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Testimony of Walter Hellerstein
Francis Shackelford Professor of Taxation
Distinguished Research Professor
University of Georgia Law School

Before the
Committee on Finance
of the
United States Senate

Hearing on

Tax Reform:
What It Means for State and Local Tax and Fiscal Policy

Federal-State Tax Coordination: What Congress Should or Should Not Do

April 25, 2012

I. INTRODUCTION

I am Walter Hellerstein, the Francis Shackelford Professor of Taxation and Distinguished Research Professor at the University of Georgia School of Law. I have devoted most of my professional life to the study and practice of state taxation and, in particular, to federal consitutional and statutory restraints on state taxation of interstate commerce.

I am honored by the Chairman's invitation to testify today. I welcome the opportunity to share with the Committee my views on the implications of federal tax reform for state taxation and, in particular, the role of Congress in authorizing or limiting state taxation of interstate commerce. I do not appear here on behalf of any client, public or private, and the views I am expressing here today reflect my independent professional judgment.

My testimony provides an overview of federal-state tax coordination in an effort to assist this Committee in determining the appropriate role of Congress with regard to matters of state taxation.[1] By federal-state tax coordination, I mean both vertical tax coordination (coordination between concurrent federal and state tax regimes) and horizontal tax coordination (coordination among state tax regimes). If my testimony has an overriding theme, it may be best captured by Justice Holmes's wise observation that "a page of history is worth a volume of logic."[2] The historical record of federal-state tax coordination provides important lessons regarding the risks and rewards of such coordination and, consequently, guidance for evaluating current and future initiatives for such coordination.

Part II of this testimony considers our experience with vertical federal-state tax coordination in connection with concurrent federal and state taxation of wealth transfers and of income. Part III considers our experience with horizontal federal-state tax coordination in connection with federal efforts to harmonize or restrain state income, excise, and property taxes. Part IV examines pending congressional proposals for federal-state tax coordination. Part V concludes.

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[1]My testimony draws freely from "Federal-State Tax Coordination: The Good, the Bad, and the Ugly," a paper prepared for a conference on Federal Tax Reform Beyond the Beltway on February 3, 2012, sponsored by the UCLA Law School and the Tax Policy Center of the Urban Institute and the Brookings Institution. That paper, in turn, draws freely from my earlier work in this area, in particular, Hellerstein, Walter, "The United States," in Bizioli, Gianluigi, and Claudio Sacchetto, *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (Amsterdam: IBFD, 2011), pp. 25-75; McLure, Charles E., Jr., and Walter Hellerstein, "Congressional Intervention in State Taxation: A Normative Analysis of Three Proposals," 31 *State Tax Notes* 9 (2004), pp. 721-35; Hellerstein, Walter, "Federal Constitutional Limitations on Congressional Power to Legislate Regarding State Taxation of Electronic Commerce," 53 *National Tax Journal* 4, Part 3 (2000), pp. 1307-25; see generally Hellerstein, Jerome R, Walter Hellerstein, and John Swain, *State Taxation*, Vols. I and II (Valhalla: Thomson Reuters, 2012 rev.).

[2] *New York Trust Co. v. Eisner*, 256 U.S. 345, 349 (1921).

II. VERTICAL FEDERAL-STATE TAX COORDINATION: CONCURRENT TAX BASES

Historically, the federal government and the states have exercised their taxing powers concurrently over two tax bases: income (through both individual and corporate income taxes) and wealth transfers (through estate and gift taxes). Federal-state tax coordination (or the lack thereof) in both contexts illustrates both the promise and pitfalls of such tax coordination.

A. Wealth Transfer Taxes

1. *Historical Background*

Perhaps the most illuminating chapter in the history of federal-state tax coordination – and one that is still being written – involves the coordination of federal and state estate and inheritance taxes ("death taxes").[3] Death taxation has a long history in the United States at both the federal and state levels.[4] The federal government levied death taxes of various types at brief intervals beginning in the late eighteenth century (including the periods 1798-1802, 1861-70, and 1898-1902). Death taxes were likewise among the earliest levies employed by the states, beginning with Pennsylvania's inheritance tax in 1826, followed by similar taxes in Louisiana (1828), Virginia (1844), and Maryland, North Carolina, and Alabama shortly thereafter.[5] "By 1916, 43 of the (then) 48 states had adopted some form of inheritance tax and state spokesmen regarded the taxation of bequests as their 'special preserve.'"[6]

2. *The Federal Estate Tax of 1916 and the Adoption of the Credit for State Death Taxes*

In 1916, Congress enacted an estate tax that laid the foundation for federal and state death taxation for the next century. The primary motivating factor for the tax was the need to raise revenue in connection with World War I.[7] The U.S. Supreme Court sustained the levy as an "indirect" tax on the transfer of property at death over the objection that it was a "direct" tax

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[3] Inheritance taxes are taxes imposed on the right or privilege of receiving property measured by the share of the decedent's property transferred to the beneficiary. The tax rate often varies by reference to the closeness of the beneficiary's relationship to the decedent. Estate taxes, on the other hand, are taxes on the right or privilege of transferring property at death, measured by the value of the estate. The estate tax rate generally takes no account of the relationship of the recipient to the decedent. Indeed, the estate tax attaches before, and is independent of, the receipt of property by the legatee or distribute. See Hellerstein, Hellerstein, and Swain, *supra* note 1, at ¶ 21.02.

[4] See *id*. at ¶ 21.01, and U.S. Advisory Commission on Intergovernmental Relations, *Coordination of State and Federal Inheritance, Estate, and Gift Taxes* (Washington: U.S. Government Printing Office, 1961), on which the following historical description heavily relies.

[5] Oakes, Eugene E., "The Development of American State Death Taxes, 26 *Iowa Law Review* 3 (1941), pp. 451-78, at pp. 451, 453.

[6] U.S. Advisory Commission on Intergovernmental Relations, *supra* note 4, at p. 27.

[7] Wilbanks, Stephanie J., *Federal Taxation of Wealth Transfers – Cases and Problems* (New York: Aspen, 2004), p.5.

on property and therefore unconstitutional because it was not apportioned among the states by population.[8]

The enactment of the federal estate tax gave rise to intensified controversy over federal-state tax relations in the realm of death taxation, which had been the focus of attention for some time. A decade earlier, representatives of state interests vigorously opposed President Theodore Roosevelt's proposal for a federal inheritance tax. They contended that death taxes should be considered as lying exclusively within the states' domain, particularly in light of the states' long and consistent reliance on this source of revenue as contrasted with the federal government's sporadic reliance on such levies.

Following World War I, state spokesmen demanded that the federal estate tax be repealed, reiterating their position that death taxes should be the exclusive province of the states.[9] When Congress failed to respond immediately to these demands, a levy that was initially regarded as a temporary wartime measure became a lightning rod for debate over the proper role of federal and state governments in the field of estate and inheritance taxation, particularly in light of pressures on state legislatures to raise revenues. By 1922, every state but two (Florida and Alabama) had a death tax and controversy increased over the propriety of continuing the federal estate tax as a permanent part of the nation's tax structure.

As a short-term solution to this problem, Congress provided a 25 percent credit for state death taxes paid against the amount due under the federal estate tax, thereby effectively ceding one-quarter of the death tax base to the states. Pressure nevertheless continued for a complete withdrawal of the federal government from the death tax field and the continuing opposition to the federal estate tax culminated in two conferences in 1925 held under the auspices of the National Tax Association. These conferences resolved that the federal government should, in fact, withdraw from the death tax field within a six-year period and in the interim should increase the 25 percent credit to 80 percent.

There was, however, an additional issue – one of interstate tax competition – that played a role in the ultimate resolution of the issue of the federal-state tax coordination controversy, which illustrates how questions of horizontal tax coordination can affect the resolution of questions of vertical tax coordination. One of the objections of those who opposed repeal of the federal estate tax was that its elimination would lead to a "race to the bottom" among states in their competition to attract wealthy residents – a competition that would undermine the role of death taxes altogether as a significant source of state revenue. These fears were exacerbated by Florida's amendment of its constitution in 1924 to prohibit

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[8] *New York Trust Co. v. Eisner*, 256 U.S. 345 (1921).

[9] Lowndes, Charles L.B., Robert Kramer, and John H. McCord, *Federal Estate and Gift Taxes* (St. Paul: West Publishing Co., 3d ed., 1974), p. 584.

inheritance taxation in an effort to lure residents from other states to locate (or at least retire) in Florida.[10] Those who were concerned about such interstate tax competition therefore urged the continuation of the federal estate tax, but with a credit for state death taxes to address the tax assignment issue.

The compromise that emerged from this controversy was the recognition, on the one hand, that the federal estate tax would be a permanent feature of the nation's tax structure, and, on the other hand, that the states had a legitimate claim to death tax revenues. The compromise was embodied in legislation in 1926 increasing the 25 percent credit for state death taxes paid (adopted two years earlier) to 80 percent of the amount due under the federal estate tax.[11] The legislation was generally viewed as serving two objectives. First, it represented a willingness of Congress to cede 80 percent of the death tax base to the states on a permanent basis and to reduce the aggregate federal-state tax burden on estates and inheritances. Second, the credit served the function of effectively providing a minimum state death tax regime that would deter interstate tax competition, because states would presumably be unable to resist the opportunity of enacting death taxes (at no tax cost to the their resident decedents or estate beneficiaries), because the state death tax would add no net tax burden as long as it did not exceed 80 percent of the federal tax burden.

3. *Federal-State Death Tax Coordination: 1926-2001*

The provision of the federal credit for state death taxes had a profound impact on federal-state tax coordination as 80 percent of the death tax base was allocated to the states and the states accommodated their death taxes to absorb the full amount of the credit that a taxpayer could claim under federal law. Indeed, for the balance of the twentieth century, the evolution of state death tax regimes reflected the states' increasing tendency to modify their statutes to adopt so-called "pickup" or "sponge" taxes designed to absorb the maximum federal estate tax credit and to eliminate estate or inheritance taxes independent of the pickup tax.[12]

During this period, Congress abandoned the 80/20 "tax base sharing" formula. In 1932, when Congress increased federal estate tax rates, it nevertheless froze the available credit for

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[10] Although Florida ultimately repealed this amendment in light of the developments discussed immediately below, it continues to attract residents from other states as a result of its constitutional prohibition on personal income taxation.

[11] See IRC § 2011.

[12] See Conway, Karen S., and Jonathan C. Rork, "Recent Developments in State 'Death' Taxes," 23 *State Tax Notes* 12 (2002), pp. 1041-45. The state death tax statutes designed to absorb the federal estate tax credit took various forms. Those states with preexisting death taxes typically imposed additional pickup taxes measured by the difference, if any, between the preexisting death tax liability and the maximum allowable federal estate tax credit. Such provisions accounted for the existence of two death taxes in a number of states. Other states adopted a single pickup tax measured by the federal estate tax credit and repealed preexisting state death taxes, if any.

state death taxes that was available under the lower 1926 rates. Congress continued this pattern with future changes in the federal estate tax rates, so that the available credit continued to reflect the 80 percent limitation based on 1926 rates and exemptions. Despite the modification of the original tax base allocation between federal and state governments, the basic pattern remained the same with the state statutes largely designed to absorb the maximum available federal tax credit.

In 2001, every one of 50 states had an estate tax that, in one form or another, was linked to the federal estate tax credit. Thirty-seven states and the District of Columbia imposed an estate tax that equaled the amount of the federal credit for state death taxes, and they imposed no other estate or inheritance tax independent of the levy designed to absorb federal estate tax credit.[13] The remaining 13 states imposed their own "independent" inheritance or estate taxes in conjunction with a residual pickup tax.[14] In these states, state laws specified that if the amount of the "independent" state death tax is less than the credit allowed against the federal estate tax, the state tax is increased to the full amount of the available credit. Three of these thirteen states were phasing out their separate taxes and were scheduled to rely exclusively on the pickup tax in the future.[15] In 2001, $6.4 billion (or 27 percent of the net federal estate tax revenue of $23.7 billion) was allocated to the states by virtue of the state death tax credit.[16]

4. *The Phase-Out of the Federal Estate Tax and the End of Federal-State Death Tax Coordination*

In 2001, as part of the tax cutting program of President George W. Bush, Congress repealed the federal estate tax (over a ten-year period), and, at the same time, eliminated the credit for state death taxes (over a four-year period).[17] Under the "sunset provisions" of the 2001 legislation, the estate tax was scheduled to reemerge, phoenix-like, in its pre-2002 form

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[13] McNichol, Elizabeth C., Iris J. Lav, and Daniel Tenny, "States Can Retain Their Estate Taxes Even as the Federal Estate Tax Is Phased Out," 23 *State Tax Notes* 8 (2002), pp. 673-91, at p. 676.

[14] *Id*.

[15] *Id*. at 677.

[16] Internal Revenue Service, Statistics of Income Division, "Estate Tax Returns Field for 2001 Decedents, by State of Residence" (Rev. Oct. 2007), available at http://www.irs.gov/taxstats/indtaxstats/article/0,,id=210770,00.html.

[17] Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. Law No. 107-16, 115 Stat. 38 (2001). The pre-2002 credit was reduced by 25 percent for estates of decedents dying during 2002, by 50 percent for estates of decedents dying during 2003, by 75 percent for estates of decedents dying during 2004, and it was eliminated for estates of decedents dying after 2004. *Id*. §§ 531, 532, 115 Stat. at 72-73. In place of the state death tax credit, Congress provided for a deduction of state death taxes from the value of the federal taxable estate. *Id*. §§ 531, 532, 115 Stat. at 73.

(including the credit for state death taxes).[18] In fact, in late 2010, Congress temporarily reinstated the federal estate tax through 2012.[19] The temporarily resurrected tax, however, was an emaciated rendition of the once robust levy. Whereas the pre-2002 version of the tax applied to estates in excess of $675,000 and at rates up 55 percent, the post-2010 version of the tax exempted all estates below $5 million with rates capped at 35 percent.[20]

The reduced profile of the revived federal estate tax was hardly surprising in light of existing anti-tax sentiment in the United States and particular animosity towards the federal "death tax."[21] More importantly for present purposes, however, Congress did *not* reinstate the credit for state death taxes in the 2010 legislation. Furthermore, it appears unlikely, given current federal revenue concerns, that the credit for state death taxes will be resuscitated in the future. It is therefore useful to discuss what is probably the final chapter in federal-state tax cooperation in the death tax field.

The reduction of the federal estate tax, and the repeal of the federal credit for state death taxes, had dramatic implications for federal-state tax coordination in the domain of death taxation. The actions at the federal level effectively eliminated the state pickup tax base in many instances. Unless states responded to these changes by severing the relationship between their death tax and the existence of the federal estate tax and the availability of a federal estate tax credit, they confronted a shrinking and, ultimately, disappearing death tax.

Of the 50 states that had some form of federally based death tax in 2001, 28 had no death tax at all by 2012, because their levies were inextricably linked to the existence of a federal levy and the federal death tax credit,[22] and they had taken no action to enact an "independent" death tax. Of the remaining 22 states with some form of death tax, many of these states' tax regimes were mere shadows of their former selves, because their residual pickup taxes had disappeared and they were left only with their relatively modest

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[18] *Id*. § 901, 115 Stat. at 150.

[19] In late 2010, Congress enacted (and the President signed) the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010," P.L. 111-312, 124 Stat. 3296 (2010).

[20] *Id*. § 302.

[21] See Graetz, Michael J., and Ian Shapiro, *Death by a Thousand Cuts: The Fight Over Taxing Inherited Wealth* (Princeton: Princeton University Press, 2005).

[22] 2012 State Death Tax Chart (March 26, 2012) available at www.mcguirewoods.com/news-resources/publications/taxation/state_death_tax_chart.pdf; see also All States Tax Guide (RIA) ¶ 210 (chart of state taxes), available at www.checkpoint.thomsonreuters.com.

"independent" inheritance or estate taxes.[23] Consequently, as one observer noted, "[i]n an odd twist of fate," state death taxes "historically regarded as most appropriately a state-level tax, are quickly becoming an artifact of the past at the state level."[24] In short, if one is looking for a cautionary tale in the history of federal-state tax coordination in the United States, there is no better place to look than the death tax regime,[25] as it has variously embodied both the best and the worst of federal-state tax coordination at various junctures in our history.

B. Income Taxes

1. *Federal-State Tax Base Conformity*

As the U.S. Supreme Court has observed, "[c]oncurrent federal and state taxation of income … is a well-established norm,"[26] and, "[a]bsent some explicit directive from Congress, we cannot infer that treatment of … income at the federal level mandates identical treatment by the States."[27] In point of fact, there has never been any such "mandate," despite Congress's recognized power to require national and subnational uniformity.[28] Moreover, while Congress at one point offered to have the federal government administer state personal income taxes if the states would closely conform their taxes to the federal model, not a single state accepted the offer.[29] The law embodying the offer was ultimately repealed for lack of use.[30] This episode

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[23] See *id.* and *supra* note 14 and accompanying text. Moreover, in March 2012, Indiana adopted legislation phasing out its inheritance tax over nine years beginning in 2013 and ending on December 31, 2021. SB 293 (signed by Governor Daniels on March 20, 2012).

[24] Nutter, Sarah E., "State Estate, Inheritance, and Gift Taxes: Uncertainty at the Federal Level Passes Down to the States," 46 *State Tax Notes* 7 (2007), pp. 481-501, at p. 484. In fact, states' taxes on inherited wealth fell from 1.4% of their total tax receipts in 2000 to less than 0.6% in 2010. U.S. Census Bureau of the Census, *Annual Survey of State Government Tax Collections* (2000, 2010), available at http://www.census/gov/govs/statetax/index.html.

[25] Indeed, wholly apart from federal-state tax coordination, the uncertainty created at the federal level in light of Congress's peripatetic approach to the estate and gift tax is a cautionary tale worthy of study on its own. See Kaufman, Beth S., "The Federal Estate and Gift Tax: A Case Study in Uncertainty," 64 *National Tax Journal* 4 (2011), pp. 943-948.

[26] *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 448 (1980).

[27] *Id*.

[28] Thus the U.S. Supreme Court has declared that "[i]t is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income." *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 280 (1978).

[29] Prior to its repeal, the Federal-State Tax Collection Act of 1972 (the FSTCA), 26 U.S.C. §§ 6361-65 (prior law), provided that a state with a "qualified State individual income tax" (i.e., a tax closely conforming to the federal model) could enter into an agreement with the United States to have its individual income taxes collected and administered by the federal government. Among other requirements, the qualifying state income tax had to adopt the federal income tax regulations "as in effect from time to time" under the Internal Revenue Code. *Id*. § 6362. As originally enacted, the FSTCA provided that it would not be effective until at least two states with collectively more than 5 percent of the federal tax returns had entered into an agreement under the statute. That requirement was

in the saga of federal-state tax coordination is a testament to deeply held beliefs about state sovereignty – and perhaps to the power of deeply entrenched state tax bureaucracies – that can impede intergovernmental tax coordination.

Despite the lack of any congressional mandate for state conformity to the federal income tax model, state personal and corporate income taxes in fact closely conform to the federal income tax. The pressure for conformity comes from "market" forces, namely, pressure from taxpayers for easing compliance and auditing burdens. At one time, some states adopted the most extreme form of federal conformity, under which the state tax was simply a percentage of the federal tax. Although no state embraces that method today, the overwhelming majority of states with broad-based income taxes employ federal adjusted gross income (personal income before personal exemptions or deductions) or federal taxable income as the computational starting point for determining state taxable income.

One of the consequences of having de facto conformity in federal and state income tax bases is that base-broadening or base-narrowing at the federal level tends to generate a response at the state level, because failure to respond ordinarily increases or decreases state tax revenues in the absence of a state rate adjustment. The Federal Tax Reform Act of 1986, for example, broadened the federal personal income tax while lowering its rates. Some deductions were eliminated, others were substantially limited, and the treatment of a variety of specific items was altered – all in the name of simplification in a revenue-neutral fashion (because federal rates were lowered). For the overwhelming majority of states whose tax bases were tied to the federal base but whose tax rates were independent of the federal rate structure, base-broadening at the federal level offered the prospect of substantial increases in tax revenues if the states did not lower their own rates as the federal government had done. In fact, 27 of the 40 states with broad-based personal income taxes enacted reforms during late 1986 and 1987,[31] with most of the states returning at least a portion of the so-called revenue "windfall" to state taxpayers.[32]

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eased by the 1976 Tax Reform Act to provide that the FSTCA would be effective on the first January 1 that was more than one year after at least one state entered into such an agreement. *Id*. The 1976 Tax Reform Act also made it clear that the federal collection plan was to be administered without added costs to the states – a provision that was adopted in response to suggestions that the states would or might be charged for the services provided by the federal government. Stoltz, Otto G., and George A., Purdy, "Federal Collection of State Individual Income Taxes," 1977 *Duke Law Journal* 1 (1977), pp. 59-141, at p. 92.

[30] The statute was repealed in 1990, eighteen years after its enactment.

[31] Gold, Steven D., "The Budding Revolution in State Income Taxes," *Proceedings of the Eightieth Annual Conference of the National Tax Association – Tax Institute of America* (1987), pp. 6-11, at p. 7. In 1991, Connecticut became the forty-first state to adopt a broad-based personal income tax.

[32] Hellerstein, Hellerstein, and Swain, *supra* note 1, at ¶ 20.02.

By contrast, when Congress narrows the federal tax base in order to stimulate the economy, it creates the opposite dilemma for the states. For example, Congress's post–September 11, 2001, economic stimulus package gave rise to conformity issues for the states. In the Job Creation and Worker Assistance Act of 2002, Congress provided for an additional first-year depreciation allowance to encourage investment. The impact of this so-called "bonus depreciation" on state revenues – assuming they took no action to decouple their tax regimes from the federal model – was substantial. Facing severe budget shortfalls even without the revenue impact of bonus depreciation, many states reacted by decoupling their tax regimes from the federal tax regime insofar as bonus depreciation was concerned. Some states enacted legislation completely decoupling from the bonus depreciation provisions, other states partially decoupled, and yet other states conformed to the federal rules. Needless to say, such lack of conformity between state and federal tax bases can create havoc for taxpayers and revenue administrations.[33]

2. *Tax "Concessions"*

There are several federal income tax provisions that reflect a sensitivity to the existence of concurrent taxation, and the concerns of federal-state tax coordination, even if they may more properly be characterized as unilateral tax "concessions" by the Congress rather than "coordination" of concurrent tax regimes. Among these are the deduction from the federal tax base for state income and property taxes and the exclusion from the federal income tax base of interest from state and local government bonds.

a. Deductibility of State and Local Taxes from the Federal Income Tax Base

State and local taxes have always been deductible, in whole or in part, from the federal income tax base, at least for those who itemized their deductions.[34] The deduction has been available whether or not such taxes were associated with the production of income, in which case the deduction would be appropriate as a matter of principle in arriving at the proper definition of taxable income. For this reason, such deductions (when not associated with the production of income) have generally been regarded as "tax expenditures" or subsidies that the federal government provides to the states. Accordingly, they may be regarded as form of revenue sharing. For fiscal year 2012, for example, the estimated fiscal significance of the deductions from federal income taxes for "nonbusiness" state and local government income taxes, sales taxes, and personal property taxes, which the tax expenditure budget characterizes

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[33] See generally Luna, LeAnn, and Ann Boyd Watts, "Federal Tax Legislative Changes and State Conformity," 47 *State Tax Notes* 8 (2008), pp. 619-25

[34] Brazer, Harvey E., "The Deductibility of State and Local Taxes Under the Individual Income Tax," U.S. House Committee on Ways and Means, 86th Cong., 1st Sess., *Tax Revision Compendium*, Vol. I (Washington: U.S. Government Printing Office, 1959), p. 407. For taxpayers who take a "standard" deduction, there is no identification of the particular expenses associated with the deduction.

as "general purpose fiscal assistance," amounted to $51 billion.[35] The fiscal significance of the deduction for taxes on real property amounted to another $26.5 billion.[36]

Historically, virtually all state and local taxes were deductible from the federal income tax base.[37] Over the past half-century, however, the scope of the deduction has narrowed. In 1964, Congress altered the nature of the deduction from one generally permissible unless explicitly denied to one that was permitted only for taxes explicitly mentioned. It thereby eliminated the deduction for so-called "sin" taxes (excise taxes on alcohol and tobacco). In 1978, in the midst of an energy crisis, Congress eliminated the deduction for state gasoline taxes. The most significant change occurred as part of the Tax Reform Act of 1986, which eliminated the deduction for state and local sales taxes, as part of the general policy to broaden and simplify the federal tax base in a revenue neutral manner. In 2004, however, Congress reinstated the deduction for residents of states without income taxes. Currently, the most significant deductions are for state income and local real property taxes. There is an ongoing policy debate about whether the deduction for state income taxes should be eliminated.

b. Exclusion for Interest from State and Local Government Bonds

The other significant tax concession – with a "cost" to the federal government estimated at value of $23.1 billion for fiscal year 2012[38] – is the exclusion from federal income tax of interest from state and local government bonds.[39] Although for many years the immunity of state and local bond interest from federal taxation was thought to be constitutionally required,[40] with the narrowing of the scope of the intergovernmental tax immunity doctrine, this view was ultimately abandoned. In 1985, the U.S. Supreme Court explicitly overruled an earlier case holding that interest from state bonds was constitutionally immune from tax and declared that "a nondiscriminatory federal tax on the interest earned on state bonds does not

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[35] U.S. Senate Committee on Finance and US House Committee on Ways and Means, Joint Committee on Taxation, *Estimates of Tax Expenditures for Fiscal Years 2010-2014* (Washington: US Government Printing Office, 2010), p. 51.

[36] *Id*. at 39.

[37] See Maguire, Steven, *Federal Deductibility of State and Local Taxes* (Congressional Research Service Report for Congress 2007), p. 1, available at http://www.policyarchive.org/handle/10207/bitstreams/18802.pdf. A provision of the original income tax of 1913 allowed a deduction for "all … State, county, school and municipal taxes … not including those assessed against local benefits." *Id*. see also Oliver, Philip D., *Tax Policy* (New York: Foundation Press, 2nd ed., 2004), p. 839.

[38] U.S. Senate Committee on Finance and U.S. House Committee on Ways and Means, Joint Committee on Taxation, *Estimates of Tax Expenditures for Fiscal Years 2010-2014* (Washington: US Government Printing Office, 2010), p. 45.

[39] IRC § 103.

[40] See Hellerstein, *Tax Aspects of Fiscal Federalism*, *supra* note 1, at 35-37.

violate the intergovernmental tax immunity doctrine." [41] The exclusion of such interest from federal income taxation nevertheless survives as a matter of congressional legislation, which has embedded that principle in the Internal Revenue Code.

III. HORIZONTAL FEDERAL-STATE TAX COORDINATION

A. Overview

Although there have occasionally been proposals for broad-based federal legislation providing for horizontal state tax coordination, such as congressional bills providing for a uniform state corporate income tax apportionment formula,[42] no federal law providing for wide-ranging horizontal state tax coordination has ever been enacted. Instead, virtually the entire body of federal law addressed to horizontal state tax coordination has focused on narrow, industry-linked issues, often by limiting the states' power to tax in precisely defined contexts. Indeed, much of this legislation may more properly be characterized as prohibiting the exercise of state tax power, whether wisely or not, rather than "coordinating" it. For example, federal legislation

- forbids the states from taxing railroad, motor carrier, and air carrier property more heavily than other commercial and industrial property;[43]
- imposes limitations on the states' power to levy stock transfer taxes;[44]
- prohibits the states from imposing user charges in connection with the carriage of persons in air commerce;[45]
- "supersede[s] any and all State taxes insofar as they now or hereafter relate to any employee benefit plan" instituted pursuant to the Employee Retirement Income Security Act (ERISA);[46]
- prohibits the states from imposing electrical energy taxes discriminating against out-of-state purchasers;[47]

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[41] *South Carolina v. Baker*, 485 U.S. 505, 526 (1985).

[42] See Hellerstein, Hellerstein, and Swain, *supra* note 1, at ¶ 8.06 and sources there cited.

[43] 49 U.S.C. §11501 (2006) (railroads); 49 U.S.C. § 14502 (2006) (motor carriers); 49 U.S.C. § 40116 (2006) (air carriers).

[44] 15 U.S.C. § 78bb(d) (2006).

[45] 49 U.S.C. § 40116 (2006).

[46] 29 U.S.C. § 1144(a) (2006).

[47] 15 U.S.C. § 391 (2006).

- prohibits state and local governments from taxing flights of commercial aircraft or any activity or service aboard such aircraft unless the aircraft takes off or lands in the taxing jurisdiction;[48]
- prohibits localities from taxing providers of direct-to-home satellite services;[49]
- limits state and local franchise fees on cable operators;[50]
- prohibits a state, other than the state of the employee's residence, from taxing the employee's compensation from an interstate rail carrier, motor carrier, or merchant mariner;[51]
- limits the states' authority to require withholding of income taxes from certain employees of water carriers;[52]
- prohibits states from taxing interstate passenger transportation by motor carriers;[53] it imposes specified restraints on state taxation of transactions over the Internet;[54]
- authorizes, under specified conditions, state taxation of charges for mobile telecommunications services;[55]
- bars state taxes whose "purpose" is to provide "compensation for claims for any costs of response or damages or claims which may be compensated under [the "Superfund" Act]"; [56] and
- prevents states from imposing income taxes on the "retirement income" of nonresidents.[57]

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[48] 49 U.S.C. § 40116(c) (2006).

[49] 47 U.S.C. § 251 (2006).

[50] 47 U.S.C. § 542 (2006).

[51] 49 U.S.C. § 11502 (2006) (railroad employees); 49 U.S.C. § 14503 (2006) (motor carrier employees); 46 U.S.C. § 11108(b) (2006) (merchant mariner employees).

[52] 46 U.S.C. § 11108(a) (2006).

[53] 49 U.S.C. § 14505 (2006).

[54] Internet Tax Freedom Act, Pub. L. No. 105–277, Div. C, Title XI, § 1104(3), 112 Stat. 2681 (1998) (as amended).

[55] 4 U.S.C. § 116 et seq. (2006).

[56] The Federal Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. § 9614(c) (2006) (commonly known as the "Superfund Act").

[57] 4 U.S.C. § 114 (2006). "Retirement income" is defined as income from qualified plans under the Internal Revenue Code as well as certain nonqualified plans that mirror qualified plans. *Id.* § 114(b)(1).

Even what is arguably the broadest piece of legislation that provides for federal-state tax coordination – the provision of a uniform jurisdictional threshold for taxation of income from interstate commerce – is limited to income from sales of tangible personal property, and thus excludes the increasingly important part of the economy that derives income from services and intangibles.[58]

If there is a leitmotif running through the federal legislation addressed to horizontal tax coordination (broadly conceived to include tax prohibitions), it is probably that the legislation typically constitutes a targeted response to a specific problem. For example, a number of the federal provisions were direct responses to U.S. Supreme Court decisions:

- The jurisdictional restraint on state taxation of income from interstate commerce derived from the sale of tangible personal property[59] was designed to confine the impact of *Northwestern States Portland Cement Co. v. Minnesota*,[60] which sustained the states' power to impose a fairly apportioned, nondiscriminatory tax on net income derived from interstate commerce.
- The prohibition on state taxation of interstate passenger transportation by motor carriers[61] was designed to overrule *Oklahoma Tax Commission v. Jefferson Lines, Inc.*,[62] which sustained an unapportioned tax on the sale of bus tickets for interstate transportation.
- The bar against states' imposition of user charges in connection with the carriage of persons in air commerce[63] was designed to overrule *Evansville-Vanderburgh Airport Authority District v. Delta Airlines, Inc.,*[64] which sustained the states' power to impose charges to recoup the costs of airport construction and maintenance.

In addition to legislation responding to specific court decisions, some of the legislation was addressed to specific abuses (or perceived abuses), such as the assessment of railroad and

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[58] 15 U.S.C. §§ 381-84 (2006).

[59] 15 U.S.C. §§ 381-84 (2006).

[60] 358 U.S. 450 (1959).

[61] 49 U.S.C. § 14505 (2006).

[62] 514 U.S. 175 (1995).

[63] 49 U.S.C. § 40116 (2006).

[64] 405 U.S. 707 (1972).

other transportation property at a higher percentage of fair market value than that applied to other commercial and industrial property. [65] Other provisions were designed to protect identifiable federal interests, such as federally authorized employee benefit plans[66] or the Outer Continental Shelf.[67] Still other provisions were intended to foster the development of particular economic activity, such as the use of the Internet.[68]

Whatever one's views may be as to the wisdom of such legislation,[69] the explanation for the existing universe of horizontal federal-state tax coordination lies largely in "history" rather than "logic," as suggested at the outset.[70]

B. A Review of the Record of Horizontal Federal-State Tax Coordination from a Policy and Practical Perspective

While the existing landscape of horizontal federal-state tax coordination may owe its features to history rather than logic, it is instructive to examine the results of these congressional forays into state taxation as an aid to determining "best practices" in this context. Although my examples are selective, I believe they illustrate what works and what does not work from a policy and practical perspective in the context of horizontal federal-state tax coordination.

1. *What Works Well: The Mobile Telecommunications Sourcing Act*

The Mobile Telecommunications Sourcing Act (MTSA)[71] enacted by Congress in 2000 is a poster child for horizontal federal-state tax coordination at its best. To understand why, one must first appreciate the constitutional rules governing state taxation of interstate telecommunications. Under jurisdictional standards that the U.S. Supreme Court articulated in *Goldberg v. Sweet*[72] under the dormant Commerce Clause, the "only" states with "a nexus

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[65] 49 U.S.C. §§ 11501, 14502 40116 (2006).

[66] 29 U.S.C. § 1114(a) (2006).

[67] 43 U.S.C. § 1333(a)(2) (2006).

[68] Internet Tax Freedom Act, Pub. L. No. 105–277, Div. C, Title XI, § 1104(3), 112 Stat. 2681 (1998) (as amended).

[69] Charles McLure and I have elsewhere set forth at some length our views as to the normative criteria that ought to govern the question of federal intervention in state taxation in the context of three proposals designed to achieve horizontal tax coordination McLure and Hellerstein, *supra* note 1. Some of these views are set forth in the ensuing discussion.

[70] See *supra* note 2 and accompanying text (quoting *New York Trust Co. v. Eisner*, 256 U.S. 345, 349 (1921) (Holmes, J.)).

[71] 114 Stat. 626 (July 28, 2000), codified at 4 U.S.C. § 116 et seq. (2006).

[72] 488 U.S. 252 (1989).

substantial enough to tax a consumer's purchase of an interstate telephone call" are (1) "a State … which taxes the origination or termination of an interstate telephone call charged to a service address within that State" and (2) "a State which taxes the origination or termination of an interstate telephone call billed or paid within that State."[73] The implications of these standards for taxation of the wireless telecommunications industry are troublesome to say the least. Consider a business traveler who lives in State A, where she receives her monthly phone bill, and, while in State B on business, makes a call to State C. Under *Goldberg*, none of these states can tax the charges for the call, because none of them can claim that the call either originates or terminates in the state *and* is charged to a service address in the state or is billed or paid within the state.

The issues become even more complex if the customer is billed not on a transaction-by-transaction basis, but instead pays, say, $50 per month for 500 minutes of calls regardless of where the calls originate or terminate. Indeed, if the customer were billed at a flat rate, the *Goldberg*-mandated inquiry would be virtually impossible, since there would be no breakdown of the charges for the calls on a transaction-by-transaction basis. A typical wireless phone bill simply shows the calls made and the minutes consumed with no itemized price allocation if one does not exceed the number of flat rate minutes. Indeed, the "charge" shown for such individual calls is "$00.00."

The difficulties involved in taxing mobile telecommunications under the regime the Court established in *Goldberg* led Congress, with the joint support of the telecommunications industry and the states, to enact the MTSA, which permits the states to tax *all* mobile telecommunications charges (for services provided by the customer's "home service provider") at the customer's "place of primary use."[74] The key operative language of the MTSA, which *both* expands *and* contracts state power to tax charges for mobile telecommunications, provides:

> All charges for mobile telecommunications services that are deemed to be provided by the customer's home service provider … are authorized to be subjected to tax, charge, or fee by the taxing jurisdictions whose territorial limits encompass the customer's place of primary use, regardless of where the mobile telecommunications services originate, terminate, or pass through, and no other jurisdiction may impose taxes, charges, or fees on charges for such mobile telecommunications services.[75]

The expansion of state power is provided by the grant of authority to the state of the customer's home service provider to tax the charge for wireless services regardless of whether that state possesses power to tax the call under the preexisting standards of *Goldberg v. Sweet*.

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[73] *Id. at* 263.

[74] 4 U.S.C. § 116 et seq.

[75] *Id.* § 117(a).

The contraction of state power is contained in the final clause that prevents any state other than the state of the customer's home service provider from taxing such charges, even if that state possessed power under *Goldberg v. Sweet* to tax the charge.

The MTSA is a model for federal-state horizontal tax coordination. It judiciously employs Congress's power to both expand and restrain state tax power in a manner that allows taxes to be collected in a sensible manner and at the same time protects taxpayers from multiple taxation. It is thus a win-win solution for all concerned and constitutes a marked improvement over the state of play prior to the enactment of the legislation.[76]

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[76] An analogous model for federal-state tax coordination is reflected in Congress's endorsement of the International Fuel Tax Agreement (IFTA). IFTA had its origins in the difficulties that the states confronted in implementing their motor fuel taxes, which generally are viewed as user fees with revenues dedicated for transportation purposes. See generally Denison, Dwight, and Rex L. Facer, "Interstate Tax Coordination: Lessons from the International Fuel Tax Agreement," 58 *National Tax Journal* 3 (2005), pp. 591-603, on which much of the discussion of IFTA is based. For practical purposes, states have always allowed individual motorists to pay fuel taxes at the pump without attempting to determine the miles driven in a particular jurisdiction. However, states have traditionally attempted to enforce fuel taxes on large commercial motor carriers based on an apportionment of miles driven in a state. The trucking industry had generally been willing to cooperate in this effort because of the importance of highways (and highway funding) to the industry. Nevertheless, the complexities of system prior IFTA were daunting. For example, "prior to IFTA a single route from Denver to Los Angeles would require the carrier to file tax forms in five different states or to obtain permits from those five states." *Id.* 592.

The complexity of the system induced a few states to coordinate their fuel tax collection. In 1983, three states initiated ITFA. Shortly thereafter, a National Governors Association working group, funded by Congress, proposed a "Model Base State Fuel Use Tax Reporting Agreement," which incorporated the earlier ITFA concepts. By 1990, sixteen states had joined ITFA. A year later, Congress took a critical step – essentially making the states an "offer they could not refuse" – by requiring that "after September 20, 1996, no State shall establish, maintain, or enforce any law or regulation which has its fuel use tax reporting requirements … which are not in conformity with the International Fuel Tax Agreement." Intermodal Surface Transportation Efficiency Act, Pub. L. No. 102-240, § 4008(g), 105 Stat. 2154 (Dec. 18, 1991), codified at 49 U.S.C. § 31705 (2006). States were further told that they "could not … enforce any law or regulation which provides for the payment of a fuel use tax unless such law or regulation is in conformity with the International Fuel Tax Agreement." *Id.* On the other hand, states that conformed to IFTA were effectively empowered to administer and enforce motor fuel taxes through a regime that would have been virtually impossible to replicate without congressional authorization.

To make a long story short, today the 48 contiguous states and 10 Canadian provinces are signatories of IFTA. See www.itfach.org. Under IFTA, carriers designate a base reporting state to which they report all their fuel tax liabilities both in the base state and in any other state in which they operate. The carrier files its quarterly fuel use tax reports to the base state, reporting its operations in all member states. Depending on whether the carrier overpaid or underpaid its taxes at the pump, determined by the difference between the taxes paid at the pump and the taxes owed based on where its operations occurred, the carrier pays its base state the net taxes due or receives a credit for the net taxes overpaid. See Pitcher, Robert C., "The International Fuel Tax Agreement: Are There Lessons Here for Sales and Use Tax Taxation?," 25 *State Tax Notes* 11 (2001), pp. 887-91. The base state distributes to the other states what the carrier owes them, or accepts on its behalf credits from the other member states. *Id*. The carrier's base state audits the carrier on behalf of all the other IFTA members. *Id*.

In short, like the MTSA, IFTA reflects the judicious exercise of Congress's power to both expand and restrain state tax power in a manner that allows taxes to be collected in a sensible and uniform manner and at the same time protects taxpayers from burdensome taxation based on inconsistent rules in different states. It thus another example of a win-win solution for both states and taxpayers that would not have been possible without congressional intervention.

2. *What Works Poorly: The Internet Tax Freedom Act*

The Internet Tax Freedom Act (ITFA)[77] enacted by Congress in 1998 is a poster child for horizontal federal-state tax coordination at its worst. ITFA is normatively flawed, logically incoherent, and technically complex if not incomprehensible. Although I can touch only briefly on each these problems here, it should suffice to support the conclusion, and I have provided more detailed proof elsewhere.[78]

ITFA imposed a three-year moratorium (subsequently extended through 2014[79]) on three types of taxes: (1) taxes on Internet access; (2) discriminatory taxes on electronic commerce; and (3) multiple taxes on electronic commerce.

a. Normative Concerns

While a normative case can surely be made for barring "discriminatory" or "multiple" taxes on electronic commerce, ITFA's definition of these terms (considered below[80]) sweeps so much more broadly than their common understanding that ITFA's bar on such taxes basically raises the question as to whether electronic commerce should be taxed at all. In this respect, it raises the same question as that raised by the blanket prohibition of taxes on Internet access. As Charles McLure and I concluded after a detailed normative analysis of ITFA,[81] the case for congressional intervention was mixed:

> The case for exempting Internet access by households is weak, no matter how Internet access is defined (narrowly, as embracing only connection to the Internet or more broadly to include telecommunications and/or digital content). Even an exemption for only basic Internet access is an extremely inefficient way to achieve the posited objectives. On the other hand, all business purchases of Internet access, telecommunications, and digital content should be tax-exempt.[82]

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[77] Pub. L. No. 105-277, tit. XI, 112 Stat. 2681 (1998). For a general consideration of ITFA, see Hellerstein, Walter, "Internet Tax Freedom Act Limits States' Power to Tax Internet Access and Electronic Commerce," 90 *Journal of Taxation* 1 (1999), pp. 5-10. ITFA is not to be confused with IFTA – the International Fuel Tax Agreement – discussed in the preceding footnote.

[78] See Hellerstein, *supra* note 77; McLure and Hellerstein, *supra* note 1.

[79] See *infra* notes 89-97 and accompanying text.

[80] See *infra* notes 83-85 and accompanying text.

[81] McLure and Hellerstein, *supra* note 1, at 725-30.

[82] *Id*. at 730.

b. Logical Concerns

Even if one were undisturbed by the normative concerns raised by ITFA, the legislation suffers from serious logical defects. For example, ITFA bars multiple taxation of electronic commerce and, for this purpose, defines a multiple tax as

> any tax that is imposed by one State…on the same or essentially the same electronic commerce that is also subject to another tax imposed by another State…(whether or not at the same rate or on the same basis), without a credit (for example, a resale exemption certificate) for taxes paid in other jurisdictions. [83]

Congress excluded from this definition sales or use taxes imposed concurrently by a state and its political subdivisions on the same electronic commerce and "a tax on persons engaged in electronic commerce which may also have been subject to a sales or use tax thereon."[84]

Although one can discern Congress's objective in enacting this provision (i.e., to prevent the same electronic commerce from being subject to tax by more than one state), the language that Congress chose to accomplish that goal is opaque at best. While preventing more than one state from taxing "the same electronic commerce" might leave some room for debate, the prevention of states from taxing "essentially the same electronic commerce" is almost an invitation for controversy. Indeed, it reads more like cocktail party conversation than a carefully thought out restraint on state taxing power.

Moreover, Congress apparently believed that two states can tax "the same" or "essentially the same" electronic commerce, even if the two levies are not imposed "on the same basis." Does this mean, for example, that Texas may not impose a sales or use tax on computer software transmitted via the Internet from a Washington State software producer, because "essentially the same electronic commerce" was subject to Washington's Business and Occupation Tax? Or is this the situation to which the "savings clause" was directed (i.e., "a tax on persons engaged in electronic commerce"), which is not regarded as a "multiple tax" even if the same electronic commerce is subject to sales or use tax? If it is, however, the savings clause may defeat Congress's objective, because many state sales taxes are legally imposed on the vendor for the privilege of engaging in selling activities [85] (including, one would think, activities in electronic commerce). Hence, one could argue that duplicative sales or use taxation of electronic commerce is permissible as long as the legal incidence of one state's sales tax falls on the seller.

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[83] Pub. L. No. 105-277, § 1104(6)(A) (1998).

[84] *Id.* § 1104(6)(B).

[85] See Hellerstein, Walter, Michael J. McIntyre, and Richard D. Pomp, "Commerce Clause Restraints on State Taxation After *Jefferson Lines*," 51 *Tax Law Review* 1 (1995), pp. 47-114, at 76.

c. Technical Concerns

Beyond the normative concerns and concerns with the internal logic of the legislation, ITFA is hideously complex and is permeated with technical flaws. Merely describing the prohibition on taxation of Internet access and the struggles of state courts and administrative tribunals with its meaning makes the point. ITFA was originally enacted in October 1998 as a three-year moratorium barring states from taxing charges for "a service that enables users to connect to the Internet to access content, information, or other services offered over the Internet."[86] However, a grandfather provision excluded from ITFA's scope a tax on Internet access that was "generally imposed and actually enforced prior to October 1, 1998," [87] and it also excluded the term "telecommunications services" from the definition of Internet access.[88] In November 2001, Congress retroactively extended ITFA for two years through October 2003.[89]

In late 2004, Congress again retroactively extended the act, this time through November 2007.[90] The 2004 extension of the moratorium added language making it clear that all forms of Internet access were covered by the moratorium, including high-speed wireline (DSL) and wireless service (i.e., telecommunications services "purchased, used, or sold by a provider of Internet access to provide Internet access").[91] At the same time, the 2004 ITFA

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[86] Pub. L. No. 105-277, §§ 1101(a) (1998).

[87] *Id.*

[88] *Id.* § 1104(5).

[89] Internet Tax Nondiscrimination Act, Pub. L. No. 107-75, 115 Stat. 703 (2001).

[90] Pub. L. No 108-435, 118 Stat. 2615 (2004).

[91] *Id.* § 2(c). The effect of this amendment was apparently to reverse decisions in cases like *America Online, Inc. v. Pennsylvania*, 932 A.2d 332 (Pa. Commw. 2007) , *aff'd*, 942 A.2d 236 (Pa. Commw. 2008) (en banc), which held that the pre-2004 version of ITFA did not bar a Pennsylvania tax on port modem management services that, among other things, converted information transmitted over the Internet from digital to analog format for transmission to customers, and *Concentric Network Corp. v. Pennsylvania*, 877 A.2d 542 (Pa. Commw. 2005) , which held that the pre-2004 version of ITFA did not bar a Pennsylvania tax on an Internet service provider's purchase of data transport services used to provide Internet access. Indeed, it is not even clear that the decision in *Concentric* was properly decided under the pre-2004 version of ITFA. The Pennsylvania tax did not apply to data-transport services purchased by cable companies and telecommunications carriers. The court held that the distinction did not violate the prohibition against "establish[ing] a classification of Internet access service providers…for purposes of establishing a higher tax rate on such providers than the tax rate generally applied to providers of similar information services delivered through other means." Pub. L. No. 105-277, § 1104(2)(A)(iv) (1998). The court reasoned that the exclusion was permissible because "[i]t is only in their capacity as public utilities or broadcasters that the telecommunications carriers or cable operators are permitted an exclusion." *Concentric*, 877 A.2d at 549. As Joseph Bright has observed in commenting on this opinion, however, "[i]f the federal statutes prohibit discrimination, it does not seem to be a sufficient justification that the discrimination is created by a second state statute." Bright, Joseph, "Court's Refund Denial on Internet Data Lines May Err on Federal Statute," 37 *State Tax*

extension provided that the prohibition did not apply to any tax on a voice or similar service using Internet Protocol (voice over Internet Protocol, or VOIP), except to the extent that the services were incidental to the Internet access (e.g., voice-capable email or instant messaging).[92]

In 2007, Congress yet again extended the act for an additional seven years through November 1, 2014.[93] The 2007 ITFA amendments expanded the definition of "Internet access" to include "a home page, electronic mail, and instant messaging (including voice- and video-capable electronic mail and instant messaging), video clips, and personal electronic storage capacity," [94] whether packaged with Internet access or provided independently.[95] The 2007

Notes 1 (2005), p. 28. In an en banc decision rejecting the taxpayer's exception to the panel decision, *Concentric Network Corp. v. Pennsylvania*, 897 A.2d 6 (Pa. Commw. 2006) (en banc), *aff'd per curiam*, 922 A.2d 883 (Pa. 2007), the court rejected the taxpayer's claim that the levy violated ITFA's bar against taxes on Internet access, on the ground that the Pennsylvania tax fell within the "grandfather" clause preserving any tax that "was generally imposed and actually enforced prior to October 1, 1998." The en banc court also reaffirmed the panel's decision that the tax did not violate the prohibition against establishing a higher tax rate on Internet service providers than the rate generally applied to providers of similar information services delivered through other means, because "the Tax Code does not classify information service providers, nor does it establish different tax rates on information services providers." *Concentric*, 897 A.2d at 15. The court further observed:

> Moreover, Taxpayer pays sales and use tax because it uses other companies' wirelines to provide its services. Taxpayer is not prohibited by the Tax Code from installing its own wirelines or from using some other technology to provide its services. If it chooses an alternate solution, it will not pay sales and use tax on purchases of telecommunications services. In short, the tax at issue here results not from a discriminatory tax on electronic commerce but from Taxpayer's business decisions.

Id. See also Priv. Ltr. Rul. 5715, Mo. Dep't of Revenue, June 16, 2009, available at www.checkpoint.thomsonreuters.com (otherwise applicable sales tax on provision of T1 transport lines and dial modem ports to Internet service providers for carrying Internet traffic is preempted by ITFA, as amended in 2007, because it includes telecommunications used by an Internet service provider to provide Internet services). Priv. Ltr. Rul. 5594, Mo. Dep't of Revenue, Apr. 20, 2009, available at www.checkpoint.thomsonreuters.com (otherwise applicable sales tax on lease of broadband capacity to Internet service provider is preempted by ITFA, as amended in 2007, because it includes telecommunications used by an Internet service provider to provide Internet services).

[92] Pub. L. No 108-435, § 6, 118 Stat. 2615 (2004).

[93] Internet Tax Freedom Act Amendments Act of 2007, Pub. L. No. 110-108, 121 Stat. 1024 (2007).

[94] *Id.* § 4.

[95] The definition of "Internet access," as revised by the 2007 ITFA amendments, provides that "Internet access"

> (A) means a service that enables users to connect to the Internet to access content, information, or other services offered over the Internet;
>
> (B) includes the purchase, use or sale of telecommunications by a provider of a service described in subparagraph (A) to the extent such telecommunications are purchased, used or sold—
>
> > (i) to provide such service; or
> >
> > (ii) to otherwise enable users to access content, information or other services offered over the Internet;
>
> (C) includes services that are incidental to the provision of the service described in subparagraph (A) when furnished to users as part of such service, such as a home page, electronic mail and instant messaging

amendments further excluded from the definition of "tax on Internet access" taxes that Michigan, Ohio, and Texas impose on gross receipts or gross income from business activity (in lieu of the typical state-level corporate income tax). The 2007 ITFA amendment also extended through 2014 the original act's grandfather clause covering preexisting state taxes on Internet that were "generally imposed and actually enforced prior to October 1, 1998."[96] In addition, however, the 2007 ITFA amendment adopted a more limited grandfathering provision for states that were taxing the telecommunications services that were covered by the moratorium for the first time (i.e., telecommunications services purchased, used, or sold to provide Internet access), which were grandfathered only through June 30, 2008.[97]

In short, ITFA is exactly what legislation designed to effectuate horizontal federal-state coordination should not be – normatively problematic, logically questionable, and a technical nightmare.

3. *What Works Passably but Defectively: Public Law 86-272*

Most existing federal legislation designed to effectuate horizontal federal-state tax coordination probably falls within the "passable but defective" category, namely, legislation that generally achieves its typically narrow objective, but with some collateral damage along the way. Public Law 86-272,[98] to which I have already alluded,[99] illustrates the point. As noted above (albeit without identifying the statute by its popular appellation), Public Law 86-272 was enacted in 1959 in direct and immediate response to the U.S. Supreme Court's decision *Northwestern States Portland Cement Co. v. Minnesota*,[100] which sustained the states' power to impose a fairly apportioned, nondiscriminatory tax on net income derived from interstate commerce. The statute prevents the states from taxing net income derived from interstate

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> (including voice- and video-capable electronic mail and instant messaging), video clips, and personal electronic storage capacity;
> (D) does not include voice, audio or video programming, or other products and services (except services described in subparagraph (A), (B), (C), or (E)) that utilize Internet protocol or any successor protocol and for which there is a charge, regardless of whether such charge is separately stated or aggregated with the charge for services described in subparagraph (A), (B), (C), or (E); and
> (E) includes a homepage, electronic mail and instant messaging (including voice- and video-capable electronic mail and instant messaging), video clips, and personal electronic storage capacity, that are provided independently or not packaged with Internet access.

Id.

[96] See *supra* note 87 and accompanying text.

[97] Internet Tax Freedom Act Amendments Act of 2007, Pub. L. No. 110-108, § 3,121 Stat. 1024 (2007).

[98] Pub. L. No. 86-272, 73 Stat. 555 (1959), codified at 15 U.S.C. §§ 381-84 (2006).

[99] See *supra* notes 59-60 and accompanying text.

[100] 358 U.S. 450 (1959).

commerce when the taxpayer's activities in the state are limited to the "solicitation" of orders for sales of tangible personal property that are fulfilled by shipments from outside the state.[101]

Somewhat ironically, Public Law 86-272's prohibition was designed merely as a temporary measure – a cease fire in place, as it were – while Congress considered broad-based legislation for horizontal tax coordination. Title II of Public Law 86-272 assigned to the House Judiciary Committee and the Senate Finance Committee the task of making "full and complete studies of all matters pertaining to the taxation by the States of income derived within the States from the conduct of business activities which are exclusively in furtherance of interstate commerce or which are a part of interstate commerce, for the purpose of recommending to the Congress proposed legislation providing uniform standards to be observed by the States in imposing income taxes on income so derived."[102] Despite a committee's production of an extensive and invaluable four-volume study (the Willis Committee Report) that recommended broad-based legislation providing for horizontal tax coordination,[103] Congress's failure to act on these recommendations is, as they say, history.

What we have instead is the legacy of more than half a century of efforts to determine the metes and bounds of a stopgap "minimum nexus" measure designed to protect the national common market without unduly restraining the states' power to tax.[104] Without prolonging this discussion any further, and indeed, providing an appropriate segue into the next part of this testimony,[105] it suffices to say that Public Law 86-272, while providing the core of tax immunity that Congress intended, at the same time has given rise to (a) considerable controversy over the scope of such immunity,[106] attributable in part, perhaps, to the narrow focus of the legislation and haste with which it was enacted; (b) an immunity based on a mid-twentieth century view of economic activity that may no longer reflect contemporary economic reality; (c) different jurisdictional standards depending on whether a taxpayer's income derives from the sale of tangible personal property, on the one hand, or from services or intangibles, on the other; and (d) extensive state tax planning to take advantage of the federal protection.

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[101] 15 U.S.C. §§ 381-84 (2006).

[102] Pub. L. No. 86-272, Tit. II, 73 Stat. 555 (1959),

[103] Special Subcomm. on State Taxation of Interstate Commerce of the House Comm. on the Judiciary, *State Taxation of Interstate Commerce*, H.R. Rep. No. 1480, 88th Cong., 2d Sess. (1964); H.R. Rep. Nos. 565 and 982, 89th Cong., 1st Sess. (1965)

[104] This legacy is reflected in the extensive body of case law and state administrative guidance spawned by Public Law 86-272, all of which is treated in detail in Hellerstein, Hellerstein and Swain, *supra* note 1, at ¶¶ 6.16–6.28.

[105] One of the principal current proposals pending before Congress is a broadening of Public Law 86-272.

[106] See *id*.

IV. CURRENT PROPOSALS FOR FEDERAL-STATE TAX COORDINATION

In light of the checkered history of legislation addressed to federal-state tax coordination, perhaps the first thing to say about the current spate of legislative proposals aimed at federal-state tax coordination is that "hope springs eternal in the human breast."[107] Among the legislative proposals recently introduced in Congress include bills that would:

- authorize the states to require remote vendors to collect sales and use taxes on sales to in-state purchasers, regardless of their physical-presence in the state (otherwise constitutionally required under *Quill*[108]) under specified conditions generally requiring harmonization and simplification of their sales and use tax regimes;[109]
- extend the protection of Public Law 86-272[110] beyond income from interstate commerce derived from the sale of tangible personal property to such income derived from all forms of economic activity and making other adjustments in the statute;[111]
- limit and define the circumstances under which states may impose income taxes on nonresidents temporarily employed in the state;[112]
- prohibit states from imposing "multiple or discriminatory" taxes on the sale or use of digital goods and services;[113]
- prohibit states from imposing a "discriminatory tax" on any means of providing multichannel programming;[114]
- impose a five-year moratorium on the imposition of by states or localities of any "new discriminatory tax" on mobile services, mobile service providers, or mobile service property;[115]

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[107] Alexander Pope, An *Essay on Man, Epistle I* (1733).

[108] *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992); see generally Hellerstein, Hellerstein, and Swain, *supra* note 1, at ¶ 19.02[3].

[109] See, e.g., S. 1452, 112th Cong., 1st Sess (2011) ("Main Street Fairness Act"); H.R. 2701, 112th Cong., 1st Sess. (2011) (same); S. 1832, 112th Cong., 1st Sess (2011) ("Marketplace Fairness Act"); H.R. 3179, 112th Cong., 1st Sess. (2011) ("Marketplace Equity Act of 2011").

[110] See *supra* notes 98-106 and accompanying text.

[111] H.R. 1439, 112th Cong., 1st Sess. (2011) ("Business Activity Tax Simplification Act of 2011").

[112] H.R. 1864, 112th Cong., 2nd Sess. (2012) ("Mobile Workforce State Income Tax Simplification Act of 2011").

[113] S. 971, 112th Cong., 1st Sess. (2011) ("Digital Goods and Services Tax Fairness Act of 2011"); H.R. 1860, 112th Cong., 1st Sess. 1860 (2011) (same).

[114] H.R. 1804, 112th Cong., 1st Sess. (2011) ("State Video Tax Fairness Act of 2011").

- prohibit a state from imposing a discriminatory tax on the rental of motor vehicles, the business of renting motor vehicles, or motor vehicle rental property;[116]
- prohibit a state from imposing a new unfair or inequitable E911 fee, tax, or surcharge with respect to prepaid mobile services, prepaid mobile service providers, or prepaid mobile customers;[117]
- prohibit a state from imposing a tax on a nonresident individual with respect to any time the individual is present in another state;[118] and
- make permanent the moratorium on Internet access taxes and the prohibition on multiple and discriminatory taxes on electronic commerce.[119]

It is plainly beyond the scope of the present endeavor to undertake a detailed analysis of any of these proposals, let alone all of them. Instead the more modest goal of this part of my testimony is briefly to examine these proposals in light of whatever lessons one might draw from the historical overview of federal-state tax coordination set forth in the preceding discussion.

A. The Main Street Fairness, Marketplace Fairness, and Marketplace Equity Acts

The Main Street Fairness Act,[120] the Marketplace Fairness Act,[121] and the Marketplace Equity Act of 2011[122] are all designed to authorize the states, under specified conditions generally requiring harmonization and simplification of their sales and use tax regimes, to require collection of sales and use taxes with respect to sales by remote sellers, notwithstanding their lack of physical presence in the state (otherwise constitutionally required by *Quill*[123]). Although the bills differ in their detail, such as the extent to which states must

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[115] S. 543, 112th Cong., 1st Sess. (2011) ("Wireless Tax Fairness Act of 2011"); H.R. 1002, 112th Cong., 1st Sess. (2011) (same).

[116] H.R. 2469, 112th Cong., 1st Sess. (2011) ("End Discriminatory State Taxes for Automobile Renters Act of 2011").

[117] H.R. 3788, 112th Cong., 2d Sess. (2012) ("E911 Surcharge Fairness Act of 2011").

[118] S. 1811, 112th Cong., 1st Sess. (2011) ("Telecommuter Tax Fairness Act of 2011").

[119] S. 135, 112th Cong., 1st Sess. (2011) ("Permanent Internet Tax Freedom Act of 2011").

[120] S. 1452, 112th Cong., 1st Sess (2011); H.R. 2701, 112th Cong., 1st Sess. (2011).

[121] S. 1832, 112th Cong., 1st Sess (2011).

[122] H.R. 3179, 112th Cong., 1st Sess. (2011).

[123] See *supra* note 108.

conform to the provisions of the Streamlined Sales and Use Tax Agreement ("SSUTA"),[124] the level of the exemption of "small" sellers from the tax collection requirement, and the precise extent of required harmonization, they share in common the concept of a "deal" authorizing collection of taxation from remote sellers in return for removal of existing burdens on such sellers through simplification and harmonization.

After undertaking a detailed analysis of an earlier (but essentially similar) version of the most demanding of these bills – the Main Street Fairness Act that applies only to states that have conformed to SSUTA – and evaluating it in light of the normative principles that ought to govern congressional intervention in state tax matters,[125] Charles McLure and I concluded that legislation along the lines outlined above was "fundamentally a move in the right direction – the prescription of simplification and greater uniformity in conjunction with the removal of nexus rules that create undesirable economic consequences."[126] We observed, among other things, that "under the prescribed conditions of simplification and uniformity, nexus rules would no longer be needed to reduce complexity and thus could no longer be justified."[127] In reaching our conclusion, we also identified the requirements of (1) reasonable vendor compensation and (2) the existence of "identical" state and local tax bases within any state as essential elements of the proposal we were endorsing. Finally, we noted that the proposed legislation struck "the proper balance between the interests of state sovereignty and those of national economic unity."[128] It respected the states' ability to establish their own tax rates, and, indeed, even went so far (perhaps further than we would have gone) as to allow the states freedom to define their own tax bases, although states were required to employ uniform definitions in determining what was and what was not taxable. At the same time, the proposed legislation imposed significant requirements on the states to harmonize and simplify their

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[124] SSUTA (as amended through December 19, 2011) is reproduced at www.streamlinedsaletax.org. SSUTA is a voluntary agreement among the states designed to "simplify and modernize sales and use tax administration in order to substantiall reduce the burden of tax compliance." SSUTA § 102. See generally Hellerstein, Hellerstein, and Swain, *supra* note 1, ch. 19A for a detailed consideration of SSUTA. As of early 2012, there were 20 "full member" states under SSUTA with most of the other states with sales taxes either "associate members" (in principle moving to "full member" status) or "advisory member" (nonconforming) states. See www.streamlinedsalestax.org.

[125] McLure and Hellerstein, *supra* note 1.

[126] *Id.* at 731.

[127] *Id.*

[128] *Id.*

systems and thereby to provide the proper foundation for requiring collection by remote sellers without subjecting them to unreasonable administrative burdens.[129]

Although I cannot speak for McLure, it is less clear to me that the other versions of the sales and use tax collection authorization legislation, at least insofar as they would authorize collection by remote vendors by states not conforming to SSUTA, would satisfy the normative criteria we identified in our earlier article. To be sure, the alternatives to the SSUTA-conformity bills do require, with respect to remote sellers, identical state and local tax bases, a single sales and use tax return, a single state-level administrative agency, the provision of adequate software to ease compliance burdens, and "hold harmless" provisions that comply with such software.[130] On the other hand, there is no provision for compensation of remote sellers, nor is there any requirement that the states harmonize the definitions in their tax bases, a key feature of the SSUTA legislation.

Despite my reservations about the merits of some of the proposals for congressional legislation addressed to state sales and use tax collection and simplification, the legislation in principle constitutes the type of federal-state tax coordination that we should applaud and encourage. Like the "poster child" identified above for such legislation,[131] the proposed legislation combines the congressional relaxation of a judicially created rule restraining state tax power along with the imposition of congressionally imposed conditions. In both cases the judicially created rule is objectionable (although for different reasons) and in both cases the congressionally imposed conditions are desirable. Accordingly, in my judgment at least, legislation of this kind is template for future federal-state tax coordination.

B. The Business Activity Tax Simplification Tax Act of 2011

The Business Activity Tax Simplification Act of 2011[132] ("BAT Act") amends Public Law 86-272[133] to extend its protection beyond taxes on net income from interstate commerce

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[129] Notwithstanding our general agreement with the thrust of the SSUTA and the SSUTA-conformity legislation, we noted that there were many aspects of such legislation about which we were less than enthusiastic. Among other things, we expressed concern over the question whether SSUTA's simplification requirements would be "more than empty promises," *id.* at 732; we questioned whether the "small remote seller" thresholds established by SSUTA (which seem to change with every meeting of the Governing Board) made any sense, *id.* (they currently are a level of $5 million of "gross national remote sales," SSUTA § 609, with various qualifications); and we noted that our support of the legislation, despite some misgivings, was based in part our belief that we were" at a critical juncture where Congress has a unique opportunity to act" and that the SSUTA legislation may be "our 'last best chance' (at least during our lifetimes) of achieving significant, if less than perfect, reform and improvement of the state sales and use tax system." *Id.* The last statement is even truer today than the day we made it, as our life expectancies shrink.

[130] S. 1832, 112th Cong., 1st Sess. (2011); H.R. 3179, 112th Cong., 1st Sess. (2011).

[131] See *supra* notes 71-76 and accompanying text.

[132] H.R. 1439, 112th Cong., 1st Sess. (2011).

attributable to the sale of tangible personal property to such income attributable to any form of business activity (including the sale of services and intangibles) and to "business activity taxes" other than net income taxes, namely, gross receipts taxes. The proposed BAT Act also establishes a general nexus requirement of "physical presence" (employees, agents performing services, or property in the state), along with de minimis "safe harbor" exceptions (e.g., presence in the state for less than 15 days). Earlier in this testimony, I characterized the original version of Public Law 86-272 as legislation that "works passably but defectively"[134] In my view, the 2011 version is even worse and should be characterized as legislation that "works poorly."[135]

From a normative perspective, the BAT Act is deeply flawed. As in the case of the proposed sales tax collection/simplification legislation discussed above, Charles McLure and I undertook a detailed analysis of an earlier (but essentially similar) version of the BAT Act from a normative perspective,[136] and we concluded that it was "clearly inconsistent with the normative considerations" there identified.[137] Among other things, we observed that it would "expand the scope for the creation of 'nowhere income,'"[138] i.e., attribution of income to states where the taxpayer was not taxable, and thus aggravate the opportunities for tax planning and the revenue loss created by Public Law 86-272. We also addressed arguments in support of the legislation that we considered to be unsound, in particular, the suggestion by representatives of the business community that businesses that are not physically present in a state receive no benefits from the state and therefore should not be required to pay taxes to such state.[139] As we pointed out, this "line of reasoning is indefensible, whether the benefits corporations receive are defined broadly, to mean the ability to earn income, or defined more narrowly to

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[133] See *supra* notes 98-106 and accompanying text.

[134] See *supra* Part III(B)(3).

[135] See *supra* Part III(B)(2).

[136] McLure and Hellerstein, *supra* note 1.

[137] *Id.* at 734.

[138] *Id.*

[139] *Id.* (citing e.g., Council on State Taxation, "Jurisdiction to Impose Business Activity Tax," a policy position, available at: http://www.statetax.org/Content/NavigationMenu/Legislative/Policy_Statements/Default271.htm The identical argument has been repeated throughout the debate over the BAT legislation most recently in hearings on current version of the BAT legislation. See *Hearing on H.R. 1439: Business Activity Tax Simplification Act of 2011*, Before the Subcomm. on Courts, Commercial and Administrative Law of the House Comm. on the Judiciary, 112th Cong., 1st Sess. (2011), p. 117 (reproducing Letter from Joseph R. Crosby, Council on State Taxation, April 13, 2011).

mean specific benefits of public spending, one of which is the intangible but important ability to enforce contracts, without which commerce would be impossible."[140]

Moreover, it seems odd, to say the least, that Congress, under the guise of federal-state tax coordination, should be enshrining as a touchstone of taxability a standard first promulgated over half-century ago as a stop-gap measure[141] and one more appropriate for the economy of the nineteenth century than of the twenty-first. If certainty and administrability are the objectives – and these clearly *are* legitimate objectives that would justify congressional legislation prescribing state nexus rules – there are alternatives for certain and administrable nexus rules that make much more practical and economic sense than physical presence. Among these would be nexus rules based on sales or apportionment factors in the state.[142]

C. Mobile Workforce State Income Tax Simplification Act of 2011

The Mobile Workforce State Income Tax Simplification Act of 2011[143] prohibits the states from imposing income taxes (and requiring withholding of such taxes) on the wages or other remuneration earned by nonresident employees in the state unless they perform duties there for more than 30 days during the year. In my view, this is another example of what "works well" in federal-state tax coordination. To be sure, there is a clear intrusion into state sovereignty, because the states generally enjoy the power to tax the income that nonresidents earn within the state. [144] On the other hand, the burden on nonresidents from complying with tax reporting obligations arising out of temporary employment in the state and – perhaps even more importantly from the standpoint of our national economic market – the burden on employers of complying with withholding obligations with respect to such employees can be extremely onerous. Moreover, it is worth keeping in mind that we are talking largely about *which* state gets to tax the income in question, not whether the income gets taxed at all,

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[140] *Id*.

[141] See *supra* notes 100-102 and accompanying text.

[142] See McLure and Hellerstein, *supra* note 1, at 734; Avi-Yonah, Reuven, "International Taxation of Electronic Commerce," 52 *Tax Law Review* 3 (1997), 507-556, at pp. 531-41; Hellerstein, Walter, "Jurisdiction to Tax Income and Consumption in the New Economy: A Theoretical and Comparative Perspective," 38 *Georgia Law Review* 1 (2003), pp. 1-70, at pp. 39-49; McLure, Charles E., Jr., "Implementing State Corporate Income Taxes in the Digital Age," 53 National Tax Journal 4, Part 3 (2000), pp. 1287-1305, at pp. 1295-97. Indeed, The Multistate Tax Commission approved a model "Factor Presence Nexus Standard for Business Activity Taxes" (available at www.mtc.gov).

[143] H.R. 1864, 112th Cong., 2nd Sess. (2012).

[144] Hellerstein, Hellerstein, and Swain, *supra* note 1, at ¶ 20.05[1].

because most states impose personal income taxes on all of the income earned by their residents, subject to a credit for taxes paid to other states.[145]

As I testified before a congressional committee considering an earlier (but similar) version of the legislation:

> In my opinion, enactment of the Mobile Workforce State Income Tax Fairness and Simplification Act of 2007 would constitute an appropriate exercise of congressional power. In expressing this opinion, I wish to make it clear that I believe the states have a legitimate interest in assuring that workers who earn income in the state pay their fair share of the state tax burden for the benefits and protections that the state provides to them. The states' legitimate interest, however, must be balanced against the burdens that are imposed on multistate enterprises, and on the conduct of interstate commerce, by uncertain, inconsistent, and unreasonable withholding obligations imposed by the states. Indeed, it is telling that a number of states themselves have implicitly recognized these burdens by adopting reciprocal provisions exempting income, or certain classes of income, earned by nonresidents in their state if the nonresident's home state grants a similar exemption to residents of the exemption-granting state.[146]

D. Prohibitions on "Discriminatory" Taxation of Specified Activities

A number of bills have been introduced into Congress to prohibit "discrimination" against specified activities. These include

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[145] *Id.* at ¶¶ 20.04[2], 20.10.

[146] *Hearing on H.R. 3359: Mobile Workforce State Income Tax Fairness and Simplification Act of 2007*, Before the Subcomm. on Commercial and Administrative Law of the House Comm. on the Judiciary, 110th Cong., 1st Sess. (2007), p. 82 (testimony of Walter Hellerstein). The following states have entered into reciprocal agreements exempting compensation paid in their states to residents of other states:

STATE	AGREEMENT WITH
District of Columbia	MD, VA
Illinois	IA, KY, MI, WI
Indiana	KY, MI, OH, PA, WI
Iowa	IL
Kentucky	IL, IN, MI, OH, VA, WV, WI
Maryland	DC, PA, VA, WV
Michigan	IL, IN, KY, MN, OH, WI
Minnesota	MI, ND
Montana	ND
New Jersey	PA
North Dakota	MN, MT
Ohio	IN, KY, MI, PA, WV
Pennsylvania	IN, MD, NJ, OH, VA, WV
Virginia	DC, KY, MD, PA, WV
West Virginia	KY, MD, OH, PA, VA
Wisconsin	IL, IN, KY, MI

See RIA State and Local Taxes for individual states, available at www.checkpoint.thomsonsonreuters.com (¶¶ 55,205, 55,325, and 55,875 for individual states).

- the Digital Goods and Services Tax Fairness Act of 2011 to prevent states from imposing "multiple or discriminatory" taxes on the sale or use of digital goods and services;[147]
- the State Video Tax Fairness Act of 2011 to prohibit states from imposing a "discriminatory tax" on any means of providing multichannel programming;[148]
- the Wireless Tax Fairness Act of 2011 to provide a five-year moratorium on the imposition by states or localities of any "new discriminatory tax" on mobile services, mobile service providers, or mobile service property;[149]
- the End Discriminatory State Taxes for Automobile Renters Act of 2011 to prohibit states from imposing discriminatory taxes on the rental of motor vehicles, the business of renting motor vehicles, or motor vehicle rental property;[150] and
- the E911 Surcharge Fairness Act of 2011 to prohibit states from imposing new unfair or inequitable E911 fees, taxes, or surcharges with respect to prepaid mobile services, prepaid mobile service providers, or prepaid mobile customers.[151]

These proposals resemble the targeted proposals typical of the limited federal-state tax coordination we have witnessed over the years including legislation forbidding states from taxing railroad, motor carrier, and air carrier property more heavily than other commercial and industrial property;[152] legislation forbidding the states from imposing electrical energy taxes discriminating against out-of-state purchasers;[153] and legislation imposing "discriminatory" taxes on electronic commerce.[154] As the preceding discussion suggests, in my judgment these narrow legislative initiatives have a mixed track record as to whether they work well, work poorly, or work passably but defectively. Because the category into which each of the proposals

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[147] H.R. 1860, 112th Cong., 1st Sess. 1860 (2011).

[148] H.R. 1804, 112th Cong., 1st Sess. (2011).

[149] S. 543, 112th Cong., 1st Sess. (2011); H.R. 1002, 112th Cong., 1st Sess. (2011) (same).

[150] H.R. 2469, 112th Cong., 1st Sess. (2011).

[151] H.R. 3788, 112th Cong., 2nd Sess. (2012).

[152] 49 U.S.C. §§ 11501, § 14502, 40116 (2006).

[153] 15 U.S.C. § 391 (2006).

[154] Internet Tax Freedom Act, Pub. L. No. 105–277, Div. C, Title XI, § 1104(3), 112 Stat. 2681 (1998) (as amended).

described above falls obviously depends on one's perspective. I would only suggest, at a minimum, that anyone who takes the time to read the efforts to define "discrimination"and related terms in these bills would have a hard time concluding that they would rank above "works passably but defectively." Indeed, the language of some of the proposals is so badly crafted that, at least in their present form, it is hard to imagine how they would not work "poorly." Perhaps one can hope for that happy day when every industry and every form of economic activity is protected by a federal statute prohibiting "discriminatory" taxation, a term that will be defined to require a uniform tax on household purchases (thus requiring a "sale for resale" exemption for all business purchases), so we would actually end up with an ideal retail sales tax in the United States.[155]

E. The Telecommuter Tax Fairness Act of 2011

The Telecommuter Tax Fairness Act of 2011 would prohibit states from imposing a tax on a nonresident individual with respect to any time the individual is present in another state.[156] This legislation is designed essentially to bar New York's "convenience of the employer" doctrine for determining the taxability of nonresidents' income associated with New York-based employment. Although I agree with this legislation as a matter of principle,[157] the case for congressional intervention into the controversy over New York's taxation of nonresidents pales by comparison to the significant issues that ought to be on Congress's federal-state tax coordination agenda.

V. CONCLUSION

If there is any overarching conclusion that one can draw from this overview of federal-state tax coordination, it may simply be that Congress should keep in mind the admonition of the Hippocratic Oath[158] – "first, do no harm" – in considering proposals for federal legislation that affect state taxation. Although Congress possesses power to provide for federal-state tax coordination that unquestionably advances the interests of all stakeholders, and it has sometimes exercised its power to achieve that end, it has also exercised its power in ways that unquestionably fail to meet that standard. Accordingly, in returning to the point with which this

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[155] See Hellerstein, Walter, Kirk J. Stark, John A. Swain, and Joan M. Youngman, *State and Local Taxation: Cases and Materials*, 9th ed. (St. Paul: Thomson Reuters, 2009), p. 611.

[156] S. 1811, 112th Cong., 1st Sess. (2011). ("Telecommuter Tax Fairness Act of 2011"). This legislation is designed essentially to bar New York's "convenience of the employer" doctrine for determining the taxability of nonresidents' income associated with New York-based employment. See generally Hellerstein, Hellerstein, and Swain, *supra* note 1, at ¶ 20.05[4][e].

[157] Hellerstein, Walter, "Reconsidering the Constitutionality of the 'Convenience of the Employer' Doctrine," 28 *State Tax Notes* 6 (2003), pp. 535-543.

[158] At least as popularly understood, whether historically accurate or not. See Wikipedia, http://en.wikipedia.org/wiki/Primum_non_nocere.

testimony began – Justice Holmes's observation that "a page of history is worth a volume of logic"[159] – perhaps we should aspire to add a few more pages of "logic" to the "volume" of our history in this domain.

[159] *New York Trust Co. v. Eisner*, 256 U.S. 345, 349 (1921).