

Recognizing and Rethinking Federal-State Tax-Base Conformity

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Date : September 25, 2013

Ruth Mason, [*Delegating Up: State Conformity with the Federal Tax Base*](#), 62 **Duke L.J.** 1267 (2013).

In contemporary governance, while the U.S. Constitution recognizes the fifty states as sovereign entities, federal and state governmental policies and operations are functionally quite intertwined. Nevertheless, state governments frequently like to show flashes of independence, particularly on hot button political issues. Hence, we have seen states like California and Massachusetts getting ahead of their federal counterparts in adopting laws and policies to protect the environment and embrace gay marriage. On the opposite side of the political spectrum, we have states like North Dakota, Texas, and Arizona challenging federal laws and policies regarding abortion rights, health care, and immigration.

Tax policy ranks among the more heated issues in modern politics. Politicians argue a lot about what rates to apply to which taxpayers, but the tax policy debate is not limited to tax rates. It is strange, therefore, just how little state individual income tax regimes differ from their federal counterpart. State tax laws tweak the federal model here and there around the edges, but in the main, all of the states that impose a broad-based income tax rely either explicitly or implicitly on federal tax laws to define their tax base. In her thoughtful article, *Delegating Up: State Conformity with the Federal Tax Base*, Ruth Mason thoroughly documents and persuasively challenges federal and state lawmakers to think more carefully about the consequences of this phenomenon.

Mason begins by documenting the extent to which state income tax regimes conform to the federal model. Forty-one states impose a broad-based income tax, and none of them determine income tax due as a simple percentage of federal tax liability. Six do use federal taxable income as a starting point; twenty-nine start with federal adjusted gross income; and the remaining six do not facially conform but nevertheless rely substantially on federal concepts, definitions, and forms like W-2s, 1099s, and federal tax return schedules. All of these states have adopted minor adjustments from federal tax laws, like requiring taxpayers to recognize interest earned on other states' bonds or excluding federally taxed Social Security benefits. But in the main, for all forty-one states with a broad-based income tax, the state tax base closely tracks the federal tax base.

As Mason recognizes, this federal-state tax-base conformity has several advantages. For example, conformity reduces the costs of both taxpayer compliance and state government tax administration; it also minimizes the potential for both double taxation and state tax arbitrage. But, she argues, in defining income, Congress has made numerous policy choices that favor or disfavor different classes of taxpayer and incentivize or disincentivize various behavioral choices. Further, the federal income tax system has expanded far beyond mere revenue raising to incorporate a variety of social welfare and economic incentive programs. Conforming state income tax laws to the federal model means signing on to all of those congressional policy choices as well—thereby reducing state autonomy and policy experimentation. Indirectly adopting congressional policy choices in this way is nontransparent and reduces political accountability. Finally, federal tax law changes can yield substantial revenue volatility in states that fail to make corresponding adjustments to their own laws in real time, and Congress's habit of changing the federal tax laws often and late only exacerbates the difficulty.

Mason also offers an interesting discussion of the relationship between federal-state tax-base conformity and state tax competition. An extensive literature debates the extent to which state tax competition is good, by constraining self-interested politicians who might otherwise be tempted to maximize revenue to pursue inefficient pet projects, or bad, by inspiring a race to the bottom that undermines the provision of important public goods. Without taking a position on

that debate, she posits that federal-state tax-base conformity at least facilitates state tax competition and political accountability therefor—for example, by requiring special reporting for deviations, thus contributing to tax salience.

Mason concludes that the prevalence of federal-state tax-base conformity suggests that its advantages outweigh its disadvantages. For that matter, as Mason explains, fully decoupling federal and state individual income tax laws would itself be financially and politically costly and, for that matter, may be nearly impossible in some instances. Partial decoupling through piecemeal deviations—additions to and subtractions from the federal base, or more and different state tax credits—offers many advantages: reflecting the policy preferences of state voters, improving political accountability, tailoring the tax base to local needs, and minimizing revenue volatility. But even partial decoupling carries significant costs for both state taxpayers (e.g., increased compliance costs) and state legislators (e.g., heightened political risk associated with greater awareness of individual deviations).

Instead, Mason proposes several incremental strategies at both the federal and state levels to ameliorate the disadvantages of federal-state tax conformity. For example, she proposes that states increase public awareness by publishing annual tax expenditure budgets, reduce revenue volatility through static rather than dynamic incorporation of federal tax laws, or at least starting their tax liability calculations with federal adjusted gross income rather than federal taxable income. She encourages Congress to pay more attention to the effect of federal tax law changes on states and to simply produce a list of changes each year to facilitate the ability of state lawmakers to adopt corresponding changes as needed. Mason also calls for more consideration of the effects of federal-state tax-base conformity in ongoing debates over federal tax policy and for more research into the nature and scope of those effects. Whether or not lawmakers and scholars heed her call, she has firmly established the case that they should.

Cite as: Kristin Hickman, *Recognizing and Rethinking Federal-State Tax-Base Conformity*, JOTWELL (September 25, 2013) (reviewing Ruth Mason, *Delegating Up: State Conformity with the Federal Tax Base*, 62 *Duke L.J.* 1267 (2013)), <http://tax.jotwell.com/recognizing-and-rethinking-federal-state-tax-base-conformity/>.