The Tax Cuts and Jobs Act of 2017: The SALT Deduction, Tax Competition, and Double Taxation

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I. INTRODUCTION

The Tax Cuts and Jobs Act of 2017 (TCJA)[1] changed the long-standing practice of allowing full deductions for state and local income and property taxes (SALT) as a personal itemized deduction from federal income taxes.

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1. Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (2017) (codified as amended in scattered sections of I.R.C. (2012 & Supp. V 2018)).

Congress accomplished this by limiting the maximum allowable deduction to $10,000.[2] In doing so, Congress eliminated a substantial portion of one of the largest deductions available to individuals.[3]

Congress changed several other provisions that also have a substantial impact on the value of the deduction for state and local taxes for individuals. First, the standard deduction increased to just under twice the amount of the previous standard deduction.[4] Second, Congress limited the deduction for qualified residence interest, a second personal itemized deduction.[5] Third, Congress eliminated the employee business expense deduction.[6] Fourth and fifth, Congress eliminated most casualty loss deductions[7] and lowered the tax rates on individuals.[8] Businesses and investments held directly or indirectly by individuals through entities—including partnerships, limited liability companies, and Subchapter S Corporations—are also limited in deducting state and local income tax on business income because income taxes are only deductible by individuals as personal itemized deductions.[9] Although the Act did not limit income tax deductibility for corporations,[10] Congress substantially decreased the tax savings value of the deduction by reducing the corporate tax rates from up to 35%[11] to 21%.[12]

2. *Id.* § 11042(a) (codified as amended at I.R.C. § 164(b)(6)).
3. *See infra* text accompanying note 52.
4. *See* Tax Cuts and Jobs Act § 11021 (codified as amended at I.R.C. § 63(c)).
5. *See id.* § 11043 (codified as amended at I.R.C. § 163(h)(3)).
6. *See id.* § 11045(a) (codified as amended at I.R.C. § 67(g)).
7. *See id.* § 11044 (codified as amended at I.R.C. § 165(h)); *see infra* text accompanying note 43.
8. *See* Tax Cuts and Jobs Act § 11001 (codified as amended at I.R.C. § 1(j)). The tax brackets for unmarried individuals changed as follows:

2017		2018	
$9,325 or less	10%	$9,525 or less	10%
Over $9,325 - $37,950	15%	Over $9,525 - $38,700	12%
Over $37,950 - $91,900	25%	Over $38,700 - $82,500	22%
Over $91,900 - $191,650	28%	Over $82,500 - $157,500	24%
Over $191,650 - $416,700	33%	Over $157,500 - $200,000	32%
Over $416,700 - $418,400	35%	Over $200,000 - $500,000	35%
Over $418,400	39.6%	Over $500,000	37%

Compare I.R.C. § 1(c) (2012), *with* I.R.C. § 1(j)(C) (2012 & Supp. V 2018).
9. *See id.* §§ 63, 67(g), 164 (2015 & Supp. 2018).
10. *See* Kyle Pomerleau, *The United States' Corporate Income Tax Rate Is Now More in Line with Those Levied by Other Major Nations*, TAX FOUND. (Feb. 12, 2018), https://taxfoundation.org/us-corporate-income-tax-more-competitive/ [https://perma.cc/32UW-T4YK].
11. I.R.C. § 11(b) (2012).
12. Tax Cuts and Jobs Act § 13001 (codified as amended at I.R.C. § 11(b)).

Over the years, the SALT deduction has been the subject of debate regarding its rationale, effectiveness, and fairness.[13] Often ignored in this debate is the effect the SALT deduction has on the ability of state governments to carry out their appropriate responsibilities supported by taxation.[14] Four states recently filed a lawsuit against the federal government seeking elimination of the SALT cap on the basis "that it will [make it] more difficult for the states to maintain their taxation and fiscal policies."[15] Seldom considered is the fact that the SALT deduction is a mechanism for mitigating the burden on taxpayers caused by double taxation of the same income.[16] This paper will focus on the role the SALT deduction has had on the ability of state and local governments to finance public benefits, including its role in mitigating double taxation. It will also examine the TCJA's dramatic change in the tax value of the SALT deduction that leads to increased interstate tax competition in a federal system.

Part II provides a brief history of the SALT deduction and the efforts previously made to eliminate or curtail its impact. Part III undertakes a detailed explanation of the financial effect the changes have on taxpayers. Part IV examines the problems of taxation in a federal system, outlining the structure of fiscal federalism and how American states perform a unique governmental role. Part V reviews multijurisdictional taxation of the same economic activities of taxpayers and the ways the tax laws have been designed to eliminate its adverse effects. Part VI analyzes the reasons for tax competition and how the limitation on the SALT deduction increases its effect.

13. For a history of the SALT deduction, see *infra* Part II; sources cited *infra* note 22.

14. *See* Kelly Phillips Erb, *States Sue IRS, Treasury to Strike Down SALT Cap Under New Tax Law*, FORBES (July 17, 2018, 4:02 PM), https://www.forbes.com/sites/kellyphillipserb/2018/07/17/states-sue-irs-treasury-to-strike-down-salt-cap-under-new-tax-law/ [https://perma.cc/7UVY-WFVM].

15. *Id*.

16. *See* GOV'T FIN. OFFICERS ASS'N, THE IMPACT OF ELIMINATING THE STATE AND LOCAL TAX DEDUCTION 3–4, 12 (2017), https://www.gfoa.org/sites/default/files/RCC%20Report%20on%20SALT%20Deduction-092017_Final.pdf [https://perma.cc/K7V8-M4XP]; *see also* Scott Drenkard, *Is the State and Local Tax Deduction in Place to Protect Against Double Taxation?*, TAX FOUND. (Sept. 21, 2017), https://taxfoundation.org/state-local-tax-deduction-place-protect-double-taxation/ [https://perma.cc/YDM4-E9GF].

II. THE HISTORY OF THE FEDERAL TAX DEDUCTION FOR STATE AND LOCAL TAXES

Since the introduction of the modern federal income tax in 1913, all state and local taxes that were not a direct fee for a benefit received were deductible from the federal income tax base.[17] In 1964, Congress made the language of the § 164 allowance of a deduction more explicit by identifying specific taxes—including state and local real and personal property taxes, income tax, general sales tax, and motor fuels tax.[18]

The first substantive change in the SALT deduction, however, was enacted in 1986.[19] In 1984, the U.S. Treasury proposed the complete elimination of the deduction for individuals,[20] which was adopted in the President's tax proposals to Congress.[21] These proposals led to significant discussion in the economic literature.[22] The final 1986 legislation, however, eliminated the deduction for state general sales taxes only.[23]

Since then, many proposals have been made to completely eliminate the SALT deduction.[24] However, the Code moved in the opposite direction with the American Jobs Creation Act of 2004, which reinstated the deduction for state and local general sales taxes as an option in lieu of deducting state and local income taxes.[25] The purpose of this measure was to provide a more equitable regime to taxpayers in states that did not have an income

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17. *See* Act of Oct. 3, 1913, ch. 16, § 2(B), 38 Stat. 114, 167 (reducing tariff duties and providing revenue for the Government and for other purposes).

18. *See* Revenue Act of 1964, Pub. L. No. 88-272, § 207(a), 78 Stat. 19, 40 (codified as amended at I.R.C. § 164(a) (1964)).

19. *See* Tax Reform Act of 1986, Pub. L. No. 99-514, § 134(a)(1), 100 Stat. 2085, 2116 (codified as amended at I.R.C. § 164(a) (1988)).

20. 1 OFFICE OF THE SEC'Y, DEP'T OF THE TREASURY, TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH: THE TREASURY DEPARTMENT REPORT TO THE PRESIDENT 78–81 (1984), https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Tax-Reform-v1-1984.pdf [https://perma.cc/UPV2-BKPJ].

21. *See* RONALD REGAN, THE PRESIDENT'S TAX PROPOSALS TO THE CONGRESS FOR FAIRNESS, GROWTH, AND SIMPLICITY 62–69 (1985) https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Reform-Proposal-1985.pdf [https://perma.cc/2ZXN-D89N].

22. *See*, *e.g.*, George F. Break, *Tax Competition and Federal Tax Deductibility*, 39 NAT'L TAX J. 349, 350–51 (1986); Martin S. Feldstein & Gilbert E. Metcalf, *The Effect of Federal Tax Deductibility on State and Local Taxes and Spending*, 95 J. POL. ECON. 710, 710–11, 720, 726–27, 730 (1987). For a thorough treatment of the issues, see Kirk J. Stark, *Fiscal Federalism and Tax Progressivity: Should the Federal Income Tax Encourage State and Local Redistribution?*, 51 UCLA L. REV. 1389, 1391, 1394–95 (2004).

23. *See* Tax Reform Act of 1986 § 134(a)(1) (codified as amended at I.R.C. § 164(a)).

24. FRANK SAMMARTINO & KIM RUEBEN, TAX POL'Y CTR., REVISITING THE STATE AND LOCAL TAX DEDUCTION 16 (2016), https://www.taxpolicycenter.org/sites/default/files/alfresco/publication-pdfs/2000693-Revisiting-the-State-and-Local-Tax-Deduction.pdf [https://perma.cc/E39Y-VYCP].

25. *See* American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 501(a), 118 Stat. 1418, 1520 (codified as amended at I.R.C. § 164(b) (2006)).

tax.[26] Since 2004, the total elimination of the SALT deduction has been a feature of many tax reform proposals.[27] These proposals were influential in the changes contained in the TCJA.

III. THE TAX CUTS AND JOBS ACT OF 2017: HOW IT WORKS AND HOW IT AFFECTS STATE AND LOCAL TAXES

Section 11042 of the TCJA is straightforward and appears clear in its effect.[28] It does not make any changes to the type of state and local taxes that may be deducted; instead, it limits the aggregate amount of the deduction to $10,000 per year—$5,000 in the case of married taxpayers filing separately.[29] Consequently, the TCJA disproportionately impacts married persons by allowing each only one-half of the deduction allowable to those filing as single or head of household.[30] The remaining value of the deduction of state and local taxes is diminished further by other changes found in the TCJA. As in the past, only individuals who itemize their deductions may use the deduction.[31] The deduction is only useful to the extent that a taxpayer's personal itemized deductions exceed her standard deduction because, under § 63, a taxpayer is entitled to deduct the larger of her personal itemized deductions or her standard deduction.[32]

The tax savings derived from the SALT deductions therefore depends on the extent the allowed total personal itemized deductions exceed the standard deduction.[33] The TCJA also made a significant change in the

26. *See* Gladriel Shobe, *Disaggregating the State and Local Tax Deduction*, 35 VA. TAX REV. 327, 339 (2016) (first citing Lawrence B. Lindsey, *Federal Deductibility of State and Local Taxes: A Test of Public Choice by Representative Government*, *in* FISCAL FEDERALISM: QUANTITATIVE STUDIES 166–67 (Harvey S. Rosen ed., 1988); and then citing American Jobs Creation Act of 2004 § 501 (codified as amended at I.R.C. § 164(b))).

27. *See*, *e.g.*, Tax Reform Act of 2014, H.R. 1, 113th Cong. § 1405(a) (2014); CONNIE MACK ET AL., PRESIDENT'S ADVISORY PANEL ON FED. TAX REFORM, SIMPLE, FAIR, AND PRO-GROWTH: PROPOSALS TO FIX AMERICA'S TAX SYSTEM 61, 83 (2005).

28. *See* Tax Cuts and Jobs Act, Pub. L. No. 115-97, § 11042, 131 Stat. 2054, 2085–86 (2017) (codified as amended at I.R.C. § 164(b) (2012 & Supp. V 2018)).

29. *Id.*

30. *See id.*

31. *See* I.R.C. § 63(c)(6).

32. *Id.* § 63. *See generally* JOINT COMM. ON TAXATION, JCX-7-13, PRESENT LAW AND BACKGROUND INFORMATION RELATED TO FEDERAL TAXATION AND STATE AND LOCAL GOVERNMENT FINANCE (2013).

33. *See* I.R.C. § 63(c)(6).

amount of the standard deduction.[34] It roughly doubles the amount of the standard deduction. The table below illustrates this change[35]:

STANDARD DEDUCTION 2017 AND 2018

	2017	2018
Single	$6,350	$12,000
Married	$12,700	$24,000
Head of Household	$9,350	$18,000

Before the passage of the TCJA, a taxpayer's SALT deduction could have been large enough to exceed the standard deduction and provide a tax savings for state and local taxes. After the TCJA, the maximum of $10,000[36] would not exceed the standard deduction for any taxpayers. Moreover, the tax savings of the SALT deduction depends on the amount of a taxpayer's other itemized deductions. These are principally composed of a portion of medical expenses,[37] residential home interest,[38] "charitable contributions,"[39] casualty losses,[40] and "miscellaneous itemized deductions."[41] After 2017, single taxpayers who are entitled to the full $10,000 will still need $2,000 in additional personal itemized deductions, and married couples and heads of households will need $14,000 and $8,000 in additional itemized deductions, respectively, before they will be able to receive any tax benefit from SALT. However, some of these itemized deductions have also been reduced. The TCJA reduced the limit for the deduction of qualified residence interest[42] and eliminated the deduction for personal casualty losses except where the loss is attributable to a federally declared disaster.[43] The TCJA also eliminated miscellaneous itemized deductions, which included the deduction for employee business expenses.[44]

The combination of these changes substantially reduces the number of taxpayers who receive any advantage from itemizing and substantially

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34. *See* Tax Cuts and Jobs Act § 11021 (codified as amended at I.R.C. § 63(c)).
35. I.R.C. § 63(c)(6)–(7).
36. Tax Cuts and Jobs Act § 11042 (codified as amended at I.R.C. § 164(b)(6)).
37. *Id.* § 11027 (codified as amended at I.R.C. § 213(f)). Section 213 grants a deduction for certain medical expenses that exceed 10% of adjusted gross income. I.R.C. § 213(f)(2). TCJA temporarily reduced that threshold to 7.5% through 2018. *Id.*
38. Tax Cuts and Jobs Act § 11043 (codified as amended at I.R.C. § 163(h)(3)).
39. *Id.* § 11023 (codified as amended at I.R.C. § 170(b)(1)).
40. *Id.* § 11044 (codified as amended at I.R.C. § 165(c)(3)).
41. *Id.* § 11045 (codified as amended at I.R.C. § 67).
42. *See id.* § 11043 (codified as amended at I.R.C. § 163(h)(3)) (reducing the limit on qualified residence interest from $1 million of indebtedness to $750,000 of indebtedness).
43. *See id.* § 11044 (codified as amended at I.R.C. § 165(h)(5)).
44. *See id.* § 11045 (codified as amended at I.R.C. § 67(g)).

reduces the tax savings by those who still can itemize.[45] The value of the SALT deduction would have been reduced for many taxpayers even if the TCJA had not provided a $10,000 cap.[46]

The TCJA has one further change that reduced the tax savings from the SALT deduction: it provided lower tax rates for individual taxpayers.[47] These tax rates reduce the value of the deduction for individuals. The tax savings provided by a deduction can be measured by the amount of the deduction times the effective tax rate.[48] The effective rates or tax brackets for individuals were lowered between 3% and 7% under the new act.[49] Consequently, even if the taxpayer received the full effective deduction of $10,000 under the TCJA, this would be worth between $300 and $700 less in tax savings to an individual taxpayer.[50]

The changes will significantly affect whether taxpayers itemize their deductions. Joint Committee on Taxation estimates indicate that the number of taxpayers who itemize their deductions will decline from 46,513,000 in 2017 to 18,011,000 in 2018[51]—a decline greater than 60%. For those who claim a deduction for state and local tax, the 42,262,000 returns in 2017 will decrease to 16,624,000 in 2018[52]—a decrease greater than 60%.

45. For example, with a decrease in the amount of itemized deductions a taxpayer can take and an increase in the amount of the standard deduction, a taxpayer's itemized deductions may not exceed the standard deduction or may be less valuable than in recent years. *See* Howard Gleckman, *21 Million Taxpayers Will Stop Taking Charitable Deductions Under the New Tax Law*, FORBES (Jan. 11, 2018, 3:52 PM), https://www.forbes.com/sites/beltway/2018/01/11/21-million-taxpayers-will-stop-taking-charitable-deductions-under-the-new-tax-law/#2388d340238f [https://perma.cc/TK37-XBUE].

46. *See, e.g.*, Robert Bellafiore, *Who Benefits from the State and Local Tax Deduction?*, TAX FOUND. (Oct. 5, 2018), https://taxfoundation.org/salt-deduction-benefit/ [https://perma.cc/JV8T-J5BT].

47. *See* Tax Cuts and Jobs Act § 11001 (codified as amended at I.R.C. § 1(j)).

48. *See Tax Credits vs. Tax Deductions*, US TAX CTR., https://www.irs.com/articles/tax-credits-vs-tax-deductions [https://perma.cc/8S22-EUHC].

49. *See* Tax Cuts and Jobs Act § 11001 (codified as amended at § 1(j)).

50. For a discussion of the lower rates enacted in 1986, see Robert Tannenwald, *The U.S. Tax Reform Act of 1986 and State Tax Competitiveness*, *in* COMPETITION AMONG STATES AND LOCAL GOVERNMENTS: EFFICIENCY AND EQUITY IN AMERICAN FEDERALISM 177, 177 (Daphne A. Kenyon & John Kincaid eds., 1991) ("[B]y collapsing the structure of federal income tax rates, the [Act] increased both the level and dispersion of the net burden of top statutory income-tax rates among states.").

51. JOINT COMM. ON TAXATION, TABLES RELATED TO THE FEDERAL TAX SYSTEM AS IN EFFECT 2017 THROUGH 2016, JCX-32-18, 6 tbl.5 (2018).

52. *Id*. at 8 tbl.7.

The total tax savings from the SALT deduction is projected to decrease dramatically as well. In 2017, the estimated total tax savings attributable to SALT was $109,443,000,000.[53] In 2018, the estimated total tax savings attributed to SALT will be $20,282,000,000.[54] This change represents additional taxes of over $89 billion.[55] The average tax savings enjoyed by approximately 42 million taxpayers in 2017 was $2,590.[56] The average tax savings enjoyed by approximately 16 million taxpayers in 2018 will be $1,220.[57] Twenty-six million taxpayers lose the entire federal tax benefit of paying state and local taxes; sixteen million taxpayers lose an average of over one-half of the federal tax benefit of paying state and local taxes.[58]

Individual business taxpayers are treated somewhat differently. The Internal Revenue Code still permits the deduction of state and local real and personal property taxes, which are classified as general business expenses or above the line deductions[59] as opposed to non-business personal itemized deductions.[60] Individual business state and local income taxes, however, are covered by the $10,000 limitation and remain personal itemized

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Income Category	2017		2018	
	Returns (Thousands)	$ Millions	Returns (Thousands)	$ Millions
Less than $10,000	3	[2]	5	[2]
$10,000 to $20,000	161	17	50	7
$20,000 to $30,000	477	92	109	25
$30,000 to $40,000	1,027	275	214	64
$40,000 to $50,000	1,635	531	421	128
$50,000 to $75,000	5,799	3,220	1,811	846
$75,000 to $100,000	6,189	5,576	2,286	1,734
$100,000 to $200,000	17,650	27,878	6,382	6,920
$200,000 to $500,000	7,816	26,160	4,148	7,081
$500,000 to $1,000,000	1,015	11,491	780	2,191
$1,000,000 and over	490	34,202	481	1,287
Total, All Taxpayers	42,262	109,443	16,624	20,282

Id.

53. *Id.*
54. *Id.*
55. *See id.*
56. *See id.*
57. *See id.*
58. *See id.*
59. For a definition of above the line deductions, see *Above the Line Deduction*, INVESTOPEDIA, https://www.investopedia.com/terms/a/above-the-line-deduction.asp [https://perma.cc/Y7V2-MM37].
60. *See* Tax Cuts and Jobs Act, Pub. L. No. 115-97, § 11042, 131 Stat. 2054, 2085–86 (2017) (codified as amended at I.R.C. § 164 (2012 & Supp. V 2018)). General sales taxes collected by business on consumers' purchases will neither be included in income nor deducted by the business. *See* I.R.C. § 164(b)(5)(D).

deductions.[61] This applies to all profit-making investment and business activities undertaken by individuals as sole proprietors or through pass-through entities, including partnerships, limited liability companies, and S corporations.[62]

The deductibility of state and local taxes by taxable corporations has not changed under the TCJA. They are still permitted a full deduction for state and local taxes.[63] The TCJA, however, has made a significant change in the tax savings attributable to the deduction of state and local taxes for corporations—what can be referred to as the after-tax cost of paying state and local taxes.[64] In the TCJA, Congress reduced the tax rate on corporate income from the standard rate of 34% to 21%.[65] To illustrate this point, assume that Corporation X had $1,000,000 in federal taxable income and deductible state and local tax expenditures of $100,000 in both 2017 and 2018. Using the rate of 34% for 2017 and 21% for 2018, the tax savings of a $100,000 SALT deduction in 2017 and 2018 would be $34,000 and $21,000, respectively. The effective after-tax cost of state and local taxes to Corporation X would be $66,000 in 2017 and $79,000 in 2018.

The TCJA will have a substantial, negative after-tax cost of paying state and local taxes for both individuals and businesses.[66] Many taxpayers will consider this cost as a significant factor in their future business activities. The purpose of this paper is to understand the consequences of the TCJA on state and local governments due to its direct effect on taxpayers. To appreciate the consequences, one needs to examine the problems of state taxation and spending in a federal system. This is referred to as fiscal federalism.[67]

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61. Tax Cuts and Jobs Act § 11042 (codified as amended at I.R.C. §§ 63(d), 164(a), 164(b)(6)).
62. *See* I.R.C. § 164(a). Income and deductible expenses of partnerships, limited liability companies, and subchapter S corporations are included in the individual income tax of their owners. For partnership and limited liability company income distributions, see *id.* § 704(a). For S corporation income tax distributions, see *id.* § 1366.
63. *See id.* § 164(a).
64. *See* Tax Cuts and Jobs Act § 13001 (codified as amended at I.R.C § 11(b)).
65. *Id.*
66. *See* JOINT COMM. ON TAXATION, *supra* note 51.
67. *See* Wallace E. Oates & Robert M. Schwab, *Economic Competition Among Jurisdiction, Efficiency Enhancing or Distortion Inducing?*, 35 J. PUB. ECON. 333, 348–52 (1988).

IV. FISCAL FEDERALISM

Governments can be classified on a sliding scale from unitary to federal.[68] A unitary government is one in which the national government does not share power with regional or subnational governmental units.[69] Conversely, federal governments, in their most general sense, are nations in which governmental functions are shared in some fashion between central and regional units.[70] Fiscal federalism, in turn, is concerned with the forms of and dynamics between multilevel governments.[71] It often addresses the problems that result from situations where both federal and state governments act concurrently.[72]

"Contrasting forces, some leading to increased fiscal centralization and some to greater decentralization, are producing an ongoing restructuring of public sectors throughout the world."[73] The trend is toward decentralization in the United States.[74] Traditional theories of federalism principally deal with the mix of regulatory powers between federal and state governments.[75] When legal scholars turn to taxation and federalism, their focus tends to be on the limitations on state action imposed through the exercise of judicial review under the U.S. Constitution and the Commerce Clause.[76] The Constitution was formulated at a time when transportation other than by sea presented barriers to trade and business mobility. The founding fathers were concerned with state laws that restricted commerce and the free movement of persons; simultaneously, state governments taxed little and provided most of their revenue needs through user fees and sales of land.[77] Interstate tax competition was simply not an issue. Indeed, American scholarship

68. *See* David Fontana, *Relational Federalism: An Essay in Honor of Heather Gerken*, 48 TULSA L. REV. 503, 506–07 (2017).

69. *See id.* at 506.

70. *See id.* at 507.

71. Wallace E. Oates, *Toward a Second-Generation Theory of Fiscal Federalism*, 12 INT'L TAX & PUB. FIN. 349, 349 (2005).

72. David A. Super, *Rethinking Fiscal Federalism*, 118 HARV. L. REV. 2544, 2551, 2553 (2005).

73. *See* Oates, *supra* note 71.

74. Erin Ryan, *Federalism and the Tug of War Within: Seeking Checks and Balance in the Interjurisdictional Gray Area*, 66 MD. L. REV. 503, 611 (2007).

75. Super, *supra* note 72, at 2551.

76. *See, e.g.*, WALTER HELLERSTEIN ET AL., STATE AND LOCAL TAXATION: CASES AND MATERIALS 23–25, 115–21 (10th ed. 2014). *But see* Daniel Shaviro, *An Economic and Political Look at Federalism in Taxation*, 90 MICH. L. REV. 895, 955, 963–66 (1992) (looking at legal issues under the Commerce Clause and examining issues relating to tax competition).

77. For a history of property taxes, see William B. Barker, *The Three Faces of Equality: Constitutional Requirements in Taxation*, 57 CASE WESTERN RES. L. REV. 1, 14–18 (2006).

views the promotion of advantageous tax competition as one of the principle consequences of state sovereign tax powers.[78]

State and local governments in a federal system are theoretically and legally open economies with respect to other states. They cannot place any overt restriction on the free movement of trade, capital, and persons. State governments have also generally adopted policies that encourage economic activity within their states.[79] Like nations, federal states have pursued policies that extend tax incentives to businesses and investors to stimulate economic development.[80] When federal states adopt these practices, they engage in interstate tax competition.[81] This trend, however, is not without its detractors. The process of decentralization has unleashed a substantial conflict between the forces of autonomy on the one hand, which support the benefits of increased independence for state and local government, and coordination on the other, which supports the benefits of centralization.[82]

In nations that were not created by federal unions like the United States, federalism begins with a decentralization of authority.[83] The simplest form of decentralization is a delegation of administrative power to subnational units to carry out enumerated functions.[84] Although variations can always occur in the way functions are carried out—especially where these functions are regionally dispersed among many units—the goal of delegation is to carry out the policies of the central government and ensure uniformity in the provision of public goods or in the general welfare of the nation as a whole.[85]

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78. *See* Shaviro, *supra* note 76, at 960; *see also infra* notes 166–67.

79. *See* NORTON FRANCIS, STATE TAX INCENTIVES FOR ECONOMIC DEVELOPMENT 1–4 (2016), https://www.urban.org/sites/default/files/publication/78206/2000636-state-tax-incentives-for-economic-development.pdf [https://perma.cc/X8AS-SGUW].

80. *See*, *e.g.*, Roger J. Vaughan, *State Taxation and Economic Development*, *in* STATE TAXATION POLICY 3, 89 (Michael Barker ed., 1983).

81. *Id*. at 99–100.

82. *See*, *e.g.*, JONATHAN A. RODDEN, HAMILTON'S PARADOX: THE PROMISE AND PERIL OF FISCAL FEDERALISM 5 (2006); Shaviro, *supra* note 76, at 960; Super, *supra* note 72, at 2556.

83. *See* Alex B. Brillantes, Jr., Associate Professor, Univ. of the Phil. & Donna Moscare, Research Assistant, Asian Res. Ctr. for Decentralization, Decentralization and Federalism in the Philippines: Lessons from Global Community, Presentation at the International Conference of the East West Center 1 (July 1–5, 2002) (transcript available online).

84. *See* Richard M. Bird, *Fiscal Decentralization and Competitive Governments*, *in* COMPETITION AND STRUCTURE: THE POLITICAL ECONOMY OF COLLECTIVE DECISIONS 129, 131–32 (Gianluigi Galeotti et al. eds., 2000).

85. *See id.* at 130–32.

Mere decentralization should be contrasted with devolution of power, which results in independent local governments.[86] When some responsibility for law and policy belong to local government, federalism as a political alternative for subnational governmental units becomes significant. True federalism requires autonomy, which can only be created by contractual agreements between central and local governments grounded in constitutional or fundamental law.[87] Federalism requires some type of legally binding independence.[88] Otherwise, if the central government has the power to abolish autonomy, there can be no true independent action by local governments.[89]

Even among true federalist nations, governmental power is divided in different ways.[90] In the area of fiscal affairs, there are three kinds of authority that are synonymous with governmental power and the sovereignty of subnational governmental units: the power to tax, the power to spend, and the power to borrow.[91] These powers have the potential, when exercised by subnational governments, to create differences between states in the provision of public goods and services and the fiscal obligations of persons and enterprises.[92] By creating these differences, these powers can profoundly affect the well-being of persons based on the state where they live or operate.[93] The exercise of powers to tax, spend, and borrow can create fiscal competition between state governments through the different supply of public benefits or imposition of tax burdens.[94]

Although there are some federal countries with fiscal autonomy, few have the three fiscal powers in like measure.[95] Differences in the scope of fiscal autonomy can be seen among three federal nations: Germany, Brazil and the United States. In some ways, these countries share common features. The differences, however, in the allocation of each nation's fiscal powers illustrates the wide range of possibilities federalism offers.

One measure of fiscal autonomy is the power to spend.[96] State governments in Germany, Brazil, and the United States have constitutional authority

86. *See id*. 132–33.
87. *See* RODDEN, *supra* note 82, at 32.
88. *See id.* at 33.
89. *See id.* at 32.
90. *See id.* at 38.
91. *See* Bird, *supra* note 84, at 140.
92. *See id*. at 140–41.
93. *Id*. (quoting COUNTRY DEP'T III, COUNTRY OPERATIONS DIV. I, LATIN AM. & THE CARIBBEAN, COLOMBIA LOCAL GOVERNMENT CAPACITY: BEYOND TECHNICAL ASSISTANCE 5 (1995)).
94. *See id*. at 142.
95. *See id*. at 134.
96. *See* Jeffrey I. Chapman, *Local Government Autonomy and Fiscal Stress: The Case of California Counties*, 35 ST. & LOC. GOV'T REV. 15, 16 (2003).

over spending.[97] In Germany, for example, where the states are known as Länders, "[t]he states are responsible for [expenditures relating to] culture, education, law and order, health, environmental protection, and regional economic policy."[98] In Brazil[99] and the United States, however, the constitution does not define specific responsibilities of the states.[100] Instead, states are free to do whatever they wish unless it is prohibited by the constitution.[101] Pluralists like James Madison supported this role for subnational governments based on the argument that decentralization of authority provides many benefits, including the more efficient provision of public goods and services.[102] This is due to the fact that smaller governmental bodies are more responsive to voter preference and better satisfy geographical preferences for government goods and services.[103] By dividing governmental authority, a nation creates competition among states and between states and the federal government, which prevents abuse and promotes experimentation at the local level.[104] These are the so-called laboratories of democracy.[105] The decline of central control over the economy brings about the economic prosperity that was part of federalism's objective.[106] This trend in the developed world can be seen in the creation of Scotland's and Wales's assemblies and a substantial shift of power to regional governments in Spain.[107] In the case of a federal regime like the United States, the spending power of federal states is unlimited except in those situations where the U.S. Constitution grants to the national government exclusive control of a matter or prohibits state power under Article I, like in the case of foreign relations.[108]

The power over expenditure is the most common form of power held by federal states, which typically is the type of power that can be granted to aid administrative decentralization.[109] Only in a true federal governmental

97. *See generally* RODDEN, *supra* note 82.
98. *Id.* at 158.
99. *See id.* at 190–91.
100. *See* U.S. CONST. art. 1 § 8–10.
101. *Id.* at 191.
102. *See* Bird, *supra* note 84, at 142 (citations omitted).
103. *See* Oates & Schwab, *supra* note 67, at 344.
104. *See* Bird, *supra* note 84, at 142 (citations omitted).
105. *See* New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).
106. *See* Bird, *supra* note 84, at 142; Oates & Schwab, *supra* note 67, at 349.
107. *See* RODDEN, *supra* note 82, at 25–26.
108. *See* U.S. CONST. art. I, § 10.
109. *See* RODDEN, *supra* note 82, at 25–27.

unit, however, is its power based on local policy and control. These states have played a major role in the provision of many public benefits to their residents including education, health, welfare, transportation and support for economic development.[110]

The policies behind the provision of benefits are quite different among the states of these three nations. Although German states have considerable spending autonomy, the German constitution or Basic Law requires the outcome of uniformity in the provision of public benefits throughout the nation.[111] In contrast, except for recent legislation in Brazil requiring states to allocate 25% of their budgets to education,[112] there is no requirement that states in Brazil or the United States provide a particular level of benefits.[113] However, the spending power of the states and national government is concurrent.[114] Many national and state programs are integrated, and the central governments provide funding to the states for specific goals.[115] Significant coordination of policies and resources occurs in these situations.[116] Clearly, however, the systems in Brazil and the United States provide significant room for diversity in spending among the states.

Spending requires funding. One way for states to fund their spending is through borrowing—a power that all three states have. In Germany and the United States, there is no federal constitutional limit on states' right to borrow.[117] In Brazil, recent federal legislation resulting from state fiscal irresponsibility has put significant constraints on states' rights to borrow.[118] States can only fund expenditures through their own resources, which include taxes, fees, borrowing, or grants from the central government.[119] Although

110. *See id.* at 26–27, 158, 191.

111. GRUNDGESETZ [GG] [BASIC LAW] art. 72(2), *translation at* http://www.gesetze-im-internet.de/englisch_gg/index.html. This requires "equivalent living conditions." *Id.*

112. RODDEN, *supra* note 82, at 193.

113. For example, in the United States, explicit Federal Government Grants to state and local government in 2002 amounted to approximately $351 billion or about 3.4% of Gross Domestic Product (GDP) and about 17.5% of total government expenditures. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT: FISCAL YEAR 2005, at 221 tbl.12.1 (2004). *See generally* David E. Wildasin, *The Institutions of Federalism: Toward an Analytical Framework*, 54 NAT'L TAX J. 247 (2004).

114. *See* Super, *supra* note 72, at 2593–94.

115. *See id.* at 2571–72.

116. *See id.* at 2557, 2563.

117. *Compare* RODDEN, *supra* note 82, at 158–60 (describing Germany), *with* U.S. CONST. art. I, § 10. The Constitution's list of state prohibitions lacks limitations on state borrowing. *See* U.S. CONST. art. I, § 10.

118. *See* Jonathan Rodden, *Federalism and Bailouts in Brazil*, *in* FISCAL DECENTRALIZATION AND THE CHALLENGE OF HARD BUDGET CONSTRAINTS 213, 238 (Jonathan Rodden et al. eds., 2003) (citing recent legislation that placed limits on borrowing and spending on state governments in Brazil).

119. *See* RODDEN, *supra* note 82, at 76.

borrowing can fund public benefits temporarily, over time, states must repay borrowers with other resources including tax receipts or with central government bailouts.[120]

State governments achieve fiscal discipline by following hard budget financing, which requires a state to rely on its own sources of funding to finance its expenditures.[121] Soft budget financing relieves states of the ultimate responsibility for their actions by providing central government bailouts to financially challenged states.[122] Bailouts lead to excess spending and borrowing by states.[123] In both Brazil and Germany, states' fiscal irresponsibility has led to massive federal bailouts.[124] Consequently, both Brazilian and German states have not had to practice fiscal constraint but have been able to compete with other states by borrowing funds to provide enhanced public benefits.[125] Additionally, borrowing without ultimate responsibility for repayment encourages Brazilian states to compete with other states though their tax systems.[126] Thus, the key to fiscally responsible autonomy of state governments is responsibility in borrowing and the power to tax.

The United States' experience supports this conclusion. In 1790, shortly after the formation of the Union, the federal government assumed the states' war debts.[127] The policy was to ensure the credit and financial position of the new nation.[128] In 1837, due to widespread economic troubles, many state governments that had built up substantiated indebtedness were in danger of reneging on these obligations.[129] Although considerable pressure was put on the federal government to bail out the states, it was clear by 1843 that the federal government would not assume states' debts.[130] Because the U.S. Constitution did not empower the federal government to compel

120. *See id.* at 158–63.
121. *See* Oates, *supra* note 71, at 354.
122. *Id.* at 355.
123. *See id.* at 355, 360.
124. *See* RODDEN, *supra* note 82, at 196, 222–24
125. *See id.* at 224.
126. *See, e.g.*, Rodden, *supra* note 118, at 230–31.
127. *See* RODDEN, *supra* note 82, at 57.
128. *See* ALEXANDER HAMILTON, *The First Report on the Public Credit (1789)*, *in* 6 THE PAPERS OF ALEXANDER HAMILTON 51, 55, 58, 69 (Harold C. Syrett & Jacob E. Cooke eds., 1962).
129. *See* RODDEN, *supra* note 82, at 63–64.
130. *Id.* at 63.

the states to pay their debts, the principle that the U.S. state governments are fiscally sovereign was established.

The third leg of complete federalism is the power to tax. The contrast between these three nations regarding the states' taxing power is dramatic. German states lack independent state taxing powers.[131] Therefore, German states cannot fiscally compete with their tax systems.

Unlike Germany, Brazilian states have some autonomy with respect to taxes. The principle tax imposed by states is the value added tax (ICMS).[132] Only the national government, not the states, can impose income taxes (IR).[133] States have the power to tax inheritances and gifts (ITCD) and motor vehicles.[134] Municipalities can tax urban land property (IPTU), real estate conveyances (ITBI), and services (ISS).[135] State have greater choices with respect to value added tax. The base for the ICMS, including some exemptions, is determined by federal law, but the states are free to legislate where the federal government has not.[136] For example, states have chosen many different rate categories for goods and a wide dispersion of rates within those categories.[137] Because of the decision-making authority left to the states, ICMS provides the ingredients for tax competition among the states.

American states present an incredibly diverse picture when it comes to taxes. They freely choose between the types of taxes and the rates, including personal and corporate income taxes, sales taxes, VAT, inheritance, estate and gift taxes, property taxes, and many different user fees.[138] Taxes are

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131. *See* GRUNDGESETZ [GG] [BASIC LAW] art. 105(1), *translation at* https://www.gesetze-im-internet.de/englisch_gg ("The Federation shall have exclusive power to legislate with respect to customs duties and fiscal monopolies."); *id.* art. 105(2) ("The Federation shall have concurrent power to legislate with respect to all other taxes the revenue from which accrues to it wholly or in part . . . ."); *see also* FED. MINISTRY OF FIN., FINANCIAL RELATIONS BETWEEN THE FEDERATION AND LÄNDER ON THE BASIS OF CONSTITUTIONAL FINANCIAL PROVISIONS 8 (2017) ("To ensure legal and economic consistency on a nation-wide basis, the Federation has made extensive use of its concurrent legislative powers in the area of taxation. This means that the Länder (together with local authorities) retain the power to levy taxes mainly in the form of local excise duties, as long as such duties are not equivalent to taxes governed by federal law.").

132. *See* JOSÉ ROBERTO AFONSO & RAFAEL BARROSO, BRAZILIAN TAX AFFAIRS 5, 26 (2007).

133. FED. REVENUE SERV., MINISTRY OF FIN., TAX SYSTEM AND ADMINISTRATION IN BRAZIL: AN OVERVIEW 4 (2002), http://receita.economia.gov.br/dados/receitadata/estudos-e-tributarios-e-aduaneiros/estudos-e-estatisticas/estudos-diversos/sistema-e-administracao-tributaria-ingles [https://perma.cc/4ZXV-4NAJ].

134. *Id.*

135. *Id.*

136. *See* AFONSO & BARROSO, *supra* note 132, at 27.

137. *See id.*

138. *See generally* HELLERSTEIN ET AL., *supra* note 76.

imposed by both state and sub-state governmental units.[139] States also fully control the tax administration and collection. In the case of personal income tax, forty-three states impose the tax, and of these, forty-one have broad based taxes.[140] Only five states, however, adopt their own base; the rest start with the federal base, subject, in many cases, to modifications for both inclusions and exclusions.[141] Eight states impose flat rates,[142] and the rest demonstrate considerable variation with tax brackets and rates up to 13.3%.[143]

Nearly all states, including the District of Columbia, impose corporate taxes.[144] Standard corporate tax rates range from 3% to 12%, with some states applying graduated rates to small businesses.[145] With such a plethora of tax choices, it would be difficult to find two states with the same mix of taxes, let alone to find two with the same rates on the tax bases they do share. Because American states have such wide latitude with respect to tax choices, diversity and tax competition among the states is quite high.[146]

The limitation on American state tax power is two-fold. Like sovereign nations in general, states are restricted by natural power and can tax only on the basis of territorial taxation and residence.[147] The Commerce Clause constitutionally limits this sovereign power, providing that taxation

139. *See generally id.*

140. *Individual Income Taxes*, URB. INST., http://www.urban.org/policy-centers/cross-center-initiatives/state-local-finance-initiative/projects/state-and-local-backgrounders/individual-income-taxes [http://perma.cc/6DP5-Z5WU]; *see also Income Tax Rates by State 2018*, TAX-RATES, http://www.tax-rates.org/taxtables/income-tax-by-state [http://perma.cc/U9WH-HFTF].

141. JARED WALCZAK, TAX FOUND., TAX REFORM MOVES TO THE STATES: STATE REVENUE IMPLICATIONS AND REFORM OPPORTUNITIES FOLLOWING FEDERAL TAX REFORM 1, 6–9 (Rachel Shuster ed., 2018), https://files.taxfoundation.org/20180327085430/TaxFoundationSR242.pdf [http://perma.cc/9ZUR-656U].

142. *See Income Tax Rates by State 2018*, *supra* note 140; *see also Individual Income Taxes*, *supra* note 140.

143. *Income Tax Rates by State 2018*, *supra* note 140.

144. *See* MORGAN SCARBORO, TAX FOUND., STATE CORPORATE INCOME TAX RATES AND BRACKETS FOR 2018, at 1, 1 (Rachel Shuster ed., 2018), https://files.taxfoundation.org/20180717150707/Tax-Foundation-FF5711.pdf [http://perma.cc/6SQT-36F4].

145. *Id.* at 1–2.

146. *See* James R. Rogers, *The Law and Policy of State Tax Compensation: Much Ado About Nothing?*, 4 Geo. J.L. & Pub. Pol'y 101, 114–15 (2006).

147. *See* Frank M. Keesling, *The Problem of Residence in State Taxation of Income*, 29 CAL. L. REV. 706, 706 (1941).

cannot be an undue burden on interstate commerce.[148] Consequently, American states are in constant competition for mobile resources including businesses and people.[149]

There are two ways that states can fiscally compete with other states—neither of which can be viewed in a vacuum. On the one hand, states may compete for persons and economic activity by increasing the supply of public benefits.[150] This form of tax competition will result in increased taxes or borrowing to pay for such benefits.[151] There are complex trade-offs between the supply of public benefits and the way states pay for them through taxes or credits that provide many possible environments for persons and businesses. In contrast, states can compete by lowering taxes.[152] The oversupply or undersupply of benefits may be the outcome of the different policies, which results in diverse fiscal environments among states in a federal system.[153]

Tax competition among states is only possible where subnational governments have true tax autonomy. Although Germany, Brazil, and the United States are all federal nations, only states like the Brazilian and American states have the capacity to compete with sister states through their tax systems. Brazilian states differ from German Länders because they have significant power to tax.[154] These powers, however, are not near what American states have. State accountability for debt or the lack thereof can constrain or expand possible tax policy choices for state governments. German and Brazilian states both differ from American states in that neither are required to practice fiscal discipline.[155] American states, however, are perceived by creditors to be sovereign states and are fully responsible for their debts with absolutely no expectation that the federal government will provide any bailouts.[156]

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148. U.S. CONST. art. I, § 8, cl. 3; Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 274 (1977).

149. *See* Rogers, *supra* note 146.

150. *See* Wallace E. Oates & Robert M. Schwab, *The Allocative and Distributive Implications of Local Fiscal Competition*, *in* COMPETITION AMONG STATES AND LOCAL GOVERNMENTS: EFFICIENCY AND EQUITY IN AMERICAN FEDERALISM 127, 127–28 (Daphne A. Kenyon & John Kincaid eds., 1991).

151. *Id*. at 128.

152. *See id*. at 127–28.

153. *See* Johnathan C. Rork, *Coveting Thy Neighbor's Taxation*, 56 NAT'L. TAX J. 775, 783 (2003).

154. *See* Keith S. Rosenn, *Federalism in Brazil*, 43 DUQ. L. REV. 577, 580 (2005).

155. *See* Richard Deeg, *Contemporary Challenges to German Federalism: From the European Union to the Global Economy*, 33 LAW & POL'Y INT'L BUS. 51, 57–58 (2001); *supra* text accompanying notes 129–30.

156. *See generally* David A. Skeel, Jr., *Is Bankruptcy the Answer for Troubled Cities and States?*, 50 HOUS. L. REV. 1063 (2013).

V. THE PROBLEM OF DOUBLE TAXATION

Many have found fault with the SALT deduction. There has been a general consensus that the real property tax represents payment for value received for public goods and services and, hence, should be treated as non-deductible consumption.[157] In the case of sales and income taxes, where the relation between taxes and benefits received is tenuous, the deduction is considered unfair because it favors high bracket taxpayers who itemize.[158] By favoring high bracket taxpayers who pay substantial state taxes, the deduction decreases the progressivity of the federal income tax.[159] Further, it may not be the best way for the federal government to subsidize state and local governments.[160] Direct subsidies are more efficient.

On the other hand, U.S. states—through income and in some cases sales taxes—have been able to achieve nontax redistributive goals through their mostly autonomous systems.[161] Indeed, the deduction is thought to increase the progressivity of state tax systems.[162] A common view is that redistributive policy is best left to the federal government—as long as the federal government is dedicated to re-distributional policy.[163] When the federal government is not dedicated, state governments end up playing a necessary role in redistribution of wealth through taxes and spending.[164]

Opposition to the state and local tax deduction is often based on the argument that there is an economic value to tax competition among states because tax competition can promote economic efficiency in the provision of public goods and services through taxation.[165] "Intergovernmental competition for fiscal resources and interjurisdictional mobility of persons in pursuit of 'fiscal gains' can offer partial or possibly complete substitutes for explicit fiscal constraints on the taxing powers."[166] Thus, those who advocate significant fiscal constraints support tax competition, which acts

157. *See* Shobe, *supra* note 26, at 349.
158. *See* Stark, *supra* note 22, at 1411, 1413–14.
159. *See* I.R.C. § 164(a) (2012 & Supp. V 2018); *see also* Stark, *supra* note 22, at 1414.
160. *See* Louis Kaplow, *Fiscal Federalism and the Deductibility of State and Local Taxes Under the Federal Income Tax*, 82 VA. L. REV. 413, 484–86 (1996).
161. *See* Shobe, *supra* note 26, at 342.
162. *Id.* at 335 n.26.
163. *See* Oates & Schwab, *supra* note 150, at 141.
164. *See id.*
165. *See, e.g.*, John Douglas Wilson, *Theories of Tax Competition*, 52 NAT'L TAX J. 269, 271–72 (1999).
166. GEOFFREY BRENNAN & JAMES M. BUCHANAN, THE POWER TO TAX: ANALYTICAL FOUNDATIONS OF A FISCAL CONSTITUTION 184 (1980).

as a check on excessive taxation by state governments. However, repealing or limiting the SALT deduction hampers states' abilities to raise their own source revenue. Consequently, the debate over deductibility often concerns the appropriate level of government services.[167] This argument has been advocated in the international setting as well, where the general consensus is that this is a beggar thy neighbor approach.[168]

While these perspectives add to our understanding of the part played by the SALT deduction, they ignore the fundamental problem of double taxation of taxpayers by more than one sovereign governmental unit. Double taxation is a well-recognized international and interstate problem where foreign nations and U.S. state governments' tax systems interact. It is, however, a poorly perceived problem of federalism where federal and state systems interact.

A. International and Interstate Double Taxation

Double taxation occurs in two different ways. The most common and understood form involves international and interstate double taxation of income.[169] This occurs in situations where there is more than one coequal sovereign with independent power over the tax base. Where transactions and taxpayers have multijurisdictional economic effects, more than one nation or state government can have an interest and a right to tax the income.[170] In the case of both international and interstate income taxation, this problem is exacerbated by the fact that there are two primary sovereign tax regimes: territorial taxation and residence taxation.[171] The general premise of territorial taxation is that sovereigns have the power and the right to tax income that arises within their borders.[172] The general premise of residence taxation is that sovereigns have the power and the right to tax their residents on world-wide income wherever earned.[173] In the United

167. *See* Wilson, *supra* note 165.

168. *See* William B. Barker, *Optimal International Taxation and Tax Competition: Overcoming the Contradictions*, 22 NW. J. INT'L L. & BUS. 161, 172–73 (2002).

169. *See generally* William B. Barker, *An International Tax System for Emerging Economies, Tax Sparing, and Development: It Is All About Source!*, 29 U. PA. J. INT'L L. 349 (2007); Vaughan, *supra* note 80.

170. *See, e.g.*, John A. Swain, *Misalignment of Substantive and Enforcement Tax Jurisdiction in a Mobile Economy: Causes and Strategies for Realignment*, 63 NAT'L TAX J. 925, 927–28 (2010).

171. William B. Barker, *International Tax Reform Should Begin at Home: Replace the Corporate Income Tax with a Territorial Expenditure Tax*, 30 NW. J. INT'L L. & BUS. 647, 650 (2010).

172. Mitchell A. Kane, *A Defense of Source Rules in International Taxation*, 32 YALE J. REG. 311, 317 (2015).

173. *Id.* at 313.

Sates, residents include both citizens and non-citizen resident aliens.[174] Corporations are resident corporations if they are incorporated within the United States.[175]

The most important international and interstate conflict over income taxation is between residence and source taxation.[176] Although there is no principle of international law that requires a nation to relinquish jurisdiction to tax once it is properly asserted,[177] nations have largely tried to ameliorate double taxation on a unilateral basis.[178] Today, the doctrine that "source jurisdiction is considered primary,"[179] and that residence taxation should defer to source, can be said to be a maxim of international tax law.[180] The two recognized methods for mitigating double taxation are exemption of foreign source income[181] and the foreign tax credit that allows a credit for foreign taxes against the income tax of the residence nation.[182]

Although state governments follow the same general principles as in the case of international taxation, these principles are mandated as part of the U.S. federal system by virtue of the Commerce Clause of the U.S. Constitution.[183] The U.S. Supreme Court has inferred under the dormant Commerce Clause that states are prohibited from doing certain acts that would put an undue burden on interstate commerce.[184] As applied to taxation, the Court has ruled a state must provide an income tax credit against both state and local taxes for taxes paid to other states.[185]

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174. *See* I.R.C. § 7701(b)(1)(A) (2012).
175. *Id.* § 7701(a)(30)(C), (b)(1)(A).
176. *See* Barker, *supra* note 168, at 181.
177. *See* RAMON J. JEFFREY, THE IMPACT OF STATE SOVEREIGNTY ON GLOBAL TRADE AND INTERNATIONAL TAXATION 43–44 (1999).
178. *See* Barker, *supra* note 168, at 181; *see also* HUGH J. AULT ET AL., COMPARATIVE INCOME TAXATION: A STRUCTURAL ANALYSIS 357 (3d ed. 2010).
179. David R. Tillinghast et al., Am. Law Inst., Int'l Aspects of United States Income Taxation 8 (Apr. 1, 1983) (unpublished draft) (on file with author).
180. For a discussion of the history behind these principles, see Barker, *supra* note 168, at 180–84.
181. For an example of an exemption system under U.S. law, providing a participation exemption for dividends paid by foreign corporations, see Tax Cuts and Job Act, Pub. L. No. 115-97, § 14101, 131 Stat. 2054, 2189 (2017) (codified as amended at I.R.C. § 245A (2012 & Supp. V 2018)).
182. I.R.C. § 901.
183. *See* U.S. CONST. art. I, § 8, cl. 3.
184. *See* Dean Milk Co. v. City of Madison, 340 U.S. 349, 353–54 (1951).
185. *See* Comptroller of the Treasury of Md. v. Wynne, 135 S. Ct. 1787, 1805 (2015) (ruling that Maryland allowing a credit against state taxes but not against local taxes is unconstitutionally discriminatory).

The Court, in reaching this result, applied the "internal consistency test," which distinguishes between a state tax structure that fails the test because it is inherently discriminatory against taxpayers with cross border activities and one that passes the test because it might result in double taxes only as a result of inconsistencies between two nondiscriminatory state schemes.[186] The essence of the constitutionally mandated system is that the principles of international taxation apply to interstate taxation.

Thus, it is a well-recognized and consistently followed principle in both international and interstate taxation that double taxation of the same tax base is contrary to fair and appropriate taxation and should be prevented if at all possible. These double tax conflicts arise between equal sovereign national or equal sovereign federal states, which can be referred to as "horizontal conflicts."[187] However, the double tax conflict that arises principally with the SALT deduction is where there can be conflicts of different levels of sovereignty within a federally organized nation, which can be referred to as "vertical conflicts."[188]

B. Double Taxation by Nations and States

There is a second type of double taxation conflict that can arise where one nation taxes the same or a similar base more than once.[189] It can happen where a unitary government or one unit of a federal system taxes different bases that overlap. For example, one jurisdiction could impose taxes on income, on consumption through a sales or Value Added Tax, or on property's value. One need only consider Henry Simons's classic definition of income as equaling consumption plus dissaving or minus savings[190] to see the relation between income and consumption taxes and the inherent overlapping taxation where both taxes are utilized by a government. Property taxes applied annually can also be characterized as a tax on the use value of

186. *Id*. at 1802. An example of the latter would be double taxation due to two states adopting logical but inconsistent regimes for source of income for territorial tax purposes. In the international setting, nations do not provide unilateral tax relief in these situations but may provide relief through bilateral tax treaties. *See* Barker, *supra* note 168, at 180–84; Barker, *supra* note 171, at 650.

187. THOMAS I. PARKINSON ET AL., COMM. ON TAXATION OF THE TWENTIETH CENTURY FUND, INC., FACING THE TAX PROBLEM: A SURVEY OF TAXATION IN THE UNITED STATES AND A PROGRAM FOR THE FUTURE 446–48 (1937).

188. *Id.* at 447.

189. *See id.*

190. *See* HENRY C. SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 50 (2d prtg. 1950).

property consumed by the taxpayer during the taxable period, which could be properly included in either an income or a consumption tax base.[191]

Taxation of overlapping tax bases is tolerable where all the taxes are imposed by the same sovereign authority—the national government in the case of a unitary state—because it is presumed that the legislature has taken the various taxes into consideration in establishing the burden on taxpayers. The key is the unspoken presumption that the total tax is not excessive. However, many sovereigns, including American states, mitigate the burden of multiple taxes internally by allowing deductions from the income tax base.[192] This is the general practice followed for income taxation of businesses.[193] It is also followed for individuals; many U.S. states that use the federal tax base for income taxation allow a deduction even for local income taxes.[194]

The incidence of double taxation in a federal system is theoretically different from international and interstate double taxation because the nature of the conflicts in tax jurisdictions is quite different. Where sovereigns tax persons and entities on their income, there are two primary bases for taxation: residence and territorial, or source taxation.[195] Although conflicts arise among different nations or different states over overlapping definitions of who is a resident[196] or the appropriate source or location of income within a jurisdiction,[197] the primary type of conflict between nations or between American states is the conflict between residence and territorial or source taxation.[198]

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191. The imputed value of the consumption of one's own property is not included in the U.S. tax base. *See* Helvering v. Indep. Life Ins. Co., 292 U.S. 371, 381 (1934). It is included in the income tax base of other nations. Switzerland is an example. *See Imputed Rental Value: What Do I Need to Know?*, CREDIT SUISSE (Apr. 12, 2018), https://www.credit-suisse.com/ch/en/articles/private-banking/eigenmietwert-das-muessen-sie-wissen-201804.html [https://perma.cc/L933-D5XR].

192. *See, e.g.*, I.R.C. § 164 (2012).

193. *See id.*

194. *See* Shobe, *supra* note 26, at 340.

195. Barker, *supra* note 168, at 181.

196. For example, the United States uses both the status of resident and that of citizen to define those subject to world-wide taxation. *See* Cook v. Tait, 265 U.S. 47, 56 (1924) (ruling that Congress has the power to tax the world-wide income of U.S. citizens). Most other countries adopt the concept of resident for world-wide taxation. *See, e.g.*, ORG. FOR ECON. CO-OPERATION & DEV., MODEL TAX CONVENTION ON INCOME AND ON CAPITAL 26 (2003).

197. *See* I.R.C. § 61 ("[I]ncome from whatever source derived . . . ."); Barker, *supra* note 168, at 202–03.

198. *See supra* text accompanying notes 176–82.

The SALT deduction, of course, does not operate where one sovereign employs multiple taxes or where two independent sovereigns adopt different tax bases, but it does operate where two vertically oriented sovereigns operate in a federal system like the United States.[199] Both the states and the federal government can and do adopt jurisdictional bases that are the same. These include territorial income taxes where an item of income that arises in a state also arises in the United States.[200] It also includes resident-based tax where a resident taxed by a particular state is also a resident taxed by the United States.[201] Where both the national government and the state impose a similar tax, double taxation can be a serious problem. Further, one cannot assume that one legislature understands the burden created by multiple taxes and will adjust its tax laws to ensure appropriate burdens. Even if one legislature adopts all tax laws and understands this burden, it is not likely that two independent sovereigns—one of which is one of fifty state jurisdictions and the District of Columbia—adopting multiple taxes with different inclusions, deductions, and rates that apply to overlapping economic bases will understand this burden. The multiplicity of the tax systems of the various U.S. state governments amply supports this conclusion.[202]

C. National and State Governments: Coordination or Competition

Double taxation is an inherent feature of a federal government like the United States. Both the federal and state governments have independent powers to tax guaranteed by the Constitution.[203] Unlike Brazil where the national government has the power to limit and coordinate state action,[204] the U.S. system does not provide a legal mechanism for resolving those conflicts that arise between national and state governments over taxation.[205] Where the national government lacks the power to coordinate the tax, borrowing, and spending powers of the states, it may only practically limit double taxation by providing unilateral relief.[206] International and American communities view such relief for international and interstate double

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199. *See generally* Stark, *supra* note 22.
200. *See* Barker, *supra* note 168, at 181.
201. *See id.*
202. *See supra* text accompanying notes 128–29.
203. *See* U.S. CONST. art. I, § 8 (empowering Congress "lay and collect" taxes); *id.* at amend. X ("[P]owers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively . . . ."); *id.* at amend. XVI (empowering Congress power to impose an income tax).
204. *See supra* text accompanying notes 118–20.
205. *See* Super, *supra* note 72, at 2093–95.
206. *See* Mitchell B. Carroll, *Tax Inducements to Foreign Trade*, 11 LAW & CONTEMP. PROBS. 760, 760–61 (1946).

taxation as mandatory.[207] Relief for federal-state double taxation received little attention in the debate over the advisability of the SALT deduction, however.

Based on the international and interstate consensus, the remedies for federal state double taxation are obvious. One method would be for one sovereign to forego and defer certain kinds of taxes to the other sovereign, giving it the exclusive rights to that base.[208] The national government has practiced this method in the case of property and general consumption taxes.[209] The national government has consistently not taxed real property, thus leaving this tax base to the state and local governments.[210] Additionally, although the national government imposes a number of specific excise taxes on goods and services,[211] it does not impose a general sales or consumption tax on goods and services.

However, the national government, most state governments, and many local governments impose income taxes. The allowance of a deduction for state and local taxes against the federal tax liability has addressed the problem of double taxation in the United States.[212] The deduction has included expenditures for more than income taxes, including property taxes and general sales taxes where the taxpayer forgoes the deduction for state and local income taxes.[213] Deductions for non-income tax expenditures is supported by the view that payments to support general governmental function adversely affect a taxpayer's ability to pay federal income tax.[214]

A deduction for taxes is not as valuable to the taxpayer as a credit would be. In both the international and interstate areas, a credit is allowed to completely offset the resident status tax liability to the extent that the federal or state tax liability is no greater than the resident tax liability.[215]

207. *See generally* Ke Chin Wang, *International Double Taxation of Income: Relief Through International Agreement 1921–1945*, 59 HARV. L. REV. 73 (1945).
208. *Id.*
209. *See generally* Ruth Mason, *Delegating Up: State Conformity with the Federal Tax Base*, 62 DUKE L.J. 1267 (2013).
210. *See generally* Laurie Reynolds, *Taxes, Fees, Assessments, Dues, and the "Get What You Pay For" Model of Local Government*, 56 FLA. L. REV. 373 (2004).
211. *See*, *e.g.*, I.R.C. § 4071 (2012) (taxing tires); *id.* § 4081 (taxing motor and aviation fuels); *id.* § 5001 (taxing distilled alcohol).
212. *See* Mason, *supra* note 209.
213. *See generally* Kaplow, *supra* note 160.
214. *Id.*
215. *See* I.R.C. § 901 (allowing foreign tax credit); *id.* § 904 (limiting foreign tax credit to amount of U.S. tax liability on foreign income).

The credit is a dollar for dollar offset against the tax due.[216] The use of credit by the federal government is not without precedent. In the past, the federal government has utilized a credit system for federal Estate and Gift taxes, allowing a credit for state death taxes against federal taxes due.[217] A SALT credit could be practically utilized for all taxpayers paying income taxes, not just for those who itemize their taxes. It would place the federal government in the same position it is in when income is sourced in a foreign country.[218] To balance the respective interests of federal and state governments, the federal government could cap the credit like it does for the Estate and Gift tax.

On the other hand, a deduction for state and local taxes only provides partial relief. The tax savings, instead of being equal to the taxes paid for a credit, is determined by the amount in taxes paid times the effective tax rate.[219] A tax credit achieves taxpayer equity by ensuring that the taxpayer burden will be no greater than the tax imposed by the higher tax jurisdiction.[220] In the federal context, taxpayer equity could be achieved by one government deferring to another government; the former must be willing to abandon its claim for taxes on behalf of the latter, either by granting a tax credit or exempting the base. Instead, a deduction achieves a type of inter-government equity or neutrality. A deduction addresses the problem of double taxation only partially: two governments share the base and offset the adverse consequences to their taxpayers by each relinquishing a portion of its tax revenue.

The federal treatment has not given states a free ticket to impose taxes as high as they wish. Although many states impose income taxes, their rates and revenues generated have not been significant compared with the federal income tax.[221] The states have implicitly recognized that income taxes are

216. *Tax Credits vs. Tax Deductions*, U.S. TAX CTR., https://www.irs.com/articles/tax-credits-vs-tax-deductions [https://perma.cc/K3AZ-QU4F].

217. *See* I.R.C. § 2011 (repealed 2014) (limiting the credits for state taxes to a percentage of the federal tax).

218. *See* INTERNAL REVENUE SERV., DEP'T OF THE TREASURY, FTC/C/10_02-05, SOURCING OF INCOME (2017), https://www.irs.gov/pub/int_practice_units/ftc_c_10_02_05.pdf [https://perma.cc/EQY7-Q5PP].

219. *Tax Policy Center's Briefing Book: Key Elements of the U.S. Tax System*, TAX POL'Y CTR., https://www.taxpolicycenter.org/briefing-book/whats-difference-between-tax- deductions-and-tax-credits [https://perma.cc/4TPQ-TDY5].

220. INTERNAL REVENUE SERV., DEP'T OF THE TREASURY, 98-5, FOREIGN TAX CREDIT ABUSE 2 (1998), https://www.irs.gov/pub/irs-drop/not98-5.pdf [https://perma.cc/V5EX-4MC8].

221. This has been true for both individual and corporate tax rates. *See Income Tax Rates by State 2018*, *supra* note 140 (showing individual rates up to 13.3%).

the primary source of general revenues to the federal government, thus conceding to the federal government's needs.[222]

The TCJA largely abandons the SALT system that has been in place since the beginning of the modern income tax at the federal level; however, the federal-state incidence of double taxation provides a justification for its existence. The next section will examine tax competition among states and the consequences to states of the curtailment of this SALT deduction.

VI. THE TCJA AND THE TAX COMPETITION EFFECT

The allocation of fiscal responsibilities between federal and state governments is undergoing a substantial change in the United States. For many years after the end of World War II, the federal government was considered the provider of overall welfare of Americans.[223] Federal legislation dominated most areas of social welfare.[224] Starting in the early years of Ronald Reagan's presidency, a trend developed toward the devolution of fiscal responsibilities to state and local government due to a more powerful voice for those who sought a smaller and less involved federal government.[225] Consequently, many programs that had previously been undertaken by the federal government, including welfare, housing, and job training, increasingly became the states' responsibility.[226] The states' administrative and financial commitments to these programs entail significant additional costs.[227]

Taxation predominately funds state expenditures for public benefits.[228] The need for additional revenue to fund public interest programs is occurring at a time when the TCJA has drastically curtailed the SALT deduction—

222. *See* CTR. BUDGET & POL'Y PRIORITIES, POLICY BASICS: WHERE DO FEDERAL TAX REVENUES COME FROM? (2018), https://www.cbpp.org/sites/default/files/atoms/files/PolicyBasics_WhereDoFederalTaxRevsComeFrom_08-20-12.pdf [https://perma.cc/R9BQ-MLRW].

223. Richard A. Musgrave, *Devolution, Grants, and Fiscal Competition*, J. ECON. PERSP., Fall 1997, at 65, 65.

224. Stark, *supra* note 22, at 1390.

225. *See* Musgrave, *supra* note 223.

226. Stark, *supra* note 22, at 1391 (citing Wallace E. Oates, *An Essay on Fiscal Federalism*, 37 J. ECON. LIT. 1120, 1120 (1999)).

227. *See* EDMUND F. HAISLMAIER, EXPANDING MEDICAID: THE REAL COSTS TO THE STATES 2–4 (2010), http://thf_media.s3.amazonaws.com/2010/pdf/wm_2757.pdf [https://perma.cc/VS7H-2EKV] (discussing the estimates of individual state costs in changes to the Medicaid program).

228. Gilbert E. Metcalf, *Assessing the Federal Deduction for State and Local Tax Payments*, 64 NAT'L TAX J. 565, 588 (2011).

a major prop to state taxation.[229] The SALT deduction supports state taxation by providing a subsidy for a state's own source revenue.[230] It has been argued that without the deduction, state and local funding will likely fail,[231] and the states will underprovide local productive goods that aid economic development.[232] The reason for this is tax competition among state and local governments.[233]

Tax competition among nations or states flourish when certain conditions are met. United States federal states represent ideal conditions. First, they are economically integrated because the Constitution requires the elimination of interstate barriers to trade, capital movement, and labor.[234] These states share one currency, the dollar, which permits the seamless interstate movement of payments and capital.[235] Capital in the form of both tangible and intangible property is also free to move across state borders.[236] Free trade, capital, and labor mobility among states permit businesses and workers to locate manufacturing, sales, financing, and other business activity in any state or nation.[237]

Where a factor of production like capital or highly skilled labor is inexpensively mobile, the optimal tax rate is zero for attracting and maintaining that capital or labor.[238] Although there are costs associated with capital flows, the factors of production flow among nations or state jurisdictions over

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229. *See* Scott Ahroni, Biagio Pilato & Benjamin Silliman, *Congress and the SALT Deduction*: *Past, Present, and Future*, CPA J., https://www.cpajournal.com/2018/01/22/congress-salt-deduction/ [https://perma.cc/6X29-JRLC].

230. *See* Metcalf, *supra* note 228.

231. *Id.* at 567–68 (citations omitted).

232. *See* John William Hatfield, *Revenue Decentralization, the Local Income Tax Deductions, and the Provision of Public Goods*, 66 NAT'L TAX J. 97, 112 (2013).

233. *See* David E. Wildasin, *Interjurisdictional Capital Mobility: Fiscal Externality and a Corrective Subsidy*, 25 J. URB. ECON. 193, 194–96 (1989).

234. *See* U.S. CONST. art. I, § 8, cl. 3; Barker, *supra* note 169, at 351.

235. *See* Kimberly Amadeo, *US Dollar Symbols and Denominations*, BALANCE (Sept. 10, 2018), https://www.thebalance.com/the-u-s-dollar-3305729 [https://perma.cc/KL89-FQTJ] ("The term U.S. dollar refers to a specific denomination and to the U.S. currency in general.").

236. *See Engagement in Interstate Commerce*, U.S. DEP'T LAB., https://webapps.dol.gov/elaws/whd/flsa/scope/ee2.asp [https://perma.cc/7ME5-ZK8Q] ("Interstate commerce means any work involving or related to the movement of persons or things (including intangibles, such as information) across state lines or from foreign countries.").

237. *See* Jon Bakija & Joel Slemrod, *Do the Rich Flee from High State Taxes? Evidence from Federal Estate Tax Returns* 36 (Nat'l Bureau of Econ. Research, Working Paper No. 10645, 2004), http://www.nber.org/papers/w10645 [https://perma.cc/RXY7-PF2E] (discussing that evidence suggests higher state estate, income, and property taxes can lead to wealthy and elderly people changing their residences).

238. *See* Wildasin, *supra* note 233, at 207–08; John Douglas Wilson, *Trade, Capital Mobility, and Tax Competition*, 95 J. POL. ECON. 835, 837–44, 851 (1987).

time.[239] Monied capital can flow quite quickly. Technologies, however, freely change locale until they become coupled with substantial, unrecovered investments in labor, physical plants, and equipment in a jurisdiction.[240] While *old* capital may become captive and be a suitable base for taxation, changes in the effective tax rate—whether positive or negative vis-à-vis one's competitive jurisdictions—will gradually change a state's or nation's store of capital over time.[241] An increase of rate will reduce capital in the case of increases in tax or will increase capital in the case of decreases in tax.[242] These changes in a state's supply of capital affect other states' supply of capital in the opposite way. This is known as an externality.[243]

Consequently, territorial taxation of capital is largely ineffective and counter-productive. Taxation of capital can be effective under a residence-based system where less mobile individuals are taxed.[244] Even though highly skilled labor and management has become increasingly more mobile, such mobility is not costless.[245] People tend to settle in a county and acquire substantial assets that make it more difficult to move. In addition, people tend to retain national or state allegiance.[246] Generally, larger jurisdictions have less mobile populations and workforces.[247] However, interstate mobility is greater because of the relative size of jurisdictions and because one need not relinquish one's national allegiance to escape undesirable state fiscal conditions.[248] This is particularly true for the elderly who have fewer economic ties with their home state.[249]

239. *See* Wildasin, *supra* note 233, at 194, 196; Wilson, *supra* note 238, at 836–37.
240. *See* David E. Wildasin, *Fiscal Competition in Space and Time*, 87 J. PUB. ECON. 2571, 2572 (2003).
241. *Id.* at 2573–77.
242. *Id.*
243. Kaplow, *supra* note 160, at 480–81; Michael Keen & Christos Kotsogiannis, *Leviathan and Capital Tax Competition in Federations*, 5 J. PUB. ECON. THEORY 177, 186 (2003).
244. Kaplow, *supra* note 160, at 458–60 (1996).
245. Wildasin, *supra* note 240, at 2571–72 (2003).
246. Tyler Schmall, *A Shocking Number of Americans Never Leave Home*, N.Y. POST (Jan. 11, 2018, 11:31 AM), https://nypost.com/2018/01/11/a-shocking-number-of-americans-never-leave-home/ [https://perma.cc/R8GX-M523].
247. R.A., *America Settles Down*, ECONOMIST (Jul. 5, 2012), https://www.economist.com/free-exchange/2012/07/05/america-settles-down [https://perma.cc/4Z9X-8BHZ].
248. *See* Bakija & Slemrod, *supra* note 237, at 1–3, 18, 23, 36.
249. *See id.*

Business, of course, can be quite mobile.[250] Corporations are different from people because formal state or national affiliation for corporations is less important today. Thus, business income taxes are most effective using territorial taxation.[251] Applied to mobile factors of production, traditional source concepts often try to capture the return on mobile capital.[252] Although basing taxation of mobile business on corporations' ability to pay may be desirable for redistributive purposes, it potentially drives that business to another location.[253] Instead, taxation of nonresidents must tax on the basis of exchange—a quid-pro-quo for benefit received.[254]

Tax competition is about jurisdictions using their tax systems to incentivize business and other economic activity within their borders.[255] More and more states and nations use tax incentives or holidays to attract business.[256] The evidence strongly suggests that most tax incentives are ineffective and only attract investment at the margin, which might not have been profitable without the incentive.[257] Thus, granting incentives can harm states in three ways. First, the cost of governments providing public benefits to enterprises may exceed the benefit derived from increased business activity.[258] A striking example is fiscal competition in Brazil aimed at attracting auto manufacturers.[259] One researcher estimated that each job created by the subsidized business cost the government approximately $350,000.[260]

Second, incentives may harm less mobile businesses and residents who pay higher taxes or receive fewer public benefits.[261] This effect compounds where increased business activity harms resident businesses by increasing the costs of labor and other essential resources.[262] Third, lowering taxes to attract capital results in less available capital in other states or nations.

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250. *See* Barker, *supra* note 169, at 351–52.

251. CURTIS S. DUBAY, A TERRITORIAL TAX SYSTEM WOULD CREATE JOBS AND RAISE WAGES FOR U.S. WORKERS 4 (2013), http://thf_media.s3.amazonaws.com/2013/pdf/bg2843.pdf.

252. Barker, *supra* note 169, at 349.

253. *Id.* at 387–88.

254. *Id*. at 371, 384–85.

255. Tax competition can be defined as a state's or nation's relinquishment, in whole or in part, of its right to tax an economic activity, with the result that its effective tax is less than that of other *states* or *countries*. Barker, *supra* note 168, at 172.

256. *See* Barker, *supra* note 169, at 363–67.

257. *See id.* at 363–67.

258. José Roberto Afonso, Sergio Guimarães Ferreira & Ricardo Varsano, *Fiscal Competition*, *in* FEDERALISM IN A CHANGING WORLD—LEARNING FROM EACH OTHER 412, 419–20 (Raoul Blindenbacher & Arnold Kohler eds., 2003).

259. *Id.* at 419.

260. *Id.* at 420.

261. *See* PEGGY BREWER RICHMAN, TAXATION OF FOREIGN INVESTMENT INCOME: AN ECONOMIC ANALYSIS 89–93 (1963).

262. *Id*. at 101.

This is particularly acute because of interstate competition where the nation's general welfare suffers.[263]

States and nations face a dilemma. Attraction of mobile business enterprises may enhance economic development.[264] States intensely compete for national and foreign businesses.[265] States and nations also need to exploit tax bases within their control to provide needed goods and services not only to their own population but to mobile business as well.[266] Tax benefits to business should not be greater than the benefits to the nation, and they should be designed to actually achieve their desired goals. If business taxation is not uniform between residents and nonresidents, residents will be harmed.[267]

Benefit is the one unassailable theory for taxation of nonresidents.[268] Unfortunately, the theory provides no practical solution to taxation. Although a locale may attract taxpayers for the specific benefits it provides,[269] one can rarely measure the public benefits from a particular locale, and thus, it is rarely possible to derive an appropriate tax cost. In many instances, however, jurisdictions compete by subsidizing business and underpricing public benefits to businesses.[270]

VII. CONCLUSION

Although tax competition among states is inherent in a federal system where there is a failure or an inability—like coordinating state tax systems in the United States—the second-best solution was the SALT deduction. The SALT deduction has operated over the years to marginalize the differences among state tax burdens. It has done this by directly reducing the cost of state taxation.[271] By lessening the cost of state taxes, SALT enabled states to tax persons, capital, and businesses that are quite mobile. The drastic curtailment of the SALT deduction has substantially increased the cost of

263. *See* Wildasin, *supra* note 240, at 2573, 2575.
264. *See* Afonso, Ferreira & Varsano, *supra* note 258, at 417.
265. *See generally* Wilson, *supra* note 165.
266. *See* Barker, *supra* note 168, at 164–65.
267. *See id.* at 193.
268. *See* Barker, *supra* note 169, at 371.
269. *See* Shobe, *supra* note 26, at 349–50.
270. *See* Oates & Schwab, *supra* note 150, at 127.
271. For a discussion of the SALT deduction, see *supra* Part II.

state taxation to many taxpayers whose businesses or services are mobile.[272] The choice for states is either to reduce taxation as part of a general nation-wide race to the bottom in taxes or, alternatively, to impose larger tax burdens on less mobile sources of revenue like property and sales taxes.[273] This challenge comes at an inopportune time for state governments when they are asked to take on greater burdens for the welfare of their people. Amazingly, the opposition to SALT is based on ignoring a fundamental truth about federalism in the United States: vertically oriented sovereigns create double taxation.[274]

This adverse consequence of double taxation between federal and state tax systems in a federal system has not received proper attention. Mitigating double taxation has been a fundamental building block of both the international and interstate tax order. The enactment of the cap on the SALT deduction largely eliminates a partial solution to federalism's double taxation that has been an accepted part of the U.S. federal tax system since the beginning of taxation in America. It harms taxpayers and the ability of states to address the needs of their populations through taxation.

As this paper has shown, following the established theory and practice of international and interstate taxation, a deduction for only a few taxpayers does not go far enough in eliminating the excess burden of federal-state double taxation. A more effective solution would be the allowance of a tax credit for state taxes offsetting federal tax liability that would be limited to a percentage of the federal tax.

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272. Formal change of one's residence for some tax purposes can be accomplished by tax planning. *See* Donald Bruce, William F. Fox, & Zhou Yang, *Base Mobility and State Personal Income Taxes*, 63 NAT'L TAX. J. 945, 961 (2010).

273. *See* Tannenwald, *supra* note 50, at 177, 199 (discussing how states lowered statutory income rates on account of the lower tax brackets in the 1986 Act).

274. PARKINSON ET AL., *supra* note 187, at 447–48.