

1987

Foreword

Richard Pomp

University of Connecticut School of Law

Follow this and additional works at: https://opencommons.uconn.edu/law_papers

 Part of the [Taxation-State and Local Commons](#)

Recommended Citation

Pomp, Richard, "Foreword" (1987). *Faculty Articles and Papers*. 247.
https://opencommons.uconn.edu/law_papers/247

HEINONLINE

Citation: 51 Alb. L. Rev. 369 1986-1987



Content downloaded/printed from
HeinOnline (<http://heinonline.org>)
Mon Aug 15 17:19:42 2016

- Your use of this HeinOnline PDF indicates your acceptance of HeinOnline's Terms and Conditions of the license agreement available at <http://heinonline.org/HOL/License>
- The search text of this PDF is generated from uncorrected OCR text.
- To obtain permission to use this article beyond the scope of your HeinOnline license, please use:

[https://www.copyright.com/cc/basicSearch.do?
&operation=go&searchType=0
&lastSearch=simple&all=on&titleOrStdNo=0002-4678](https://www.copyright.com/cc/basicSearch.do?&operation=go&searchType=0&lastSearch=simple&all=on&titleOrStdNo=0002-4678)

SYMPOSIUM REFORMING STATE TAX SYSTEMS

FOREWORD

*Richard D. Pomp**

Once upon a time, issues of state and local taxation played to a small audience. Federal tax matters held center stage; state and local issues were relegated to the wings. Lately, however, state and local tax matters have emerged from their understudy status and have started to compete for equal billing. The major accounting firms have expanded their state and local personnel and have organized special consulting divisions to work with state officials. Law firms have also begun competing for what was formerly the domain of accountants. Academics are discovering what a small but devoted number of their colleagues had already known: that state and local tax issues present all of the intellectual challenges inherent in the study of the federal corporate and personal income taxes and the wealth transfer tax, with the additional attractiveness of a constitutional dimension. Further, whereas many of the weaknesses in the federal tax system are well documented, intensely analyzed, and the subject of lively scholarly debate, state tax issues are an unexplored territory by comparison.

Most state tax systems are ripe for reexamination by policymakers, legislators, and academics. The premises that underlie a traditional state tax system are under severe attack. Many state tax systems developed in a far simpler time—a time when substantial sectors of the economy, such as transportation, communications and banking, were either regulated or subject to significant federal controls. State tax systems evolved when the economy was dominated by mercantile and manufacturing activities, and little thought had to be given to

* Professor of Law, University of Connecticut School of Law; Visiting Professor of Law, New York University School of Law. B.S., University of Michigan; J.D., Harvard University. The author wishes to thank Gene Corrigan, Steve Gold, Mike McIntyre, Ollie Oldman, and Rob Plattner for their helpful comments on a draft of the Foreword.

the tax treatment of services. Multinational corporations and conglomerates were yet to emerge, and few corporations had substantial amounts of foreign income. It was a world in which corporations did not electronically transfer funds around the globe almost instantaneously, 800 telephone numbers were not widespread, large mail order houses had not yet proliferated, video shopping was still a fantasy, and the pace of federal tax reform was comfortingly slow. In addition, state taxes were typically low enough to discourage much litigation.

Today, the world is not so simple and state tax systems have been overtaken by technological advances, new forms of business organizations, the globalization of business, changes in the judicial climate, and the relaxation of federal controls over the economy.¹ Many states now have had some type of temporary commission to study their tax structures. While in most cases these commissions were responding directly to a financial crisis, others, like New York's, were formed because of legislative concerns that the existing tax structure was atavistic.²

Federal tax changes have also helped move state tax issues onto center stage. The Economic Recovery Tax Act of 1981 (ERTA) gutted the federal corporate income tax by revamping the treatment of depreciation and by introducing safe-harbor leasing. Many of the largest corporations in the United States paid no corporate income tax for several years as a consequence of ERTA.³

ERTA had a major impact upon the field of state taxation. Because no state wishes to reinvent the Internal Revenue Code, state personal and corporate income taxes are, with varying degrees of fidelity, based on federal concepts. If ERTA's rules on depreciation and safe-harbor leasing had been incorporated into state tax laws, many states would have suffered significant losses of tax revenue without receiving commensurate benefits. Accordingly, many states refused to embrace fully the federal changes and "decoupled" from ERTA's rules on depreciation and safe-harbor leasing.⁴ More fundamentally, many states started to question the degree to which other aspects of their tax

¹ This issue is more fully developed in Pomp, *State Tax Reform for the Eighties*, 16 CONN. L. REV. 925 (1984). See also Corrigan, *Interstate Corporate Income Taxation—Recent Revolutions and a Modern Response*, 29 VAND. L. REV. 423 (1976).

² See Pomp, *State Tax Reform New York Style*, in 1985 NAT'L TAX ASS'N—TAX INST. AM. PROC. 192 (1985); see also J. DODGE, *STRUCTURING STATE AND LOCAL TAX REFORM COMMISSIONS* (1986).

³ See CITIZENS FOR TAX JUSTICE, *CORPORATE INCOME TAXES IN THE REAGAN YEARS* (1984).

⁴ For a background discussion, see NEW YORK STATE LEGISLATIVE COMMISSION ON THE MODERNIZATION AND SIMPLIFICATION OF TAX ADMINISTRATION AND THE TAX LAW, *THE ARTICLE 9-A FRANCHISE TAX: SHOULD NEW YORK ADOPT ACRS?* (Staff Report Dec. 31, 1984).

laws should emulate and mimic the Internal Revenue Code.⁵ The decoupling issue sharply focused both the revenue costs and the administrative benefits of conforming with the federal system.

ERTA also had severe repercussions for state and local tax practitioners. By decreasing the impact of the federal income tax on many corporations, ERTA substantially increased the relative significance of state income taxes, especially in states that had decoupled. In many cases, a corporation's state corporate tax was greater than its federal corporate tax—a situation that did not escape notice by CEO's or corporate tax managers. State and local tax practitioners became the object of new interest on the part of corporate management. Corporations that had typically treated state issues as secondary to federal concerns reexamined their own priorities. Emphasis shifted from issues of compliance to those of planning.

ERTA was one episode in a period of rapid federal tax changes that started with the Revenue Act of 1978 and the Crude Oil Windfall Profit Tax Act of 1980. ERTA was followed by the Tax Equity and Fiscal Responsibility Act of 1982, the Social Security Amendments of 1983, and the Deficit Reduction Act of 1984, each of which posed challenges for state tax systems. The most dramatic perturbation, however, was the Tax Reform Act of 1986 (TRA), which significantly broadened the federal tax base. Because the bases of most state income taxes are linked to the federal base, the TRA has had the effect of increasing state revenue. This increase in state revenue has been widely described as a "windfall," although another description might be "reparations"—reparations for the damage wrought upon state tax structures by the base erosion that had previously marked the federal system and that had undermined most state revenue bases.⁶ This federal erosion of state revenue occurred at the same time that the Congress was cutting federal aid to all state and local governments. Between 1981 and 1986, for example, as part of the "new federalism," state and local governments lost \$76 billion in federal grants and aid.⁷

⁵ See, e.g., NEW YORK STATE LEGISLATIVE COMMISSION ON THE MODERNIZATION AND SIMPLIFICATION OF TAX ADMINISTRATION AND THE TAX LAW, THE NEW YORK STATE PERSONAL INCOME TAX: AN OVERVIEW (Staff Report May 29, 1985), revised as Pomp, *Restructuring a State Income Tax in Response to the Tax Reform Act of 1986*, 36 TAX NOTES 1195 (1987), reprinted in 1988 NAT'L TAX ASS'N—TAX INST. AM. PROC. (forthcoming 1988), a revision of Pomp, *Simplicity and Complexity in the Context of a State Tax System*, in REFORMING STATE TAX SYSTEMS (S. Gold ed. 1986).

⁶ See Pomp, *supra* note 5.

⁷ See Pomp, *supra* note 5, 36 TAX NOTES at 1196 (citing Windfall or Pitfall? The Opportunities and Risks in State Conformity to Federal Tax Reform 2-3 (AFSCME 1987)).

By restoring the state tax bases, the TRA could have been viewed as an integral and constructive part of this new federalism—but was not. Shortly after the enactment of the TRA, the cry throughout many state capitals was to give the so-called windfall back to the taxpayers. Of course, the revenue will be “given back” regardless of whether the increase is used to finance spending programs, offset budget deficits in states having depressed economies (especially those states dependent upon agriculture and natural resources), improve education, or is used for tax reductions; the only question is to whom will the revenue be returned?

As a matter of logic, rather than of politics, the states did not have to pass through any of their increase in revenue to taxpayers. Nevertheless, many states were under severe political pressure to make some changes in their income tax. In the short term, many states could do nothing more than simply reduce their rates or increase their personal exemptions, although others did make more ambitious attempts to restructure their personal and corporate income taxes. In the long term, one commentator has predicted that, because of the TRA, we will witness a revolution that will eventually transform most state income taxes.⁸

The editors of the Review are to be complimented for their appreciation of the forces for change acting on state and local tax systems and for the timeliness of their decision to sponsor a Symposium issue that brings together articles covering state corporate and personal income taxes, wealth transfer taxation, and the taxation of banking. The Symposium opens with the author's study of New York's corporate income tax, portions of which were prepared for the New York Legislative Tax Study Commission, and which led to that State's recent restructuring of its corporate income tax. Because corporate income taxes are sufficiently impenetrable to non-initiates, they have typically been immune from radical legislative surgery. Even most tax study commissions have leveled their shotguns on other, more approachable targets. As a result, unlike New York, other states have been content to only tinker with their corporate income taxes. As the only state to have recently restructured its corporate income tax, New York's example might inspire similar action elsewhere.

The second article is by Professor Michael J. McIntyre of Wayne State Law School. Powerfully bright, creative, and ever good-humored,

⁸ See Gold, *The Budding Revolution in State Income Taxes*, a paper presented at the Annual Conference of the National Tax Association—Tax Institute of America (Pittsburgh, Pennsylvania Nov. 9, 1987).

whether fielding phone calls at 7:00 a.m. on Sunday morning, flying to Albany with no notice, or drafting bills at 3:00 a.m., Professor McIntyre served as a consultant to the New York Tax Study Commission. His article evaluates New York's recent changes in the personal income taxation of the family, many of which were proposed by Professor McIntyre. Until its recent reforms, New York, like many other states, basically relied upon a system of separate filing provisions for married couples, an approach which the Congress had abandoned in 1948. Furthermore, the tax treatment of low-income persons relied upon the capricious and complicated interplay of five different relief mechanisms. As Professor McIntyre documented in an earlier article in this Review,⁹ the old rules for taxing the family were unprincipled and incoherent, an administrative nightmare for both taxpayers and the tax administration, and a major reason why New York had one of the most complicated personal income taxes in the country. But in one of the real success stories of state tax reform, virtually overnight New York replaced its antediluvian approach with a simpler and fairer tax system, and its new approach is the subject of Professor McIntyre's article.

These first two articles, although set in the context of New York, have broader implications, and provide lessons that can be usefully applied in other states. The third article is set in a more general context and tackles an often ignored feature of state tax systems—wealth transfer taxation. Professor Ira Mark Bloom of Albany Law School, one of the nation's foremost commentators on wealth transfer taxation, proposes that states enact a generation-skipping tax. In what will undoubtedly be viewed as a seminal article, Professor Bloom functions as a one-person legislative committee, for which the states should be indebted. He provides a lucid explanation of the newly-enacted federal generation-skipping tax and the federal credit for state generation-skipping taxes, which many state policymakers are unaware of or misunderstand. He next shows the states how, by adopting a similar tax, they can raise revenue in a fair manner and without increasing the tax burden on their taxpayers. His proposals should be heartily embraced by legislatures across the country.

Sandra B. McCray, formerly counsel to the Multistate Tax Commission, and now with the Advisory Commission on Intergovernmental Relations, closes out the Symposium with an article on the taxation of multistate banking. Ms. McCray's previous work has revamped

⁹ See McIntyre, *Tax Consequences of Family Sharing Practices Under New York Law: A Critique and a Proposal for Reform*, 49 ALB. L. REV. 275 (1985).

traditional ways of viewing constitutional restraints on state powers of taxation, and she now focuses her penetrating insight on an emerging area of the law: the income tax implications arising from the deregulation of banking. Traditional methods of taxing banks were developed by the states in the late 19th and early 20th centuries, when banks were confined to a single geographical location. With the deregulation of banking and the relaxation of geographical restraints, these traditional methods are proving to be inadequate. Even worse, these older methods are clashing with more modern approaches by the states, and, as Ms. McCray forcefully argues, this clash may result in violations of the Commerce Clause. Ms. McCray charts a path that resolves this constitutional imbroglio. She ends with a sober warning that underscores the importance of her article: if the states do not act on their own and agree on a more or less uniform approach to the taxation of multistate banks, the Congress may impose one by fiat.

These articles deal with many of the pressing problems confronting practitioners and policymakers today. The authors are all experienced writers and pedagogues who have made their complex subjects accessible even to those who might not be members of the tax cognoscenti. These articles should serve as a stepping stone for legislators and their staffs as they struggle with the increasingly complex tax issues of the coming decade.