

The States Are Not Sovereign

To the Editor:

An article in *State Tax Notes*, (Aug 2, 2010, p. 275, *Doc 2010-16836*, or *2010 STT 145-1*) reported on the Multistate Tax Commission's annual conference.

One of the speakers was David Brunori, who addressed questions of federalism. According to your write-up, Brunori urged state tax officials "to worry less about preserving state sovereignty and more about encouraging fair and effective tax laws." I agree.

The states are not "sovereign." To the extent that there may have been any doubt about that, the point was decisively settled in 1865 when Generals Lee and Johnston surrendered to the Northern armies.

Although it is certainly appropriate for states to be able to determine whom they will tax and at what rates and what kinds of taxes they will impose, many aspects of our tax system would benefit from conformity among the states.

Our economy is very different from the country's economy of 1789. It is part of an international economic system. Multistate corporations spend huge amounts of money and resources complying with the different tax systems imposed by the states and, when the tax rules involve the allocation of income among the different states in the context of corporate income taxes, the country does not benefit by allowing each state to determine its share of the pie.

The development of apportionment formulas in the different states illustrates the point. Under our present system, every state is free to choose its own apportionment method. While some states have adopted economically sensible formulas to determine their shares of a multistate corporation's income, other states have adopted apportionment formulas aimed at attracting businesses by emphasizing the source of receipts over the presence of property and employees, rejecting labor and capital as sources of income in favor of a market-based approach. Corporations are faced with a bewildering variety of apportionment formulas that often bear no relationship to a reasonable determination of each state's share of their income.

Nexus is another area in which conformity would be desirable. There is no reason why each state should have the ability to determine whether the extent of a corporation's contacts are sufficient to

submit it to the state's taxing jurisdiction. Uniform rules would eliminate much of the confusion and expense of compliance.

Uniformity would also be desirable in the treatment of employees and others who work in a number of states. Literally, most state personal income tax statutes require a nonresident to pay tax if he or she works in the state for as much as one day. Although state revenue departments have not enforced these statutes literally because to do so would be administratively impossible, the laws remain on the books. A uniform rule for all states would simplify the lives of employees who have to file tax returns and employers who have to withhold taxes.

I have argued in these pages that the states will never voluntarily agree on uniform rules and that the only way to achieve greater uniformity would be by federal legislation.¹ Although many of my friends in state governments have expressed disagreement with this view, I continue to hold it. Imposing uniform rules on the states regarding nexus and apportionment of income would not significantly impede the states' fiscal independence, and it would result in great benefits for taxpayers and, I believe, for administrators as well. Total uniformity could not be achieved, because state revenue departments would often disagree on the interpretation of statutes, but having uniform statutory provisions in these areas would certainly help.

Up to now, Congress has generally been unwilling to impose its views on the states, and its track record when it has done so has not always been exemplary, but ultimately I am convinced that this is the direction in which we should move. Brunori is absolutely right. The states should stop worrying about preserving a "sovereignty" that does not exist and should work toward making their laws more sensible. They should not stand in the way of federal legislation that would establish uniform standards.

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¹Peter L. Faber, "Should the States Determine Their Own Tax Destinies? Federalism in the 21st Century," *State Tax Notes*, Apr. 10, 2006, p. 111, *Doc 2006-5313*, or *2006 STT 68-1*.