

---

# Federal Legislation, Federal Tax Reform and the States



0

## Purpose

---

- **Review federal legislation affecting state taxation**
  - What is going on
  - What's likely to happen
- **Lessons learned (hard way) over time**
- **Overview of federal reform**
- **Issues for the states**
- **Common themes**

1

## **Business Activity Tax**

---

- **Expansion of P.L. 86-272**
- **Physical presence + carve-outs standard**
  - 21 days
  - Protected activities
- **Independent and dependent contractor exclusion**
- **Issues for states**
  - Revenue impacts
  - Opportunities for planning/sheltering

2

## **Remote Sales**

---

- **Authority to require remote sellers to collect**
  - If Streamlined Sales Tax Agreement is operational
  - If Member of the Agreement
  - If Agreement meets simplification standards in legislation
  - If seller is above "Small Business Exception"
    - \$5 million in national sales (last year)
- **Legislation expected to be introduced soon**
  - Senators Dorgan and Enzi

3

## Remote Sales: Issues for States

- **Vendor compensation**
- **Telecommunications simplification**
- **Federal court review**
- **Small seller exception**



## Cuno Legislation

- **Authoring tax incentives for economic development**
- **Tests for incentives**
- **Issues for states**
  - **Clarity and certainty**
  - **Avoid unintended consequences/litigation**
  - **Protect commonly used incentives**

## **Other Legislation**

---

- **Internet Tax Nondiscrimination Act**
- **Telecommunications Act rewrite**
  - Simplification, VoIP, “Competitive Equity”
- **Nonresident taxation**
- **4-R Act for interstate pipelines**
- **4-R Act for telecommunications firms**

6

## **Prognosis**

---

- **Little likely to happen in next 12 months**
  - Most action on House side
- **Senate Finance calendar “crowded”**
  - Budget, Social Security, Tax Reform, Medicaid savings, yada, yada, yada....
- **Efforts to bundle items and push trade-offs**

7

## Lessons Learned

---

- **Increased preemption efforts**
  - ‘New’ industries/technologies
  - Win many “battles” at one level
  - Desire for “one set of rules”
- **Lack of context**
  - No partnership
  - No sense of intergovernmental fiscal system



8

## Lessons -- Cont.

---

- **Lack of institutions**
  - Committees of jurisdiction
  - Executive agencies
  - CBO, CRS
- **Congress sees itself as referee or protector**
  - Choose among ‘friends’
  - Restrict states to pursue ‘national priorities’
  - Trade-off issues

9

## Challenges for States

---

- **Saying “No” ain’t good enough**
- **Need to ID what is important and what we want**
- **How can we get to “one set of rules”**
  - Multi-state, action
  - Federal/state coordination
  - Federal framework



10

## Reform Options

---

- **Reduce taxation of capital income**
  - RSAs, LSAs, gains and dividends exclusion, consumed income tax
- **Reform of current income tax**
  - Broaden base, reduce rates
  - State and local tax deduction
- **National Sales tax**
  - Retail tax on all goods/services
- **Value Added tax**
  - Transaction, European-style
- **“Flat” tax**
  - Integrated business/individual income tax

11

## Operating Premise

---

- **State base must necessarily follow federal base**
  - No compliance systems
  - No 3rd party reporting systems
  - Taxpayer compliance and burden
- **No Federal Tax = No State Tax**



## Tax Reform Symposium

---

- **System unable to handle fundamental reform; incremental reforms more likely**
- **Broaden income base; savings incentives**
- **Without federal income tax, maintenance of state tax is unrealistic**
- **National sales tax is unworkable and undesirable**
- **Transaction VAT should be considered as source of revenue for federal government**

## **Symposium -- Cont.**

---

- **Coordination with VAT could improve state taxes; requires coordination of bases**
- **Local taxes may prevent coordination with VAT**
- **Best opportunities for coordination require common bases**
- **Repeal of state-local deduction cuts differently across states**
- **AMT effectively eliminating deduction anyway**
- **To influence, states need to enter debate early and with on voice**

14

## **Tax Reform -- Punchline**

---

- **Elimination of income tax brings greatest restrictions**
- **Near-term proposals are likely to pose greatest risk to states**
  - **Narrowing of base with tax-preferred savings**
  - **State and local deductibility is problematic-- less so with AMT repeal**
- **Comprehensive reform proposals hold some peril, but offer opportunity as well**
- **Optimum coordination will require state base to follow federal base**

15



## Common Themes

---

- Risks to state tax authority are great
- Opportunities to improve state taxation
- Will require different relationship to federal government
- More cooperation/coordination -- Less “stay out of my business”

