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Senate Finance Committee holds hearing on state and local tax and fiscal policy



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The U.S. Senate Committee on Finance held a hearing April 25, 2012 entitled "Tax Reform: What It Means for State and Local Tax and Fiscal Policy." In his opening statement, Finance Committee Chairman Max Baucus (D-MT) expressed a need to ask whether the current system of taxation makes sense and, keeping in mind the proper division of power between the federal and state governments as it relates to the tax code, what Congress can do to efficiently help state and local government maintain sustainable budgets.

Witnesses at the hearing were: Frank Sammartino, Assistant Director for Tax Analysis, Congressional Budget Office; Kim Rueben, Senior Fellow, Urban-Brookings Tax Policy Center; Walter Hellerstein, Francis Shackelford Distinguished Professor of Taxation Law, University of Georgia School of Law; Joseph Henchman, VP of Legal & State Projects, Tax Foundation; and Sanford Zinman, Owner, Zinman Accounting. ([Click here](#) for the witnesses' written testimony)

Congress' role in state and local tax policy

In his opening statement, Ranking Member Orrin Hatch (R-UT) said that Congress' goal should first be to "do no harm" to state and local governments when considering federal tax reform, and specifically federal legislation that affects state taxation. Ms. Reuben testified that any reform will affect state fiscal policy, but that Congress could take action to help states by explicitly considering the effects of federal tax reform on



state governments. As she noted, if federal reform is not done carefully, it could exacerbate existing problems and further complicate tax preparation. In particular, Ms. Rueben noted that the uncertainty in federal tax rules, such as the temporary extensions of credits, deductions, and tax rates complicate state forecasting and the budgetary process. She also emphasized that any federal reform may require transitional relief to state governments.

Professor Hellerstein testified that Congress' objectives in federal tax reform as it relates to states should be to remove unreasonable burdens, not restrict states from exercising their taxing powers, and strive to achieve both of these objectives at once. He cited as an example of a best practice for federal-state coordination, the Mobile Telecommunications Sourcing Act. He stated that it judiciously employs Congressional power to both expand and restrain state taxing power such that it allows taxes to be collected in a sensible manner and at the same time protects taxpayers from multiple taxation.

Mr. Henchman testified that Congress should get involved in state taxation only "to preserve the federal government's power" and to restrain states from harming national economic growth through uncertainty and incompatible standards. Notably, when asked how tax reform should happen, Mr. Henchman suggested that congressional action should be broad and comprehensive and should "use the 1986 template" rather than a piecemeal approach. He suggested that Congress start with a "blank slate" when addressing tax reform.

Current federal legislative proposals affecting state taxation

The hearing shifted to current federal legislative proposals affecting state taxation and the appropriateness of Congress' action on these proposals. Senator John Thune (R-SD) asked Professor Hellerstein whether he thought it was appropriate for Congress to set the "rules of the road" to avoid multiple taxation as the digital economy grows. Senator Thune suggested that the Digital Goods and Services Tax Fairness Act, which he introduced, is an example of this proper framework. Professor Hellerstein agreed but cautioned that it is "important to be done surgically" so as to prevent against possible abuses due to uncertainty contained in the bill as currently drafted.

Senator Benjamin Cardin (D-MD) stressed the need for Congressional action to establish a level playing field in the sales and use tax arena, particularly as it relates to purchases made over the internet. Ms. Rueben agreed, saying that Congressional action is a "no brainer." However, Mr. Henchman noted that there are over 9,600 sales tax jurisdictions in the United States and that, administratively, it would be difficult for sellers to comply with federal legislation requiring them to collect tax on internet sales. Senator Cardin disagreed, saying that this is "being used as an excuse for inaction." When asked about the "intricacies and complications of state and local taxes" Mr. Henchman stressed the need for overall simplification and said that "Congress can lay the framework" for this.

Ranking Member Hatch questioned Professor Hellerstein on states' patchwork of rules requiring the filing of personal income tax returns in non-resident states and on states becoming more aggressive in imposing income taxes on non-resident

individuals working temporarily in the state. Professor Hellerstein replied that this is an example of an area that works well in federal-state coordination. He commented that legislation in the House, the Mobile Workforce State Income Tax Simplification Act, addresses which state gets to tax the income, not whether the income gets taxed.

Conclusion

In his closing statement, Chairman Baucus noted that "none of this is easy," and that the Internal Revenue Code has seen over 15,000 changes since 1986. When it comes to federal tax reform, he emphasized that "we need to bite the bullet and come up with constructive alternatives." He concluded by noting that uncertainty is one of the biggest impediments to economic growth today, a sentiment shared by Senator Snowe.

Observation

"The Senate's interest in state and local tax issues is encouraging," notes Doug Lindholm, President and Executive Director of the Council On State Taxation in Washington, D.C. "This hearing may be the impetus needed to advance many important state tax issues of concern to taxpayers, including the Mobile Workforce State Income Tax Simplification Act, the Marketplace Fairness Act and similar remote sales tax collection legislation, the Digital Goods and Services Tax Fairness Act, the Wireless Tax Fairness Act, and the Business Activity Tax Simplification Act."

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