

States Worry About Tax Reform

by [Pamela M. Prah](#), Staff Writer, *Stateline**
<http://www.pewstates.org/projects/stateline>

States are hoping they don't lose out in billions of dollars in tax breaks if Congress reforms the tax code this year. Groups representing governors and local governments have pressed Congress to essentially "do no harm" to state and local government coffers when crafting legislation to overhaul the U.S. tax code.

But U.S. Senator Max Baucus, chairman of the U.S. Senate Finance Committee, warned states and localities at a committee hearing Wednesday (April 25) that everything is on the table as Congress tries to cut the federal deficit.

This includes tax policies that states and localities heavily rely on to finance the construction of roads, schools and other projects, namely the federal exemption on municipal bonds. Many investors find municipal bonds attractive because the interest income is exempt from federal taxes and in many cases, state and local taxes. In exchange, the state that issues the bonds can save money on borrowing costs, lowering the cost of the project.

"For every dollar we spend on infrastructure through a tax-exempt bond, 20 cents goes to tax breaks for higher-income taxpayers," Baucus, a Democrat from Montana, [said](#), during the session that explored the impact of tax reform on state and local governments. "A uniform subsidy would mean each taxpayer receives the same subsidy regardless of tax bracket."

Local governments are urging Congress to keep the federal exemption on municipal bonds. "At this time, when infrastructure demands are great, yet direct federal assistance to state and local governments is shrinking, the ability of states and localities to issue tax-exempt bonds becomes more significant," wrote a group representing localities, including the National Association of Counties and National League of Cities.

One change that many states and governors would like Congress to make is to allow states to require remote vendors to collect state sales taxes, commonly known as the Amazon tax because sites like Amazon have been criticized for not collecting state sales taxes. States figure they would be able to collect more than \$22 billion in sales taxes they say they are owed but can't collect without a change in policy.

"The Internet facilitates tax avoidance; the lack of an effective system to collect sales taxes at the time of purchase causes many Americans to incur – but not pay – the taxes they legally owe," the National Governors Association [wrote](#).

If they didn't know it already, states were clearly put on notice that the days of congressional bailouts were over. U.S. Senator Orrin Hatch, the ranking Republican on the committee, was blunt: "It simply is not the responsibility of the federal government to address state budget shortfalls."

Hatch noted the U.S. Census Bureau has reported that state government tax collections in fiscal year 2011 were actually up nearly 8 percent from the revenue collected in fiscal year 2010. “Something else is driving state budget shortfalls, and I think in many instances the principal issue for states is their own unsustainable spending,” the Utah Republican [said](#).

* *Stateline* is a nonpartisan, nonprofit news service of the Pew Center on the States that provides daily reporting and analysis on trends in state policy.