03-01 Respecting Federalism

3.1 Preamble

The U.S. Constitution creates a unique federalism that shares governmental power between the federal government and the states. The vast majority of what most citizens think of as “government” consists of state and local governmental services—the schools, the roads, the police and fire protection, the civil and criminal justice systems, and the motor vehicle departments. States cannot provide these governmental services without the power to raise revenues. Retaining state tax sovereignty is a key element in preserving the American system of federalism.

Federalism is more than a practical idea that allows states to efficiently serve our country’s basic needs for education, transportation, and safety. To ensure the blessings of liberty for all generations to come, the 10th Amendment to the U.S. Constitution intentionally diffuses power between the federal government and the states, each to act within their spheres of competence.

The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

Federal preemption of state taxing authority undercuts the very life-blood of state power and distorts the Constitution’s intentional balance of power between the federal government and the states that created it. Federal grants may help states deliver services, but they are no substitute for the independent power to raise revenue and determine state policy guaranteed by the Constitution. The Multistate Tax Commission urges the federal government to recognize and support the role of the states within our constitutional structure as co-equal sovereigns.

The federal government and the states share not only sovereignty, but taxpayers. Due respect for their citizen-taxpayers requires that the federal and state governments arrange their tax systems in a cooperative manner. The need to tax cannot be avoided, but the cost and inconvenience of compliance burdens can be minimized and the efficiencies of the respective systems can be enhanced by mutual respect and coordination.

While the states and the federal government share authority and responsibility for taxation and revenue, in recent years the states’ ability to raise their own revenue through
their tax systems has come under intense pressure from the federal government by
preemption of state and local taxation that affects various aspects of interstate
commerce. 1 At the same time, the devolution of governmental responsibilities from the
national government to the states has increased the importance of preserving state taxing
authority.

3.2 Congress Should Refrain from Interfering in State Taxing Authority

The Multistate Tax Commission opposes congressional interference in legitimate state
taxing authority. A meaningful federalism requires the federal government to leave to
states the sovereignty to determine and administer their own taxes within constitutional
limits.

Both the Supreme Court and Congress have espoused this view of federalism. In Dows v.
Chicago, 11 Wall. 108, 110, (1871), the Court said “It is upon taxation that the several
States chiefly rely to obtain the means to carry on their respective governments, and it is
of the utmost importance to all of them that the modes adopted to enforce the taxes levied
should be interfered with as little as possible.” Congress has expressly recognized the
importance of federal non-interference in state tax matters with the Tax Injunction Act,
28 U.S.C. § 1341, which explicitly prohibits federal district courts from hearing
challenges to state tax laws except under certain narrow and limited circumstances. This
same philosophy should guide Congress to limit the jurisdiction of any federal court over
state tax matters.

The Constitution itself provides crucial protection for multistate businesses, primarily
with the Due Process Clause and the Commerce Clause. As interpreted by the Supreme
Court, these constitutional provisions fully protect multistate businesses from unfair
imposition of tax, rendering unnecessary further congressional intervention.

Current proposals for congressional limitations on state taxing jurisdiction over multistate
businesses are more restrictive than necessary and are inconsistent with what the U.S.
Supreme Court has determined is required for a fair tax system under its due process and
dormant commerce clause jurisprudence. The proposed restrictions would grant favorable
treatment to certain industries, particularly those of the “new” economy that can operate
in cyberspace, at the expense of bricks and mortar businesses, particularly local
businesses. This would render state income taxes less fair and less effective.

Congressional actions over the last 40 years preempting state taxation of multistate
businesses in general with P.L. 86-272, and certain industries in particular, have raised
significant concerns about whether the U.S. system of federalism is at risk.

The Multistate Tax Commission respectfully urges Congress to refrain from exercising
its authority to preempt state tax laws in a manner that unnecessarily duplicates
protections available to taxpayers under the U.S. or state constitutions, that treats one

1 See, e.g., preemption of state tax on air travel, 49 U.S.C. §40116 (b) & (c); on interstate motor carrier
tavel, 49 US.C. §14505; on stock transfers, 15 U.S.C. § 78bb (d); on direct satellite broadcast, 47 U.S.C. §
251; on internet access, Internet Tax Freedom Act, P.L. 105-277.
group of taxpayers more favorably than others, that creates unpredictable and unintended consequences through ambiguous provisions, or that pursues national economic or fiscal objectives at the expense of state and local interests.

3.3 Congress Should Exercise its Authority Only to Further Cooperative Efforts Among the States to Simplify and Make More Uniform their Tax Systems as They Affect Multistate Businesses.

The Commission respectfully urges Congress to limit the exercise of its constitutional authority regarding state tax laws to situations that increase uniform treatment of similarly situated taxpayers.

The U.S. Supreme Court has repeatedly held that interstate commerce may be required to pay its fair share of state and local taxes even without explicit congressional approval. But Congress under its commerce clause power may affirmatively authorize states to tax multistate businesses when states have committed themselves to a multistate effort to adopt by agreement or compact sufficiently uniform and simple tax systems to remove undue compliance burdens. That kind of congressional action would recognize states’ sovereignty rights to set substantive tax policy, would serve to protect interstate commerce, and importantly, would ensure that similarly situated taxpayers are treated equally.

The development of the Streamlined Sales and Use Tax Agreement may follow precisely this method of enlisting congressional legislation to affirm a uniformity agreement among states that protects multistate businesses from undue compliance burdens. Proposals currently being suggested for congressional action would grant states authority to require remote sellers lacking physical presence in a state to collect use tax if the states are compliant with the state-drafted and state-enacted Streamlined Sales and Use Tax Agreement. This congressional oversight does not dictate substantive tax policy to states, but merely makes certain that state sales and use taxes are of sufficient uniformity and ease of compliance that there is no undue burden on interstate commerce—the quintessential requirement of *Quill Corp v. North Dakota*, 504 U.S. 298 (1992).

The Commission’s Policy Statement 02-02 also endorses this approach as the appropriate role for Congress. The Policy urges Congress to repeal P.L. 86-272 restrictions for states that have enacted the factor presence nexus standard. The factor presence nexus standard was specifically developed to provide certainty to multistate businesses in determining whether income tax nexus exists with a particular taxing jurisdiction. Like the Streamlined Sales and Use Tax Agreement, this cooperative effort by states also ensures uniformity with respect to state nexus standards. By easing the compliance burden borne by multistate businesses, states that adopt this simplified, uniform nexus standard should be permitted to exercise their sovereign authority to tax the income earned within their borders.
The Commission urges Congress to enhance federalism by encouraging cooperative state uniformity programs to remove tax compliance burdens on interstate commerce so that tax burdens can be imposed fairly and equitably.

3.4 The Executive Branch of the U.S. Government Should Also Further Equitable and Uniform Treatment of Similarly Situated Taxpayers in Negotiating Treaties and Trade Agreements.

The Multistate Tax Commission respectfully urges the Executive Branch to recognize state and local taxing interests in negotiating treaties and trade agreements and to consult with the states about such negotiations. The MTC also urges the Executive Branch to refrain from entering into any agreement that exceeds the authority of the federal government with regard to the states, that treats one group of taxpayers more favorably than others, that unnecessarily duplicates protections available to taxpayers under the U.S. or state constitutions, that creates unpredictable and unintended consequences through ambiguous provisions, or that pursues national economic or fiscal objectives at the expense of state and local interests.

3.5 Congress Should Facilitate Sensible Federal-State Cooperative Taxing Measures.

The Multistate Tax Commission encourages Congress to seek methods to enhance cooperation between the states and the federal government to simplify administration and improve proper compliance for those taxes shared by the states and the federal government. Most states simplify the compliance burdens on their citizen/taxpayers by basing state taxes on various federal tax bases. The Multistate Tax Commission respectfully urges Congress to minimize adverse effects on states and localities when changing federal tax policy.

Finally, to create a forum for on-going discussions for fiscal federalism, the Multistate Tax Commission suggests that Congress, in cooperation with the states and the President, revive a liaison organization established by law between the states and the federal government similar to the former Advisory Commission on Intergovernmental Relations.