How the 2020 Elections Could Affect State and Local Tax Policy

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In this article, Roberti, Bertothy, and Sawyer discuss the U.S. federal and state fiscal and economic landscape leading up to the November 3 election, the candidates and tax issues at stake on the ballot, and trends in state taxation likely to be affected by the election results.

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With the November 2020 elections only days away, the economic, social, and political climate continues to be defined by uncertainty and rapid change. While there is no clear picture of what the outcomes of the federal, state, and local races will be, the results may have far-reaching consequences for state and local governments as they consider responses to the budget challenges induced by the ongoing COVID-19 pandemic, including both revenue shortfalls and increased resource demands.

This article will explore the United States federal and state fiscal and economic landscape heading into the election, the candidates and the issues at stake on the ballot (that is, tax matters for consideration and ballot measures), and recent trends in state taxation likely to be affected by the election results. The article also provides a high-level overview of the current environment in terms of the intersection of economic fallout from the COVID-19 pandemic and the upcoming elections, what to expect during and immediately after the elections, and what state tax policy repercussions taxpayers ought to prepare for in response to those results.

Federal and State Economic Conditions

As 2020 began, the U.S. economy was showing continued growth and the national unemployment rate was 3.6 percent. All of that changed in an instant with the official declaration of the global COVID-19 pandemic in March. The International Monetary Fund has projected a 4.9 percent drop in global real GDP and a drop in U.S. real GDP of 8 percent for 2020. Meanwhile, the national unemployment rate skyrocketed with over 60 million first-time unemployment claims filed over 25 weeks starting in March. While these numbers are grim, the U.S. Department of Labor reported that the national unemployment rate had declined to 7.9 percent in September — down from a high of 14.7 percent in April, demonstrating a net gain of approximately 11.4 million jobs from May to September. Despite the recent decrease, the U.S. has seen an overall 3.5 percentage point increase in the unemployment rate since January, representing a total loss of approximately 10.8 million jobs through October.

2 Tedros Adhanom Ghebreyesus, Director-General, World Health Organization, “WHO Director-General’s Opening Remarks at the Media Briefing on COVID-19 - 11 March 2020,” Mar. 11, 2020 (announcing that the World Health Organization had “made the assessment that COVID-19 can be characterized as a pandemic”).
3 International Monetary Fund, “World Economic Outlook Update, June 2020: A Crisis Like No Other, an Uncertain Recovery” (June 2020).
Both the economic impact and job recovery have varied greatly among different economic sectors. The U.S. Commerce Department’s Bureau of Economic Analysis identified a U.S. real GDP contraction of 5.0 percent on an annualized basis in the first quarter of 2020 and an additional 31.4 percent (annualized) shrinkage of the economy in the second quarter of 2020 — the largest economic decrease on record since World War II. However, on September 10, Blue Chip Indicators, an economic consultancy, initially forecast 24 percent nationwide GDP growth for the third quarter of 2020 and has projected recovery to pre-COVID-19 GDP levels by the end of 2021.

From a state tax perspective, state revenue expectations were from the outset of the pandemic characterized by the Federation of Tax Administrators as “grim,” largely because of the immediate drop in economic activity as governments around the world imposed travel, work, and public gathering restrictions to control the spread of the COVID-19 virus. From March to July, the federation reported that state revenue was down approximately 7.5 percent, with the largest percentage drops for corporate income and sales tax revenue. Much of the drop in revenue collections was attributable to deferred return filing and payment deadlines, which in turn contributed to significant July revenue increases for both personal and corporate income taxes. Regardless of the timing shift, the Urban Institute has reported that overall revenue is down approximately $28.2 billion for the first five months of 2020 compared with 2019, and the National Association of State Budget Officers (NASBO) reported that fiscal 2020 general fund revenue was down by 3 percent (down 1.6 percent if delayed filing deadlines are taken into account) compared with fiscal 2019 — a situation it projects will worsen into fiscal 2021 and 2022 because the 2020 numbers reflect strong economies in 2019, delayed economic fallout, and that both individual and business income tax revenue effects are typically slower to rebound since they are based on prior-year activity.

The depressed level of state revenue is generally expected to continue while the U.S. economy recovers, and will be sensitive to any potential federal aid to the states and to other global events such as the drop in global oil and gas prices that has caused declines in severance tax revenue in some states and diminished revenue overall from that industry sector. Such revenue strains put added pressure on state governments because, unlike the federal government, all states but one have a balanced budget requirement in their state constitution. This budget impact has been noticeable, for example, in Massachusetts and New Jersey, where fiscal 2021 budgets, typically enacted early in the prior year, were not finalized while the states watched to see whether additional federal funding would help offset the fiscal consequences of the pandemic. New Jersey enacted a budget on September 29, but the Massachusetts budget is still under consideration. In a move not seen in recent history, New Jersey even went so far as to extend its fiscal year-end for 2020 from June 30 to September 30 to provide time to close the year with a balanced budget. Other states have been forced to call special sessions to address supplemental budget measures by either passing continuing resolutions, enacting additional tax measures or expanding borrowing.

The federal government has not been idle in responding to this historic health and economic crisis, enacting several coronavirus relief bills, including the Families First Coronavirus Response Act (P.L. 116-127), the Coronavirus Aid, Relief, and Economic Security Act (P.L. 116-136), and the Paycheck Protection and Health Care Enhancement Act (P.L. 116-139), authorizing over $2.8 trillion in spending. Of that relief spending, $150 billion was allocated to assist state and local governments with designated COVID-19-related expenditures. State associations including

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NASBO and the National Governors Association have requested at least another $500 billion in less-restricted aid to the states to weather the financial impact of the pandemic. Such federal relief to help bridge projected substantial state fiscal 2021 revenue shortfalls may hinge on the results of the November 2020 election.

The November 2020 Ballot

At the federal level, control of both chambers of Congress and the presidency will be decided. Currently, Democrats control the House of Representatives, and Republicans control the Senate and the White House. While it is anticipated that Democrats will retain control of the House, control of the Senate and the White House is hotly contested. Control of Congress could have significant implications both for tax policy that may influence state-level tax regimes and for direct federal funding to the states to help shore up struggling budgets arising from the pandemic. In recent weeks, congressional Democrats have signaled a desire to delay acting on tax issues to address the federal financial deficit until after the economy finds its footing again, an approach that has been taken at both the federal and state levels during and immediately following previous financial crises. However, Democratic presidential candidate Joe Biden has partially undercut that message, signaling in an interview that he would pursue the corporate income tax components of his tax plan “on day one” if he wins the presidency.

Details of the presidential candidates’ proposed tax plans are still evolving. President Trump continues to articulate strong support for the Tax Cuts and Jobs Act, and proposes to expand the Opportunity Zones program, create “tax credits for companies that bring jobs from China back to America,” expand full expensing eligibility, cut individual tax rates for the “middle class,” reduce the capital gains tax rate, and implement payroll tax cuts and forgiveness of the payroll tax deferral implemented in September via executive order. Trump has not mentioned plans regarding TCJA provisions scheduled to expire or phase out during the next several years, including the 2022 expiration of research and development immediate expensing, the further limitation of net interest expense limitations, and the 2023 expiration of full expensing.

Meanwhile, Biden has proposed increasing corporate rates from 21 percent to 28 percent, imposing a corporate minimum tax on book income for companies with net income exceeding $100 million, implementing a 10 percent surtax on companies that shift manufacturing overseas, encouraging relocation of manufacturing back to the United States through a 10 percent tax credit, strengthening the global intangible low-taxed income provisions, and increasing top marginal rates and capping itemized deductions for individuals.

In the states, only 11 gubernatorial races will be decided in November. Of those races, three — Delaware, North Carolina, and Washington — involve an incumbent Democrat, and six — Indiana, Missouri, New Hampshire, North Dakota, Vermont, and West Virginia — involve an incumbent Republican. The remaining two races — Montana (held by the Democrats) and Utah (held by the Republicans) — are for an executive position open because of term limits and retirement, respectively.

On the legislative front, all states will hold legislative races except Alabama, Louisiana, Maryland, Mississippi, New Jersey, and Virginia. Coming into the elections, only 14 states are under split-party control, with the legislative and executive branches controlled by different parties. The other 36 states are controlled by party trifecta, with one party controlling both legislative chambers and the executive branch — 21 trifectas are held by Republicans and 15 by Democrats. Trifecta control has shifted during the last two election cycles, with Democrats securing an additional six state trifectas in 2018 and one in


2019 and Republicans losing a trifecta in 2019. This continuing trend toward Democrat control of legislative branches could have significant implications for state tax policy, particularly as states grapple with the financial pressures wrought by the COVID-19 pandemic.

Finally, an important aspect of the 2020 elections is the reduced number of ballot measures before voters in November. A significant storyline in the buildup to the elections has been limited access to the ballot for initiatives, with signature gathering hampered by pandemic response restrictions including social distancing requirements. For example, controversy in Idaho over whether signature gathering could be granted additional time or could be secured via electronic signatures made its way to the U.S. Supreme Court, which granted Idaho’s request for a stay of a lower federal district court order permitting electronic signatures and extending the signature collection deadline. In its decision, led by Chief Justice John G. Roberts Jr., the Court said Idaho was entitled to impose reasonable, non-discretionary restrictions on placing items on the ballot without infringing voting rights, especially when less strict rules as permitted by the district court may impose strains on a state already facing a wide variety of challenges because of the pandemic.

With these challenges in mind, it is no surprise that the number of tax measures on state ballots is less than it has been in recent elections in presidential years. Further, because of the likely increased use of mail-in ballots, the results of the election may take days or weeks to finalize. Of the measures that will be on a ballot, several stand out.

Most notable is California’s Proposition 15. If approved it would amend Article XIII A of the California constitution (Proposition 13) by requiring local assessors to value most commercial and industrial real property at fair market value on a regular cycle while preserving protections for residential property owners. Proposition 13, which was approved by voters in 1978, established an event-based system of real property assessment under which all real property in California is assigned a base-year value that reflects FMV at the time of purchase or new construction. Increases on this base-year value are limited to no more than 2 percent annually, absent a change in ownership or new construction. Proposition 15 would eliminate those protections for commercial and industrial real property and subject them to cyclical reassessments to market value while retaining Proposition 13 protections for other real property (primarily residential real property). Approval of Proposition 15 will likely result in increased property taxes for any commercial or industrial property that has not been subject to a Proposition 13 event in recent years.

Another high-profile measure is an Illinois ballot question that would amend the state’s constitution to allow a progressive individual income tax rate structure. If the ballot measure is approved, then legislation enacted in 2019, but effective contingent on passage of the ballot measure, would amend the Illinois individual income tax rate structure to repeal the current 4.95 percent flat tax and impose a graduated individual income tax with rates ranging from 4.75 percent up to 7.99 percent beginning in 2021. The same contingent legislation passed in 2019 would increase the corporate income tax flat rate from 7 percent to 7.99 percent. Together with the existing 2.5 percent personal property tax replacement income tax, the overall Illinois corporate tax rate would be 10.49 percent.

17 Id. at 3-4 (stating that “such reasonable, nondiscretionary restrictions are almost certainly justified by the important regulatory interests in combating fraud and ensuring that ballots are not cluttered with initiatives that have not demonstrated sufficient grassroots support,” that “the initiative process is just one aspect of a primary and general election system facing a wide variety of challenges in the face of the pandemic,” and that weight should be given to states’ “discretionary judgments about how to prioritize limited state resources across the election system as a whole”).
20 While the proposal to adopt a graduated income tax was initiated before the onset of the pandemic, the new top marginal rate under Illinois Public Act 101-008 would return the state’s corporate and top individual income tax rates to levels last reached in 2011 when the legislature adopted a temporary 7 percent flat rate through 2014 (Public Act 096-1496, 96th Gen. Assemb. (Ill. 2011)).
At the local level, voters in the city and county of San Francisco are being asked to consider several tax-related measures. Key among these measures is Proposition F, a business tax reform package that would increase the rate of the city’s gross receipts tax while phasing out the city’s payroll tax in 2021. The measure includes temporary tax relief for restaurants, retail and manufacturing businesses, hotels, and arts organizations on their first $25 million in gross receipts, and increases to $2 million the threshold for a small business exemption from the gross receipts tax. Three other tax-related ballot measures in the city are (1) Proposition L, which would impose an additional gross receipts tax rate on large businesses, increasing progressively based on the ratio of the pay of the highest-paid executive to median employee pay; (2) Proposition I, which would increase the rates on the city’s real property transfer tax based on value; and (3) Proposition J, which would impose a parcel tax on real property located in the city.

Voters in several other state and local jurisdictions will also consider tax rate changes (both increases and decreases) on November 3. Tax rate increases are on the table in Alaska (Measure 1 would increase taxes on some oil production in the North Slope); Arizona (Proposition 208 would impose a 3.5 percent additional income tax on individuals with income exceeding $250,000 for single filers and $500,000 for joint filers); Arkansas (Issue 1 would make permanent a 0.5 percent sales tax earmarked for transportation); Denver (a ballot measure to increase that city’s local sales tax rate from 4.31 percent to 4.56 percent); Portland, Oregon (a measure would impose a new payroll tax, at a rate of up to 0.75 percent of wages, on employers in the Portland metropolitan area with more than 25 employees); and Seattle (a measure to replace the current city car license fee and 0.1 percent local sales tax with a 0.15 percent sales tax, the proceeds from which would be dedicated to providing local transportation funding).

Meanwhile, Colorado voters will consider a ballot measure (Proposition EE) that would replace the current city car license fee and 0.1 percent local sales tax with a 0.15 percent sales tax, the proceeds from which would be dedicated to providing local transportation funding.

Trends in State Taxation

The results of the elections and the start of the 2021 state legislative cycle will coincide with continued revenue pressure caused by the pandemic that was wholly unanticipated at the start of 2020. When 2020 began, revenues across the states were steadily increasing with a 10-year run of year-over-year growth, states were projecting an approximate 3 percent growth in general fund revenue for fiscal 2020 and 3.4 percent in fiscal 2021, and states were expected to continue replenishing and strengthening rainy day funds that were gutted by the Great Recession. Despite this strong revenue growth, many states were entertaining revenue-raising legislative proposals of varying types, especially on businesses, to fund additional state and local services, often invoking the mantra that business does not pay a “fair share” of taxes. These efforts continued even though research has shown business tax revenue reliably constitutes a substantial portion of overall state and local tax revenue — 43.5 percent in fiscal 2018, a percentage that has remained within 1 percentage point since it was first evaluated in 2002 — and that those tax payments on average equate to more than the benefits business receives from the states. Regardless, the trends and proposals in state tax policy over the past several years establish

a menu of options for legislators to consider during 2021 with elections in the rearview mirror.

The past several years have seen rapid and diverse developments in state tax policy. *South Dakota v. Wayfair Inc.*23 ushered in a wave of rapid sales tax changes, with all but two states — Florida and Missouri — adopting sales tax economic nexus provisions for remote retailers, and all but three states — Florida, Kansas, and Missouri — adopting marketplace facilitator provisions. During that same period, states including Utah and Maryland have explored significant expansions to their sales tax base to include a range of services not currently taxed, with Utah enacting such an expansion but, facing a voter referendum, repealing the provision before it could take effect. Further, several states gave serious consideration to subjecting sales of internet advertising or data collection to tax, with the Maryland legislature adopting such a proposal, which Gov. Larry Hogan (R) vetoed.24 A veto override effort regarding this legislation is pending for the next legislative session. Similar proposals have included efforts to tax digital advertising,25 the sale of personal information,26 and data mining.27

These state efforts to expand the taxation of digital services fall in line with the global trend toward imposing new digital services taxes, with the Organization for Economic Cooperation and Development leading the development and negotiation of tax regimes to encompass new digital services and products through pillar 1 of the OECD tax framework. Several other countries, including France and the United Kingdom, have developed their own approaches to digital services taxes, while the OECD process has moved slowly in the face of U.S. resistance to the proposals.

While not all these sales-tax-related efforts have been successful to date, they do provide a roadmap on the sales tax front as to where states may go following the 2020 elections.

The corporate income tax side of the ledger has also seen significant activity over the past two years. Many states that impose a corporate income tax have addressed the significant changes to the federal corporate tax code made by the TCJA and the CARES Act, with many decoupling from the significant base expansions under the international provisions (GILTI, the foreign-derived intangible income deduction, repatriation, etc.), the domestic IRC section 163(j) limitation on business interest expense, and changes to net operating loss provisions. The state implications of the TCJA and the CARES Act are likely to continue to be scrutinized after the election regardless of which party controls the federal branches of government, because conformity adjustments may be viewed as an indirect method to raise additional state revenue. Other, less subtle corporate tax policy proposals have been considered recently that may also attract renewed attention as revenue generators because of the financial fallout of the pandemic.

Among the recent corporate income tax trends and proposals, several stand out as likely to be further discussed in 2021. These include perennial conversations in separate-reporting states about adopting mandatory unitary combined reporting (MUCR), and in MUCR states, about instituting worldwide combined reporting provisions. Both permanent and temporary rate increases and surcharges are also likely to be proposed during 2021, and have already been enacted in New Jersey, with the extension and increase of the corporate surtax through 2023 and the institution of a millionaire’s tax.28

Other revenue-raising proposals from recent years include tried and true approaches such as offering taxpayers amnesty and voluntary disclosure agreement programs, sales tax prepayment requirements, and other tax prepayment authorizations. Gross receipts taxes have also seen a resurgence with recent adoption of such legislation in Oregon and proposals in other states. Proposals to impose an additional corporate income tax determined based on the ratio of the pay of the highest-paid executive to the median employee pay have received some attention in

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24 H.B. 732 (Md. 2020).
25 L.B. 989 (Neb. 2020); S. 8506 (N.Y. 2020).
26 B. 23-760 (D.C. 2020); A. 9112 (N.Y. 2020).
various locations across the country (Portland, Oregon enacted such a tax in 2016). Other measures directly targeting business taxpayers include “excess profits” taxes on companies that have found success during the pandemic, financial transaction taxes, head taxes based on the number of employees in a jurisdiction, and various property-tax-related measures such as split-roll proposals to raise revenue from business property. States may also explore new excise taxes on sports betting and legalized marijuana, carbon taxes and fees, opioid taxes, and individual income tax increases for wealthy taxpayers as potential sources of revenue.

In the face of potentially dire revenue challenges, legislatures moving into fiscal 2021 likely will reexamine with more interest this wide array of tax policy proposals that have been raised over the past several years but discarded when the state revenue was on a steady upward trajectory.

If history is a guide to what states may do, it is useful to look at state responses to the 2001 and 2008 recessions, even though those recessions were of a different character than the COVID-19 pandemic. In the years following the onset of those recessions, states were typically slow to increase taxes to raise revenue, instead erring on the side of cutting spending to avoid burdening a nascent economic recovery before enacting typically limited and temporary revenue-raising measures in the second or third year of recovery. And even then, the responses were varied across the country, with some states enacting temporary rate increases, imposing higher rates on high-income individuals, increasing excise taxes on gambling, tobacco, and alcohol, and in some cases suspending the use of some credits and deductions.

In fact, at least one state has already followed some of these policy ideas it used in 2008. In June California again suspended the use of California NOLs and imposed a cap on the amount of business tax credits some companies can use, effective for tax years 2020-2022. The law includes an extended carryover period for affected NOLs and tax credits.\(^{29}\)

This temporary suspension, but permitted future usage, of the NOLs and tax credits may provide a roadmap for other states. For instance, Louisiana in 2015 enacted limitations on the use of NOLs and dividends received deductions that capped taxpayer deductions at 72 percent of otherwise available deductions.\(^{30}\) Colorado in 2010 temporarily limited the amount of NOLs that could be subtracted from federal taxable income to $250,000.\(^{31}\) And Illinois in 2011 temporarily suspended some net loss deductions while extending the carryforward life of those disallowed deductions.\(^{32}\)

Measures creating a short-term limitation of tax asset utilization may ultimately increase taxpayer liabilities and create immediate negative economic consequences by reducing business cash liquidity for operations, job creation and retention, and investment in infrastructure and research. It may be prudent for taxpayers to be cautious of promises that these changes will remain temporary. In 2012 Connecticut enacted what was supposed to be a temporary 20 percent corporate income tax surcharge scheduled to expire after the 2014 tax year. However, the legislature extended the surcharge in 2013, 2015,\(^{33}\) and 2019, and in 2020 Gov. Ned Lamont (D) has proposed maintaining the surcharge and delaying the expiration of another business tax.\(^{34}\) A Connecticut business tax credit liability offset limitation has shown a similar pattern of volatility — imposed in 2002 to limit credit usage to 70 percent of liability, the limit was dropped to 50.01 percent in 2015, was incrementally re-increased to 70 percent by 2019, and then was reduced again to 65 percent in 2019.\(^{35}\) This same dynamic is also active in New Jersey, where legislation enacted as part of the state’s budget

\(^{29}\) 2020 A.B. 85 (enacted June 29, 2020).

\(^{30}\) These limitations were repealed in 2018 by Act 4, 2018 Louisiana Second Extraordinary Session, which limited the cap to 2015, 2016, and 2017 tax years.


\(^{33}\) The 2015 extension by the Connecticut legislature reduced the surcharge rate to 10 percent for tax year 2018 and beyond.

\(^{34}\) Gov. Ned Lamont, “FY 2021 General Fund Deficit Mitigation Plan” (Oct. 1, 2020) (proposing to delay the repeal of the capital base tax and the reduction of the corporate business tax surtax rate to zero until after the 2021 fiscal year).

discussion extends through 2023 a corporate business tax surtax previously scheduled to expire after 2021.

Exploring the Implications of Electoral Result Scenarios

The confluence of the COVID-19 pandemic’s state fiscal fallout, the November 2020 elections, and all states being in session has the potential to flood taxpayers with revenue proposals during the 2021 legislative cycle. While recent fiscal numbers have shown fiscal 2020 revenue has not dropped as significantly as projected, many of the factors driving that — such as federal provisions enhancing unemployment benefits and stimulus spending — have either expired or are not likely to be renewed by the time the elections are held.

Looking at the federal level, a sweeping victory by Democrats could be a direct benefit to state revenues if the post-election administration pursues an agenda of providing federal monetary relief directly to states while also repealing portions of the TCJA that reduce revenue. Any adjustments and expansions of the federal income tax base will filter to those states with rolling conformity to the IRC and will drive conversations in selective conformity states — potentially reopening the conformity debate across the board for TCJA provisions incorporated into, or excluded from, state tax codes. Many legislators, however, are likely to be hesitant to directly raise taxes immediately as the economy is still trying to recover. A mirroring increase in Democrat power at the state level may also drive an emboldened approach to revenue raising to restore the states’ ability to spend, though potentially tempered by the desire to foster promising economic recoveries in the states.

Meanwhile, a Republican presidential victory and continued control of the Senate may result in a more limited transfer of funding from the federal government to the states. If the Republican party can also gain control of the House of Representatives, then extensions of expiring TCJA provisions and potential payroll tax cuts could be on the horizon — otherwise the status quo should be expected regarding federal rates and revenue raising, even in the face of nearly unprecedented deficit spending. Such a victory may drive progressive ideas and revenue-raising measures forward in the states where Democrats hold sway, along with necessary budget cuts and government service disruptions. Similar budget cuts and spending limitations may be likely in state governments controlled by Republicans, but those states may also find themselves exploring the revenue-raising options available depending on the depth and severity of fiscal 2021 economic turmoil and state and local revenue disruption.

After November: Final Observations and Expectations

To date, most states have not acted aggressively to address current and looming budget shortfalls caused by the pandemic. Instead, they have been drawing from rainy day funds and hoping for additional federal intervention. However, if federal fiscal relief does not materialize and strains on state finances intensify, states will be forced to act. The history of state responses to the 2001 and 2008 recessions provide some semblance of a roadmap of state responses that raised revenue on already struggling taxpayers, but the pandemic financial crisis is proving to be different, caused not as much by systemic financial issues, but rather an acute shutdown of the economy followed by a confused and tentative reopening.

State tax policy leaders may find it prudent to avoid long-term tax reform efforts during the 2021 period of recovery, and instead focus on short-term, temporary revenue-raising measures that affect the economy as little as possible. On the other hand, it would not be surprising to see the upcoming state legislative sessions tackle a flurry of tax proposals that could run the gamut of tax policy options that have been laid out over the years. If 2020 has been a year of uncertainty for lawmakers, 2021 could turn out to be a very active year for both lawmakers and taxpayers across the country.