

Top State And Local Tax Policies Of 2025

By **Sanjay Talwani**

Law360 (December 22, 2025, 5:15 PM EST) -- The federal budget bill President Donald Trump signed in July changed the revenue picture for states, and some separated from federal policy to avoid severe impacts.

The ever-growing digital economy also brought new challenges and opportunities for states, with interest in the taxation of digital advertisements and new limits on what internet activities are allowed before triggering nexus in a state.

Here, Law360 looks at some of the top state and local tax policies of the past year.

States Question Federal Conformity

The federal budget bill's provisions on corporate investments flow to several state tax systems without action from those states, resulting in reduced state revenue. As a result, a few states that automatically conform to federal tax changes have decoupled significantly from those provisions.



Corporate investment provisions in the federal budget bill that President Donald Trump signed into law in July resulted in reductions of state revenue, and as a result, a few states that automatically conform to federal tax changes have decoupled significantly from those provisions. (Photo by Aaron Schwartz/Sipa USA via AP Images)

According to Tax Foundation data, the most costly change for states over the next 10 years — impacting nearly all of them — is the return to the immediate deduction of research and experimental expenses

under Internal Revenue Code **Section 174**, instead of amortizing expenses over five years. The restoration of the full first-year expense of machinery and other property under IRC **Section 168(k)**, affecting 17 states, is expected to bring the biggest overall hit in fiscal year 2026.

Other changes include a new provision for first-year expensing for qualified production property such as factories in IRC **Section 168(n)** and increases to expense deductions for small businesses under IRC **Section 179** from \$1 million to \$2.5 million and business interest deductions under IRC **Section 163(j)**.

Michigan's budget, signed in October, **decouples from those provisions**, preventing an estimated \$540 million revenue drop next fiscal year and less thereafter.

Pennsylvania's **budget bill decouples** from the Section 163(j) business interest measure, the up-front R&E deduction and the immediate expensing of production property, preventing an estimated \$1.1 billion in revenue loss. Washington, D.C., **is also decoupling** from corporate changes in the bill and from the overtime and tipped income provisions.

Jared Walczak, vice president of state projects at Tax Foundation, noted that the expensing provisions are largely restorations of prior policy, which he said most states would never have considered decoupling from. The R&E deduction was the law from 1954 through 2022 and was widely considered good policy for promoting business investment, he said.

"Most states believe that research development is a good thing and would not want to discriminate against it in their tax code," Walczak said.

But bringing the deduction to a single year has one-year costs for states that they will have to get past before it becomes relatively affordable again, he said.

Delaware, he said, tried to "split the difference" in its budget bill, returning to first-year deductions for the R&E for investments expenses going forward, but not changing the amortization schedules retroactively for investments made in tax years 2022 to 2025 as the federal bill does. That's an option for other states to consider, he said, if they want to avoid the one-time hit but not "create a state penalty" for research and development.

Aidan Davis, state policy director for Institute for Taxation and Economic Policy, said the corporate provisions in the federal bill are among the biggest cost drivers for reducing state revenue. It was not a popular bill, she said, and many state lawmakers are bringing a critical eye to its provisions.

The near-term shortfalls from the front-loading of deductions could be significant, and the federal bill shifts costs to the states, making balanced budgeting harder for state lawmakers, she said.

"There are some real challenges in the states, and I think almost everyone anticipates that the budget picture is getting worse in the states in the years to come," Davis said. "Lawmakers need to be coming at this really with a long-term view in mind."

The federal corporate breaks don't necessarily translate into the state systems in a helpful way, she said. For example, a deduction for R&E investment lowers revenue for a state, even though the investments themselves, and the local benefits from them, may be somewhere else.

"And I think lawmakers recognize that and are really thinking through, is it worth the loss of state-level revenue to help with investment that could or could not flow into my individual state?" she said.

Pondering Digital Ad Taxes

A handful of states have seen legislative proposals to tap digital advertising revenue for taxation while the two states that have gone forward with such legislation are fighting challenges in court.

Maryland's first-in-the-nation digital advertising tax remains in effect, though under challenge, with **the Fourth Circuit striking down a provision** of the tax law on First Amendment grounds. **Washington state is defending its new law**, extending its sales tax to advertising services but exempting most non-internet advertising, from a challenge by Comcast. The company said the law violates the federal Internet Tax Freedom Act, which generally bars discriminatory tax treatment of electronic commerce.

In Rhode Island, a proposal by Democratic Gov. Daniel McKee **would have imposed a 10% tax** on digital ad revenue of companies with annual revenue topping \$1 billion, with \$20 million in revenue forecast for 2027, but the provision was **removed by lawmakers**. A similar measure **was also pulled** from Illinois' budget bill.

In Massachusetts, lawmakers have proposed several **bills to tax digital advertising** with differing details, generally taking aim at large global corporations with staggered tax rates based on annual global revenues, designating some of the revenue for specific purposes.

Digital ad taxes also have been proposed in Montana and South Dakota, but the proposals gained little traction.

In Minnesota, a legislative panel heard a proposal for **an excise tax on data mining** by large social media companies estimated to raise \$334 million over four years. It was not included in the state's final tax package.

K.J. Bagchi, vice president of technology policy for the Chamber of Progress, which describes itself as a left-of-center tech coalition, said it's natural for states to look to bigger revenue generators as a way to solve their budget concerns. But legislation like those proposals, he said, impacts the numerous online applications and services, like YouTube and mapping programs, that consumers expect for free. Added costs would be pushed down to the consumer, including to small businesses trying to use the internet to get the word out about themselves.

A digital ad tax "just adds insult to injury at a time when families are already being crushed by the cost of living crisis," he said. And the implementation and assessment would require privacy-intrusive methods to gain the needed information, he said.

The Council on State Taxation has long opposed digital ad taxes, saying business-to-business taxes, or taxes on business inputs, raise costs and place states imposing them at a competitive disadvantage. Karl Frieden, COST's vice president and general counsel, said state lawmakers, anticipating revenue needs, may wait to see what happens in the courts.

But even if courts bless the tax laws, he said, that doesn't mean states should go ahead with the taxes. Digital ad taxation "was bad tax policy before Maryland enacted it and will continue to be," Frieden said.

Many states may look at broadening their sales tax bases, as many tangible products are being replaced with intangible versions, Frieden said. State laws, which vary in their treatment of intangible personal property, haven't kept up with that, and there may be legitimate reasons to consider changing laws to include digital products, he said, at least in business-to-consumer transactions.

"But that gets more complicated if they start to go after things that are just explicitly digital [business-to-business], which is what digital advertising is," he said.

Digital ad taxes like those in place are even worse than broad-based value-added taxes, Frieden said, because they explicitly target business-to-business transactions.

COST also noted that the U.S. government has been among the strongest critics of national digital service taxes in other nations, and it has argued that enactment of those taxes at the state level would significantly undermine federal international policy.

Darien Shanske, professor at University of California, Davis School of Law, noted that states are likely to soon be under fiscal pressures.

"Meanwhile, tech companies reap enormous undertaxed profits that often are a direct result of undertaxed consumption — and hence there are very compelling tax reasons for states to look to digital service-type taxes," he said.

He said concerns about the Maryland litigation is misplaced because, he thinks, the state will ultimately prevail. Second, he said, different state courts likely would respond to a different tax even more positively.

"Third, and as a general matter, I think states should proceed when they have the better arguments and not cede tax policy to the bigger battalions of lawyers," he said.

State tax laws have not been revised to reflect new kinds of transactions, wealth and income in the digital age, said Nick Johnson, senior fellow at ITEP, and that threatens "to leave state revenue systems in the dust" if they don't adapt.

Core to that transformation, he said, is the collection by corporations of vast amounts of consumer data.

"It's not surprising that state policymakers are pushing forward with various models for adapting their revenue systems to this new economy and ensure that communities are compensated appropriately for how companies are harvesting personal data," Johnson said.

The "Cookie" Nexus

Massachusetts became the latest state to implement parts of the Multistate Tax Commission guidance on what internet activities by retailers end protections against state income taxation under the Interstate Income Act of 1959, also known as P.L. 86-272.

Under what is known as **the cookie regulation in Massachusetts**, finalized in October, out-of-state retailers with more than \$500,000 in annual sales in the state that place cookies on consumer devices establish nexus with the state for income tax purposes. **A New Jersey regulation** addressing internet activity **is being challenged** by the American Commerce Marketing Association, which said a live online chat with customers ends P.L. 86-272 protections while the same content delivered over the phone does not. The ACMA is also **appealing a court ruling** upholding regulations in New York.

David Swetnam-Burland of Brann & Isaacson, part of the team representing the ACMA, said states may think it's unfair they can't tax income of businesses outside their borders selling products to their residents. But the U.S. Constitution was written to prevent such unilateral regulation of interstate commerce by individual states, he said.

"Only Congress can amend or repeal a federal statute, and no state administrative agency can change the meaning of federal law," Swetnam-Burland said. "If the states think they have a better policy, they should make their pitch to Congress."

Stefi George, chair of the state and local tax practice at Akerman LLP, said P.L. 86-272 guidance across states so far has largely oversimplified the concept of cookies. Before enacting laws limiting the scope of the federal protection, states should evaluate the extent to which they have authority to impose limitations on the federal statute and take note of previous approaches taken by other states and resulting litigation.

The Massachusetts regulation avoids the procedural and retroactivity issues that plagued California and New York but may be susceptible to challenge on other grounds, such as federal preemption, George said.

Richard Pomp, professor at University of Connecticut School of Law, questioned where the actual business activity of the placement of the cookie takes place, for the purposes of the protections.

"It's not good enough that it be on your computer because 86-272 talks about business activity," Pomp said. "So where was the placement of that cookie? There's the activity."

He pointed to the Massachusetts Supreme Judicial Court's 2022 decision in [U.S. Auto Parts Network Inc. v. Commissioner of Revenue](#) , which **upheld a state board's abatement** of a tax against that company. That opinion said in a footnote that there are two kinds of cookies: first-party cookies, placed by the website being visited, and third-party cookies, placed by advertising and others.

Why, Pomp asked, is the cookie considered business in Massachusetts when the activity on the server to place it may have occurred in another state?

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