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Nicholas J. Letizia

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NOTES

THE FEDERAL COLLECTION OF STATE INDIVIDUAL INCOME TAXES

I. Introduction

The recent economic recession and the rapidly escalating costs of many governmental services have compelled state and local governments to reevaluate their tax structures.¹ Although high expenditures are a primary cause of financial difficulties, governments on all levels find themselves in the perplexing position of having to increase their social services while their revenue sources decrease.²

States have traditionally relied on taxes to finance the expansion of services,³ and most states have enacted broad-based income taxes

1. For a discussion of the financial problems of state and local governments, see STAFF OF THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION, 92 CONG., 1ST SESS., GENERAL EXPLANATION OF THE STATE AND LOCAL FISCAL ASSISTANCE ACT AND THE FEDERAL-STATE TAX COLLECTION ACT OF 1972, at 6 (Comm. Print 1973) (hereinafter cited as GENERAL EXPLANATION); E. FRIED, A. RIVLIN, C. SCHULTZE & N. TEETERS, SETTING NATIONAL PRIORITIES: THE 1974 BUDGET 8-10 (1973).

2. Governments are in the business of providing services, not profit maximization. Certain services are so essential that they must be provided despite the costs involved. Governments with narrow tax bases are being placed in financial squeezes which may not be solved simply with reductions in nonessential services and the enactment of additional taxes. For an analysis of New York City's financial problems in light of this discussion, see Stern, *Danger of City Fiscal Crisis Seems Real, but Will Budget Retrenchment or New Taxes Resolve It?*, N.Y. Times, Oct. 30, 1974, at 27, col. 1. During economic recessions the demand for public assistance increases while consumption and income, two major tax sources, fall. In 1971 the consumption and personal income taxes accounted for 31.1% of total state revenue sources and 48.48% of total state tax receipts. These amounts were derived from sources in ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, FEDERAL-STATE-LOCAL FINANCES: SIGNIFICANT FEATURES OF FISCAL FEDERALISM 31 (1973-74 ed.).

3. Rothenberg, *A New Look in State Finances: Tax Reduction and Restructured Tax Systems*, 27 NAT. TAX J. 175 (1974).

which yield additional revenue without raising tax rates.⁴ Federal grant-in-aid⁵ and revenue sharing funds⁶ also increase a state's fiscal resources and relieve pressure for additional taxes.⁷ Revenue Sharing was intended to replace restricted grants-in-aid and permit state and local governments to receive federal funds pursuant to an allocation basis which rewarded state and local tax efforts.⁸

4. For a discussion of the development of state personal income taxes see L. ECKER-RACZ, *THE POLITICS AND ECONOMICS OF STATE-LOCAL FINANCE* 43-44 (1970). Income taxes provide additional revenue without increasing rates during periods of economic growth due to an increase in the base of the tax. See, e.g., J. DUE & A. FRIEDLAENDER, *GOVERNMENT FINANCE: ECONOMICS OF THE PUBLIC SECTOR* 321 (1973). The yield of progressive income taxes increases at a more rapid rate than the increase in the income base. *Id.* Moreover, inflation does not cause a progressive income tax to impose an onerous burden on the lower income groups. See Beer & Walther, *Inflation and the Progressivity of the Federal Individual Income Tax*, 10 CALIF. W.L. REV. 537 (1974).

5. For a good introduction to the use of grants-in-aid in a federal system, see Ervin, *Federalism and Federal Grants-In-Aid*, 43 N.C.L. REV. 487 (1965). An exhaustive compendium of sources in this area may be found in LEGISLATIVE REFERENCE SERVICE FOR THE SENATE SUBCOMM. ON INTERGOVERNMENTAL RELATIONS, 91ST CONG., 2D SESS., *BIBLIOGRAPHY OF FEDERAL GRANTS-IN-AID TO STATE AND LOCAL GOVERNMENTS 1964-1969* (Comm. Print 1970).

6. The State and Local Fiscal Assistance Act of 1972 (Revenue Sharing) provided for the distribution of federal tax revenue to the states. 31 U.S.C. §§ 1221-63 (Supp. II, 1972). For excellent discussions of Revenue Sharing in light of federal-state fiscal relations see O. STOLZ, *REVENUE SHARING: LEGAL AND POLICY ANALYSIS* (1974) [hereinafter cited as STOLZ]; Calaba, *The Analysis and Application of the State and Local Fiscal Assistance Act of 1972*, 28 TAX L. REV. 375 (1973) [hereinafter cited as Calaba]; Comment, *The Revenue Sharing Act of 1972: United and Untraceable Dollars from Washington*, 10 HARV. J. LEGIS. 276 (1973); 2 FORDHAM URBAN L.J. 621 (1974).

7. Rothenberg, *A New Look in State Finances: Tax Reduction and Restructured Tax Systems*, 27 NAT. TAX J. 175, 176 (1974).

8. See GENERAL EXPLANATION 41-44. Although the allocation under Revenue Sharing is determined in part by the local tax effort a recipient may use Revenue Sharing funds to permit tax relief. In 1973, 18 states expected to use some of the funds to provide some form of tax relief; 14 of these states maintained that property tax reduction was their primary goal. In 16 states officials expected Revenue Sharing funds to postpone future tax

An unutilized provision of Revenue Sharing provides for the optional piggybacking of state income taxes upon the federal income tax.⁹ The Internal Revenue Service (IRS) would act as the state's collector and enforcer. The state, however, would lose some control, both legislatively and judicially, over its personal income tax laws. All judicial challenges, except those involving state constitutional questions or issues pertaining to the relationship between state and federal governments, would be tried in federal courts.¹⁰

Revenue Sharing is a five year experiment;¹¹ piggybacking has no time limits and appears to have been envisioned by Congress as a long-term solution for state and local financial problems.¹² Two or more states, accounting for at least five percent of the taxpayers in the United States, must request federal collection of their individual income taxes before the Act can take effect.¹³ If the minimum number of states adopt piggybacking, the federal government will permit these states to utilize the national income base and relieve them of the excessive administrative costs of collecting an income tax.

Because piggybacking could dramatically reshape a state's tax

increases. 1973 COMPTROLLER GENERAL OF THE UNITED STATES, REPORT TO THE CONGRESS, REVENUE SHARING: ITS USE BY AND IMPACT ON STATE GOVERNMENTS 21-22. "The funds for [R]evenue [S]haring are appropriated out of federal income tax collections. What the recipient governments are actually doing is sharing in the efficiency of the federal tax system [They] should look upon [R]evenue [S]haring as a stay of execution rather than as a windfall from Uncle Sam. They should use this stay of execution as a period in which to reflect on how better to utilize their own resources." Calaba 426-27.

9. INT. REV. CODE OF 1954, §§ 6361-65.

10. *Id.* § 6361(d)(1).

11. 31 U.S.C. § 1224(b)(1) (Supp. II, 1972).

12. Senator Edmund S. Muskie remarked: "The second provision [of Revenue Sharing] would offer the States the option of utilizing the machinery of the Federal Government to collect State income taxes for them. Both of these provisions are intended to encourage the States to make better use of the progressive income tax rather than continuing to rely so heavily on regressive taxes like the property tax and the sales tax." *Hearings on General Revenue Sharing Before the House Comm. on Ways and Means*, 92d Cong., 1st Sess., pt. 3, at 458 (1971).

13. Pub. L. No. 92-512 § 204(b) (Oct. 20, 1972), 86 Stat. 945.

structure¹⁴ and provide long term stability, this Note will examine the fiscal and administrative feasibility of such a system.

II. Historical Perspective

It is generally conceded that a broad-based income tax is the most

14. Revenue Sharing, in theory, attempted to revitalize the federal system by decentralizing the federal grant system. States and localities enjoyed the use of federal monies in a much less restricted manner than was possible under conditional grants. Piggybacking, however, places more power in Washington, and seems to oppose the underlying motivation of Revenue Sharing. This appears to be a strange formula for revitalizing federalism unless piggybacking is viewed as a means of direct sharing in the federal income tax base. "The most ignored aspect of Public Law 92-512 [Revenue Sharing] is Title II, which provides for the federal collection of state individual income taxes. If a significant number of states elect to have the federal government collect the state income taxes, the concept of revenue sharing could be altered dramatically. Instead of the federal government transferring \$5 billion per year to the states and localities in the form of a transfer payment, a transfer of a portion of the federal income tax base directly to the states and localities would achieve the same result. Thus, pure revenue sharing may result from this dormant provision in the legislation. The Congressional approval of this shift in the tax base will be difficult to obtain because it represents a further diminution in the power of Congress. However, the long-term interests of the federal system will be best served by sharing this efficient, progressive, and responsive tax source with state and local governments." STOLZ 143. One potential problem with Federal collection of state individual income taxes lies in the perception of the taxpayers themselves. Although the federal government would only be the agent of the states, it is feared that taxpayers would view the piggyback tax liability as a federal tax increase and the results from this perception could seriously impair the revenue raising capability of the federal government. *Hearings on General Revenue Sharing Before the House Comm. on Ways and Means, 92d Cong., 1st Sess., pt. 5, at 955 (1971)*. Direct sharing in the federal income tax should create interest on the part of the states in congressional changes in the base. "As a practical matter, would this vested interest of the states restrict the freedom of Congress to make major changes in Federal laws to carry out some new fiscal policy? Or, would this close tie to the Federal income tax system tend to be advantageous from the standpoint of fiscal policy in that if the states accepted the Federal changes without revising their own tax rates, the fiscal effects of the change would be reinforced? The alternatives involved in these questions cannot be dismissed as insignificant." Conlon, *Federal Participation in State Tax Administration*, 24 NAT. TAX J. 369, 375 (1971).

productive tax at the disposal of all levels of government in the United States.¹⁵ The personal income tax base has been most fully developed by the federal government; significant utilization of a personal income tax base by state and local governments is a modern development.¹⁶ Previously, states relied upon consumption and excise taxes, and local governments depended upon property taxes, to finance their budgets.¹⁷ These narrow tax bases¹⁸ could not support the increasingly expensive services provided by such governments.¹⁹ Many states have therefore enacted a personal income tax, long considered the domain of the federal government, to finance their activities.²⁰

In structuring their personal income tax laws, states borrowed heavily from federal experience.²¹ It was not long before cooperation between federal and state collection agencies began.²² A major goal of this cooperation is to reduce the costs of collection and enforcement,²⁴ thereby increasing the net yield from the tax. Using both

15. See, e.g., W. BLUM & H. KALVEN, *THE UNEASY CASE FOR PROGRESSIVE TAXATION* (1963); J. PECHMAN, *FEDERAL TAX POLICY* 53 (rev. ed. 1971); Calaba 427.

16. Rothenburg, *A New Look in State Finances: Tax Reduction and Restructured Tax Systems*, 27 *NAT. TAX J.* 175 (1974).

17. L. ECKER-RACZ, *THE POLITICS AND ECONOMICS OF STATE-LOCAL FINANCE* 32-37 (1970).

18. A narrow tax base generally results in a more regressive tax structure. Crooks, *Replacing Unfair State Taxes: Income Taxes as an Alternative*, *PEOPLE & TAXES*, Nov. 1974, at 6, col. 1.

19. J. PECHMAN, *FEDERAL TAX POLICY* 211-13 (rev. ed. 1971).

20. See note 16 *supra* and accompanying text.

21. See note 88 *infra* and accompanying text.

22. See text accompanying notes 25-47 *infra*.

23. For a general discussion of the compliance costs under the federal tax system see COMMISSION TO REVISE THE TAX STRUCTURE, *REFORMING THE FEDERAL TAX STRUCTURE* 13 (1973). For a more rigorous analysis, see A. OTT & D. OH, *SIMULATION OF REVENUE AND TAX STRUCTURE IMPLICATIONS OF BROADENING THE FEDERAL INCOME TAX BASE*, in *STUDIES IN SUBSTANTIVE TAX REFORM* 59 (1969).

24. The first statutory recognition of federal state cooperation in tax administration appeared in the Act of Aug. 5, 1909, ch. 6, 36 Stat. 11 which permitted state officials to examine the corporate returns of an excise tax measured by income. This was four years prior to the ratification of the sixteenth amendment to the Federal Constitution, which authorized the

statutory and informal arrangements, states have had access to federal tax returns since the early stages of the federal income tax.²⁵ Congressional authorization for the examination of federal tax returns of non-corporate entities came with the passage of section 257 of the Revenue Act of 1926.²⁶ This Act permitted states to review federal tax returns at the request of state governors.²⁷

As the use of state income taxes increased, some states encountered problems concerning nonresidents' income derived from sources within the state and residents' income derived from sources outside the state.²⁸ These difficulties, coupled with the belief that

direct taxation of income. Turner, *Federal-State Cooperation in Tax Administration*, 9 WM. & MARY L. REV. 958 (1968) [hereinafter cited as Turner]. In 1913 the present right of the states as dictated by the INT. REV. CODE OF 1954, § 6103(b)(1) was enacted in the Act of Oct. 3, 1913, ch.16, 38 Stat. 114, which granted the governors of all states having a general income tax access to all corporate returns or abstracts of such returns.

25. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, INTERGOVERNMENTAL COOPERATION IN TAX ADMINISTRATION, SUMMARY OF REPORT A-7, at 2 n.2 (1965) [hereinafter cited as SUMMARY]. The tax commissioner of Massachusetts sent state examiners to Washington, D.C., to review federal tax returns as early as 1920. *Id.*

26. Act of Feb. 26, 1926, ch. 27, 44 Stat. 9, *as amended*, Act of May 29, 1928, ch. 852, 45 Stat. 795.

27. T.D. 4291, IX-1 Cum. Bull. 127 (1930) provided for the inspection of federal income tax returns by state officers for state income tax purposes. This decision was approved on June 9, 1930 by an executive order from President Hoover, X-1 Cum. Bull. 148 (1931). At the time of the enactment of the Revenue Act of 1926, Act of Feb. 26, 1926, ch. 27, 44 Stat. 9, fifteen states were taxing either individual or corporate income or both. Section 257 of the Revenue Act of 1926 explicitly gave states access to federal tax information provided that the governor of a state desiring such information requested it, and that the information would be made available subject to the rules prescribed by the Secretary of the Treasury and approval by the President. SUMMARY 2. Between January 1929 and January 1932 ten additional states enacted income tax legislation. This sudden interest in income taxation by the states spurred President Hoover and the secretary of the treasury to act under section 257 of the Revenue Act of 1926 because overlapping taxation by the federal government and the states was becoming increasingly significant. *Id.*

28. This problem is uniquely associated with the states. SUMMARY 2.

federal tax laws enjoyed greater respect than those of the states,²⁹ persuaded state tax officials to demand greater access to federal tax information.³⁰

The Revenue Act of 1934³¹ provided for the attachment of a form containing tax information³² to an individual's federal tax return to facilitate collection of state income taxes.³³ This requirement, never fully implemented,³⁴ was eliminated in 1935 by the "Costigan Amendment,"³⁵ which has remained virtually intact to the present.³⁶

29. *Id.* at 2-3.

30. *Id.*

31. Act of May 10, 1934, ch. 277, 48 Stat. 683.

32. These forms included the taxpayer's name, address, income, deductions, credits, and tax liability information. Turner 959.

33. *Id.*

34. *Id.*

35. Act of Apr. 19, 1935, ch. 74, 49 Stat. 158.

36. INT. REV. CODE OF 1954, § 6103(b)(2): "State bodies or commissions.—All income returns filed with respect to the taxes imposed by chapters 1, 2, 3, and 6 (or copies thereof, if so prescribed by regulations made under this subsection), shall be open to inspection by any official, body, or commission, lawfully charged with the administration of any State tax law, if the inspection is for the purpose of such administration or for the purpose of obtaining information to be furnished to local taxing authorities as provided in this paragraph. The inspection shall be permitted only upon written request of the governor of such State, designating the representative of such official, body, or commission to make the inspection on behalf of such official, body, or commission. The inspection shall be made in such manner, and at such times and places, as shall be prescribed by regulations made by the Secretary or his delegate. Any information thus secured by any official, body, or commission of any State may be used only for the administration of the tax laws of such State, except that upon written request of the governor of such State any such information may be furnished to any official, body, or commission of any political subdivision of such State, lawfully charged with the administration of the tax laws of such political subdivision, but may be furnished only for the purpose of, and may be used only for, the administration of such tax laws." The criminal sanctions for unauthorized disclosure also remains substantially unchanged. *Id.* § 7213(a)(2): "State employees—Any officer, employee, or agent of any State or political subdivision, who divulges (except as authorized in section 6103 (b), or when called upon to testify in any judicial or administrative proceeding to which the State or political subdivision, or such State or local official, body, or commission, as such, is a party), or

In 1949 the Secretary of the Treasury sponsored a conference of federal, state, and local representatives to devise a system for the reciprocal flow of taxpayer information between the states and the IRS.³⁷ This meeting resulted in the implementation of formal income tax audit agreements and the exchange of audit abstracts between the IRS and the states.³⁸ Disproportionate benefits accrued

who makes known to any person in any manner whatever not provided by law, any information acquired by him through an inspection permitted him or another under section 6103 (b), or who permits any income return or copy thereof or any book containing any abstracts or particulars thereof, or any other information, acquired by him through an inspection permitted him or another under section 6013 (b), to be seen or examined by any person except as provided by law, shall be guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than \$1,000, or imprisoned not more than 1 year, or both, together with the costs of prosecution." Following the enactment of the "Costigan Amendment" the need for special state schedules persisted. In 1936 individuals had to file these schedules once again. T.D. 4626, XV-1 Cum. Bull. 61 (1936). The use of the schedules finally came to an end in 1940. T.D. 4989, 1940-2 Cum. Bull. 97 (1940). During the period of 1935-40, state tax officials utilized several methods of examining federal tax returns. In addition to an inspection of the duplicates on file in field collection offices, some state officials also purchased photostatic copies of returns at rates set by the IRS, others bought copies of the IRS's audit adjustments, and finally, some went directly to Washington (and field offices after the IRS was decentralized) to microfilm returns, manually prepare abstracts, and type public lists of federal taxpayers. These various methods produced additional revenue even if they were only used to identify federal taxpayers who had failed to comply with state tax laws. The IRS did not actively foster the broadening of this program since it was burdened by visiting officials, and any payments for its services went to the Department of the Treasury, not to the IRS. SUMMARY 3. The introduction of a computer system has greatly increased the states' ability to retrieve federal taxpayer information. Turner 960. For a good discussion of the introduction and use of data processing hardware in Federal tax administration see Smith, *Automation in Tax Administration*, 34 LAW & CONTEMP. PROB. 751 (1969). See also Excerpts from the 1973 *Annual Report of the Commissioner of Internal Revenue Related to Data Processing*, 9 CCH 1974 STAND. FED. TAX REP. ¶ 8750.

37. Turner 961.

38. *Id.* "The conferees agreed that the various agencies of government should (1) exchange information as to audit plans and techniques; (2) exchange audit findings on selected returns to reduce insofar as possible

to the states under these agreements; states, suffering from a paucity of experienced auditors, were unable to match the volume or revenue producing information provided to them by the IRS.³⁹ Furthermore, states reviewed the IRS information at virtually no cost.⁴⁰ Due to the disproportionate benefits enjoyed by the states and the high costs incurred on the federal level, the IRS was not enthusiastic about the program.⁴¹ Another cause for the retarded growth of federal-state audit exchange agreements was the general incompatibility between federal and state income tax laws.⁴²

The initiative for strengthening the federal-state program came in 1955 when the President's Committee on Intergovernmental Relations (the Kesstenbaum Committee) endorsed administrative cooperation as a vehicle for intergovernmental tax coordination.⁴³

New audit exchange agreements were tailored to the individual tax structures of the respective states. The factors which give these agreements the flexibility largely responsible for their wide acceptance are:⁴⁴

separate and repeated audits of the same taxpayer by the several agencies of government. As a means of making that policy effective, it was recommended that such information as is now available as to audit plans be immediately exchanged between those agencies of government interested in such an exchange; and, that 'pilot' exchanges of audit findings on selected returns be exchanged during the year 1950 on a test basis in a limited area. The Treasury Department agreed to an initiation of this recommendation by making available to the interested States and local governments a copy of its plans in respect to its audit program of individual income tax returns. Further, the Treasury will solicit the assistance of one or two States to test, on a cooperative basis, an audit program for Federal and State income tax returns." Turner at 961-62 n.11.

39. *Id.* at 962.

40. *Id.*

41. SUMMARY 3.

42. J. CHOMMIE, *THE INTERNAL REVENUE SERVICE* 163 (1970) [hereinafter cited as CHOMMIE].

43. SUMMARY 4.

44. The purpose of these agreements was to "permit more effective deployment of income tax audit resources at both levels, avoid duplication of effort, and safeguard taxpayers against the ordeal of repeated audits." *Id.* at 3. The pilot program which included five states (Colorado, Kentucky, Montana, North Carolina, and Wisconsin) failed to produce the desired reciprocal effects. The participating states enthusiastically en-

[T]he Commissioner of Internal Revenue and the governor of the state agree to authorize their subordinates to (1) establish mutual programs for exchanging information on a reciprocal basis in order to secure returns, improve enforcement efforts, determine tax liability and effect collection of tax from persons subject to taxes in either jurisdiction, and (2) seek out any other methods of cooperation which may be mutually agreeable.⁴⁵

Studies⁴⁶ indicate that these agreements have been beneficial.⁴⁷ By maximizing the benefits of audit exchanges, the resultant avoidance of duplication of work enhances the overall efficiency of the

dorsed the agreements but the IRS reacted as it had done during the 1940s and failed to encourage the expansion of federal-state cooperation efforts. *Id.* Between 1950 and 1955 Wisconsin collected an additional \$3 million of income taxes, penalties, and interest; at the end of one year Minnesota reported additional income taxes of \$860,000, and North Carolina almost \$1 million in additional taxes on a total of 6000 assessments. CHOMMIE 162. In fiscal year 1960 the IRS attributed an additional \$10.6 million in federal tax revenue to the information which it obtained from state governments. The estimated cost for the internal development of this would have been \$250,000, while the cost of furnishing information to the states was less than \$50,000. Furthermore, it is estimated that the states gain a total of at least \$10 million annually. SUMMARY 6. In 1962 information supplied by twenty states and the District of Columbia increased federal delinquent tax collections by \$22 million. In calendar year 1964 the information from the states yielded an additional \$7 million in assessments of deficiencies. Another 1964 survey of eighteen participating states and the District of Columbia indicated that federal information was responsible for an additional \$25 million in tax deficiencies. Turner 964. Public consciousness of the programs will significantly deter tax evasion, and moreover, studies do not reflect the present value of future tax collections resulting from the improved enforcement process. SUMMARY 6.

45. Turner 963.

46. See, e.g., Chommie 163.

47. The disparity in benefits from these agreements has dissipated over time as the gap between the IRS' audit capacity and that of the states narrowed. *Id.* at 164. The quality of state income tax audit statistics are no longer the motivation behind these agreements. The IRS recognizes that some potentially useful data may be procured from sundry state lists, such as, names and addresses of workers covered under state unemployment insurance programs. SUMMARY 4. For an illustrative checklist of potential sources for the IRS compiled on the basis of specific agreements, see *id.* 4-6.

system and reduces the marginal costs of collecting delinquent tax dollars.

III. The Federal-State Tax Collection Act of 1972

Amidst the fanfare surrounding the signing of the State and Local Fiscal Assistance Act of 1972 (Revenue Sharing Act),⁴⁸ an important provision was overlooked and remains dormant. Title II of the Revenue Sharing Act, the Federal-State Tax Collection Act of 1972 (Collection Act),⁴⁹ amended the Internal Revenue Code of 1954 to provide for the piggybacking of certain state individual income taxes onto the federal tax.⁵⁰

Structural differences in personal income taxation on the three levels of government has caused problems in our federal system. Piggybacking requires a waiver of the concurrent jurisdiction in the personal income tax base; participating states surrender their personal income tax policy-making powers⁵¹ and adopt federal law.⁵² With increased uniformity of federal and state personal income tax laws,⁵³ the federal government absorbs the responsibility of collection and enforcement of the state tax.⁵⁴

Once a state becomes a participant in the piggyback system,⁵⁵ the

48. 31 U.S.C. §§ 1221-63 (Supp. II, 1972); see note 6 *supra*. For a discussion of the fanfare surrounding the signing of Revenue Sharing, see Stolz 1.

49. Pub. L. No. 92-512 (Oct. 20, 1972), 86 Stat. 945.

50. INT. REV. CODE OF 1954, §§ 6361-65.

51. See text accompanying notes 63-80 *infra*.

52. *Id.*

53. At the time of consideration of the Act twenty-eight states out of forty-one with general income taxes had adopted the federal tax base. S. REP. NO. 1050, 92d Cong., 2d Sess. 18 (1972).

54. *Id.* By encouraging standardization of tax laws piggybacking will reduce the costs of administration. Presently, under various state tax laws special administrators are required for each system due to the divergence in state income tax laws. Piggybacking will permit the states to share in the efficiency of the federal government in tax collection. The difference in efficiency is partly due to "the larger size of the Federal operation and the greater uniformity of its jurisdiction appear to provide economies of scale." *Id.* at 19.

55. To participate in the piggyback system a state must enter into an agreement with the Secretary of the Treasury or his delegate, who will

federal government will collect all qualified state individual incomes taxes and transfer them to the states within three business days after they have been deposited in a Federal Reserve Bank.⁵⁶ A taxpayer has the right to contest his state's individual income tax liability in the same manner as he can challenge his federal income tax liability.⁵⁷ The federal government will represent the states in all judicial and administrative proceedings except suits involving a state's constitution⁵⁸ and proceedings involving the relationship be-

determine whether the state has a qualified individual income tax plan, and will convey the finding to the governor of the applying state within sixty days. *Id.* § 6363(a). This agreement must be in effect during the taxable period in which the federal government will collect the electing state's taxes. *Id.* § 6362(f)(1). The determination of whether the state has a qualified plan is made without regard to section 6362(f)(1) of the Internal Revenue Code of 1954, which requires that such an agreement be in existence if a tax is to be a qualified one. *Id.* If the state's tax plan does not qualify, the state has sixty days from the notice of the rejection to file a petition for review in the appropriate federal court of appeals. *Id.* § 6363(d)(1). This judicial proceeding is granted a preference under the Act and shall be heard and resolved as expeditiously as possible. *Id.* § 6363(d)(4). A state may withdraw from the system by notifying the Secretary or his delegate, or by enacting a substantive change in its tax law which impairs the law's qualified status. *Id.* § 6363(b).

56. *Id.* § 6361(c)(1). Criminal penalties must also be transferred within thirty days of their receipt even though they are not treated as tax collections. Congress expects that transfers will be made more quickly than the Act requires to the extent that the IRS' resources allow, and an estimation process may be utilized to provide for the faster flow of such transfers. GENERAL EXPLANATION 54. Adjustments must be made at least once each fiscal year on account of the difference arising from the use of estimated collections. *Id.* § 6361(c)(2). Any difference between the total withholding and the taxpayer's total individual income tax liability will be divided between the accounts on the basis of the required amounts which had to be paid. *Id.* § 6361(d)(2). If, for example, \$5100 was collected for a taxpayer who had a state income tax liability of \$800 and a federal income tax liability of \$4000, the state tax is one-sixth of the total tax liability. The refund will be allocated between the state and federal government in accordance with the one to six ratio. Therefore, the state will receive \$50 and the federal government will receive \$250.

57. *Id.* § 6361(b).

58. *Id.* § 6361(d)(1)(B)(i). If a state court obtains jurisdiction because of a state constitutional issue or an issue arising from the relationship

tween the United States and a state.⁵⁹

The Collection Act amended section 6405 of the Internal Revenue Code of 1954 (concerning reports of certain refunds or credits to the Joint Committee on Internal Revenue Taxation)⁶⁰ so qualified state individual income taxes for a taxable year shall be treated as a portion of a refund or credit for the federal income tax liability for that year.⁶¹ The amendment also increases the jurisdictional amount for small cases in the Tax Court from \$1,000 to \$1,500, to accommodate additional disputes.⁶²

A. Qualified Resident Taxes

To qualify under the Collection Act, a state tax must be based on federal taxable income or federal tax liability.⁶³ A tax based on

between the state and the federal government it does not retain jurisdiction to determine the tax liability unless the court would otherwise have jurisdiction, "as might occur where the suit involves title to property clouded by tax liens." GENERAL EXPLANATION 53. State inspectors have access to tax returns and information but they can not proceed against the taxpayer for any liability. GENERAL EXPLANATION 53.

59. INT. REV. CODE OF 1954, § 6361(d)(1)(B)(ii). The laws of a participating state must not provide any criminal or civil penalties with respect to a qualified tax other than those which a taxpayer is subject to under federal law. By omitting an item on both forms, for example, a taxpayer is subject to two separate impositions of the appropriate federal sanction—one by the federal government and the other by the state government. *Id.* § 6362(f)(6).

60. *Id.* § 6405(e).

61. *Id.*

62. *Id.* § 7463(a).

63. Participating states may determine their own tax rates under both types of qualified resident taxes. Taxes based on federal taxable income may include progressive or proportional rates. GENERAL EXPLANATION 55. Taxes based on a percentage of federal tax liability must be levied at a uniform rate, thereby providing the state tax the same degree of progressivity as offered by the federal tax. INT. REV. CODE OF 1954, § 6362(c)(1).

64. By minimizing the diversity in the participants' tax laws Congress hopes the process will operate simply as if the number of federal individual income tax returns had been proportionately increased. Federal taxable

federal taxable income of residents must adhere to the federal definition of such income.⁶⁴ A state income tax based upon a percentage of an individual's federal income tax liability must be adjusted to eliminate state income taxes on income derived from obligations of the United States.⁶⁵ Adjustments to augment state tax revenues by adding both federal deductions for state income taxes and income from state and municipal obligations, which was exempt from federal income taxes, are permitted.⁶⁶

B. Qualified Nonresident Taxes

A state tax on wages and other business income of nonresident individuals derived from sources within the levying state must meet several tests in order to utilize the enforcement resources of the IRS. First, the taxing state must have a qualified resident income tax⁶⁷ in effect while imposing a tax on nonresidents' income derived from sources within the state.⁶⁸ This tax may not be applied against nonresident individuals who derive less than 25 percent of their total wage and business income within the state.⁶⁹ An additional requirement prevents a state from taxing the income of nonresidents to a greater extent than income of residents.⁷⁰

income must be adjusted to (1) remove interest on obligations of the United States which is taxable under federal individual income tax laws, (2) add any federal deductions for state income taxes, and (3) add the net income from state and municipal obligations which is exempt from federal income taxes. INT. REV. CODE OF 1954, § 6362(b)(1). Permitted adjustments allow states to impose a minimum tax on tax preferences and allow credits for income taxes paid to another state or a political subdivision of a state. *Id.* § 6362(b)(2). The computation of this credit must be in accordance with rules prescribed by the Secretary of the Treasury or his delegate. GENERAL EXPLANATION 57.

65. INT. REV. CODE OF 1954, § 6362(c)(2).

66. *Id.* The tax based on a percentage of federal income tax liability, like the qualified resident tax based on federal taxable income, will not fail solely because of a credit for state and local income taxes paid to another state. *Id.* § 6362(c)(4). This credit must be computed in accordance with rules prescribed by the Secretary of the Treasury or his delegate. *Id.*

67. *Id.* § 6362(d)(1)(E).

68. *Id.* § 6362(d)(1)(A).

69. *Id.* § 6362(d)(1)(C).

70. *Id.* § 6363(d)(1)(D). A nonresident taxpayer is limited by the ratio

In authorizing collection of nonresident taxes on income derived from sources within the state, Congress permits participating states to maximize the breadth of their income tax bases.⁷¹ The various limitations in the statute⁷² minimize the administrative burden upon the IRS and assure uniformity of state income tax laws.

of his wages and other business income to his adjusted gross income when determining the allowable deductions against his wages and other business income derived from sources within the state. *Id.* See also GENERAL EXPLANATION 60. It is expected that as to the computation of the state tax on nonresidents the IRS will issue a regulation providing for an adjustment for all business expenses related to the production of wages which are subtracted from gross income. Moreover, the regulation should permit all allowable deductions for the purpose of determining whether nonresidents are bearing a disproportionate burden of the tax. *Id.* Generally, all income derived from sources within a state are expected to pass a test requiring that the labor which yielded the income was performed in the levying state. INT. REV. CODE OF 1954, § 6362(d)(1)(B).

71. GENERAL EXPLANATION 60.

72. A state must adhere to eight additional requirements before income tax will be collected by the federal government. First, the laws of a participating state must incorporate all future changes in the federal individual income tax for the effective period of the agreement. INT. REV. CODE OF 1954, § 6362(f)(2)(A). Second, state laws must be amended to provide that any changes made by the state in its qualified tax law during a taxable year which coincides with a calendar year, will only apply to the current taxable year unless the change is enacted before November 1. If Congress initiated a change in a state's qualified tax law this requirement is waived to the extent of the congressional alteration. *Id.* § 6362(f)(2)(B). Third, participating states may not impose any tax on the income of individuals other than (1) a qualified resident tax, (2) a qualified nonresident tax, and (3) a separate tax on the investment income received or accrued by individuals domiciled within the state but not residents of that state according to the residency rules previously set forth. This latter tax is ineligible for federal collection. *Id.* § 6362(f)(3). See also GENERAL EXPLANATION 64. Fourth, the taxable year of individuals under the qualified state taxes must be the same as their taxable year for federal income taxes. INT. REV. CODE OF 1954, § 6362(f)(4). Fifth, a married taxpayer who files a joint return for federal income tax purposes may not file a separate return for the state tax, and a married taxpayer filing a separate return for federal tax purposes may not file a joint return for the state tax. *Id.* § 6362(f)(5). Sixth, state treatment of income derived from conduits must be the same as the federal treatment of income from these sources. Conduits include

C. Residence

Since a high level of uniformity of state and federal tax laws is essential for the successful operation of piggybacking, the diverse residency definitions of states were a major obstacle in the uninhibited flow of the system. Congress decided that it was necessary for all states entering the program to adopt a uniform residency definition.⁷³ In establishing the uniform residency rule, Congress sought to strike a balance between the administrative problems caused by frequent changes in a taxpayer's residency status and "the potential

partnerships and partners, trusts and their beneficiaries, subchapter S corporations and their shareholders, and any other entity and individual having a beneficial interest therein which is treated as a conduit for the taxes imposed by Chapter 1 of the INT. REV. CODE OF 1954. *Id.* § 6362(f)(7). This section avoids differences in double taxation by states and the federal government. It is unclear, however, whether this provision prohibits a state from administering an independent tax on conduits. If states are not permitted to enact independent legislation, states which now tax unincorporated businesses or subchapter S corporations will suffer a loss of revenue by entering the piggyback system. Seventh, state law must not diminish any relief provided to a member of the armed forces guaranteed by 50 U.S.C. § 574 (App. 1970) (Soldiers and Sailors Civil Relief Act of 1940). *Id.* § 6362(f)(8). Under section 574 a serviceman will not lose or acquire a residence strictly because of military orders. For the purpose of a qualified tax, a member of the armed forces is not a resident or domiciliary of a state because his absence from his original domicile or residence as a result of being under military orders. GENERAL EXPLANATION 67. Compensation for military service is not deemed to be derived from sources within a state of which the individual is neither a resident nor a domiciliary. This exception, however, does not apply to nonmilitary income received by such a taxpayer. INT. REV. CODE OF 1954, § 6362(f)(8). Eighth, a participating state's law must not contravene the provisions of 49 U.S.C. §§ 27, 325(a), 923 (Interstate Commerce Act) or 29 U.S.C. § 1512 (Federal Aviation Act of 1958) with respect to withholding liability to the extent that these laws apply to the nonresident tax. These sections prohibit the withholding of any compensation of employees of an interstate carrier unless more than 50% of the individual's compensation from the employing carrier in the prior calendar year was earned in the levying state. If more than 50% of the compensation was not earned in a single state then withholding is only required by the state of the employee's residence. INT. REV. CODE OF 1954, § 6362(f)(9). *See also* GENERAL EXPLANATION 67.

73. GENERAL EXPLANATION 60-61.

for manipulation that a long time period State residency rule might provide."⁷⁴

Individuals may find themselves being residents of more than one state under the Collection Act's various tests. Instead of arbitrarily authorizing a taxpayer to pay only one tax to a given state, Congress decided that the most equitable solution would be to allocate an individual's income on the basis of the amount of time the taxpayer resided in each state.⁷⁵ Although this process simplifies the allocation of an individual's income tax liability where such individual is a resident of more than one piggybacking state, the Collection Act does not offer any relief where the individual is a resident of both piggybacking and non-piggybacking states. Conflicts between the taxing jurisdictions will continue under such circumstances.

74. *Id.* at 61. The purpose of this uniform residency requirement is to curtail the present situation where a taxpayer may evade the state income taxes of state *A* by asserting that he is a resident of state *B*, and conversely, maintaining that he is a resident of state *A* while attempting to circumvent the taxing authority of state *B*. *Id.* An individual is treated as a resident of the levying state for a taxable year only if his principal place of residence has been within the state for at least 135 consecutive days and a minimum of thirty days of that period are in the same taxable year. A nonresident who does not meet the requirements with respect to the taxable year and is domiciled in the state for at least 30 days during the taxable year will also be treated as a resident. The 30 days need not be consecutive for purposes of determining a taxpayer's domicile. A citizen or resident of the United States who fails to meet the above residency test should be taxed as a resident of the state where he is domiciled provided that he meets the 30 day test. *Compare* INT. REV. CODE OF 1954, §§ 6362(e)(1)(A)-(B) *with* GENERAL EXPLANATION 61.

75. INT. REV. CODE OF 1954, § 6362(e)(4). The residency rules will also affect withholding deductions and declarations of estimated income. A resident under the Act, subject to a qualified resident tax, is liable for the payment due under either withholding or estimated tax provisions if he reasonably expects to reside in the state for 30 days. An individual is considered to be subject to a nonresident tax if he reasonably expects to receive wages and other business income during the taxable year. The Secretary or his delegate may provide for the proper integration of state and federal withholding by prescribing withholding rates. An employer is compelled to furnish an employee with a withholding statement, similar to the federal W-2 form, for any state tax withheld. *Compare* INT. REV. CODE OF 1954, §§ 6362(e)(4)-(5) *with* GENERAL EXPLANATION 63.

D. Estates and Trusts

An individual's estate is considered a resident of the last state of which the decedent was a resident.⁷⁶ Wide variations in state treatment of trusts spurred Congress to construct this uniform residency rule.⁷⁷ A testamentary trust is treated as a resident of the last state in which the deceased settlor was a resident.⁷⁸ The residence of an inter vivos trust is the state in which the principal contributor was a resident for the longest period of time during the three year period immediately preceding the trust's creation.⁷⁹ If a trust has more than one residence or no residence under these rules, its residence is to be determined under principles prescribed by the Secretary of the Treasury or his delegate.⁸⁰

IV. Analysis of the Federal Legislation

As seen by Congress, the system's advantages include: (1) more effective administration of federal and state income tax laws; (2) a reduction of the average costs of administration of state tax laws; (3) tax simplification; (4) significant increases in state tax revenues.⁸¹

States should initially gain revenue because federal regulations have substantially shortened the time within which an employer must deposit income taxes withheld from employees.⁸²

More effective administration of federal and state individual income tax laws can be attained by reducing processing costs.⁸³ En-

76. INT. REV. CODE OF 1954, § 6362(e)(2).

77. GENERAL EXPLANATION 61-62.

78. INT. REV. CODE OF 1954, § 6362(e)(3)(A).

79. *Id.* § 6362(e)(3)(B). The principle contributor is the individual who contributed the assets with the highest fair market value at the time of the creation of the trust. *Id.* § 6362(e)(3)(C)(ii). If subsequent contributions are made the highest fair market value of assets conveyed is determined as of the date of their receipt. GENERAL EXPLANATION 62.

80. GENERAL EXPLANATION 62.

81. The total value of the corpus is to be equal to the sum of the fair market value of all contributions at the time of contribution. *Id.*

82. H.R. REP. NO. 1018, 92d Cong., 2d Sess. 15-16 (1972).

83. SPECIAL COMMITTEE OF THE NATIONAL ASSOCIATION OF TAX ADMINISTRATORS (NATA), FEDERAL COLLECTION OF STATE INDIVIDUAL INCOME TAXES UNDER PUBLIC LAW 92-512, at 17-18 (1972) (hereinafter cited as NATA REPORT).

forcement activities, however, would remain unaffected by the Collection Act. The IRS could not increase its audits of returns,⁸⁴ and current federal-state cooperation prevents significant overlapping of enforcement activities.⁸⁵

Reduction in state court case loads can be considered a reduction of administrative costs. However, the number of state income tax cases in proportion to the total case load in state courts does not appear significant,⁸⁶ and most, if not all, of this state tax litigation will have to be absorbed by the federal system.⁸⁷ While many states presently rely upon federal tax precedents and rulings,⁸⁸ the states' power to modify these decisions would be lost under the Collection Act.

The statute does not preempt a state's policymaking authority over its individual income tax laws.⁸⁹ It merely limits the taxes that the federal government will collect for a state.⁹⁰ States may utilize

84. The Act makes no additional appropriations to the IRS.

85. NATA REPORT 17-18.

86. *Id.* at 19.

87. *Id.* This is true except in cases involving either state constitutional issues or the relationship between the state and the federal government. See notes 57-59 *supra* and accompanying text.

88. Almost all of the states use federal decisions and regulations in interpreting the provisions of their individual income taxes. N.J. Tax Policy Comm. REP. PART V: NON-PROPERTY TAXES IN A FAIR AND EQUITABLE TAX SYSTEM 81 (1972). The reason for their widespread use stems from the adoption of federal adjusted gross income or federal taxable income, with modifications, as the starting point for computing an individual's state income tax liability. NATA REPORT 19. Thirty-six states presently use federal definitions as their computational starting points for their individual income taxes. Most of these states also follow the Internal Revenue Code of 1954 when it is not in conflict with existing state law. See 1 P-H STATE & LOCAL TAXES ¶ 1002 (1974). A savings would result, however, where one action under the Act would replace two separate ones, as exists under present law. If the state tax does not complicate the return in such a way as to require additional utilization of judicial resources, the Act could make drastic inroads in terms of efficiency. However, since the state caseload is light this increased efficiency must be evaluated in terms of a state's surrender of control over both the judicial and legislative policy implications of its individual income tax. NATA REPORT 18-19.

89. GENERAL EXPLANATION 51.

90. See notes 63-72 *supra* and accompanying text.

tax credits, which would otherwise disqualify the tax for piggybacking, if the credits are separately administered by the state.⁹¹ Unfortunately, the maintenance of such a direct payment system requires personnel and equipment which would diminish the savings achieved by federal collection. This problem will confront any state that chooses to impose forms of income taxation other than the basic qualified taxes.

Tax simplification is another goal of the Collection Act.⁹² Since most states already use federal definitions as the starting point for computing state taxable income,⁹³ simplification for taxpayers filing in only one state would be minimal.⁹⁴ Filing in two or more states by a nonresident should be simpler under the Act.⁹⁵ Employers will have to deal with one set of withholding requirements; however, the employers must adjust their cash flow to meet faster deposit regulations.⁹⁶

A substantial increase in state tax revenues through piggybacking

91. GENERAL EXPLANATION 57-58. A compendium of credits to state personal income taxes may be found in ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, FEDERAL-STATE-LOCAL FINANCE: SIGNIFICANT FEATURES OF FISCAL FEDERALISM 276-79 (1973-74 ed.).

92. See text accompanying note 81 *supra*. The tax simplification may defeat Congress' goal of minimizing the administrative burden on the IRS. First, the IRS must separate withholding reports for nonresidents because the tax must be withheld if the individual reasonably expects to earn income in a state for thirty days or more. Second, residency requirements permit an individual to be a resident of more than one state. These returns would have to be separated manually. NATA REPORT 24-25.

93. See note 88 *supra*.

94. NATA REPORT 22-23.

95. *Id.* at 23.

96. GENERAL EXPLANATION 54. Generally, states require monthly deposits while federal regulations demand weekly deposits. Since the Act requires state withholding taxes to be transferred to the state within three business days from the employer's deposit, it is expected that faster collections will provide a one-time windfall because weekly transfers will include some amounts which would have been collected by the state in the following fiscal year under present law. The increase in the flow of revenue to the states will vary according to the present withholding regulations in each state. The increase in a state's cash flow, however, could be realized by changing present state withholding requirements. NATA REPORT 20-22.

is doubtful.⁹⁷ However, an increase in revenues could occur where a taxpayer had previously evaded state taxes but complied with federal tax law. Under piggybacking a taxpayer must comply with both tax laws since they will be reported on the same form.⁹⁸

The National Association of Tax Administrators (NATA) has isolated four possible disadvantages of the Collection Act: (1) a state's loss of flexibility in determining its own tax program,⁹⁹ (2) the Act's effect on state autonomy,¹⁰⁰ (3) fiscal problems due to state constitutional requirements for a balanced budget,¹⁰¹ and (4) piggybacking's adverse consequences on the availability of various revenue data.¹⁰²

A state's loss of flexibility in determining its own tax program and the Collection Act's effect on state autonomy are interrelated. Certain prerogatives associated with a sovereign which devises and administers its own income tax will be surrendered.¹⁰³ States must analyze the trade-off between political autonomy and economic independence in determining the desirability of piggybacking. States will have access to a broad-based tax that will yield significant revenue at a lower cost than the state could achieve acting alone.¹⁰⁴ Piggybacking's return of unrestricted funds and the broad federal revenue base capable of yielding significant funds with slight rate increases¹⁰⁵ reinforce federalism by providing states with the means for fiscal responsibility. Many localities are already "economic vassals" of the federal government¹⁰⁶ and it is probable that piggybacking will not worsen their fiscal plight.

97. NATA REPORT 21. *But see* GENERAL EXPLANATION 51, 54.

98. Simonetti, *Washington Report, New Tax Legislation: Piggyback Rides, Bows and Arrows, and Other Diversion*, 4 TAX ADVISER 36, 37 (1973).

99. NATA REPORT 27-32.

100. *Id.* 32-34.

101. *Id.* 34-35.

102. *Id.* 35-36.

103. *See* note 55 *supra*.

104. GENERAL EXPLANATION 17-18.

105. *See* note 15 *supra*.

106. Professor Edward C. Banfield of the University of Pennsylvania, who is author of *The Unheavenly City*, also sees the cities in a broad decline. President Nixon's "new federalism" was a variation on "Vietnamization." Mr. Banfield says: "[A] way for the Federal Government to put the responsibility on other people, the villagers in effect, without really removing themselves from control." Lydon, *In Big Cities, Realistic Voters*

Certain states may encounter constitutional problems in entering into agreements requiring the adoption of federal individual income tax laws. A major consideration is the constitutional requirement of many states for a balanced budget.¹⁰⁷ The fiscal uncertainty produced by a potential federal tax cut late in a year could seriously decrease a state's expected revenues and make it difficult to project a balanced budget. A possible solution would be for Congress to rule out any tax law changes beyond the date when states could adjust their rates to reflect the new modifications.¹⁰⁸

Finally, states have a vital interest in maintaining certain information obtained from individual income tax returns,¹⁰⁹ particularly to assist them in estimating future revenues. Under the Collection Act, states can continue to receive supporting schedules to a taxpayer's federal return¹¹⁰ so that necessary information would still be accessible.¹¹¹ The Act simply divorces the administration of the state's individual income tax from the receipt of cash. Records¹¹² would continue to be maintained by the states.¹¹³ Those states which

in This Election Year Are Aware of How Limited Are Mayors' Powers, N.Y. Times, Feb. 18, 1975, at 17, col.1.

107. NATA REPORT 35. The state constitutional problems in prescriptive adoption of federal income tax law are considered in Comment, *Constitutionality of a Federalized State Income Tax*, 1963 WIS. L. REV. 445. See also ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, FEDERAL-STATE COORDINATION OF PERSONAL INCOME TAXES 153-66 (1965). The additional costs incurred in projecting state revenue must be set-off against any savings from the federal collection in evaluating the efficiency of the system.

108. A state may make a change in the base or rate of a qualified tax before November 1 of the calendar year for which the tax is collected. INT. REV. CODE OF 1954, § 6362(f)(2)(B).

109. NATA REPORT 35-36.

110. Simonetti, *Washington Report, New Tax Legislation: Piggyback Rides, Bows and Arrows, and Other Diversions*, 4 TAX ADVISER 36, 37 (1973).

111. These schedules would have to conform to the federal individual income tax returns in order to facilitate the operation of the system by the IRS.

112. These records would include the schedules and tax records for state taxes other than individual income taxes.

113. If a state chooses to enact a direct payment system of credits or a tax on investment income of domiciliaries (INT. REV. CODE OF 1954, §

utilize tax returns to provide somewhat bizzare information¹¹⁴ will have to develop alternative means of procuring such data.¹¹⁵

These difficulties underscore the NATA disagreement with the congressional finding that "a significant increase of State tax revenue should result from consolidation of the administration of Federal and State income taxes."¹¹⁶ While NATA concedes that certain savings in processing costs may be realized, the same cannot be said for enforcement costs.¹¹⁷ Since the Collection Act does not provide increased resources for the IRS and present cooperative efforts between the states and the IRS have been unsuccessful,¹¹⁸ NATA believes the deleterious effects of decreasing total audit man-hours is far too great a price for an insignificant reduction in processing costs.¹¹⁹

However, at a 1974 meeting of NATA, William W. Williams, Deputy Commissioner of the IRS, remarked: "[w]e do believe . . . that we can collect State revenues more efficiently and economically than the States . . . because of the economies of a large scale operation such as ours."¹²⁰

V. Conclusions

Once the Treasury Department promulgates the regulations necessary to implement the Collection Act, each state can evaluate any potential savings.¹²¹ Present resistance stems from the natural conviction of state legislators and tax administrators that they can administer an individual income tax as well as the federal govern-

6362(f)(3)(C)) it will be necessary to maintain certain records. The maintenance of these records, however, will infringe upon the elimination of duplicate administrative efforts.

114. For several examples, see NATA REPORT 35-36.

115. *Id.* at 35.

116. S. REP. No. 1050, 92d Cong., 2d Sess., pt. 1, at 19 (1972).

117. NATA REPORT 17-18.

118. *Id.*

119. NATA prefers federal cost sharing of state individual income tax audit and collection programs. NATA REPORT 47-49.

120. Remarks of William E. Williams, Deputy Commissioner of Internal Revenue, prepared for delivery before the NATA. Portland, Ore., June 3, 1974, 9 CCH 1974 STAND. TAX REP. ¶ 8751, at 76,007.

121. NATA REPORT 27.

ment.¹²² This reasoning overlooks a significant by-product of the Act—total integration of the different levels of government sharing the same tax base.¹²³

Piggybacking has been utilized in the past¹²⁴—the piggybacking of local sales taxes on state sales taxes is widespread.¹²⁵ Maryland¹²⁶ and Indiana¹²⁷ employ piggybacking in the collection of state and county personal income taxes.¹²⁸ Other states offer their localities additional piggyback options.¹²⁹ While piggybacking may impinge state autonomy in political terms, it strengthens its economic freedom. The potential for increased state financing would assist electing states to solve their economic problems on the state level.

A state has the option of participating in the program and can always leave the system when it desires.¹³⁰ Even when participating, a state retains certain flexibility in determining the type and rates of individual income tax imposed and in developing its own system of direct payment credits outside the state income tax.¹³¹

122. L. ECKER-RACZ, *THE POLITICS AND ECONOMICS OF STATE-LOCAL FINANCE* 160 (1970).

123. See generally G. BREAK, *INTERGOVERNMENTAL FISCAL RELATIONS IN THE UNITED STATES* 36-67 (1967).

124. Piggybacking is an important feature of local finance in Scandinavian countries. *Id.* at 36 n.12. Canada has had great success with piggybacking the provincial income taxes. J. STRICK, *CANADIAN PUBLIC FINANCE* 100-07 (1973).

125. G. BREAK, *INTERGOVERNMENTAL FISCAL RELATIONS IN THE UNITED STATES* 37 (1967). For a listing of states collecting local sales taxes, see *ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, FEDERAL-STATE-LOCAL FINANCES: SIGNIFICANT FEATURES OF FISCAL FEDERALISM* 84-89 (1973-74 ed.).

126. MD. ANN. CODE art. 81, § 283 (Supp. 1974).

127. IND. ANN. STAT. §§ 16-3.5-1-1 to -1-12 (Burns Supp. 1974).

128. The Advisory Commission on Intergovernmental Relations has included a piggyback county income tax in their uniform personal income tax statute. *ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, 1970 CUMULATIVE ACIR STATE LEGISLATIVE PROGRAM*, § 15-62-21, at 46-47 (1969).

129. See *ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, FEDERAL-STATE-LOCAL FINANCES: SIGNIFICANT FEATURES OF FISCAL FEDERALISM* 84-89 (1973-74 ed.).

130. See note 55 *supra*.

131. See note 91 *supra* and accompanying text.

Piggybacking will likewise facilitate the central management of the personal income tax base.¹³² This is a desirable goal where there is multi-governmental utilization of the same tax base. The resources spent by the federal government to improve the equity and efficiency of the personal income tax would effectuate a national tax policy whose benefits would inure to all states participating in the piggyback system. State tax reform legislation could achieve similar goals, but previous performance has shown that while "[t]he spirit is . . . willing, the flesh is weak."¹³³

If successful in income taxation, piggybacking systems may be designed in other areas of tax overlapping between the various levels of government and thus increase the reduction in the cost of collecting taxes.¹³⁴ The Collection Act's potential for tax reform and revitalizing a state's revenue structure could be the impetus to unshackle the states from their fiscal impotence.

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132. See generally G. BREAK, INTERGOVERNMENTAL FISCAL RELATIONS IN THE UNITED STATES 33-50 (1967); L. ECKER-RACZ, THE POLITICS AND ECONOMICS OF STATE-LOCAL FINANCES 159-64 (1970).

133. *Matthew* 26:41. The states, historically, were content in seeing that the overall tax structure was progressive. Attempts to approve the progressivity of state and local taxes is a relatively recent phenomenon. Rothenberg, *New Look in State Finances: Tax Reduction and Restructured Tax Systems*, 27 NAT. TAX J. 175,178 (1974). See also Crooks, *Replacing Unfair State Taxes: Income Taxes as an Alternative*, PEOPLE & TAXES, Nov. 1974, at 6, col. 1; Reinhold, *States Shift From Property Tax in Bid to Equalize School Funds*, N.Y. Times, Feb. 5, 1975, at 39, col. 1. For an exhaustive examination of the incidence of taxes in the United States, see J. PECHMAN & B. OKNER, WHO BEARS THE TAX BURDEN? (1974). New Jersey has been attempting to reform its tax structure in recent years. See [1972] N.J. TAX POLICY COMM. REP. (1972).

134. Piggybacking has been suggested as the means of collecting state value added taxes. Special Comm. on the Value-Added Tax of the Tax Section, American Bar Association, *Technical Problems in Designing a Broad-Based Value-Added Tax for the United States*, 28 TAX LAW. 193, 219 (1975).

