

Consider State and Local Tax Systems When Making Federal Policy Changes

RESOLUTION 2017-2

Background

Under the U.S. Constitution both federal and state governments have the right to establish their own, separate systems of taxation. State and local governments rely on two primary revenue sources — income and consumption taxes. State and local income tax systems have generally been developed in coordination with the federal income tax system, and fundamental aspects of the state and local income taxes, including the definition of income, allowable deductions, third-party reporting, and compliance — among others — are heavily dependent on federal income rules.

This system of income tax conformity has effectively created a tax base and tax system that is in many ways integrated and is effectively shared between the federal, state and local governments. This both eases the burden of compliance on taxpayers and simplifies administration for all parties.

Additionally, it is the state and local governments in this country that impose consumption taxes most often in the form of a retail sales or gross receipts tax, which have no direct federal counterpart.

A number of factors, including the fiscal condition of the federal government, the broadening reach of the alternative minimum tax and the expiration of earlier tax reductions, may occasion a policy debate in the U.S. about fundamental reform of the federal tax system. Alternatives mentioned in the past include elimination or substantial revision of the corporate income tax, adoption of a value added or other national consumption tax, and substantial simplification and “flattening” of the personal income tax. The nature of the current income tax system means that changes to federal laws will often have a substantial fiscal and administrative impact at the state and local level.

The interaction of federal and sub-national tax systems and the impacts on states and localities is evident in some of the federal policy changes in years past, including the phase-out of the federal estate tax, broadening of allowable deductions for retirement contributions and broadening the depreciation allowance for businesses.

Failure to take into account the fiscal, administrative and policy implications for states and localities of federal income tax changes leads to nonconformity and considerable new complexities and recordkeeping burdens for taxpayers and tax professionals. Failure to involve the states in proposed federal laws affecting state and local consumption taxes means that any resulting law may fail to achieve its goals or interfere with the functioning of that tax base, so important to many governmental programs. Such failure also affects the state and local tax structure as a whole, compliance programs, and levels of service to taxpayers. They can also lead to the effective preemption of state and local tax bases and the loss of opportunities to leverage improvements in the overall tax system. There are often alternative ways to achieve desired changes to federal policy that minimize or eliminate any need for states and localities to make

adjustments to their own tax systems and thus keep the federal, state and local systems in harmony.

Resolution

The Federation of Tax Administrators (FTA) supports Congressional efforts to formally and carefully consider the positive and negative impact of potential federal tax measures on state and local income tax systems, including generation of revenue estimates. Congress is encouraged to identify federal tax actions that can lead to nonconformity and to estimate the impact of those actions. States and local governments with income and consumption taxes and taxpayers should work in concert to educate Congress on the effects of federal changes that force states and localities to reduce conformity and to jointly seek the creation of procedures that will reduce or eliminate the need for such state and local action.

The FTA also supports Congress's commitment to consult with state and local governments on consumption tax issues since it is the state and local policymakers who have extensive experience in the administration of these consumption taxes.

This resolution shall automatically terminate three years after the Annual Business Meeting at which it is adopted, unless reaffirmed or replaced in the normal policy process. Passed by the membership by voice vote during the Annual Meeting of the membership June 14, 2017.