

Prepared Statement of  
**Joseph Henchman**  
**Tax Counsel & Director of State Projects**  
**Tax Foundation**

Hearing on  
**State Taxation:**  
**The Impact of Congressional Legislation on**  
**State and Local Government Revenues**

Before the U.S. House Committee on the Judiciary,  
Subcommittee on Commercial and Administrative Law

April 15, 2010

# The Role of Congress in State Tax Legislation: Ensuring that State Taxation Does Not Do Harm to the National Economy

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## **Mr. Chairman, Ranking Member Franks, and Members of the Subcommittee:**

I appreciate the opportunity to testify today on the role of Congress in ensuring that state taxation does not do harm to the national economy.

This is not a new issue. One of the reasons we have a Constitution is because of states’ impulse to do death-with-a-thousand-cuts to the national economy through their tax policy.<sup>1</sup> As Professor Daniel Shaviro put it, “Perceived tax exportation is a valuable political tool for state legislators, permitting them to claim that they provide government services for free.”<sup>2</sup>

Frowning on these divisive and destructive practices, the Founders inserted constitutional provisions empowering Congress and the courts<sup>3</sup> to restrain state tax power.<sup>4</sup> For over a

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<sup>1</sup> See, e.g., *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 224 (1824) (Johnson, J., concurring) (“[States’ power over commerce,] guided by inexperience and jealousy, began to show itself in iniquitous laws and impolitic measures . . . , destructive to the harmony of the states, and fatal to their commercial interests abroad. This was the immediate cause, that led to the forming of a convention.”); 1 STORY CONST § 497 (“[I]here is wisdom and policy in restraining the states themselves from the exercise of [taxation] injuriously to the interests of each other. A petty warfare of regulation is thus prevented, which would rouse resentments, and create dissensions, to the ruin of the harmony and amity of the states.”); Statement of Gouverneur Morris, SUPPLEMENT TO MAX FARRAND’S THE RECORDS OF THE FEDERAL CONVENTION OF 1787 at 360 (“These local concerns ought not to impede the general interest. There is great weight in the argument, that the exporting States will tax the produce of their uncommercial neighbors.”).

<sup>2</sup> Daniel Shaviro, “An Economic and Political Look at Federalism in Taxation,” 90 Mich. L. Rev. 895, 957 (1992).

<sup>3</sup> The power of the federal courts to act when Congress is silent is inferred as an implication of the Commerce Clause, a doctrine often referred to as the “dormant” or “negative” Commerce Clause. See, e.g., *Willson v. The Black Bird Creek Marsh Co.*, 27 U.S. 245 (1829).

century and a half, states' power of taxation stopped at their border and did not extend to interstate commerce.<sup>5</sup>

That changed in the 1977 *Complete Auto* decision, where the Supreme Court permitted states to tax interstate commerce if the tax met a four-part test:<sup>6</sup>

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<sup>4</sup> See U.S. CONST. art. I, § 8, cl. 3 (Interstate Commerce Clause); U.S. CONST. art. I, § 10, cl. 2 (Import-Export Clause); U.S. CONST. art. IV, § 2, cl. 1 (Privileges and Immunities Clause); U.S. CONST., amend. XIV, § 1 (Privileges or Immunities Clause).

The Commerce Clause prohibits states from imposing a tax on activity out-of-state while leaving identical activity in-state untaxed. See *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318 (1977) (invalidating a New York tax imposed solely on activity out-of-state while leaving identical activity in-state untaxed); *Westinghouse Elec. Co. v. Tully*, 466 U.S. 388 (1984) (invalidating a New York scheme exempting activity in-state while simultaneously imposed a tax on identical activity out-of-state); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) (invalidating a Hawaii tax imposed on a category of products but exempting activity in-state); *Am. Trucking Ass'n v. Scheiner*, 483 U.S. 266 (1987) (invalidating a Pennsylvania scheme imposing fees on all trucks while reducing other taxes for trucks in-state only); *New Energy Co. v. Limbach*, 486 U.S. 269 (1988) (invalidating an Ohio tax credit to all ethanol producers but disallowed for non-Ohio producers); *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994) (invalidating a Massachusetts general tax on dairy producers where the revenue was then distributed to domestic dairy producers); *Camps/Newfound/Owatanna, Inc. v. Town of Harrison*, 520 U.S. 564 (1997) (invalidating Maine's denial of the general charitable deduction to organizations that primarily serve non-Maine residents). But see *Dep't. of Revenue of Ky. v. Davis*, 553 U.S. 328 (2008) (upholding Kentucky's exclusion from tax of interest earned from its state bonds, but not other states bonds, on the grounds that Kentucky is acting as a market participant no different from any other bond issuer).

The Import-Export Clause prohibits states from penalizing activity that crosses state lines, particularly imports. See, e.g., *Michelin Corp. v. Wages*, 423 U.S. 276, 295 (1976) (stating that the Import-Export Clause prohibits import taxes that "create special protective tariffs or particular preferences for certain domestic goods....").

The Privileges and Immunities Clause of Article IV and the Privileges or Immunities Clause of the Fourteenth Amendment protects the right of citizens to cross state lines in pursuit of an honest living. See, e.g., *United Bldg. & Constr. Trades v. Mayor*, 465 U.S. 208, 219 (1984) (identifying "pursuit of a common calling" as a privilege of citizenship protected by the Constitution); *Saenz v. Roe*, 526 U.S. 489 (1999) (invalidating a law that did not restrict state travel *per se* but discouraged the crossing of state lines with a punitive and discriminatory law); *id.* at 511 (Rehnquist, J., dissenting) ("The right to travel clearly embraces the right to go from one place to another, and prohibits States from impeding the free passage of citizens); Erwin Chemerinsky, *CONSTITUTIONAL LAW* 450 (2d ed. 2002) ("The vast majority of cases under the [Article IV] privileges and immunities clause involve states discriminating against out-of-staters with regard to their ability to earn a livelihood.").

<sup>5</sup> See, e.g., *Freeman v. Hewit*, 329 U.S. 249, 252-53 (1946) ("A State is ... precluded from taking any action which may fairly be deemed to have the effect of impeding the free flow of trade between States"); *Leloup v. Port of Mobile*, 127 U.S. 640, 648 (1888) ("No State has the right to lay a tax on interstate commerce in any form.").

<sup>6</sup> See *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). The case came about after a series of cases in the 1950s and 1960s where the Court treated essentially identical taxes differently based on "magic words" in the statute. For example, an annual license tax imposed on the in-state gross receipts of an out-of-state company was invalidated as discriminating against interstate commerce, but an otherwise identical franchise tax on in-state going concern value, measured by gross receipts, was upheld as valid. Compare *Ry. Express Agency v. Virginia*, 347 U.S. 359 (1954) ("*Railway Express P*") and *Ry. Express Agency v. Virginia*, 358 U.S. 434 (1959) ("*Railway Express IP*").

- ◆ **Nexus:** there has to be a sufficient connection between the state and the taxpayer.
- ◆ **Fair Apportionment:** the state cannot tax beyond its fair share of the taxpayer's income
- ◆ **Nondiscrimination:** the state must not burden out-of-state taxpayers while exempting in-state taxpayers
- ◆ **Fairly Related:** the tax must be fairly related to services provided to the taxpayer.

The test is well-formulated but much of it is ignored today.

On apportionment, states have drifted away from a once-uniform rule, with successive rounds of states' grabbing revenue from other states (see table) through modified formulas, throwback rules, and combined reporting.<sup>7</sup>

Regarding nondiscrimination, states and localities put hefty taxes on rental cars and hotel rooms used primarily by out-of-state residents,<sup>8</sup> and taxes designed to be stealth and punitive on certain products, such as telecommunications.<sup>9</sup>

And regarding taxes being fairly related to services, it's assumed today that any tax is fairly related, even though only residents benefit from most state and local spending.<sup>10</sup>

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<sup>7</sup> See Chris Atkins, "A Twentieth Century Tax in the Twenty-First Century: Understanding State Corporate Tax Systems," TAX FOUNDATION BACKGROUND PAPER NO. 49 (Sep. 2005) at 6-9 ("Apportionment: How Much of the Pie Can You Eat?")

<sup>8</sup> See, e.g., Joseph Henchman, "Cities Pursue Discriminatory Taxation of Online Travel Services: Real Motivation is to Shift Tax Burdens to Nonresidents; Result is Harm to Interstate Commerce," TAX FOUNDATION SPECIAL REPORT NO. 175 (Feb. 2010), <http://www.taxfoundation.org/publications/show/25786.html>; Andrew Chamberlain, "The Case Against Special Rental Car Excise Taxes," *Tax Policy Blog* (Apr. 18, 2006), <http://www.taxfoundation.org/blog/show/1440.html>.

<sup>9</sup> See, e.g., Joseph Henchman, "States Target Cell Phones for a Stealth, Burdensome Tax," TAX FOUNDATION FISCAL FACT NO. 116 (Jan. 18, 2008), <http://www.taxfoundation.org/research/show/22881.html> ("State and local governments should not single out one product for stealth tax increases, as they are doing with cell phones. Such actions distort market decisions, violating the sound-tax-policy principle of neutrality. Cell phone users are often overtaxed relative to consumers of other goods, and at risk of double taxation. Finally, the wide number of taxing authorities and the wide variety in rates makes tracking problematic and burdensome.").

<sup>10</sup> See, e.g., *Goldberg v. Sweet*, 488 U.S. 252, 266-67 (1989) ("The purpose of this test is to ensure that a State's tax burden is not placed upon persons who do not benefit from services provided by the State. Appellants would severely limit this test by focusing solely on those services which Illinois provides to telecommunications equipment located within the State. We cannot accept this view. The tax which may be imposed on a particular interstate transaction need not be limited to the cost of the services incurred by the State on account of that particular activity.").

**STATE APPORTIONMENT FORMULAS: ONCE UNIFORM, NOW NOT**

State	Kept Uniform Rule?	Formula	Statute
Alabama	Yes	Evenly weighted three-factor formula.	Alabama Code §40-27-1(IV)(9)
Alaska	Yes	Evenly weighted three-factor formula.	Alaska Stat. §43.19.010(IV)(9)
Arizona	No	Three-factor formula with double-weighted sales factor or enhanced sales factor formula 80-10-10 (sales, property, payroll).	Ariz. Rev. Stat. §43-1139(A), Form 120, Instructions
Arkansas	No	Three-factor formula with double-weighted sales factor.	Ark. Code. Ann. §26-51-709
California	No	Three-factor formula with double-weighted sales factor.	Cal. Rev. & Tax Code §25128(a), Cal. Rev. & Tax Code §25128.5
Colorado	No	One-factor sales formula.	Colo. Rev. Stat. §39-22-303(2)(b), Colo. Rev. Stat. §24-60-1301(IV)(9)
Connecticut	No	Single-factor gross receipts formula for income other than that derived from the sale or use of tangible personal or real property, and three-factor formula with double-weighted sales factor for income derived from the sale or use of tangible personal or real property.  Three-factor formula with double-weighted sales factor for income derived from the manufacture, sale, or use of tangible personal or real property.	Conn. Gen. Stat. §12-218(b) and (c)
Delaware	Yes	Evenly weighted three-factor formula.	Del. Code Ann. tit. 30, §1903(b)(6)
Florida	No	Three-factor formula with double-weighted sales factor.	Fla. Stat. ch. 220.15(1)
Georgia	No	One-factor sales formula.	Ga. Code Ann. §48-7-31(d)
Hawaii	Yes	Evenly weighted three-factor formula.	Haw. Rev. Stat. §255-1(IV)(9)
Idaho	No	Three-factor formula with double-weighted sales factor.	Idaho Code §63-3027(i)(1)
Illinois	No	One-factor sales formula.	35 ILCS 5/304(h)(3)
Indiana	No	Three-factor formula 90-5-5 (sales, property, payroll).	Ind. Code §6-3-2-2(b)
Iowa	No	One-factor sales formula.	Iowa Code §422.33(2)(b)
Kansas	Yes	Evenly weighted three-factor formula.	Kan. Stat. Ann. §79-3279(b)(1)
Kentucky	No	Three-factor formula with double-weighted sales factor.	Ky. Rev. Stat. Ann. §141.120(8)
Louisiana	Yes	Evenly weighted three-factor formula for corporations without a specified formula (i.e., businesses other than manufacturing, merchandising, transportation, or services, etc).	La. Rev. Stat. Ann. §47:287.95(F)(2)
Maine	No	One-factor sales formula.	Me. Rev. Stat. Ann. tit. 36, §5211(8)
Maryland	No	Three-factor formula with double-weighted sales factor and a one-factor sales formula for manufacturers.	Md. Code Ann. §10-402(c)(1) and (2)
Massachusetts	No	Three-factor sales formula with double-weighted sales factor.	Mass. Gen. Laws ch. 63, §38(c)
Michigan	No	One-factor sales formula for purposes of computing Michigan Business Tax (MBT).	Mich. Comp. Laws §208.45(a)(1), Mich. Comp.

			Laws §208.1301(2), Mich. Comp. Laws §208.1303(1)
Minnesota	No	Three-factor formula 87-6.5-6.5 (sales-property-payroll).	Minn. Stat. §290.191(2)
Mississippi	Varies	No general apportionment formula. One-factor sales formula for taxpayers that are not required to use a designated apportionment formula based on specific type or line of in-state business activity.	Miss. Reg. 35.III.8.06(II)(B), Unofficial Tax Commission guidance
Missouri	Yes	Evenly-weighted three-factor formula or optional one-factor sales formula for corporations other than certain public utilities and transportation companies.	Mo. Rev. Stat. §32.200(IV)(9), Mo. Rev. Stat. §143.451.2
Montana	Yes	Evenly weighted three-factor formula.	Mont. Code Ann. §15-31-305
Nebraska	No	One-factor sales formula.	Neb. Rev. Stat. §77-2734.05(1)
New Hampshire	No	Three-factor formula with double-weighted sales factor.	N.H. Rev. Stat. Ann. §77-A:3(II)(a)
New Jersey	No	Three-factor formula with double-weighted sales factor.	N.J. Stat. Ann. §54:10A-6
New Mexico	Yes	Evenly weighted three-factor formula.	N.M. Stat. Ann. §7-4-10(A)
New York	No	One-factor receipts formula.	N.Y. Reg. Sec. 4-2.2(b)
North Carolina	No	Three-factor formula with double-weighted sales factor.	N.C. Gen. Stat. §105-130.4(i)
North Dakota	Yes	Evenly weighted three-factor formula.	N.D. Cent. Code §57-38.1-09
Ohio	N/A	For purposes of the commercial activity tax, the state has specific rules describing how gross receipts are situated to the state.	Ohio Rev. Code Ann. §5733.05(B)(2)
Oklahoma	Varies	Evenly weighted three-factor formula; corporations meeting investment criteria may double-weight the sales factor.	Okla. Stat. tit. 68, §2358(A)(5)
Oregon	No	One-factor sales formula.	Or. Rev. Stat. §314.650(1)
Pennsylvania	No	Three-factor formula 90-5-5 (sales, property, payroll).	72 P.S. §7401(3)2(a)(9)(A)
Rhode Island	Yes	Evenly weighted three-factor formula.	R.I. Gen. Laws §44-11-14(a)
South Carolina	No	Three-factor formula with double-weighted sales or optional one-factor sales formula for manufacturers, sellers, distributors and renters of tangible property.	S.C. Code Ann. §12-6-2250, S.C. Code Ann. §12-6-2290, Form 1120SC Instructions, C Corporation Income Tax Return
Tennessee	No	Three-factor formula with double-weighted sales factor.	Tenn. Code Ann. §67-4-2012(a)
Texas	N/A	One-factor gross receipts formula.	Tex. Tax Code Ann. §171.105(a), Tex. Tax Code Ann. §171.106(a)
Utah	Varies	Evenly weighted three-factor formula, unless election is made to use apportionment formula with double weighted sales factor.	Utah Code Ann. §59-7-302, Utah Code Ann. §59-7-311, Utah Admin. Code R865-6F-8
Vermont	No	Three-factor formula with double-weighted sales factor.	Vt. Stat. Ann. tit 32, §5833(a)
Virginia	No	Three-factor formula with double-weighted sales factor.	Va. Code. Ann. §58.1-408
West Virginia	No	Three-factor formula with double-weighted sales factor.	W. Va. Code §11-24-7(e)
Wisconsin	No	One-factor sales formula.	Wis. Stat. §71.25(6)(a)
District of Columbia	Yes	Evenly weighted three-factor formula.	D.C. Code Ann. §47-1810.02(d)

Source: Commerce Clearinghouse; Tax Foundation.

Nexus survives as a restraint on state power, although it is now under attack.

## Corporate Income Tax

First there's the state corporate income tax. It's a dying tax, killed off by thousands of credits, deductions, abatements, and incentive packages. In the late 1970s during the time of the *Complete Auto* case, the tax raised nearly 10% of state tax revenue; today it's hovering around 6% (see table). Corporations try to plan their way out of it, resulting in serious compliance and administrative costs compared to other revenue sources.<sup>11</sup>

### THE DYING STATE CORPORATE INCOME TAX: NATIONWIDE COLLECTIONS AS A PERCENTAGE OF TOTAL STATE TAX REVENUE AND AS A PERCENTAGE OF TOTAL STATE REVENUES

	% of Tax	% of Total
1977	9.1%	4.5%
1978	9.5%	4.8%
1979	9.7%	4.9%
1980	9.7%	4.8%
1981	9.4%	4.6%
1982	8.6%	4.2%
1983	7.7%	3.7%
1984	7.9%	3.9%
1985	8.2%	4.0%
1986	8.1%	3.8%
1987	8.3%	4.0%
1988	8.2%	4.0%
1989	8.4%	4.1%
1990	7.2%	3.4%
1991	6.6%	3.1%
1992	6.6%	2.9%
1993	6.8%	3.0%

	% of Tax	% of Total
1994	6.9%	3.1%
1995	7.3%	3.2%
1996	7.0%	3.0%
1997	6.9%	3.0%
1998	6.6%	2.8%
1999	6.2%	2.7%
2000	6.0%	2.6%
2001	5.7%	2.7%
2002	4.7%	2.3%
2003	5.2%	2.2%
2004	5.1%	1.9%
2005	5.9%	2.4%
2006	6.7%	2.7%
2007	7.0%	2.6%
2008	6.5%	3.0%
2009	6.1%	N/A

Source: US Census; Tax Foundation.

<sup>11</sup> See, e.g., Organization for Economic Cooperation and Development, "Tax and Economic Growth," ECONOMICS DEPARTMENT WORKING PAPER NO. 620 (Jul. 11, 2008) ("[C]orporate taxes are found to be most harmful for growth, followed by personal income taxes, and then consumption taxes."); David Brunori, STATE TAX POLICY at 84 (2004) ("In many cases, the amount of time and resources devoted to the [state corporate income] tax outweighs its financial contribution to the states."); Richard Pomp, "The Future of the State Corporate Income Tax: Reflections (and Confession) of a Tax Lawyer," in THE FUTURE OF STATE TAXATION (David Brunori ed. 1998); J. Dwight Evans, "The Approaching State Corporate Income Tax Crisis," TAX FOUNDATION BACKGROUND PAPER NO. 14 (Sep. 1995), <http://www.taxfoundation.org/research/show/570.html>; Joel Slemrod & Marsha Blumenthal, "The Income Tax Compliance Cost of Big Business," TAX FOUNDATION SPECIAL ACADEMIC PAPER (Nov. 1993), <http://www.taxfoundation.org/publications/show/639.html>;

The beggar-thy-neighbor policies of apportionment formula games, mercantilist film and investment credit programs,<sup>12</sup> destructive gross receipts taxes,<sup>13</sup> and corporate welfare<sup>14</sup> are the reason for the collapse of this tax as a revenue source. But rather than fix those problems, the push by some states has been to reach across state lines with the nebulous concept of “economic nexus.”<sup>15</sup>

A uniform physical presence standard would limit these destructive state efforts to export tax burdens and will decrease transaction costs for interstate business activity.<sup>16</sup>

## Sales Tax

Sales taxes were first adopted by states in the 1930s, quickly followed by “use” taxes to discourage consumers from buying goods in lower-tax states. Use taxes seek to equalize tax burdens with a tax on transactions occurring in other states -- essentially a protectionist measure.<sup>17</sup>

But judicial decisions have barred states from forcing non-physically present individuals and businesses to collect their use taxes.<sup>18</sup> These decisions are premised both on the geographic

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<sup>12</sup> See Will Luther, “Movie Production Incentives: Blockbuster Support for Lackluster Policy,” TAX FOUNDATION SPECIAL REPORT NO. 173 (Jan. 2010), <http://www.taxfoundation.org/publications/show/25706.html>.

<sup>13</sup> See Andrew Chamberlain & Patrick Fleenor, “Tax Pyramiding: The Economic Consequences of Gross Receipts Taxes,” TAX FOUNDATION SPECIAL REPORT NO. 147 (Dec. 2006), <http://www.taxfoundation.org/research/show/2061.html>.

<sup>14</sup> See, e.g., Melvin L. Burstein & Arthur J. Rolnick, “Congress Should End the Economic War Among the States,” FEDERAL RESERVE BANK OF MINNEAPOLIS 1994 ANNUAL REPORT 9 (1):3-19 (urging a congressional end to states “using financial incentives to induce companies to locate, stay, or expand in the state.”).

<sup>15</sup> See, e.g., Joseph Henchman, *Why the Quill Physical Presence Rule Shouldn't Go the Way of Personal Jurisdiction*, 46 STATE TAX NOTES 387 (Nov. 5, 2007), <http://www.taxfoundation.org/commentary/show/22785.html> (“Abandoning the physical presence rule in *International Shoe* led to confusion and uncertainty, resulting in an area of law in which no one is sure what the rules are. Abandoning the *Quill* physical presence rule would result in the same.... First, applying geography-based income taxes or geography-based sales taxes with a standard unconstrained by geography risks multiple taxation and burdensome compliance costs.... Second, simply imposing the existing taxation regime on e-commerce would burden e-commerce more than bricks-and-mortar businesses.... Third, there is a high likelihood that e-commerce would become subject to multiple taxation under an economic nexus standard.... Fourth, how far in space and time economic nexus can go remains undetermined.... Fifth, adopting an economic nexus standard would unsettle expectations and threaten retroactive application of taxes, endangering economic investments.... Overturning the present standard without being sure about what replaces it will repeat the mistake made by the progeny of *International Shoe*.”).

<sup>16</sup> *Id.*

<sup>17</sup> See, e.g., Joseph Henchman, “Amazon Tax? Laws Signal Business Unfriendliness and Will Worsen Short-Term Budget Problems,” TAX FOUNDATION SPECIAL REPORT NO. 176 (Mar. 8, 2010), <http://www.taxfoundation.org/publications/show/25949.html>, citing *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937).

<sup>18</sup> See, e.g., *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 (1992) (“[Nexus] limit[s] the reach of State taxing authority so as to ensure that State taxation does not unduly burden interstate commerce.”); *id.* at n. 6 (“North Dakota’s use tax illustrates well how a state tax might unduly burden



limit of state powers and on the difficulty of complying with over 8,000 constantly changing sales taxes, with different bases, rates, and exemptions, and contrary to popular belief, are not aligned with even 9-digit or even 5-digit zip codes.<sup>19</sup>

Brick-and-mortar retailers claim unfairness: they must collect sales tax while their online and out-of-state competitors don't. Of course, the proposal on the table is to impose a *greater* obligation on out-of-state and online businesses, forcing them to collect thousands of different sales taxes, while brick-and-mortar retailers need to track and collect only one.<sup>20</sup>

We have the Streamlined Sales Tax Project (SSTP), an effort to simplify and harmonize state sales taxes in the hope that Congress or the Supreme Court will permit states to impose use tax collection obligations on out-of-state companies.<sup>21</sup> While the SSTP has made notable progress on uniform definitions, meaningful efforts to simplify have been avoided.<sup>22</sup> The SSTP's work is far from finished.

We have "Amazon taxes" that expand nexus even further than previous cases.<sup>23</sup> These taxes have actually reduced revenues in states that have adopted them and are considered by most to be unconstitutional.<sup>24</sup>

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interstate commerce."); *National Bellas Hess, Inc. v. Dep't of Revenue of State of Ill.*, 386 U.S. 753, 759-60 (1967) ("If Illinois can impose such burdens, so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the Nation with power to impose sales and use taxes. The many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose "a fair share of the cost of the local government.").

<sup>19</sup> See, e.g., Joseph Henchman, Testimony to the Maryland Legislature on the Streamlined Sales Tax Project (Feb. 18, 2009), <http://www.taxfoundation.org/research/show/24346.html> ("At [the SSTP] New Orleans meeting in July 2008, for instance, I asked if any effort was being made to reduce the number of sales taxing jurisdictions, and/or to align them with 5-digit zip codes. 'No and no,' was the short but honest answer.").

<sup>20</sup> See, e.g., Joseph Henchman, "Amazon Tax' Laws Signal Business Unfriendliness and Will Worsen Short-Term Budget Problems," TAX FOUNDATION SPECIAL REPORT NO. 176 (Mar. 8, 2010), <http://www.taxfoundation.org/publications/show/25949.html>.

<sup>21</sup> See, e.g., Joseph Henchman, Testimony to the Maryland Legislature on the Streamlined Sales Tax Project (Feb. 18, 2009), <http://www.taxfoundation.org/research/show/24346.html>, citing Joseph Henchman, "Nearly 8,000 Sales Taxes and 2 Fur Taxes: Reasons Why the Streamlined Sales Tax Project Shouldn't Be Quick to Declare Victory," *Tax Policy Blog* (Jul. 28, 2008), <http://www.taxfoundation.org/blog/show/23423.html>.

<sup>22</sup> *Id.*

<sup>23</sup> See, e.g., Joseph Henchman, "Amazon Tax' Laws Signal Business Unfriendliness and Will Worsen Short-Term Budget Problems," TAX FOUNDATION SPECIAL REPORT NO. 176 (Mar. 8, 2010), <http://www.taxfoundation.org/publications/show/25949.html> ("New York relied on two U.S. Supreme Court cases, *Scripto, Inc. v. Carson* and *Tyler Pipe Indus. v. Washington Dep't of Revenue*, where in-state independent persons were so necessary and significant in establishing and maintaining the out-of-state company's market in the state that the companies were deemed to be present in the state. These 'attributional nexus' cases have been described by the Supreme Court itself as the "furthest extension" of nexus.... New York's law is an unprecedented expansion of state taxing authority. The affiliates are responsible for only 1.5% of Amazon.com's sales in New York, and there is no evidence that the affiliates even target New Yorkers (they operate via websites, available

## Individual Income Tax

Half the states require nonresident employees to set up individual income tax withholding for their *first* day of travel into the state.<sup>25</sup> Sixteen more states also require withholding after a certain point. And that's just withholding, not the obligation to file a return or pay taxes.<sup>26</sup>

A few years ago, we got a call from a woman in Ohio. Her son was a soccer goalie and he had earned \$28,000. Spread across this woman's kitchen table were 10 state income tax returns, divvying up the tax on \$28k. States are becoming more aggressive with nonresident income taxes, hunting schedules via Twitter, demanding travel vouchers, generally imposing a colossal compliance burden that is a net revenue wash, transferring tax dollars from low-tax, low-expense states to the states with the highest tax burdens.<sup>27</sup>

## Conclusion

The states are hurting, it is true. They aren't entirely innocent in that predicament.<sup>28</sup> But state fiscal pain does not justify beggar-thy-neighbor policies that impose significant compliance and deadweight losses on the national economy. State power to tax should not extend to everything everywhere. Simplification should be something everyone embraces. As Chief Justice Marshall said, "The power to tax is the power to destroy."<sup>29</sup> And state tax overreaching can destroy.

As a country we have gone from the artisan to Amazon.com. But the sophistication of technology does not override the timeless constitutional principles designed to restrain states from burdening interstate commerce and imposing uncertainty on the national economy.<sup>30</sup>

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worldwide). The affiliates neither engage in direct solicitation nor provide any crucial sales support for Amazon.com in the state.").

<sup>24</sup> See, e.g., Joseph Henchman, "'Amazon Tax' Laws Signal Business Unfriendliness and Will Worsen Short-Term Budget Problems," TAX FOUNDATION SPECIAL REPORT NO. 176 (Mar. 8, 2010), <http://www.taxfoundation.org/publications/show/25949.html>.

<sup>25</sup> See Council on State Taxation, "Nonresident Personal Income Tax Withholding."

<sup>26</sup> *Id.*

<sup>27</sup> See David Hoffman & Scott A. Hodge, "Nonresident State and Local Income Taxes in the United States," TAX FOUNDATION SPECIAL REPORT NO. 130 (Jul. 1, 2004), <http://www.taxfoundation.org/research/show/94.html>.

<sup>28</sup> See, e.g., Joseph Henchman, "State Budget Shortfalls Present a Tax Reform Opportunity," TAX FOUNDATION SPECIAL REPORT NO. 164 at 9 (Feb. 2009), <http://www.taxfoundation.org/research/show/24321.html> ("Those states hardest hit by the recession are those that relied the most heavily on capital gains, high-income earners, and corporate profits... Revenue from [these tax sources] does spike during times of economic boom, but it plummets during a bust. States without spending controls get into trouble by assuming for spending purposes that the years of revenue windfall will continue.").

<sup>29</sup> *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 431 (1819).

<sup>30</sup> See, e.g., Daniel Shaviro, *An Economic and Political Look at Federalism in Taxation*, 90 MICH. L. REV. 895, 902 (1992) ("Today's more integrated national economy presents far greater opportunities than existed in 1787 for states in effect to reach across their borders and tax nonconsenting nonbeneficiaries.").



**Tax Foundation**  
National Press Building  
529 14th Street, N.W., Suite 420  
Washington, DC 20045

202.464.6200  
[www.TaxFoundation.org](http://www.TaxFoundation.org)

#### **ABOUT THE TAX FOUNDATION**

The Tax Foundation is a non-partisan, non-profit research institution founded in 1937 to educate taxpayers on tax policy. Based in Washington, D.C., the Foundation's economic and policy analysis is guided by the principles of sound tax policy: simplicity, neutrality, transparency, and stability. The Tax Foundation seeks to make information about government finance more understandable, such as with the annual calculation of "Tax Freedom Day," the day of the year when taxpayers have earned enough to pay for the nation's tax burden and begin earning for themselves.

#### **ABOUT THE CENTER FOR STATE FISCAL POLICY AT THE TAX FOUNDATION**

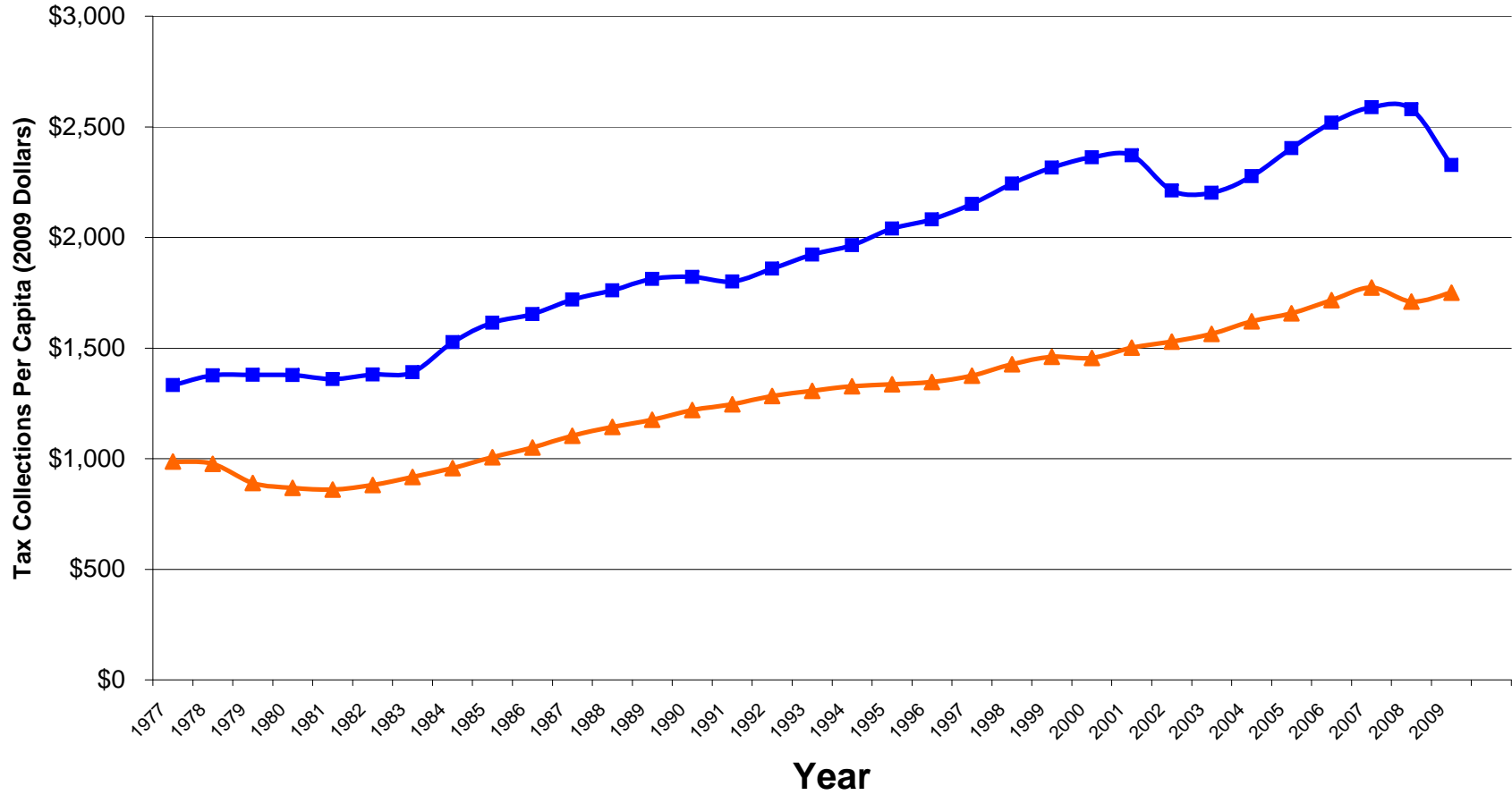
The Tax Foundation's Center for State Fiscal Policy produces timely, high-quality, and user-friendly data and analysis for elected officials, national groups, state-based groups, grassroots activists, the media, business groups, students, and the public, thereby shaping the state policy debate toward simple, neutral, transparent, stable, and pro-growth tax policies.

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The Tax Foundation's Center for Legal Reform educates the legal community and the general public about economics and principled tax policy. The Center's research efforts focus on the scope of taxing authority, the definition of tax, economic incidence, and taxpayer protections.

# Total State & Local Tax Revenue, United States

Adjusted for Inflation; Does Not Include Federal Stimulus Aid

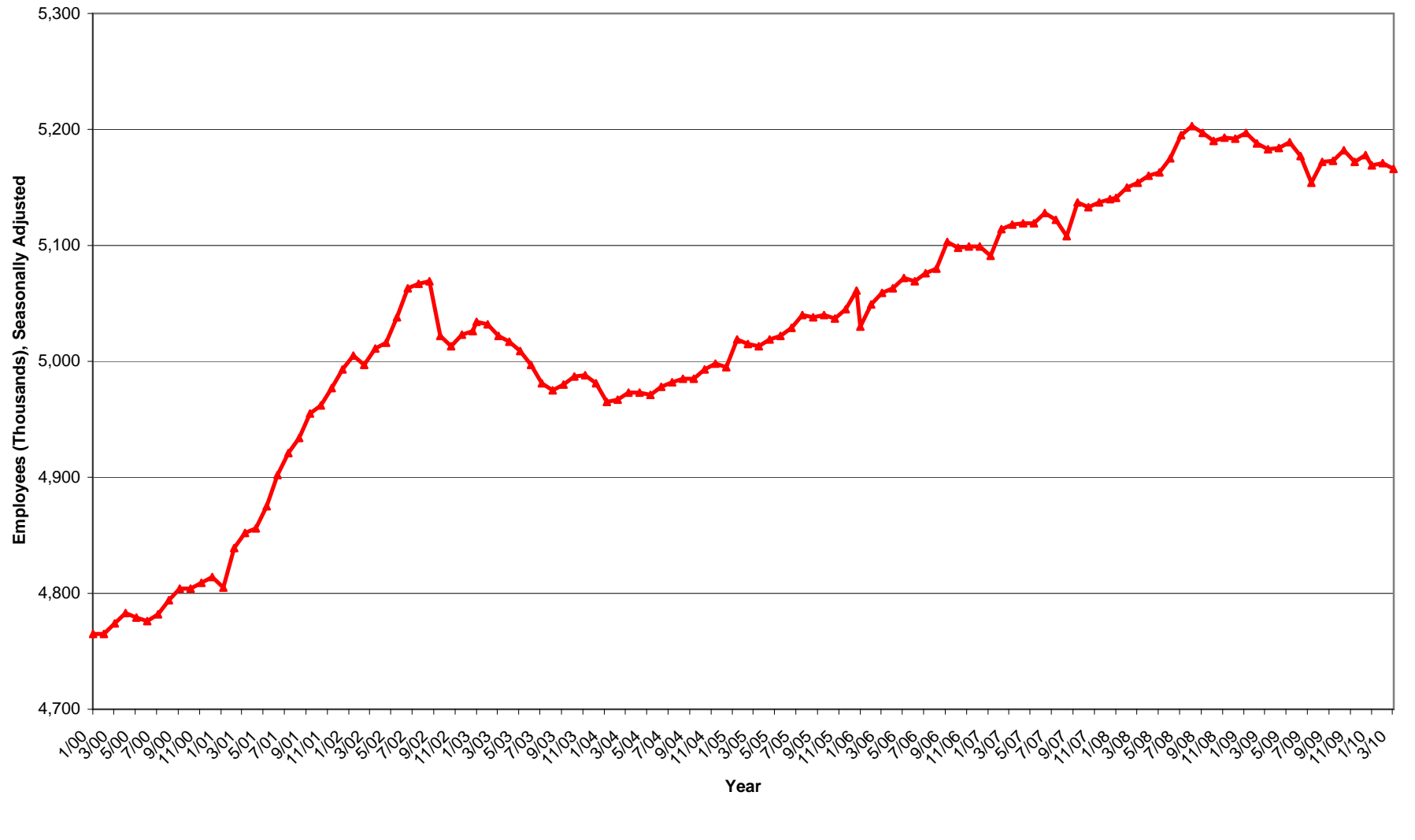


Source: Tax Foundation. Revenue figures are from the U.S. Census and state revenue and budget reports. Inflation adjustment is GDP Deflator data from the St. Louis Federal Reserve. Population figures are from the U.S. Census. Local tax data from 2001 and 2003 are not available.



# State Government Employment, 2000-2010

Source: Tax Foundation compilation of Bureau of Economic Analysis data



# State & Local Government Employment, 2000-2010

Source: Tax Foundation compilation of Bureau of Economic Analysis data

