemption. This misleadingly named tax break, which was expanded under OBBBA, allows the wealthiest venture capitalists to receive a 100 percent tax exemption on gains from qualified startup investments that have rapidly increased in value.

QSBS overwhelmingly benefits wealthy households, with more than **94 percent** of the exclusion going to those with incomes above \$1 million, an income group that is disproportionately white. The primary beneficiaries of this tax break are startup founders and venture capital investors; according to **one report**, 2.8 percent of venture backed startup founders are Black or Latino, despite these groups representing roughly **one-third** of the U.S. population. The economic and racial equity issues of this provision mean state policymakers should prioritize decoupling from this provision. Like California – home to a significant share of venture capitalists – other states can also decouple and follow the recent changes in **Maine and Oregon** this year, creating opportunities to protect existing state revenue while reducing economic and racial inequities.

The expansion of 529 college savings plans is another inequitable tax change. The 2017 Trump tax law expanded 529 plans – originally intended to help families save for college – to allow withdrawals for private K-12 tuition. This year’s law broadened those uses even further, allowing additional private K-12 education expenses to qualify.

While a good education is an important pathway for equity, a tax break for tuition **raises important equity concerns**. These expanded tax benefits disproportionately subsidize wealthy families who have already enrolled their children in private schools, have the financial resources to contribute to 529 plans, and benefit more from tax advantages because they are in higher income tax brackets. Due to longstanding inequities in income and wealth, these benefits also tend to flow to white households, because private school enrollment is disproportionately white. Some 65 percent of children **enrolled in private school** are white, 12 percent are Hispanic, and 9 percent are Black, while **children in public schools** are 44 percent white, 29 percent Hispanic, and 15 percent Black.

States should avoid compounding these inequities by offering additional state tax breaks tied to 529 plans beyond the federal benefit. Instead, states should decouple from these provisions to protect their revenue and prioritize investments in public education and other services that support students and expand access to postsecondary opportunities. Lawmakers can follow the lead of the 10 states that have already done so, like **Oregon** or **Vermont**. Those



states require repayment of the benefit from any state tax credits or deductions claimed for contributions to a 529 plan that are for nonqualifying expenses like K-12 expenses.

The new \$40,000 cap on state and local tax (SALT) deductions also has important equity implications. At the federal level, the SALT cap is a deduction for primarily both income taxes and property taxes, but at the state level it's mostly just a deduction for property taxes (the reason is that states generally disallow income tax deductions). So raising this cap at the state level **benefits** only those homeowners who itemize their taxes and who also have high property tax liability.

Most middle- and low-income homeowners, including the great majority of Black and Hispanic homeowners, do not itemize their taxes and pay less than \$10,000 in property taxes, and therefore will not benefit from this change. Only a small number of relatively wealthy, white households will benefit if states conform to this change. States like California have a fixed conformity date earlier than the date the new federal law was enacted, meaning they are not linked to the new SALT cap. The latest change to the cap only immediately **impacts 18 states**, so, there are already states that don't link to the current SALT cap, but they should not reverse course.

There is a better way to help mitigate property tax affordability issues and it is known as a "**property tax circuit breaker**." The policy credits back property taxes that go beyond a certain share of a household's income. Currently, 29 states and Washington, D.C. have programs that help low- and moderate-income households of all races afford their property tax bills. Because of **historic housing discrimination** this means circuit breakers help communities of color. States could use the revenue preserved by declining to expand SALT deductions to create or strengthen circuit breaker programs that provide more **equitable** and **effective** relief.

Conforming to Corporate Tax Breaks Deepens Racial Disparities

Policies that provide corporate tax breaks and enable corporate tax avoidance worsen racial and income disparities. They reduce the revenue available to fund public investments that benefit everyone and tilt the distribution of income toward the owners of corporate assets, who are disproportionately wealthy and white.



ITEP research shows that in the first year a federal corporate tax break takes effect, white households receive 88 percent of the benefits that remain in the U.S., despite making up just 67 percent of the population. By contrast, Black and Hispanic households – 12 percent and 9 percent of all households, respectively – each receive just 1 percent. The effects of a corporate tax cut at the state level are similar.

The new federal law features many provisions **that provide breaks to corporations** that exacerbate racial inequities. When a state incorporates a federal corporate tax cut into its own tax code, it is similarly giving a tax break to mostly wealthy, white shareholders and executives of these corporations, thereby exacerbating racial inequity.

If states conform to these breaks for corporations, the potentially costliest feature of the new federal law is the restoration and expansion of 100 percent **bonus depreciation**. This allows highly profitable corporations to report little or no taxable income as long as they invest in equipment or factories. Instead of deducting costs over an asset's useful life, companies can claim the full deduction in the first year, creating a massive upfront tax break.

Another costly provision is the tax break for **Foreign-Derived Deduction Eligible Income** (FDDEI). Because it is calculated from pre-apportionment income – the full pool of corporate profits reported on federal returns – a deduction generated in one state reduces taxable income in every conforming state. Although 19 states have decoupled, 26 still allow the deduction, often at significant cost. Colorado recently repealed it and expects to raise more than **\$72 million annually**; estimates put the annual cost at about **\$60 million** in Oregon and **\$24 million** in Georgia.

On the other hand, a corporate reform that states should link to is the provision on **Net Controlled Foreign Corporation Tested Income** (NCTI), which captures profits reported by the foreign subsidiaries of U.S. corporations. Like the federal government, states have a strong interest in preventing companies from sidestepping taxes by shifting profits to offshore tax havens. For states not ready to adopt **worldwide combined reporting** (WWCR), conforming to NCTI offers a practical alternative by linking to an established, IRS-audited measure of foreign profits. Including NCTI in state tax codes helps protect state tax bases from offshore tax avoidance. Strengthening these rules advances racial justice in the tax code through reigning in corporate tax avoidance that primarily benefits large, multinational corporations and their shareholders – who are disproportionately wealthy and white.



Conformity Makes It Harder to Invest in Public Programs that Improve Equity

Incorporating these new federal tax breaks into state tax codes will not only disproportionately benefit wealthy, white households, but also deprive states of revenue. Without that revenue, states will struggle to meet balanced budget requirements and sustain health care, nutrition, education and other programs that are important to and help low- and middle-income households of all races succeed.

For example, if all states decided to incorporate into their own tax codes the new federal deductions for tips and overtime income, the cost to states would be **\$8.6 billion** in 2026. While many tipped workers do have low incomes and are people of color, and despite the presence of an income cap for the deduction, this tax break will do very little, if anything, to advance equity.

That's because the tip and overtime deductions provide no benefit to the lowest income families, who typically have little to no income tax liability and thus gain nothing from a new tax deduction. Among those families who would get a tax break, higher income families up to the income cap would see larger benefits - exacerbating existing racial inequities in the income distribution. Among tipped workers, workers of color **tend to have lower earnings** and **receive fewer tips** - meaning the same dynamics are at play even among those who could potentially benefit from that deduction.

The revenue states would lose could be better spent on programs that are targeted toward families that need an income boost, such as job training, universal child care, and paid family leave programs. Or states could create or boost Child Tax Credits (CTC) or Earned Income Tax Credits (EITC), both **effective policies** for helping low- and moderate-income workers make ends meet. Bottomline, deductions for tips and overtime are too expensive and ineffective to warrant state adoption.

The sweeping changes to the federal tax code enacted through OBBBA **reversed** much of the progress the tax code had made toward advancing racial and economic equity. Efforts to create a more just tax system for communities disproportionately harmed by inequitable policies were sidelined by a massive giveaway to wealthy households, largely financed at the expense of those with



the lowest incomes. This transfer of wealth could deepen further as states debate whether to adopt these federal provisions into their own tax laws.

Conformity is the most significant and timely fiscal issue facing state lawmakers. Ongoing state legislative debates must consider the impact of conformity on equity and revenue. By decoupling from these costly and inequitable federal tax changes, lawmakers have an opportunity to reduce racial and economic wealth gaps and preserve critical revenue needed to invest in programs that help households thrive.



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