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One Tax to Rule Them All: Rethinking Fiscal Federalism's Tax-Assignment Problem

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Peter A. Prescott*

One Tax to Rule Them All: Rethinking Fiscal Federalism's Tax-Assignment Problem

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I. INTRODUCTION

In J.R.R. Tolkien's *The Lord of the Rings*, the Dark Lord Sauron created the One Ring to enslave the leaders of the elves, dwarves, and humans.¹ On it, Sauron inscribed the latter half of this poetic warning: "One ring to rule them all, one ring to find them; One ring to bring them all and in the darkness bind them."² The intergovernmental tax system proposed here for the United States might well be described in the same way—one federal-level tax structure to "rule" (and largely replace) the fifty states' current tax structures. Because the proposed structure is centralized, it would better "find" multi-state taxpayers and it would more efficiently and effectively "bring" and "bind" their corresponding tax bases (e.g., taxable income) before converting those bases into tax revenue that would feed expenditures at the federal and state government levels.³ To develop and support that proposal, this Article revisits fiscal federalism's tax-assignment problem using traditional tax policy considerations and with an eye toward reevaluating the conventional wisdom disfavoring centralized taxation in light of recent developments in the field of behavioral economics.⁴

Broadly speaking, fiscal federalism deals with "the vertical structure of the public sector" in order to "align[] responsibilities and fiscal instruments with the proper levels of government."⁵ Taxes are one of those fiscal instruments, making the tax-assignment problem one aspect of the broader fiscal federalism dynamic.⁶ In short, the tax-assignment problem addresses the assignment of taxing power and specific taxes to the proper level of government in a federal system.⁷ While there are numerous other fiscal federalism issues (e.g., expendi-

1. J.R.R. TOLKIEN, *THE LORD OF THE RINGS* 49 (Houghton Mifflin ed., Harper Collins Publishers 2004) (1994).

2. *Id.*

3. Depending on one's views on the usefulness of government programs, the "darkness" part might apply to the proposal as well. As President Ronald Reagan once observed: "[T]he nine most terrifying words in the English language are: I'm from the Government, and I'm here to help." Ronald Reagan, *The President's News Conference: August 12, 1986*, THE AM. PRESIDENCY PROJECT, <http://www.presidency.ucsb.edu/ws/index.php?pid=37733&st=&st1=> [<http://perma.unl.edu/K697-8DVJ>]. This Article does not take a position on what the proper level of government spending should be, instead focusing on how best to raise the needed revenue after those spending decisions are made.

4. One of the first behavioral economists described the field as "economics done with strong injections of good psychology and other social sciences." RICHARD H. THALER, *MISBEHAVING: THE MAKING OF BEHAVIORAL ECONOMICS* 9 (2015).

5. Wallace E. Oates, *An Essay on Fiscal Federalism*, 37 J. ECON. LITERATURE 1120, 1120 (1999) [hereinafter Oates, *Essay*].

6. John Norregaard, *Tax Assignment*, in *FISCAL FEDERALISM IN THEORY AND PRACTICE* 49, 49 (Teresa Ter-Minassian ed., 1997).

7. Richard A. Musgrave, *Who Should Tax, Where, and What?*, in *TAX ASSIGNMENT IN FEDERAL COUNTRIES* 2, 11–13 (Charles E. McLure, Jr. ed., 1983).

ture assignment and budgetary management in a federal system),⁸ this Article focuses almost exclusively on the tax-assignment problem and only implicates those other issues when necessary to further the tax-assignment discussion.

At bottom, the proper assignment of taxes among the federal government and the fifty state governments is driven by the tradeoff between the benefits of having a centralized, uniform tax system and those created by intergovernmental tax competition in a decentralized system. The current U.S. system has centralized and decentralized aspects but tilts heavily toward the latter approach. Thus, each state is free to impose taxes that overlap with federal taxes (e.g., business income taxes) or target completely different tax bases (e.g., general sales taxes and property taxes).⁹ The resulting mix of state and federal taxes creates a number of problems that are summarized here and explored in greater detail later. First, taxpayers are encouraged to reduce their aggregate state tax liability by rearranging activities to take advantage of variations in state taxing systems. More aggressive taxpayers may even lobby state legislators to create such tax-reducing variations in exchange for the taxpayers' agreement to move their economic activities into the state in question. Neither of these taxpayer behaviors is desirable because each involves a tax-driven distortion of the taxpayer's pre-tax activities that may result in suboptimal resource allocations. Second, the presence of fifty-one separate tax systems in the United States greatly increases aggregate tax administration costs for taxpayers and taxing authorities. For taxpayers, that lack of uniformity means more time and money spent preparing multiple tax returns, trying to understand multiple sets of tax rules, and planning to legally reduce their total taxes by navigating those rules. While the fifty-one federal and state tax administrators may be individually quite cost-effective, in the aggregate the parallel administrative operations needed to enforce their non-uniform tax systems are not. Finally, the lack of uniformity can create inequitable results among U.S. taxpayers because uneven tax systems will inevitably cause some similarly situated taxpayers to pay different tax amounts for no good reason. Furthermore, in the business arena, the uneven tax treatment from non-uniform tax systems can unfairly create competitive advantages that favor one business over another. Clearly, whatever the benefits of intergovernmental tax competition are, the costs of a decentralized tax system in the United States are considerable.

8. For a more comprehensive fiscal federalism discussion, see, for example, FISCAL FEDERALISM IN THEORY AND PRACTICE, *supra* note 6.

9. See Kirk J. Stark, *The Federal Role in State Tax Reform*, 30 VA. TAX REV. 407, 420 (2010) (providing an overview of the mix of various taxes that the states use to raise revenue).

Because there is ample reason to believe that those competition benefits are dwarfed by the costs outlined above, this Article proposes revising the United States' current multitiered taxation system to consolidate most taxing power at the federal level and to replace most state and local taxes with unconditional intergovernmental transfers that are funded out of the incremental federal-level taxes. Only real property taxes and license taxes would remain with the state governments. Note that, although one could certainly argue that the mix of taxes used in the United States could be improved,¹⁰ this proposal ignores that separate and distinct issue by simply assuming that the current mix of state taxes will be consolidated with existing federal taxes (e.g., income taxes) or relocated to the federal level (e.g., sales taxes), as appropriate. From a tax-assignment perspective, this centralization is intended to improve the efficiency, cost effectiveness, and fairness of the overall tax system by increasing uniformity.

The remainder of the proposal is intended to preserve, to the extent possible, the benefits of decentralized government despite the newly centralized tax system. The broader fiscal federalism literature supports the conclusion that decisions regarding public goods and other governmental benefits should be made at the lowest level of government encompassing the benefit in question. Decentralizing these expenditure decisions should lead to the best alignment between a government's benefits and its residents' preferences for those benefits.¹¹ Thus, the proposed system retains the existing level of state and local expenditure decision-making to preserve that narrowly tailored fit of government benefits to the residents' preferences. The funds needed by the states to provide those benefits would come from unconditional intergovernmental transfers, maximizing the states' ability to customize governmental benefits without federal government interference.¹² While the U.S. Congress would retain the power to adjust the magnitude of those transfers, ideally the transfers should be fixed at constant amounts to increase the states' revenue stability and to better shield their provision of governmental benefits from localized economic ebbs and flows. Of course, the federal government would continue to provide its own set of governmental benefits (e.g., national defense) and would also continue to exert influence over state-provided benefits through the use of conditional intergovernmental transfers (e.g., matching federal funds for federally approved Medicaid

10. See, e.g., *id.* at 436–42 (outlining steps that the federal government could take to “promote the adoption of more crisis-resilient state revenue structures” that depend on a less volatile mix of taxes).

11. Wallace E. Oates, *On the Evolution of Fiscal Federalism: Theory and Institutions*, 61 NAT'L TAX J. 313, 314 (2008).

12. Ehtisham Ahmad & Jon Craig, *Intergovernmental Transfers*, in FISCAL FEDERALISM IN THEORY AND PRACTICE, *supra* note 6, at 73, 87.

services), just as it does under the current system.¹³ Thus, the current system's customization benefits derived from decentralized governmental responsibilities are preserved and augmented by the new uniformity benefits derived from consolidating most taxes at the federal level.

Taken together, this Article's proposed mix of centralized fiscal instruments and decentralized government responsibilities delivers an improved U.S. tax system while striking the right fiscal federalism balance. Part II of this Article begins by briefly describing the United States' current federal and state tax system before providing a more detailed explanation of the proposed solution to fiscal federalism's tax-assignment problem. It closes by examining the proposed solution's viability under the U.S. Constitution. Part III analyzes and compares the proposed solution to the current system using principles drawn from the fiscal federalism literature and traditional tax policy considerations involving economic efficiency, equity, and administrative complexity. Importantly, several key fiscal federalism objections to centralized taxation, particularly when that approach is combined with decentralized governmental spending, are reconsidered in light of recent advances in the field of behavioral economics. Part III concludes with the determination that the proposed solution is an improvement over the current system. Part IV discusses a handful of other alternatives that are occasionally championed in the tax law and fiscal federalism literature. Finally, this Article concludes in Part V with the observation that, while the proposed tax-assignment solution may be politically untenable in the United States at this time, it is certainly worth pursuing.

II. ONE TAX SYSTEM TO RULE THEM ALL

Just as Sauron used the One Ring to impose his will on the rulers of Middle Earth,¹⁴ the federal government would use the intergovernmental tax system proposed here to impose a single federal-level tax structure in place of the fifty states' current tax structures. Happily, this latter imposition should improve taxation within the United States without creating any of the dire consequences that accompanied Sauron's rule in Middle Earth.¹⁵ This Part sets the stage for the detailed tax policy and fiscal federalism analysis that follows in Part III by briefly describing the United States' current federal and state tax system and providing a more detailed explanation of the intergov-

13. ALISON MITCHELL, CONG. RESEARCH SERV., MEDICAID FINANCING AND EXPENDITURES 1 (2015).

14. TOLKIEN, *supra* note 1, at 49–51.

15. *Id.* at 873 (recounting the Black Gate's opening and the great host of Orcs that issued from it). No burning and plundering by an Orc army are anticipated at this time if the tax system proposed here is adopted.

ernmental tax system that this Article proposes as a solution to fiscal federalism's tax-assignment problem. Because a solution that is not legally permissible is not a solution at all, this Part closes by examining whether the proposed solution is legal under the U.S. Constitution.

A. The Current System

Structurally, the current U.S. tax system is a web of overlapping federal and state taxes because the U.S. Constitution, which establishes outer boundaries for the federal and state governments' powers, permits the federal government to impose income taxes and certain other taxes (e.g., wealth transfer taxes) without explicitly limiting the states' taxing power.¹⁶ That permissiveness has led to considerable overlap among the main federal taxes (i.e., individual income taxes, corporate income taxes, payroll taxes, wealth transfer taxes, and excise taxes) and the main state taxes (i.e., individual income taxes, corporate income taxes, payroll taxes, property taxes, general sales taxes, selective sales taxes, license taxes, severance taxes, and wealth transfer taxes).¹⁷ Thus, most types of tax imposed by the federal government are also imposed by the states. Taking into account the partial overlap between the federal excise taxes and states' selective sales taxes, only property taxes, general sales taxes, and severance taxes are exclusively imposed at one level of government.¹⁸

The magnitude of each category of federal and state taxes is shown in Table 1 for fiscal year 2015:¹⁹

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16. See U.S. CONST. art. 1, § 8, cl. 1 (permitting federal excise taxes); *id.* amend. XVI (permitting federal income taxes); *id.* amend. X (reserving unaddressed powers to the states and the people).
 17. See *infra* note 19 and accompanying text (tabulating federal and state revenue contributions from various types of taxes).
 18. See *infra* note 19 and accompanying text.
 19. The federal tax revenue data shown in Table 1 is taken from DEP'T OF THE TREASURY, COMBINED STATEMENT OF RECEIPTS, OUTLAYS, AND BALANCES OF THE UNITED STATES GOVERNMENT (2016), <https://www.fiscal.treasury.gov/fsreports/rpt/combStmt/cs2015/receipt.pdf> [<https://perma.unl.edu/RK3Y-Z6LY>]. With the exception of the property tax data, the aggregate state tax revenue data is taken from U.S. CENSUS BUREAU, 2015 ANNUAL SURVEY OF STATE GOVERNMENT TAX COLLECTIONS (2016), <https://factfinder.census.gov/faces/nav/jsf/pages/searchresults.xhtml?refresh=t> (follow the link to the Bureau's website and copy and paste the "2015 Annual Survey of State Government Tax Collections" into the search bar). Property tax data for the twelve months ending June 30, 2015, is taken from U.S. CENSUS BUREAU, QUARTERLY SUMMARY OF STATE & LOCAL TAX REVENUE tbls.1, 2 (2017), <http://www.census.gov/govs/qtax/>. Complete data is not yet available for fiscal year 2016.

Table 1: Comparison of FY2015 Federal and State and Local Tax Revenues by Category (Amounts in billions)(a)

Tax Category	Federal	States
Income Taxes		
Individual	\$1,540.8	\$338.1
Corporate	343.8	49.1
Payroll Taxes	1,065.3	(b)
Property Taxes		
State		15.1
Local		489.3
Sales Taxes		
General		286.2
Selective		145.1
Excise Taxes	98.3	
License Taxes		52.2
Severance Taxes		12.6
Wealth Transfer Taxes	19.2	4.8
Miscellaneous Taxes	181.4	10.9
Total FY2015 Tax Revenue	<u>\$3,248.8</u>	<u>\$1,403.4</u>

Notes:

(a) FY2015 ended on 9/30/2015 for the federal government and on 6/30/2015 for most state governments.

(b) Omitted because the most recent payroll tax data available for the states is from FY2014.

As noted in Table 1, payroll tax data is not yet available from the United States Census Bureau for the states' fiscal year 2015. However, the most recent data from fiscal year 2014 shows that the states' main payroll taxes, which cover unemployment compensation and workers' compensation, were \$62.3 billion and \$15.2 billion, respectively.²⁰ Assuming that a similar amount of state payroll taxes was collected in fiscal year 2015, federal tax revenues were approximately two times the aggregate state and local tax revenues for that year.²¹ Furthermore, more than 48% of all federal and state tax revenue came from income taxes.²² When payroll taxes and sales taxes (including excise taxes) are combined with income taxes, they represent more

20. U.S. CENSUS BUREAU, STATE AND LOCAL GOVERNMENT FINANCES BY LEVEL OF GOVERNMENT AND BY STATE: 2014 tbl.LF1400A1 (2017), http://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=SLF_2014_00A1&prodType=table.

21. As shown in Table 1, federal tax revenue for fiscal year 2015 was \$3248.8 billion. After inclusion of the estimated \$77.5 billion in payroll taxes, the aggregate state and local tax revenue from Table 1 becomes \$1480.9 billion. Therefore, federal tax revenues were 2.19 times larger than state and local tax revenues.

22. As shown in Table 1, total tax revenue for fiscal year 2015 was \$4652.2 billion. The total income taxes at all levels of government for fiscal year 2015 were

than 80% of all federal and state tax revenue.²³ With the exception of sales taxes, the bulk of those taxes are federal.

By necessity, each of these federal and state taxes is accompanied by a separate tax compliance process and administration. For example, in fiscal year 2014 the federal government and forty-three states administered an individual income tax.²⁴ Forty-five states and the federal government administered a corporate income tax in that fiscal year.²⁵ Although the federal government does not have a general sales tax, taxpayers still faced forty-five separate state general sales tax regimes and taxing authorities.²⁶ The problem is compounded for selective sales taxes (including excise taxes) because numerous distinct sales taxes are covered by that term.²⁷ Clearly, the United States' current tax system quickly becomes quite complex for taxpayers with connections to more than one or two states.

Once the respective levels of government have harvested the tax revenue, an intricate set of intergovernmental transfers from the federal government to the state governments begins. In fiscal year 2014, federal grants to state and local governments totaled \$576.9 billion.²⁸ That money was spread over 1078 categorical grants and twenty-one block grants.²⁹ Categorical grants "can be used only for a specifically aided program and usually are limited to narrowly defined activities."³⁰ The twenty-one block grants were also targeted at specifically aided programs, but they gave the recipient state government significantly more discretion over how to go about meeting the programs' objectives.³¹ Despite that difference in the level of federal oversight, block grants and categorical grants are conditional transfers because their receipt is conditioned upon each state government's agreement to use the transferred funds for a particular purpose.³² Unconditional intergovernmental transfers, which leave each state free to use the

\$2271.8 billion. Therefore, approximately 48.8% of total tax revenue came from income taxes.

23. The sum of all income, payroll, sales, and excise taxes in Table 1 equals \$3866.7 billion. That amount is 83.1% of the \$4652.2 billion total tax revenue for fiscal year 2015. If property taxes, which will not be touched by the proposed federal consolidation, are excluded, then income, payroll, sales, and excise taxes exceed 93% of total tax revenue.

24. CHERYL LEE ET AL., U.S. CENSUS BUREAU, STATE GOVERNMENT TAX COLLECTIONS SUMMARY REPORT: 2014, at 3 (2015).

25. *Id.*

26. *Id.* at 2.

27. *Id.*

28. ROBERT JAY DILGER, CONG. RESEARCH SERV., FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS: A HISTORICAL PERSPECTIVE ON CONTEMPORARY ISSUES 5 tbl.2 (2015). The estimate for fiscal year 2015 is \$628 billion. *Id.*

29. *Id.* at 10 tbl.4.

30. *Id.* at 2.

31. *Id.*

32. Ahmad & Craig, *supra* note 12, at 86–87.

transferred funds to tailor its governmental benefits to its residents' preferences, were not used in the United States in fiscal year 2014.³³ Thus, the current U.S. system of intergovernmental transfers largely serves to promote federal government policy objectives at the state level and to correct fiscal imbalances arising when the states accept responsibility for administering the resulting federal programs but lack the revenue on their own to fund the increased expenditures resulting from those programs.³⁴

Finally, the federal and state governments spend money to provide governmental benefits. At the federal level, some of those governmental benefits are acquired by the federal government directly (e.g., national defense, national parks, and the regulation of interstate commerce).³⁵ As discussed immediately above, others are acquired indirectly by exerting influence over state-provided benefits through the use of conditional intergovernmental transfers (e.g., health, income security, and transportation).³⁶ In addition, each state uses its own tax revenue to acquire governmental benefits that are locally customized to fit the preferences of its residents (e.g., public education and corrections).³⁷ The resulting mix of benefits can be difficult to untangle if residents wish to trace a specific benefit back to the government officials who are ultimately responsible for it. Under the current U.S. system, deciding whether each level of government provides governmental benefits that are commensurate with the taxes it imposes, and the intergovernmental transfers that it receives, is even more difficult.

B. The Proposed System

This Article's solution to the tax-assignment problem for the United States is designed to improve the intergovernmental tax system's performance without negatively impacting the federal and state governments' ability to provide governmental benefits to their residents. That outcome will be achieved by two steps. First, the tax system's uniformity will be increased through consolidation of most taxing power at the federal level. Second, the federal government will replace the current state taxes with unconditional intergovernmental

33. DILGER, *supra* note 28, at 10 tbl.4. Dilger refers to unconditional transfers as general revenue sharing grants in Table 4.

34. In the language of fiscal federalism, this sort of fiscal imbalance, or gap, between revenue at one level and expenditure requirements at another level is called a "vertical imbalance." Ahmad & Craig, *supra* note 12, at 74–76. In contrast, "horizontal imbalances" arise when different states provide differing levels of governmental benefits to federal residents. *Id.* at 76.

35. DEP'T OF THE TREASURY, *supra* note 19, <https://www.fiscal.treasury.gov/fsreports/rpt/combStmt/cs2015/outlay.pdf> [<https://perma.unl.edu/6SNS-B467>].

36. DILGER, *supra* note 28, at 6 fig.1.

37. NAT'L ASS'N OF STATE BUDGET OFFICERS, STATE EXPENDITURE REPORT: EXAMINING FISCAL 2013–2015 STATE SPENDING 2–4 (2015).

transfers that are funded out of the incremental federal-level taxes. That approach will leave largely undisturbed the states' ability to provide governmental benefits that are locally customized to fit the preferences of its residents.

1. *Tax Assignment*

Properly dividing taxing power between the federal and state levels of government is a critical part of optimizing governmental performance in a federal system.³⁸ Fiscal federalism scholars often classify taxes as benefit or nonbenefit taxes depending on whether the tax in question is directly related to receipt of a specific governmental benefit.³⁹ The states' license taxes shown in Table 1 are a benefit tax because only people who acquire a license from the state pay the tax (e.g., a license to sell liquor).⁴⁰ Income taxes and sales taxes are classic examples of nonbenefit taxes.⁴¹ Consistent with the general fiscal federalism principle of assigning taxes and expenditures to the lowest level of government that fully encompasses the resulting benefit, economists usually recommend assigning benefit taxes to the government providing the related benefit.⁴² Although other factors are considered when assigning nonbenefit taxes, they tend to be assigned to higher, more centralized, levels of government.⁴³

The tax-assignment approach advocated here is mostly consistent with those general principles. The main nonbenefit taxes—income taxes (individual and corporate), payroll taxes,⁴⁴ sales taxes (general and selective), severance taxes, and wealth transfer taxes—are assigned to the federal government. As a benefit tax, license taxes remain state-level taxes. For the reasons outlined more clearly below, real property taxes also remain state-level taxes.⁴⁵ To prevent the

38. S Gurumurthi, *Intergovernmental Fiscal Relations: Three Faces of Tax Sharing— I*, 33 *ECON. & POL. WKLY.* 2301, 2301 (1998).

39. Oates, *Essay*, *supra* note 5, at 1125.

40. See Gurumurthi, *supra* note 38, at 2307.

41. Charles E. McLure, Jr., *The Nuttiness of State and Local Taxes—and the Nuttiness of Responses Thereto*, 25 *ST. TAX NOTES* 841, 842 (2002) [hereinafter McLure, *The Nuttiness*] (noting that “sales taxes on business purchases and corporate income taxes” are taxes “that do not reflect benefits of public services provided to the taxpayer”).

42. Oates, *Essay*, *supra* note 5, at 1120.

43. *Id.* at 1125–26.

44. Although payroll tax payments may result in the receipt of future governmental benefits, like Social Security payments, they are arguably nonbenefit taxes because “the relationship may be weak between tax payments and services provided.” Norregaard, *supra* note 6, at 67–68.

45. Although the reasons for the special treatment of real property taxes are discussed further below, it is worth noting that some fiscal federalism scholars assert that such taxes are actually benefit taxes. Oates, *Essay*, *supra* note 5, at 1126 n.11. That dispute classification suggests that keeping real property taxes at the state level (i.e., the lowest level fully encompassing the real property and

states from undermining the federal government's sole claim to the taxes assigned to it, Congress will issue legislation using its Commerce Clause authority that preempts the states' ability to regulate interstate commerce through taxation (other than license and real property taxation). The expected benefits obtained through this tax centralization approach are discussed in Part III.

There is one determinative reason why real property taxes are the only nonbenefit taxes retained at the state level, and there are three additional reasons why that result is a good idea. The determinative reason is that a federal property tax would be unconstitutional because, as a direct tax,⁴⁶ it must be apportioned by population instead of property value.⁴⁷ The additional reasons are almost as compelling. First, centralization of real property taxes at the federal level would not simplify tax administration because real property is already only taxed once by the state containing it⁴⁸ and because the tax's main source of conflict is determining the real property's value, a factual dispute that would not be affected if a uniform federal system of real property taxes replaced the current state tax systems.⁴⁹ Second, real property cannot be picked up and moved to a different state. So, taxing it does not encourage tax avoidance techniques that reduce the tax's ability to raise revenue and that distort taxpayer behavior in pursuit of tax minimization.⁵⁰ Third, leaving real property taxation at the state level preserves some state-level control over revenue, which would allow each state to increase the level of governmental benefits provided by that state to its residents if that increase comports with its residents' preference for those benefits. Real property taxes are a natural fit here because they are typically used to provide localized governmental benefits like education⁵¹ and because, compared to many of the other types of taxes, they are a fairly stable revenue source that can provide steady support for those benefits.⁵²

Simply reassigning current state-level taxes to the federal government isolates the tax-assignment problem from the question of

the governmental benefits accorded to it) is consistent with the broader fiscal federalism policy discussed above.

46. Nat'l Fed'n Indep. Bus. v. Sebelius, 567 U.S. 519, 570–71 (2012) (recounting the history of the Supreme Court's direct tax definition).

47. U.S. CONST. art I, § 9, cl. 4 ("No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.").

48. *See supra* Table 1 (reporting that property taxes are only collected by state and local governments).

49. FERDINAND P. SCHOETTLE, STATE AND LOCAL TAXATION: THE LAW AND POLICY OF MULTI-JURISDICTIONAL TAXATION 54–55 (2003).

50. Daniel Shaviro, *An Economic and Political Look at Federalism in Taxation*, 90 MICH. L. REV. 895, 913 (1992).

51. JOSEPH E. STIGLITZ, ECONOMICS OF THE PUBLIC SECTOR 423 (3d ed. 2000).

52. Stark, *supra* note 9, at 422–23.

whether the current mix of taxes used in the United States is optimal. The specific approach necessary to carry out that reassignment depends on the particular tax involved. For example, state income taxes would simply fold into the existing federal income tax system. While that change would be significant for taxpayers in states that do not use an income tax, or ones whose tax base deviates significantly from federal taxable income, the change would not require an adjustment to the federal tax base.⁵³ Only the marginal tax rates applied to that tax base would need adjustment so that federal taxes generate enough revenue to replace the eliminated state income taxes. For taxes that do not exist at the federal level, like the states' general sales tax, Congress would create a federal version.⁵⁴ Presumably, the new federal general sales tax would employ the same general mix of taxable transactions and exemptions currently used in the majority of states.⁵⁵ The new general sales tax rate would then be set at the level needed to replace the states' aggregate general sales tax revenue.

While restructuring the U.S. tax system in this manner would involve many new statutory provisions and important policy decisions, most of those details are not necessary to understand and analyze the tax-assignment problem. However, the fate of Internal Revenue Code section 164 is relevant because that section has direct fiscal federalism consequences.⁵⁶ Section 164 permits federal income taxpayers to deduct various state and local taxes, including real property taxes,⁵⁷ personal property taxes,⁵⁸ income taxes,⁵⁹ and general sales taxes⁶⁰ when calculating their federal taxable income. Other state-level taxes are deductible if they are part of a trade or business or are connected to the production of income.⁶¹ Those federal income tax deductions effectively act as an indirect transfer from the federal government to the state governments by reducing the amount of income tax collected by the federal government and permitting the states to increase tax collections without imposing the full cost of the additional taxes on their

53. In fiscal year 2014, seven states did not employ an individual income tax, and five states did not have a corporate income tax. LEE ET AL., *supra* note 24, at 3.

54. See DEP'T OF THE TREASURY, *supra* note 19, <https://www.fiscal.treasury.gov/fsreports/rpt/combStmt/cs2015/receipt.pdf> [<https://perma.unl.edu/RK3Y-Z6LY>] (showing no federal general sales tax revenue for fiscal year 2015).

55. For example, the majority of states exempt groceries from sales tax, and some also exempt clothing. SCOTT DRENKARD & JARED WALCZAK, TAX FOUND., STATE AND LOCAL SALES TAX RATES IN 2015, at 5 (2015).

56. See Stark, *supra* note 9, at 425–27 (observing that the favorable federal income tax deductibility awarded to some state taxes, but not others, influences state taxation decisions).

57. I.R.C. § 164(a)(1) (2017).

58. § 164(a)(2).

59. § 164(a)(3).

60. § 164(b)(5)(A).

61. § 164(a).

residents.⁶² At minimum, the portions of section 164 dealing with state income taxes and general sales taxes should be repealed with the elimination of those taxes. Because federal taxes are not deductible,⁶³ the federal-level replacement taxes would not reduce taxpayers' federal income taxes. Ideally, Congress would also repeal the section 164 deduction for all state taxes, including property taxes and those connected to trade or business activity, because the resulting indirect intergovernmental transfer is difficult for voters to monitor or reject.⁶⁴ If Congress determined that the states needed funds to replace these indirect section 164 transfers, it could authorize direct intergovernmental transfers in their place that would be more transparent to voters.

2. *Intergovernmental Transfers*

Stripping the states of most taxing authority, while leaving them responsible for providing governmental benefits, creates an intergovernmental misalignment of revenue and expenditure needs. The two main approaches to closing that fiscal gap are intergovernmental transfers from the federal government to the states and tax-revenue sharing between those two levels of government.⁶⁵ The primary difference between these two approaches is that the former are not necessarily tied to tax revenue while the latter's flow of funds, from the federal government to the states, fluctuates with changes in tax revenue.⁶⁶ Because providing a steady stream of revenue to the state governments should supply steady support for the states' governmental benefits, intergovernmental transfers are preferred over tax-revenue sharing.

Using intergovernmental transfers that are fixed in amount and stable improves on the existing model of state-tax financed governmental benefits by assigning the financing function to the level of government that is most capable of managing the risk of changes in the amount of taxes collected due to economic fluctuations (e.g., business

62. See Stark, *supra* note 9, at 425–27 (explaining how the federal subsidy to state taxpayers scales with those taxpayers' federal marginal tax rates, which has nudged the states to build progressive tax systems that try to capture larger federal subsidies).

63. I.R.C. § 275(a)(1)–(3), (5)–(6) (2017).

64. This step would have the additional side benefit of simplifying compliance for some individual federal income taxpayers because eliminating the state tax deduction would push more of them into using the standard deduction. As a result, those taxpayers would not need to track, claim, or substantiate other itemized deductions. See I.R.C. § 63(b) (2017) (giving individuals a choice between the standard deduction and itemized deductions).

65. Teresa Ter-Minassian, *Intergovernmental Fiscal Relations in a Macroeconomic Perspective: An Overview*, in FISCAL FEDERALISM IN THEORY AND PRACTICE, *supra* note 6, at 3, 11–15.

66. *Id.*

cycles). Unlike the individual states, which can only raise tax revenue from their separate tax bases, the federal government raises tax revenue from a tax base that includes all the states and therefore represents a diversified portfolio of state tax bases. State-specific economic downturns that would present revenue-raising issues for the states involved are smoothed out by offsetting revenue increases from other states that are experiencing economic growth. When that diversification protection fails, the federal government's superior borrowing power, when compared to the states, and its ability to print money enable it to more efficiently and inexpensively cover the resulting budgetary shortfall.⁶⁷ Given debt's relative importance to the financing of governmental benefits during the recent economic downturn,⁶⁸ the states and their residents would benefit from relying on the federal government's centralized financing.

Fixing the amount of state funding through intergovernmental transfers is likely to raise concerns that the states could lose the ability to influence their economies through expenditure adjustments. While this concern is valid, several aspects of the proposed system make it less likely to be a serious problem. First, each state can modestly increase its tax revenue to pay for increased expenditures by ad-

67. Of the major credit rating agencies, only Standard & Poor's assigns the United States a credit rating that is not its highest. Even then, Standard & Poor's AA+ is still quite good. Alexandra Scaggs, *S&P Affirms U.S. AA+ Credit Rating, Maintains Stable Outlook*, BLOOMBERG (June 10, 2015, 6:30 PM), <http://www.bloomberg.com/news/articles/2015-06-10/s-p-affirms-u-s-aa-credit-rating-maintains-stable-outlook> [<https://perma.unl.edu/5G4F-6UPB>]. In contrast, only twenty-eight states have an equivalent or better rating from S&P, and most of those have had lower ratings in the past. Pamela M. Prah & Stephen C. Fehr, *Infographic: S&P State Credit Ratings, 2001-2014*, THE PEW CHARITABLE TRUSTS (June 9, 2014), <http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2014/06/09/sp-ratings-2014> [<https://perma.unl.edu/FW4T-5ZDB>]. According to Moody's, only fifteen states have earned a rating matching the United States' rating. MOODY'S INV'R SERV., *RATING CHANGES FOR THE 50 STATES FROM 1970, at 2* (2015).

68. At its peak during fiscal year 2009, the deficit contributed 40.2% of total federal outlays, and that contribution ratio stayed above 30% through fiscal year 2012. See DEP'T OF THE TREASURY, *COMBINED STATEMENT OF RECEIPTS, OUTLAYS, AND BALANCES OF THE UNITED STATES GOVERNMENT: 2010 COMBINED STATEMENT* (2010), <https://www.fiscal.treasury.gov/fsreports/rpt/combStmnt/cs2010/finhigh.pdf> [<https://perma.unl.edu/9MQV-TMHQ>] (reporting a deficit and outlays of \$1415.7 billion and \$3520.1 billion for fiscal year 2009, and \$1294.2 billion and \$3456.0 billion for fiscal year 2010); DEP'T OF THE TREASURY, *COMBINED STATEMENT OF RECEIPTS, OUTLAYS, AND BALANCES OF THE UNITED STATES GOVERNMENT: 2012 COMBINED STATEMENT* (2012), <https://www.fiscal.treasury.gov/fsreports/rpt/combStmnt/cs2012/finhigh.pdf> [<https://perma.unl.edu/S9T3-T8TX>] (reporting a deficit and outlays of \$1296.8 billion and \$3599.3 billion for fiscal year 2011, and \$1089.2 billion and \$3538.3 billion for fiscal year 2012).

justing its real property tax rates,⁶⁹ which should be a fairly stable source of additional revenue.⁷⁰ Second, each state could effectively reduce the taxes paid by its residents by choosing to return some of the money received from the federal government directly to its residents.⁷¹ Furthermore, a state could increase current expenditures by borrowing against its stream of intergovernmental transfers and using portions of subsequent transfers to repay the bonds. In these three ways, the states would retain significant control over their annual budgets despite primarily relying on intergovernmental transfers instead of tax revenue.

Two other aspects of the intergovernmental transfers warrant discussion—their unconditional nature and the method used to allocate the transfers among the states. In addition to being fixed in amount, the transfers that replace the states' tax revenue would be unconditional. Unlike conditional transfers, which require the recipient states to use the transferred funds only for specific purposes, unconditional transfers come with “no strings attached” and can be used by the recipient states in any manner.⁷² Thus, while conditional transfers would be a means for the federal government to exert control over the states' expenditures, unconditional transfers free each state to customize its governmental benefits to its residents' preferences without federal government interference. The resulting tailored distribution of governmental benefits should increase overall societal utility when compared to the more uniform distribution that would arise from federally controlled conditional transfers.⁷³ In appropriate situations (e.g., setting minimum governmental benefit standards for all U.S. citizens, dealing with problems that span multiple states, or when interjurisdictional spillover benefits are present), the federal government would continue to use conditional transfers that heavily influence the states' expenditure decisions toward greater national

69. This ability is not insignificant when state and local revenues are considered. *See supra* Table 1 (reporting that property taxes were \$504.4 billion in fiscal year 2015, or 35.9% of total state and local tax revenue).

70. *See Stark, supra* note 9, at 422 (summarizing the current consensus on state tax volatility that “property taxes tend to be more stable than sales and income taxes”).

71. While a government returning money to its residents rather than spending the money on other governmental benefits is not common, the State of Alaska does just that every year when it pays its Alaska Permanent Fund dividend. The Alaska Permanent Fund's principal comes from the state's mineral lease income and must be invested. ALASKA CONST. art. 9, § 15. However, its income “shall be deposited in the general fund unless otherwise provided by law.” *Id.* The Alaska legislature requires payment of a permanent fund dividend to qualifying Alaskans each year in an amount determined by a statutory formula. ALASKA STAT. §§ 43.23.005, .025(a), .055(1) (2016).

72. Ter-Minassian, *supra* note 65, at 13–15.

73. Oates, *Essay, supra* note 5, at 1121–22.

uniformity.⁷⁴ But, those conditional transfers would augment, not replace, the unconditional transfers discussed here.

The choice of allocation method for dividing the total intergovernmental transfer amount among the states will depend on whether Congress wants to use the transfers to redistribute funds among those states. At minimum, the factor or factors used should be objectively measurable and hard to manipulate so that the states cannot easily game the allocation system. The two obvious choices are allocation by relative population and allocation by relative total tax revenue paid by residents of each state. If population is chosen as the factor, already-collected United States Census data could be used to calculate each state's allocation.⁷⁵ By providing a per-capita transfer amount to each state, the allocation system would reflect a view that each person is entitled to an equivalent level of governmental benefits. The effect would be redistributive because funds would shift from states with above-average per-capita tax payments to states with below-average per-capita tax payments.⁷⁶ In practice, that redistributive shift toward equal shares would be affected by cost variations in the states' provision of governmental benefits.⁷⁷ Including a regional cost-of-living adjustment would help preserve an equal level of governmental-benefits purchasing power per resident.⁷⁸ If total tax revenue is chosen as the factor, annual federal tax collections could be used to calculate each state's allocation.⁷⁹ While not redistributive among the states, because each state would get back the amount its residents collectively paid, this approach would presumably do a better job accounting for the varying costs of providing governmental benefits in different states because higher prices and higher salaries would lead to greater tax revenue, greater allocation factors, and greater governmental-benefit costs. However, it could be more complicated to administer than a population factor because some of the taxes involved may have ties to multiple states (e.g., the resident of one state buying

74. WALLACE E. OATES, *FISCAL FEDERALISM* 85–94 (1972) [hereinafter OATES, *FISCAL FEDERALISM*].

75. The U.S. Constitution and federal statute require the collection of population data every ten years. U.S. CONST. art. I, § 2, cl. 3; 13 U.S.C. § 141(a) (2017).

76. OATES, *FISCAL FEDERALISM*, *supra* note 74, at 78–81.

77. Ahmad & Craig, *supra* note 12, at 76 (“Subnational governments differ in their fiscal capacities . . . because the need for and the cost of providing certain services differs among regions.”).

78. Using a regional cost-of-living adjustment is admittedly a rough approximation of the actual cost variations involved, but it may be suitable when applied to a wide range of benefits. For a discussion of more detailed expenditure-equalization approaches, see *id.* at 101–04.

79. Ter-Minassian, *supra* note 65, at 11. Note that “[s]haring of tax revenues can be arranged on a tax-by-tax basis, with different coefficients of distribution among levels of government for each tax or on the entire pool of central government tax revenues.” *Id.*

goods from a merchant in another state). Whether Congress chooses population, total tax revenue, or some combination of those two factors is a political decision that will not affect this Article's proposed solution to fiscal federalism's tax-assignment problem.

3. *Expenditure Responsibility*

As noted above, the intergovernmental transfers' unconditional nature would preserve the states' current level of control over expenditure decisions. Generally, that localized control over governmental benefits should lead to a mix of benefits that satisfies the states' residents.⁸⁰ It also empowers the states to compete with each other to attract residents and businesses by assembling a desirable benefit mix that produces more value for residents than their accompanying tax obligations.⁸¹ That competition could include everything from purchasing public goods (e.g., parks and libraries) to increasing employment opportunities by providing private subsidies that lure out-of-state businesses to relocate.⁸² Unlike the present system, where a significant portion of the competition for businesses involves indirect subsidies made through tax credits and tax holidays, the direct subsidies used in expenditure-based competition should be more transparent to taxpayers who can then assess whether their elected officials are using their funds wisely.⁸³

Taxpayers would have several methods of curtailing overspending by state officials. As an outer bound on spending, voters can demand fiscal discipline by insisting that states operate under balanced-budget restrictions. Indeed, many states already have such restrictions in place to discourage the purchase of governmental benefits that exceed what taxpayers are willing to pay for them.⁸⁴ Voters may also conclude that their state government wastes too much of the intergovernmental transfer it receives or that it should not spend the entire intergovernmental transfer because it cannot find enough worthwhile governmental benefits to purchase on the voters' behalf.

80. Oates, *Essay*, *supra* note 5, at 1121–22.

81. Wallace E. Oates, *Fiscal Competition or Harmonization? Some Reflections*, 54 NAT'L TAX J. 507, 508 (2001).

82. *Id.*

83. Louise Story, *The Empty Promise of Tax Incentives*, N.Y. TIMES, Dec. 2, 2012, at A1 (identifying more than \$80 billion of local tax incentives used each year to attract companies and observing that “[a] full accounting . . . is not possible because the incentives are granted by thousands of government agencies and officials, and many do not know the value of all their awards”).

84. NAT'L CONFERENCE OF STATE LEGISLATURES, NCSL FISCAL BRIEF: STATE BALANCED BUDGET PROVISIONS 3 tbl.1 (2010) (listing the forty-nine states—all but Vermont—with constitutional or statutory provisions, or both, designed to curtail unbalanced budgets). The report notes that only twenty-two states claim that a legal enforcement mechanism accompanies that balanced-budget requirement. *Id.* at 8–9.

In those situations, voters can try to reduce the amount of federal taxes imposed on them, leave for another state that offers a superior set of benefits justifying their tax payments, or demand that the state distribute a portion of the funds it receives from the federal government directly to them (i.e., the equivalent of a federal tax refund). If the state is responsive to that distribution demand, then logically the resulting mix of governmental benefits and tax refunds should approximate the mix resulting from the current system where the state justifies the taxes it levies by providing governmental benefits to its taxpayers.⁸⁵ Under those circumstances, there should be no difference between a voter demand for a federal tax refund and a refusal to pay additional state taxes.⁸⁶ While instances of governments returning funds to taxpayers do exist,⁸⁷ numerous empirical studies have shown that intergovernmental transfers increase a community's governmental expenditures more than an equivalent increase in the community members' private income. This "flypaper effect"—so named because, like a fly on flypaper, money tends to stick where it hits—suggests that depending on tax refunds to properly calibrate governmental benefit expenditures when the federal government's transfer to a state is too large may not always work.⁸⁸ Nevertheless, voters should have sufficient tools to influence the states' governmental benefit expendi-

85. The logic underlying this conclusion is straightforward. Assuming that a state's voters' appetite for governmental benefits is constant regardless of whether the current system or the proposed system is in place, those voters will object if the state keeps more tax revenue than is needed to obtain those benefits. Under the current system, voters will object to tax levies that exceed the revenue amount needed to obtain those governmental benefits. Under the proposed system, voters will object to the state retaining intergovernmental transfers in excess of what is needed to obtain those governmental benefits and will demand a distribution of the excess. Either way, a responsive state government should end up with the same amount of tax revenue to spend on the same governmental benefits.

86. This conclusion follows from the "veil hypothesis" found in fiscal federalism literature. According to that hypothesis, "a grant to a community is fully equivalent to a central tax rebate to the individuals in the community." Oates, *Essay, supra* note 5, at 1129. In other words, an unconditional intergovernmental transfer from the federal government to a state government (i.e., to the state community) is equivalent to a federal tax rebate directly to the state's residents. This Article's proposal converts state-level taxes into federal-level taxes, so a federal tax rebate under the proposal is roughly equivalent to reduced state taxes in the current system.

87. *See supra* note 71 (discussing the Alaska Permanent Fund and its annual dividend to Alaskans).

88. James R. Hines & Richard H. Thaler, *The Flypaper Effect*, 9 J. ECON. PERSP. 217, 218 (1995) ("For unrestricted block grants, the estimated effects [on local spending] are often closer to 100 percent than to [the] 5 or 10 percent [predicted by theory].").

ture decisions so that they are largely consistent with the voters' collective preferences, just as they do in the current system.⁸⁹

C. Constitutional Viability

To carry out this proposal, Congress would need to do three things: (1) preempt the states' ability to impose taxes, other than real property taxes and license taxes; (2) revise the federal tax system to raise the additional tax revenue needed to replace the preempted state taxes; and (3) create the unconditional intergovernmental transfer system needed to fund the states' governmental benefit expenditures. The latter two are clearly within Congress's enumerated constitutional powers.⁹⁰ Similarly, there is no real debate whether the Commerce Clause gives Congress the ability to restrict certain types of taxing behavior by the states (e.g., discriminatory state taxation).⁹¹ The only open issue is whether the Commerce Clause power permits Congress to limit the states' taxing power to the extent proposed here. While the Supreme Court has not directly addressed that issue, and there are legitimate arguments supporting either conclusion, the likely answer is yes.⁹²

89. For example, voters might adapt the state tax-limitation triggers used in states like Oregon and Colorado to fit this purpose. In Oregon, if total tax receipts exceed estimated receipts by more than two percent, the entire excess is automatically returned to taxpayers. Martin A. Sullivan, *Magic Money to Pay for Future Tax Cuts*, 145 TAX NOTES 1079, 1080 (2014). A state wishing to diminish the flypaper effect could put in place, in advance, triggers tied to the size of the unconditional intergovernmental transfer received that would limit its effective size by requiring an automatic distribution to the state's residents. *See id.* at 1079–80 (describing how some states have proactively used tax triggers to effectively cap the amount of tax revenue they receive each year).

90. The U.S. Constitution endows the federal government with broad taxing and spending powers. U.S. CONST. art. 1, § 8, cl. 1; *id.* amend. XVI.

91. *See* Comptroller of the Treasury of Md. v. Wynne, 135 S. Ct. 1787, 1794 (2015) (“Although the Clause is framed as a positive grant of power to Congress, ‘we have consistently held this language to contain a further, negative command, known as the dormant Commerce Clause, prohibiting certain state taxation even when Congress has failed to legislate on the subject.’”); Okla. Tax Comm’n v. Jefferson Lines, Inc., 514 U.S. 175, 179 (1995); Michael T. Fatale, *Common Sense: Implicit Constitutional Limitations on Congressional Preemption of State Tax*, 2012 MICH. ST. L. REV. 41, 45 (concluding that the federal government has little ability to preempt a state tax, but acknowledging that “the Commerce Clause confers upon Congress . . . the power to prevent states from engaging in discrimination that would inure to the benefit of local commercial interests and other forms of state-based economic protectionism”).

92. One enterprising law student commentator has even argued that the Commerce Clause gives the Supreme Court the power fill the legislative void left by Congress by expanding its dormant Commerce Clause jurisprudence to force uniform taxation at the state level. Brian L. Hazen, Comment, *Rethinking the Dormant Commerce Clause: The Supreme Court as Catalyst for Spurring Legislative Gridlock in State Income Tax Reform*, 2013 BYU L. REV. 1021, 1024. *But see* Charles E. McLure, Jr. & Walter Hellerstein, *Congressional Intervention in State*

The main argument in favor of Congress's power to preempt the states' taxing power is that the Commerce and Supremacy Clauses combine to give Congress a near-absolute regulatory power over economic activity within the United States that trumps the states' attempts to tax that activity. According to recent Supreme Court case law:

"The power of Congress over interstate commerce is not confined to the regulation of commerce among the states," but extends to activities that "have a substantial effect on interstate commerce." Congress's power, moreover, is not limited to regulation of an activity that by itself substantially affects interstate commerce, but also extends to activities that do so only when aggregated with similar activities of others.⁹³

Therefore, the Commerce Clause gives Congress the power to regulate a set of solely intrastate activities that, in the aggregate, substantially affect interstate commerce.⁹⁴ Only non-economic activity,⁹⁵ economic inactivity,⁹⁶ and, presumably, non-economic inactivity fall outside the Commerce Clause's scope. Congress's regulatory power extends to economic activity even when the regulated activity is one that traditionally falls within the states' purview.⁹⁷ Because the state taxes that Congress would need to prohibit apply to economic activities that substantially affect interstate commerce, the states' ability to impose those taxes is a form of economic regulation that falls within the scope of Congress's Commerce Clause power.⁹⁸

Taxation: A Normative Analysis of Three Proposals, 31 ST. TAX NOTES 721, 724 (2004) (arguing that the courts should leave this problem to Congress because "[l]egislative remedies can be more nuanced than judicial remedies").

93. *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 567 U.S. 519, 549 (2012) (first quoting *United States v. Darby*, 312 U.S. 100, 118–19 (1941); and then citing *Wickard v. Filburn*, 317 U.S. 111, 127–28 (1942)).

94. *Id.*

95. *United States v. Morrison*, 529 U.S. 598, 613 (2000) (rejecting Congress's use of the Commerce Clause to address gender-motivated crimes of violence because they "are not, in any sense of the phrase, economic activity"); *id.* ("[T]hus far in our Nation's history our cases have upheld Commerce Clause regulation of intrastate activity only where that activity is economic in nature."); *United States v. Lopez*, 514 U.S. 549, 561 (1995) (rejecting Congress's use of the Commerce Clause to prohibit carrying a firearm near a school because that prohibition "has nothing to do with 'commerce' or any sort of economic enterprise" and "is not an essential part of a larger regulation of economic activity").

96. *Nat'l Fed'n of Indep. Bus.*, 567 U.S. at 557.

97. *Gonzales v. Raich*, 545 U.S. 1, 24–25, 41 (2005) (holding that the Commerce Clause permits Congress to regulate the personal medicinal use of marijuana while under the care of a physician despite the fact that medical care provided by a physician is traditionally regulated by the states).

98. *Nat'l Fed'n of Indep. Bus.*, 567 U.S. at 549–50. This result is also consistent with the Supreme Court's recent dormant Commerce Clause jurisprudence. *See Comptroller of the Treasury of Md. v. Wynne*, 135 S. Ct. 1787, 1795 (2015) (using the dormant Commerce Clause to invalidate Maryland's tax scheme by focusing on the relative effect it had on intrastate and interstate economic activity).

If Congress exercises that Commerce Clause power to directly invalidate state tax laws that fall within that Clause's scope, the constitutional issue becomes whether the federal or state law reigns supreme. As the Supreme Court noted in *Gonzales v. Raich*, a case dealing with California's attempt to legalize medical marijuana in the face of a federal law criminalizing all marijuana use:

The Supremacy Clause unambiguously provides that if there is any conflict between federal and state law, federal law shall prevail. It is beyond peradventure that federal power over commerce is "superior to that of the States to provide for the welfare or necessities of their inhabitants," however legitimate or dire those necessities may be.⁹⁹

The Court went on to observe that "state action cannot circumscribe Congress' plenary commerce power."¹⁰⁰ Thus, the Supreme Court's cases dealing with Congress's affirmative use of its Commerce Clause power indicate that Congress can regulate the states' ability to tax and that Congress's power to do so is absolute.

That view is championed by one of the foremost academic experts on state and local taxation,¹⁰¹ but it is not universally held. Proponents of a more limited Congressional reach in this area question whether the Commerce Clause reaches nondiscriminatory state taxes¹⁰² and whether the federalism structure that the Founders built into the Constitution's Supremacy Clause authorizes Congress to completely preempt state taxation using its Commerce Clause power.¹⁰³ The former concern boils down to the assertion that "the preemption of a [nondiscriminatory] state tax constitutes the regulation of the 'states as states'" instead of as economic actors.¹⁰⁴ That position is difficult to square with the Supreme Court's invalidation of California's medical marijuana law in *Raich* because the California law was nondiscriminatory, and by regulating medicine California was, with-

99. *Raich*, 545 U.S. at 29 (quoting *Maryland v. Wirtz*, 392 U.S. 183, 196 (1968)).

100. *Id.*

101. See Walter Hellerstein, *A Primer on State Tax Nexus: Law, Power, and Policy*, 55 ST. TAX NOTES 555, 558 (2010) (testifying before Congress that the Commerce Clause power to set state tax nexus rules allows Congress to do "just about anything" and that "it may preempt state legislation that would be constitutional under the dormant Commerce Clause"); Walter Hellerstein, *Federal Constitutional Limitations on Congressional Power to Legislate Regarding State Taxation of Electronic Commerce*, 53 NAT'L TAX J. 1307, 1309 (2000) ("[T]he [Supreme] Court has explicitly indicated that Congress possesses power to legislate uniform state tax rules among the states . . ."); see also Kirk J. Stark, *The Quiet Revolution in U.S. Subnational Corporate Income Taxation*, 23 ST. TAX NOTES 775, 783 (2002) ("Congress plainly has the authority under the Commerce Clause to preempt state or local taxation of multistate or multinational corporations.").

102. Fatale, *supra* note 91, at 69–77.

103. Michael J. McIntyre, *Thoughts on the Future of the State Corporate Income Tax*, 25 ST. TAX NOTES 931, 941–44 (2002).

104. Fatale, *supra* note 91, at 73.

out question, acting as a state, not an economic actor.¹⁰⁵ This argument also contradicts the Supreme Court's long-standing, four-pronged *Complete Auto* test for evaluating whether the dormant Commerce Clause invalidates a state tax because that test permits invalidation of a nondiscriminatory tax if the tax fails one of the other prongs (e.g., it is not fairly apportioned).¹⁰⁶ In short, though it does not happen often, Congress's Commerce Clause power can invalidate nondiscriminatory state taxes.

Whether that power permits complete preemption of a state's power to impose a specific tax, or set of taxes, is another matter. The legal argument against a broad preemption power is grounded in the Constitution's federalism principles.¹⁰⁷ Those principles led the Founders to disperse governmental power among the federal and state sovereigns with the newly created federal government dominant within its limited sphere of enumerated powers and the states dominant everywhere else.¹⁰⁸ For that balance-of-power arrangement to work, presumably neither the federal government nor the states should have the power to destroy the other's sovereignty.¹⁰⁹ That constraint would limit the federal government's ability to prevent state taxation if doing so would be equivalent to destroying the states' sovereignty by denying the states any means of independently raising revenue to fund their governmental activities.¹¹⁰ If this logic is correct, Congress's

105. *Raich*, 545 U.S. at 5–6.

106. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 287 (1977) (“[N]o claim is made that the activity is not sufficiently connected to the State to justify a tax, or that the tax is not fairly related to benefits provided the taxpayer, or that the tax discriminates against interstate commerce, or that the tax is not fairly apportioned.”); *accord* *Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 183–84 (1995).

107. McIntyre, *supra* note 103, at 938 (concluding that traditional federalism concepts prevent Congress from using “its enumerated powers to abolish a major state revenue source in the guise of regulating interstate commerce”).

108. See U.S. CONST. art. I, § 8 (enumerating the powers afforded to Congress); *id.* art. VI, § 2 (“This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land.”); *id.* amend. X (“The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.”).

109. For that reason, an early Supreme Court holding denied the states the power to tax the federal government or its instrumentalities because “the power to tax involves the power to destroy.” *McCulloch v. Maryland*, 17 U.S. 316, 431 (1819). Interestingly, the opinion went on to note that:

the States have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of the constitutional laws enacted by Congress to carry into execution the powers vested in the [Federal] Government. This is, we think, the unavoidable consequence of that supremacy which the Constitution has declared.

Id. at 436.

110. McIntyre, *supra* note 103, at 942.

Commerce Clause power would not actually be plenary as the states' conflicting fundamental right to tax would overcome it. The Supreme Court's language in *Raich* and other nontax Commerce Clause cases would still be valid because those cases dealt with lesser state powers that are not fundamental to the states' existence as a sovereign.¹¹¹

While that reasoning has some merit, and may even be what the Founders originally envisioned when they thought about their predominately local, agrarian economy while drafting the Constitution,¹¹² the United States' subsequent progression to a national, industrial economy and then to a global, information economy has undermined its force.¹¹³ Throughout that evolution, the Supreme Court has steadily asserted that "the taxing power of a State is one of its attributes of sovereignty" and that that power "may be exercised to an unlimited extent upon all property, trades, business, and avocations . . . except so far as it has been surrendered to the Federal government, either expressly or by necessary implication."¹¹⁴ As Congress's Commerce Clause power expanded in response to the economy's transformation into something that no single state could effectively regulate,¹¹⁵ the states' sovereign taxing power shrank accordingly. Given the Commerce Clause power's current breadth, it seems likely Congress's responsibility for regulating the national economy trumps the states' ability to raise revenue using one or more specific taxes. Furthermore, loss of recourse to one or more taxes is not

111. *See, e.g.*, *Gonzales v. Raich*, 545 U.S. 1, 9 (2005) (finding California's attempt to regulate the medical marijuana market unconstitutional).

112. *See* THE FEDERALIST NO. 45 (James Madison) (expressing no apparent concern that the federal government's new power to regulate commerce would endanger the power of the state governments).

113. William F. Fox & John A. Swain, *The Federal Role in State Taxation: A Normative Approach*, 60 NAT'L TAX J. 611, 611–12, 612 n.2 (2007) (recognizing that "perverse economic effects, such as might occur with tax havens and some other forms of tax competition" have "become increasingly problematic with economic globalization"). The United States' transition to an information-based economy has further complicated these interstate tax issues. *See, e.g.*, Kendall L. Houghton & Walter Hellerstein, *State Taxation of Electronic Commerce: Perspectives on Proposals for Change and Their Constitutionality*, 2000 BYU L. REV. 9, 56–75 (discussing some of the state tax problems caused by electronic commerce and the constitutional limits on Congress's power to solve them).

114. *Union Pac. R.R. Co. v. Peniston*, 85 U.S. 5, 29 (1873).

115. *See, e.g.*, *Wickard v. Filburn*, 317 U.S. 111, 125 (1942) (extending the Commerce Clause so that "even if appellee's activity be local and though it may not be regarded as commerce, it may still, whatever its nature, be reached by Congress if it exerts a substantial economic effect on interstate commerce," which in the instant case was represented by the national market for wheat); *NLRB v. Jones & Laughlin Steel Corp.*, 301 U.S. 1, 42 (1937) ("When industries organize themselves on a national scale, . . . how can it be maintained that their industrial labor relations constitute a forbidden field into which Congress may not enter when it is necessary to protect interstate commerce from the paralyzing consequences of industrial war?").

the same as an outright ban on all taxation. Because the tax-assignment solution proposed here would not completely prevent the states from raising revenue through taxation, prohibiting them from using certain specific taxes (e.g., income taxes and sales taxes) should be permissible.¹¹⁶ After all, the states still retain their sovereign power to tax so long as the tax in question is not tied to economic activity (e.g., a head tax).

III. ANALYSIS OF THE ONE TAX SYSTEM PROPOSAL

The proposal's main objective is to capture the numerous benefits that come from a centralized tax system providing greater uniformity to taxpayers. Unfortunately, those uniformity benefits are not cost-free because centralization necessarily reduces any benefits derived from the intergovernmental tax competition currently present in the United States' decentralized tax system. This Part draws on two different, but related, analytical frameworks to analyze and compare the proposed solution to the current system. First, traditional tax policy considerations are employed. Then, the alternatives are evaluated using fiscal federalism principles that take into account both taxation and governmental expenditures. While tax policy considerations tilt in favor of the proposed solution's greater uniformity, the fiscal federalism analysis identifies several potential objections to the proposal's combination of centralized taxation and decentralized governmental spending. However, because recent advances in the field of behavioral economics suggest that those theoretical objections are not likely to be significant in practice, this Part concludes with the determination that the proposed solution is an improvement over the current system.

A. Tax Policy Considerations

Traditionally, legal scholars evaluate the relative merits of competing tax policies or systems using the broad principles of economic efficiency, complexity or ease of administration, and equity.¹¹⁷ For that reason, those three considerations are important tools for determining whether the proposed tax-assignment solution is superior to the current system. Each one is employed here.

116. On occasion, Congress has preempted state taxation. A notable recent example is the Internet Tax Freedom Act, 47 U.S.C. § 151 (2012), which prevented states from taxing Internet access and from imposing "multiple or discriminatory taxes on electronic commerce." *Id.*

117. MICHAEL J. GRAETZ & DEBORAH H. SCHENK, FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES 28 (Robert C. Clark et al. eds., 6th ed. 2009); *see also* Peter A. Prescott, *Taxing Luck*, 83 MISS. L.J. 117, 156–75 (2014) [hereinafter Prescott, *Taxing Luck*] (using the three tax-policy considerations to evaluate the taxation of income received due to luck rather than labor or capital).

1. *Economic Efficiency*

All else being equal, a tax system that distorts taxpayer decision-making is inferior to one that does not because that distortion causes economically inefficient behavior. In the absence of taxes, taxpayers should make decisions that maximize their personal welfare.¹¹⁸ To the extent that tax consequences change those decisions, a taxpayer's personal welfare is reduced not only by the tax revenue paid to the government (which should benefit society as a whole), but also by the additional deadweight loss resulting from that change (which is simply foregone personal welfare).¹¹⁹ An economically efficient tax system minimizes that deadweight loss by avoiding situations where tax-induced behavioral distortions drive decision-making.

The current tax system's lack of uniformity among the states distorts taxpayer decision-making by creating the functional equivalent of tariffs on economic activity crossing state lines.¹²⁰ The tariff-like effect occurs because the taxpayer's location, or the activity's location, affects which state or states tax the economic activity.¹²¹ Thus, a multistate business deciding whether to enter another state (or transact with its residents) must factor that state's taxes into its business decision. High taxes create a tariff-like barrier to entry that the taxpayer must internalize through reduced profits, shift to its customers through higher prices (if the market permits), or plan around. Regardless of the coping mechanism, the costs connected with the high taxes will discourage some taxpayers from undertaking what would otherwise be a private-welfare-maximizing step. Of course, lower state taxes may have the opposite distorting effect by encouraging out-of-state taxpayers to enter a state when they might not otherwise do so.

That fact inevitably causes states to compete for economic development, and the accompanying jobs, by using tax incentives that intentionally distort taxpayer decisions in the state's favor.¹²² Although each enticed business may be better off after capturing the promised tax incentives, overall those incentives are not economically efficient because the business and the impacted states collectively suffer a deadweight loss when the business's allocation of its resources and activities among the states is suboptimal.¹²³ Assuming that the busi-

118. GRAETZ & SCHENK, *supra* note 117, at 28.

119. ROBERT S. PINDYCK & DANIEL L. RUBINFELD, *MICROECONOMICS* 335–39 (7th ed. 2009).

120. Shaviro, *supra* note 50, at 898–99.

121. *Id.* at 900–01.

122. Story, *supra* note 83 (discussing how business' demands for tax incentives "creat[ed] a high-stakes bazaar where they pit local officials against one another to get the most lucrative packages").

123. Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 *HARV. L. REV.* 377, 398–99 (1996) ("Even a tax break that succeeds in attracting a business investment to a

ness would only distort its behavior if the tax incentive offered exceeded the portion of the deadweight loss born by that business, the tax incentive's net negative consequences are born entirely by the states through misallocated private economic development and foregone taxes.¹²⁴ Ironically, that means the states, viewed as a group, use tax incentives to buy a net reduction in private economic development.¹²⁵

Even in the absence of direct state tax competition, tax differences among states can unintentionally—at least from the perspective of state taxing authorities—distort taxpayer decisions. Misalignment of state tax laws can result in situations where certain income or sales are taxed by several states or not taxed by any state.¹²⁶ Predictably, taxpayers try to avoid the former while pursuing the latter. The resulting multistate tax planning distorts the taxpayer's resource-allocation decisions in ways that reduce the taxpayer's pre-tax welfare to gain a larger, offsetting tax benefit. As with intentional distortions, the overall effect is suboptimal resource allocations and reduced tax revenue. Unfortunately, the impact of these distortions has increased as the United States has moved to an information economy where intangible, intellectual property; cheap, instantaneous long-distance communications; and relatively low transportation costs make it easier for taxpayers to rearrange their affairs to exploit unintentional state tax system differences.¹²⁷

state will represent a net loss for the states collectively, as long as that investment (together with all its derivative benefits for the winning state) would have occurred in some state in the absence of the incentive.”).

124. The state that loses the tax competition suffers the most because it misses out on the business's optimal amount of economic development and on the resulting state taxes. Although the winning state captures a lesser amount of economic development and foregoes some tax revenue, the losses may be offset by the gains from state taxes connected with that economic development. Thus, the winning state still benefits through the business's suboptimal economic development in the state and, possibly, some increased tax revenue.
125. Taken to an extreme, such intentional tax competition creates a “race to the bottom” scenario where competition drives the states to set their effective tax rates at, or near to, zero to attract and retain businesses. In this circumstance, of course, business will revert back to economically efficient resource allocation and opt not to pay any taxes.
126. The latter is euphemistically called “nowhere” or stateless income. William F. Fox, Matthew N. Murray & LeAnn Luna, *How Should a Subnational Corporate Income Tax on Multistate Businesses Be Structured?*, 58 NAT'L TAX J. 139, 157 tbl.1 (2005). The “stateless income” phenomenon also occurs in the international tax context and has received significant attention in recent years. *See, e.g.*, Edward D. Kleinbard, *Stateless Income*, 11 FLA. TAX REV. 699 (2011).
127. Dan Bucks, *A Key to Full and Fair Apportionment*, 70 ST. TAX NOTES 29, 30 (2013) (acknowledging that comprehensive data is not available which demonstrates the magnitude of the increase in “domestic income shifting aimed at eroding state corporate tax bases,” but observing that “the opportunities for avoiding state corporate taxes have increased as business operations change in response to

The proposed centralized tax system eliminates unintentional state tax distortions and greatly restricts the states' ability to intentionally distort taxpayer decision-making. Replacing all current state taxes (except real property taxes and license taxes) with one uniform set of federal taxes closes the existing gaps between state tax systems that give rise to the unintentional distortions outlined above. Taxpayers could no longer systematically rearrange their affairs in pursuit of unintended state tax reductions that rely on suboptimal resource allocations because the only remaining differences are tied to tax bases—real property and state-issued licenses—that cannot be transferred between states.¹²⁸ Furthermore, the states' loss of control over most taxes would also limit their ability to intentionally lure taxpayers into making decisions that, while good for the taxpayer and the winning state, create a net loss overall when the misallocated private economic development and foregone taxes are fully taken into account.¹²⁹ Under the proposed system, tax competition among the states would be limited to real property taxes and license taxes. Because the latter is one of the lower-revenue state taxes, the amount of leverage it could provide is limited.¹³⁰ Although intentional property tax competition among the states would persist, on the whole the proposed switch to a centralized, uniform tax system should significantly improve economic efficiency by reducing state tax-related distortions of taxpayer decisions.

2. Tax Administrative Complexity

No one likes complexity when it comes to taxes.¹³¹ Ideally, our tax system should be so straightforward that taxpayers and taxing au-

electronic and communications technologies, deregulation, globalization, and a shift of corporate assets to intangibles”).

128. The states' control over property taxes and license taxes is not likely to create unintentional distortions because there is no potential overlap among the states for these taxes. Only one state has the power to tax a given piece of real property because that property is only located in one state. The same is true for license taxes and other benefit taxes. While a state legislature may decide to set those taxes lower than similar taxes in surrounding states to attract taxpayers, that decision is an intentional attempt to distort taxpayer decision-making.
129. *See supra* notes 122–25 and accompanying text (explaining how this overall net loss comes about).
130. *See supra* Table 1 (reporting aggregate state license taxes of \$52.2 billion, which was approximately 3.7% of total state tax revenue in fiscal year 2015).
131. *See* NAT'L TAXPAYER ADVOCATE, 2012 ANNUAL REPORT TO CONGRESS 3 (2012) (“The most serious problem facing taxpayers—and the IRS—is complexity of the Internal Revenue Code”); NAT'L TAXPAYER ADVOCATE, 2014 ANNUAL REPORT TO CONGRESS iii–iv (2014) (grouping six of the twenty-three “most serious problems encountered by taxpayers” under the heading “The Right to a Fair and Just Tax System: Complexity”). Tax professionals and law professors may be exceptions to this statement because complex laws provide a steady stream of business for the former and publication fodder for latter.

thorities would incur minimal costs in connection with its administration. In reality, both sides spend considerable amounts of time and money navigating through the tax system.¹³² For that reason, tax scholars and policymakers regularly look for ways to reduce those administrative costs by reducing the tax system's complexity. Their efforts typically target three distinct types of complexity—compliance complexity, transactional complexity, and rules complexity—because each type increases administrative costs, usually for taxpayers and taxing authorities.¹³³ While there is no magic formula for combatting tax system complexity, decreasing the number of tax rules that apply to each taxpayer and promoting the consistent and uniform application of those rules to taxpayers should improve the tax system by reducing these three sources of unwanted administrative costs for both sides.

Compliance complexity is the complexity that taxpayers confront while complying with their tax-reporting obligations, including the preparation and filing of the tax returns and the maintenance of sufficient records to support the amounts shown on those returns.¹³⁴ For taxing authorities, this type of complexity is the procedural complexity faced when attempting to effectively and efficiently administer the tax laws.¹³⁵ Not surprisingly, the current tax system's decentralized approach of overlapping taxes administered by the federal government and fifty states creates significant compliance complexity.¹³⁶ For example, a taxpayer doing business in multiple states must file a separate income tax return for each state and a federal income tax return.¹³⁷ Because each government's laws are slightly different, each tax return requires some customization and, most likely, a distinct set

132. In 2012, the National Taxpayer Advocate estimated that “individuals and businesses spend about 6.1 billion hours a year complying with the filing requirements of the Internal Revenue Code” and that annual compliance costs exceed \$150 million. NAT'L TAXPAYER ADVOCATE, 2012 ANNUAL REPORT TO CONGRESS 5–6 (2012).

133. See, e.g., DAVID F. BRADFORD, UNTANGLING THE INCOME TAX 266–67 (Harv. Univ. Press 1986) (distinguishing three types of complexity—compliance, transactional, and rule); Steve R. Johnson, *The E.L. Wiegand Lecture: Administrability-Based Tax Simplification*, 4 NEV. L.J. 573, 581–82 (2004) (considering the same concepts, but breaking complexity into detail complexity, outcome complexity, and forms complexity).

134. Prescott, *Taxing Luck*, *supra* note 117, at 170.

135. Peter A. Prescott, *Jumping the Shark: The Case for Repealing the TEFRA Partnership Audit Rules*, 11 FLA. TAX REV. 503, 520 (2011) [hereinafter Prescott, *Jumping the Shark*] (evaluating compliance complexity in the context of the IRS's partnership audit procedures).

136. Janet G. Stotsky & Emil M. Sunley, *United States*, in FISCAL FEDERALISM IN THEORY AND PRACTICE, *supra* note 6, at 359, 361–62.

137. For a corporation doing business in all fifty states, that could mean forty-six income tax returns. See LEE ET AL., *supra* note 24 (reporting that forty-five states impose a net income tax on corporations).

of supporting tax records that reflects those differences.¹³⁸ Thus, the current tax system imposes substantial compliance costs on taxpayers.

The compliance-complexity picture for taxing authorities under the current tax system is slightly different, but the overall result of unnecessarily high compliance costs is the same. Even if each taxing authority is quite efficient at administering its own tax laws and minimizes its compliance costs, the fact that each state's tax administration operates in parallel with those in the other states injects unnecessary compliance costs into the overall tax system because each state tax agency will need to separately scrutinize the taxpayer's tax return and may have to dispute the same tax issues with the same taxpayer instead of dealing with them all at once. To prevent multistate taxpayers from taking inconsistent factual and legal positions in different states, the state tax administrators engage in information exchange arrangements with their counterparts in the federal government and other states.¹³⁹ Of course, the personnel redundancies (e.g., fifty-one tax commissioners) needed to support those parallel tax administrations are incrementally costly, too.¹⁴⁰

Consolidating most tax administration at the federal level should significantly reduce the costs associated with compliance complexity. For taxpayers, the compliance burden will greatly diminish because they will only have to deal with one set of tax rules requiring one set of tax records and one set of tax returns. On the tax authority side, the parallel state tax administrations with their redundant personnel and duplicative tax return review and dispute processes would largely fold into the existing federal tax administration. Accordingly, from the compliance-complexity perspective the proposed tax system is clearly superior to the one currently in place.

Moving to the proposed tax system would also reduce transactional-complexity costs. Transactional complexity decreases when tax-system changes make it easier for taxpayers to legally minimize their taxes by arranging their affairs in a straightforward manner.¹⁴¹ Es-

138. For example, basis rules require completely different asset accounts. *See, e.g.*, IND. CODE § 6-3-1-3.5(b)(5) (2017) (defining "taxable income" for corporations to include an adjustment that removes the effects of any bonus depreciation deduction allowed under I.R.C. § 168(k) in the taxable year that the property was placed in service).

139. *See, e.g.*, I.R.C. § 6103(d)(1) (2017) (requiring the IRS to make the federal tax returns and associated information that it receives "open to inspection by . . . any State agency, body, or commission . . . which is charged under the laws of such State with responsibility for the administration of State tax laws for the purpose of . . . the administration of such laws").

140. Those incremental costs may not always be viewed negatively. *See* Stotsky & Sunley, *supra* note 136, at 362 (noting that "the loss of state jobs" was one reason state governments have resisted centralizing tax administration in the past).

141. BRADFORD, *supra* note 133, at 267.

entially, managing transactional complexity means acknowledging that tax systems are never perfectly economically efficient and then seeking to minimize the transactional cost of any ensuing behavioral distortions. As discussed above, the current tax system facilitates distortion of taxpayer decisions through intentional tax competition among the states to attract taxpayers and through unintentional mismatches between state tax systems.¹⁴² The intentional distortions from state tax competition cause taxpayers to spend time and money lobbying and negotiating with state legislators and tax officials to capture tax incentives from the state.¹⁴³ The states also incur costs competing with other states to lure taxpayers using tax incentives.¹⁴⁴ Similarly, the unintentional distortions increase transactional-complexity costs because taxpayers spend time and money working with tax professionals to identify and exploit the misalignments between state tax laws (i.e., loopholes) that lead to unintended tax savings and because taxing authorities must dedicate considerable resources to identifying and closing those loopholes.¹⁴⁵ Because moving to the proposed tax system would eliminate unintentional state tax distortions and greatly restrict the states' ability to intentionally distort taxpayer decision making, taxpayers and taxing authorities would no longer need to engage in the tax planning and lobbying activities that give rise to the current tax system's economically unproductive transactional-complexity costs.

Installing a single, uniform tax system for most state taxes should diminish the negative effects of rules complexity, too. The new system would make it easier for taxpayers and the taxing authorities to understand how the tax system's rules apply to interstate commerce.¹⁴⁶ At present, both sides must interpret and apply the complex set of rules that govern the taxation of businesses and transactions that span more than one state. Those rules address fundamental tax issues such as: (1) whether a business has sufficient contacts with a state to create nexus that subjects it to taxation by that state,¹⁴⁷ (2) how to

142. See *supra* notes 120–27 and accompanying text.

143. Story, *supra* note 83 (“[The companies] dictate their terms, and we’re not really in a position to question their deal terms [because] [w]e don’t have the sophistication or the resources to negotiate with a company that has the wherewithal the size of a country.” (quoting a county official in Texas)).

144. *Id.*

145. INST. ON TAXATION & ECON. POLICY, “NOWHERE INCOME” AND THE THROWBACK RULE 1 (2011), <http://www.itep.org/pdf/pb39throw.pdf> [<https://perma.unl.edu/N8Y7-DAPR>] (“[M]any large businesses are aware that they can set up their operations to maximize nowhere income and minimize the taxes they owe.”).

146. See Prescott, *Jumping the Shark*, *supra* note 135, at 520 (explaining that rules complexity arises when the written and unwritten rules are difficult to interpret and apply).

147. See, e.g., *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (deciding whether North Dakota could require a mail-order retailer to collect and remit use tax on

identify the share of a business taxpayer's income that the state can tax because the activities generating that income are part of the taxpayer's unitary business operating in that state,¹⁴⁸ and (3) how to source and apportion the business taxpayer's income from its unitary business among the states that have the ability to tax it.¹⁴⁹ The rules complexity resulting from these three issues is compounded by the fact that each state has its own set of rules to answer them and that none of them has a single, obviously correct answer. Not surprisingly, the resulting web of overlapping rules leads to many tax disputes. Even if these cross-border issues are resolved, disputes often still arise over how to properly determine intercompany transfer prices when legally separate entities in a consolidated business enterprise transact with each other.¹⁵⁰ In recent years, interstate transfer pricing problems have become particularly common and difficult to resolve as intangible intellectual property and services have become a more prominent part of the U.S. economy because the greater mobility associated with those types of income has made it easier for multi-state businesses to engage in cross-border intercompany transactions that attempt to shift income from high-tax states to low-tax states.¹⁵¹ All four of these contentious, and tricky, tax issues would become moot if the current set of state-specific tax rules is replaced by the centralized, uniform tax system proposed here. Consequentially, that change would simplify the tax rules for multi-state businesses and significantly reduce the amount of wasteful tax litigation.

its sales into the state when that retailer merely solicited sales from outside the state and shipped them into the state via the mail or common carriers).

148. See, e.g., *Edison Cal. Stores, Inc. v. McColgan*, 183 P.2d 16, 20 (Cal. 1947) (ruling that despite the fact that business operations spanned multiple commonly owned entities, "if the operations in California contributed to the net income derived from the entire operations in the United States, then the entire business is so clearly unitary as to require a fair system of apportionment by the formula method in order to prevent either overtaxation or undertaxation").
149. See, e.g., *Butler Bros. v. McColgan*, 315 U.S. 501, 509 (1942) (concluding that an apportionment formula based on property, payroll, and sales is appropriate "to allocate to California its just proportion of the profits earned by appellant from this unitary business").
150. Transfer pricing has become such an important, and thorny, issue that the Multi-state Tax Commission created the Arm's-Length Adjustment Service Committee to "support states seeking to improve equitable business tax compliance in circumstances where taxpayers are found to use transactions among related parties to undermine equity in taxation." MULTISTATE TAX COMM'N, DESIGN FOR AN MTC ARM'S-LENGTH ADJUSTMENT SERVICE i, iii (2015), <http://www.mtc.gov/getattachment/The-Commission/Committees/ALAS/Draft-of-Final-Design-Design-for-ALAS.pdf.aspx> [<https://perma.unl.edu/ESG2-CK2A>].
151. *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13 (S.C. 1993), is a classic example of this sort of cross-border tax planning by Toys "R" Us, Inc. Of course, in the end that planning did not work out well for the taxpayer. *Id.* at 18-19.

In short, the proposed tax system's cross-border uniformity would reduce the costs resulting from compliance complexity, transactional complexity, and rules complexity.¹⁵² Given that reality, one might wonder why taxpayers and the states have not already standardized the states' tax systems to capture those simplification savings. In fact, many states have taken steps to do just that—at least partially.¹⁵³ On the individual and corporate income tax fronts, most states have passed laws tying their income tax bases to the “taxable income” in the federal Internal Revenue Code.¹⁵⁴ Furthermore, forty-eight states and the District of Columbia are members of the Multistate Tax Commission,¹⁵⁵ which “is an intergovernmental state tax agency working on behalf of states and taxpayers to administer, equitably and efficiently, tax laws that apply to multistate and multinational enter-

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152. Permitting real property taxes and license taxes to remain at the state level, and non-uniform across the states, should not have much effect on the proposed tax system's complexity. As should be clear from the discussion above, the benefits of greater uniformity are most significant when the tax base in question is mobile and when legal issues, not factual issues, are involved because the former are specific to a particular taxing jurisdiction and the latter are taxpayer specific. The tax base for real property taxes is real property, which by its nature is located in only one state and is immobile. Therefore, there is little compliance complexity because the property owner must only report to the one state taxing authority with the power to tax the property's value. In addition, with the exception of lobbying the state for a real property tax reduction, real property taxes are not vulnerable to the types of tax planning that lead to transactional complexity. Finally, because the major issue for real property taxes is factual (i.e., the property's value), moving to a federal real property tax system is not likely to reduce the number of tax disputes due to rules complexity.
153. It appears that partial standardization is about the best that can be hoped for from the states. When Congress presented the states with an opportunity to piggyback their income tax on the federal income tax, with tax administration to be carried out by the IRS, no state elected to pursue that option. Stotsky & Sunley, *supra* note 136, at 362.
154. On the individual income tax front: “Of the 41 states (plus the District of Columbia) with broad-based personal income taxes, 40 states and the District connect in some way to the federal system by incorporating a range of federal tax expenditures—exclusions, deductions, and credits—into their state tax codes.” THE PEW CHARITABLE TRUSTS, TAX CODE CONNECTIONS: HOW CHANGES TO FEDERAL POLICY AFFECT STATE REVENUE 1 (2016), http://www.pewtrusts.org/~media/Assets/2016/02/FiscalFed_FederalTaxPolicyChangesReport_v6_WEB.pdf [<https://perma.unl.edu/ZF4D-PUYR>]; see also Jane G. Gravelle & Jennifer Gravelle, *How Federal Policymakers Account for the Concerns of State and Local Governments in the Formulation of Federal Tax Policy*, 60 NAT'L TAX J. 631, 640–43 (2007) (examining how state tax revenue was affected when the federal government changed income tax definitions which the state had adopted); Ruth Mason, *Delegating Up: State Conformity with the Federal Tax Base*, 62 DUKE L.J. 1267 (2013) (outlining the costs and benefits of the states' decisions to piggyback on the federal tax base).
155. *Member States*, MULTISTATE TAX COMM'N, <http://www.mtc.gov/The-Commission/Member-States> [<https://perma.unl.edu/H52X-2AVG>].

prises.”¹⁵⁶ One of the Commission’s main objectives is to “promot[e] uniformity or compatibility in significant components of tax systems” by developing uniform model laws that the member states then adopt as their own.¹⁵⁷ Those model laws focus on sales taxes, use taxes, and income taxes where cross-border tax issues are most prevalent.¹⁵⁸ Unfortunately, the states’ current efforts fall short because not all states participate in these two simplification approaches and because many that do still make some state-specific changes to the Code or the model statutes. Thus, the proposed tax system would still reduce complexity-related administrative costs for taxpayers and taxing authorities.

3. *Equity*

Uniformity usually improves equity among taxpayers because the rules in a uniform tax system apply equally to all. Therefore, it is not surprising that the proposed tax system fairs well when equitable tax-policy principles are considered. Tax equity focuses on whether the tax burden needed to fund the required level of governmental benefits is fairly distributed across the taxpayers contributing to those benefits.¹⁵⁹ One traditional measure of fairness—horizontal equity—is relatively uncontroversial because it requires that similarly situated taxpayers contribute the same amount of taxes to the common undertaking.¹⁶⁰ The other fairness measure—vertical equity—is satisfied when the tax distribution fairly reflects an agreed-upon external measure, like the level of benefits received by the taxpayers under consideration or the taxpayer’s ability to pay the taxes.¹⁶¹ Vertical equity determinations are controversial because reasonable people disagree about the external measure that should be used to assess vertical equity and about what constitutes a fair distribution under a given measure (e.g., whether a progressive, proportional, or regressive tax is fair when using the ability-to-pay criterion to assess vertical equity). Because the proposal’s main purpose is to replace the existing patchwork system of state-specific taxes with a nationwide system of uniform taxes, this analysis focuses on whether that change improves or reduces equity.¹⁶²

156. *The Commission*, MULTISTATE TAX COMM’N, <http://www.mtc.gov/The-Commission> [<https://perma.unl.edu/AD8W-UJ8H>].

157. *Id.*

158. *Multistate Tax Compact*, MULTISTATE TAX COMM’N, <http://www.mtc.gov/The-Commission/Multistate-Tax-Compact> [<https://perma.unl.edu/2MS2-CGB4>].

159. GRAETZ & SCHENK, *supra* note 117, at 27.

160. *Id.*

161. *Id.*

162. Although it is true that the proposal’s shift from the varying mix of taxes and rates imposed on taxpayers by their separate states to a uniform federal set of taxes and rates will necessarily change the tax situation for individual taxpayers, net taxes paid to government by those taxpayers do not need to change much, or

Standardizing taxes across state borders should improve horizontal equity by imposing the same set of rules on all taxpayers operating within each state.¹⁶³ Currently, a multistate business can use the tax-planning opportunities described above to reduce the tax burden on its operations within a given state.¹⁶⁴ That multistate business may also be able to lobby for special tax preferences from the state in exchange for agreeing to enter the state in the first place.¹⁶⁵ Together, these reductions give the multistate business an advantage over local competitors who only operate within that state. While it is arguably true that the multistate and local businesses differ in geographic scope, with respect to their operations within the state they are still similarly situated taxpayers who should receive equal tax treatment by that state. That conclusion is equally true in situations where the state attempts to target out-of-state taxpayers for higher taxation. Thus, the proposed tax system's imposition of a single nationwide tax system that eliminates cross-border tax effects should improve horizontal equity.

From a vertical equity perspective, the current tax system raises several tax-distribution concerns that would not arise under the proposed system. For example, to the extent that a multistate business successfully avoids a state's taxation, that business claims some governmental benefits from that state by virtue of its activities within that state without paying for those benefits.¹⁶⁶ As a result, state taxpayers are unfairly left to overpay for those benefits.¹⁶⁷ Furthermore, because multistate businesses tend to be larger and have greater fi-

at all. For example, formerly low-tax states could decide to simply return some of the unconditional grants that they receive from the federal government to their taxpayers.

163. Cross-border tax differences can result in unfairness when the tax disparities they created are not enough to distort taxpayers' behavior (i.e., there is inelastic demand for the behavior in question with respect to taxes) because they can cause two otherwise identical taxpayers to pay differing amounts of tax purely because of the state they chose to locate in. Shaviro, *supra* note 50, at 901.
164. *See supra* note 145 and accompanying text (recounting the costs that taxpayers and taxing authorities incur because unintentional gaps and misalignments exist).
165. *See supra* notes 142–44 and accompanying text (describing multistate business's efforts to exploit intentionally provided tax incentives).
166. A classic example of this result occurred in *Quill Corp. v. North Dakota*, 504 U.S. 298, 301–02 (1992), in which North Dakota was not allowed to collect use tax from an out-of-state retailer on sales to customers within its borders even though the retailer clearly benefited from the services provided by the state (e.g., the roads used to deliver the retailers goods to its customer and, at a broader level, the state's economy).
167. Foisting disproportionately high state taxes on an out-of-state business would be equally unfair because that out-of-state business ends up paying for governmental benefits enjoyed by local taxpayers. Of course, a tax that discriminates against interstate commerce in this manner "is virtually *per se* invalid," and "will survive only if it 'advances a legitimate local purpose that cannot be adequately

nancial resources than local businesses, a system that effectively taxes such businesses at a lower rate than their local competitors is regressive and would be deemed unfair by most.

One equitable argument in favor of the current tax system's state-specific taxes is that each state's taxpayers are not similarly situated with taxpayers in other states because they have different preferences regarding governmental benefits that are reflected in the states' differing tax levels (assuming no deficit spending).¹⁶⁸ To the extent that these higher or lower taxes actually map to more or less governmental benefits (i.e., the federal government does not force cross-border subsidization of benefits by redistributing funds from one state to another), this argument in favor of the current system is valid. Of course, it cannot extend to the funding of governmental benefits that all U.S. residents are entitled to receive regardless of their state. In addition, under the proposed tax system each state would retain the power to match its level of governmental benefits to its residents' preferences by simply returning some of its unconditional grant to them instead of spending it on additional benefits. For that reason, this argument in favor of the current tax system fails to outweigh the horizontal- and vertical-equity benefits of moving to a centralized, uniform tax system.

In the end, it all comes down to uniformity. Under each of the three tax policy considerations, the proposed tax system is superior to the current tax system for taxpayers and taxing authorities because the proposed system increases uniformity. Greater uniformity discourages the wasteful behavioral distortions—whether intentional or unintentional—that reduce economic efficiency. It also positively affects the tax system's complexity by eliminating the overlapping sets of tax rules and taxing jurisdictions that currently plague taxpayers and taxing authorities alike. Finally, greater uniformity improves horizontal and vertical equity by ensuring that the same tax rules apply to similarly situated taxpayers, regardless of geographic location within the United States, and by preventing large multistate businesses from using interstate tax-law mismatches to effectively create a regressive tax system that allows them to avoid bearing their fair share of the benefits provided by the states. For all these reasons, a traditional tax policy analysis favors the proposed change over the status quo.

served by reasonable nondiscriminatory alternatives.” Dep’t of Revenue of Ky. v. Davis, 553 U.S. 328, 338 (2008) (citations omitted).

168. For example, the fact that Californians paid, on average, \$5325 of state and local taxes in 2013 might signal that they desire more services from their state and local governments than do Texans, who only paid, on average, \$3862 that year. *State and Local Tax Revenue, Per Capita*, TAX POL’Y CENTER (Mar. 20, 2017), <http://www.taxpolicycenter.org/statistics/state-and-local-tax-revenue-capita> [<https://perma.unl.edu/S3FD-CS9A>].

B. Fiscal Federalism Considerations

From a fiscal federalism perspective, the proposed tax-assignment change is desirable if the resulting distribution of taxes among the federal government and the states improves the government's overall performance, taking into account both levels.¹⁶⁹ Evaluating the new tax assignments requires considering the taxes themselves and the pairing of those taxes with the governmental responsibilities that they fund. Pairing matters to fiscal federalists because they generally believe that governmental benefits, and the accompanying taxes, should be provided by the lowest level of government encompassing those benefits and taxes.¹⁷⁰ That fiscal-decentralization bias reflects the view that lower levels of government should be more responsive to their residents' preferences for governmental benefits and taxes,¹⁷¹ and that competition between those lower-level governments should limit exploitation by government officials—who may be more interested in personal gain than helping the people they represent—by pushing all governing units to optimize the combination of taxes and benefits they provide.¹⁷² Consistent with fiscal federalism's joint concern over taxes and governmental expenditures, the analysis here has two distinct lines—tax-specific considerations and tax-coordination considerations.

Like the tax-policy considerations, the tax-specific fiscal federalism considerations strongly favor the proposed tax system's consolidation of most taxes at the federal level. However, the tax-coordination fiscal federalism considerations are more mixed and raise the strongest, and most common, objections to the proposal. Those objections concern the proposal's combination of centralized taxation and decentralized governmental expenditures because separating responsibility for those two functions may weaken intergovernmental competition's ability to optimize government behavior. In the end, while the fiscal federalism analysis is not as one-sided as the tax policy analysis, it does support the proposed change.

169. Musgrave, *supra* note 7, at 2.

170. Oates, *Essay*, *supra* note 5, at 1125.

171. David E. Wildasin, *Pre-Emption: Federal Statutory Intervention in State Taxation*, 60 NAT'L TAX J. 649, 653 (2007).

172. Paolo Liberati, "Which Tax" or "Which Tax for What?": *Tax Assignment in the Theory of Fiscal Federalism*, 39 PUB. FIN. REV. 365, 375 (2011). In short, Liberati advocates for a public-choice-based theory of competitive federalism because voter mobility constrains the nonbenevolent despots who we appoint as agents to represent our interests. Geoffrey Brennan & James Buchanan, *Normative Tax Theory for a Federal Polity: Some Public Choice Preliminaries*, in TAX ASSIGNMENT IN FEDERAL COUNTRIES, *supra* note 7, at 52, 59–63.

1. *Tax-Specific Considerations*

Not surprisingly, many of the main tax-specific fiscal federalism considerations overlap heavily with the tax-policy considerations discussed above. When evaluating a tax in isolation, fiscal federalists are primarily concerned with whether the tax is imposed on an appropriate set of taxpayers and whether it will produce a steady supply of tax revenue to fund the desired level of governmental benefits.¹⁷³ To that end, they prefer tax systems that cannot be easily avoided, are imposed on the people who receive the corresponding governmental benefits, and have relatively stable tax bases.¹⁷⁴ Some fiscal federalists also argue that a good tax system helps ensure an equal distribution among residents of the community's shared resources (e.g., natural resources like oil and gas reserves).¹⁷⁵

A tax is easily avoided when it has a mobile tax base that can be readily moved from one taxing jurisdiction to another. Under those circumstances, sophisticated taxpayers will exploit the tax-arbitrage opportunities created when states use different tax bases or tax rates by relocating themselves, or their economic activities, to states with lower taxes. The resulting economic efficiency and administrative complexity costs are discussed at length above.¹⁷⁶ To curtail those costs, fiscal federalists assert that the states should tax immobile tax bases (e.g., real property, natural resources, and state-provided governmental benefits) while leaving more mobile tax bases to the federal government (e.g., business income taxes and sales taxes) because the federal government's jurisdictional reach is not as easily avoided.¹⁷⁷

173. See, e.g., OATES, FISCAL FEDERALISM *supra* note 74, at 121–25 (starting from the states' need to “divert needed resources into the public sector” through taxation before noting that economists have “long stressed . . . the avoidance of *excess burden*” and that the “tax system should have an equitable pattern of incidence”).

174. See, e.g., *id.* at 123–24 (explaining that efficiency considerations support tax systems where the taxing units are “unable to avoid the burden of the tax by altering behavior” to move beyond the tax's reach and that “it is generally desirable . . . to have decentralized levels of government finance programs with their own revenues”); see also Liberati, *supra* note 172, at 371 (“Local taxes should then be applied on an immobile basis.”).

175. See, e.g., Charles E. McLure, Jr., *Tax Assignment and Subnational Fiscal Autonomy*, 54 BULL. FOR INT'L FISCAL DOCUMENTATION 626, 628 (2000) [hereinafter McLure, *Tax Assignment*] (discussing the economic efficiency and equity issues created by the localized concentration of natural resources (e.g., oil) and why those issues support taxing natural resources at the national level).

176. See *supra* subsections III.A.1–2.

177. McLure, *Tax Assignment*, *supra* note 175, at 628–30; see also Gurumurthi, *supra* note 38, at 2302–07 (considering the proper assignment of most types of taxes within a federal system). Of course, a taxpayer can still evade a federal tax by moving itself or, in some cases, its economic activities outside the federal government's taxing jurisdiction. That international tax problem parallels the problem discussed in this Article with one key exception—there is no analog to the federal government sitting above the nations that can impose a common tax system over

The current decentralized U.S. system does a poor job of avoiding mobile tax bases at the state level. As noted in Table 1, two of the states' largest revenue sources in fiscal year 2015 were income taxes and sales taxes, which are among the most mobile tax bases. The states' uneven taxation of business income and sale transactions is particularly problematic because the resulting cross-border tax arbitrage opportunities distort the behavior of multistate taxpayers by encouraging them to allocate their resources in the pursuit of tax savings instead of maximum economic productivity.

The proposal would substantially improve the U.S. tax system's performance by restricting the states' taxing power to real property taxes and license taxes. These two taxes have highly immobile tax bases because they are tied to the taxing state by virtue of physical location or originating governmental authority. Neither of those attributes can be easily severed from the state that taxes them. For that reason, taxation at the state level is appropriate. The remaining taxes—including the highly mobile income taxes and sales taxes—would shift to the federal government and face a uniform tax system spanning the entire United States. That change would eliminate the interstate tax-arbitrage opportunities that currently make legal tax avoidance possible for many multistate taxpayers.

The opposite is also true. Just as a good tax system limits the ability of taxpayers to avoid their tax obligations, a good tax system limits the government's ability to tax outsiders who receive few, if any, of the benefits provided by that government.¹⁷⁸ That limitation is important because, from a political perspective, taxes imposed on outsiders (i.e., nonresidents) to pay for benefits going to residents are often quite popular for obvious reasons.¹⁷⁹ Under the current tax system, the Consti-

all of them. Nevertheless, the United States and some other developed countries have struggled with the problem in recent years. See *Base Erosion and Profit Shifting*, ORG. FOR ECON. CO-OPERATION & DEV, <http://www.oecd.org/ctp/beps/> [<https://perma.unl.edu/MM7G-2A2J>] (“Base erosion and profit shifting (BEPS) refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations. Under the inclusive framework, over 100 countries and jurisdictions are collaborating to implement the BEPS measures and tackle BEPS.”).

178. Norregaard, *supra* note 6, at 54 (including “it should not be possible to ‘export’ the tax to nonresidents” in his list of factors that should determine whether a particular tax should be assigned to the national level or the subcentral level).

179. Travel taxes (e.g., taxes on hotel occupancy and car rentals) are a familiar example. In the words of Senator Russell Long of Louisiana, “Don’t tax you, don’t tax me, tax that man behind the tree.” John H. Cushman, Jr., *Russell B. Long, 84, Senator Who Influenced Tax Laws*, N.Y. TIMES, May 11, 2003, <http://www.nytimes.com/2003/05/11/us/russell-b-long-84-senator-who-influenced-tax-laws.html> [<https://perma.unl.edu/RQ22-SJ45>].

tution limits the states' ability to tax nonresidents.¹⁸⁰ Nevertheless, the existence of fifty separate state taxing regimes increases the possibility that states may successfully "export" some of their taxes to nonresidents with minimal contacts to the taxing state. By concentrating taxing power at the federal level, the proposed tax system would effectively eliminate that possibility by doing away with state-level distinctions between residents and nonresidents, in relation to U.S. residents. In addition, federal-level income and sales taxes are arguably better aligned with governmental benefits in light of the federal government's increasing importance as regulator of the national economy and provider of governmental benefits to U.S. residents. For those reasons, the proposed tax centralization should modestly improve the U.S. tax system under this criterion.

A third important tax-specific consideration is the tax system's allocation of tax-revenue volatility among the federal government and the states. A volatile tax-revenue stream creates problems by encouraging the government to expand governmental benefits during periods of economic growth and increasing tax revenue, and by forcing the later contraction of those same (now-expected) benefits when tax revenue craters during a recession or depression.¹⁸¹ Such benefit swings contribute to unrealistic taxpayer expectations during good times and the potential for unmet demands for assistance during bad times.¹⁸² Thus, a good tax system minimizes the magnitude and impact of those benefit swings by shifting tax-revenue volatility to the level of government that is best able to cope with it.¹⁸³

For a number of reasons, the federal government is better positioned to withstand tax-revenue volatility than the individual states. Because the federal government's taxing jurisdiction includes all of the states, the federal tax base represents a diversified portfolio of the states' tax bases. That tax-base diversification should mitigate the impact of state-specific economic fluctuations on the federal government's ability to provide stable governmental benefits, including the intergovernmental transfers used by the states to pay for some of the benefits that they provide to their residents, by allowing it to offset

180. *See, e.g.*, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (exploring the limitations imposed by the Due Process and Commerce Clauses on the states' power to tax nonresidents).

181. Stark, *supra* note 9, at 416–17.

182. *Id.* at 416–17.

183. *Id.* at 436–42 (recommending that the federal government not encourage the states to rely on more volatile taxes and suggesting ways that the federal government could encourage the opposite behavior by the states); *see also* Darien Shanske, *How Less Can Be More: Using the Federal Income Tax to Stabilize State and Local Finance*, 31 VA. TAX REV. 413, 429 (2012) ("Because sub-national entities are not going to be subject to the full consequences of poor financial decision-making ex post, it is particularly important that the federal government nudge these other entities to better policies ex ante.").

one state's economic growth against another state's recession. When that diversification protection fails because too many states simultaneously undergo an economic downturn, the federal government is better able to cover the resulting tax-revenue shortfall through borrowing money at lower interest rates.¹⁸⁴ Of course, in extreme cases the federal government can always cover shortfalls by printing money.¹⁸⁵

The federal government's relative strength in this area suggests that it should take steps to internalize tax-revenue volatility while ensuring that the states have a stable revenue source for funding their provision of governmental benefits.¹⁸⁶ The proposed tax system can accomplish that goal by assigning taxing power to the federal government and providing the states with unconditional intergovernmental transfers that are relatively stable and fixed in amount.¹⁸⁷ Of the two allocation methods discussed in subsection II.B.2, the population-based, per-capita allocation method should prove more stable than the method allocating transfers based on each state's relative contribution to the federal government's total tax revenue for the year. In fact, the latter approach would actually undermine the federal government's stabilizing effect by shifting much of the tax-revenue volatility back to the states. Thus, the proposed tax system's ability to manage tax-revenue volatility and its impact on the provision of governmental benefits is an improvement on the tax-assignment strategy used currently.

Finally, as a matter of fundamental fairness, a good tax system should help ensure that its residents share the benefits from commu-

184. *See supra* note 67 and accompanying text (comparing the borrowing power of the federal government to that of the individual states). For some states (and their major cities), the borrowing power discrepancy is extreme. *See* Monique Garcia, *Rauner, Madigan Blame Each Other for Illinois' Credit Rating Downgrade*, CHI. TRIB., June 9, 2016, <http://www.chicagotribune.com/news/local/politics/ct-illinois-credit-rating-downgrade-rauner-madigan-met-0610-20160609-story.html> [<https://perma.unl.edu/H4TW-KGN2>] (reporting Illinois' downgrade to two notches above junk bond status, which should result in significantly increased future borrowing costs, and anticipating that the higher interest rates resulting from the city of Chicago's current junk status will cost "taxpayers tens of millions of extra dollars").

185. *Knox v. Lee (Legal Tender Cases)*, 79 U.S. 457 (1871) (holding that the U.S. Constitution gives Congress the authority to approve the issuance of paper money). The states are forbidden to print money. U.S. CONST. art. 1, § 10 ("No State shall . . . coin Money; emit Bills of Credit; [or] make any Thing but gold and silver Coin a Tender in Payment of Debts . . .").

186. Stark, *supra* note 9, at 437–38 (arguing that if the federal government has a compelling interest in "minimizing the risk of state fiscal crises," then it should take action to discourage the states from adopting a mix of taxes that are highly volatile).

187. It is worth noting that at least one of the two taxes remaining at the state level—the real property tax—is currently one of the most stable sources of state revenue. *Id.* at 422–23.

nal resources equally (e.g., natural resources like oil and natural gas).¹⁸⁸ This last tax-specific consideration leads to different optimal tax systems depending on whether the states are viewed as separate communities or whether the United States is one community. Fiscal federalists have long observed that only the highest level of government in a multilevel system is capable of redistributing resources among residents in the lower levels.¹⁸⁹ Therefore, if the states are separate communities with separate sets of communal assets, then state taxation of those assets is appropriate because there is no need to redistribute the benefits from assets that are unequally distributed among the states. However, if the United States is one community with one set of communal assets, then it is difficult to justify why some states (e.g., Alaska and North Dakota) should disproportionately benefit from communal assets simply because those assets (e.g., oil reserves) happen to reside within their boundaries. In that case, a centralized tax system does a better job capturing the economic benefits of communal assets and sharing them equally among the states.

To some extent, the federal components of the current tax system equalize the benefits of communal assets like oil and gas reserves by taxing the income from businesses that develop those assets and spending the resulting revenue on government benefits that go to all U.S. residents regardless of state residence. That said, a certain level of resource inequality persists because the individual states containing those resources can use state taxes to claim a disproportionate share of the resulting economic benefits. As a result, the residents of those resource-rich states disproportionately benefit from the happenstance of their geographic proximity to those communal assets.¹⁹⁰ Moving to the proposed centralized tax system should produce a more equal distribution of these benefits among the states by pooling all tax revenues (except real property taxes and license taxes¹⁹¹) at the fed-

188. See McLure, *Tax Assignment*, *supra* note 175, at 629 (“Questions of equity also arise: why should those who live in resource-rich areas have access to public services on more favourable terms than those in other areas?”).

189. See OATES, *FISCAL FEDERALISM*, *supra* note 74, at 6–8, 14 (explaining why a central government is better suited to redistribute wealth among the member of a federal system); Musgrave, *supra* note 7, at 11 (endorsing as a tax-assignment rule the principle that “progressive taxation, designed to secure redistributive objectives, should be primarily central”).

190. Of course, when energy prices fall, these oil-revenue dependent states suffer. John W. Schoen, *Painful Transition for Energy States as Oil Revenues Evaporate*, CNBC (Apr. 22, 2016), <http://www.cnbc.com/2016/04/18/painful-transition-for-energy-states-as-oil-revenues-evaporate.html> [https://perma.unl.edu/7STP-NAHY] (identifying the oil-revenue dependent states and reporting how they have been hurt by falling oil revenue).

191. Arguably, leaving these two taxes at the state level is suboptimal under this criterion because each tax can be used to over-tax the resources located within a state. For example, the presence of oil underneath a plot of land increases its property value, which increases the resulting real property taxes.

eral level. If those federal funds are then distributed among the states using a per-capita allocation method to determine the size of each state's unconditional intergovernmental transfer, the overall effect would be to increase fairness by providing each U.S. resident with an equal share the benefits from communal resources.

Focusing solely on tax-specific fiscal federalism considerations, the proposed tax-assignment change is desirable because it would increase tax fairness and economic efficiency while reducing the costs of dealing with tax-revenue volatility. Taxpayers would have a more difficult time avoiding their tax responsibilities, and state governments would lose much of their ability to "export" taxes by imposing them on nonresidents. The federal government would assume the task of coping with tax-revenue volatility because its broad fiscal powers make it uniquely qualified to effectively manage that volatility risk so that governmental benefit levels are not unnecessarily compromised during economic downturns. Given these conclusions, and the similar results from the tax policy analysis in section III.A, if there is any justification for retaining the current system, it must come from tax-coordination fiscal federalism considerations.

2. *Tax-Coordination Considerations*

Tax-coordination considerations expand the analysis of a federal tax system to factor in the relationship between the assignment of taxing authority to different levels of government and those governments' responsibility for providing governmental benefits. Generally, the fiscal federalism literature supports the conclusion that taxing authority should be aligned with expenditure authority so that governmental benefits and the tax revenues that fund them are paired.¹⁹² That broad principle leads to two related considerations. First, arguments in favor of locating expenditure authority at a particular level of government may influence, and even dictate, the answer to fiscal federalism's tax-assignment problem. Second, any misalignment between tax revenue and governmental expenditures should be carefully scrutinized to determine whether the resulting costs of that misalignment are justified by an offsetting benefit. Because the proposal combines centralized taxation and decentralized governmental expenditures, these two new considerations highlight some concerns about the proposal's desirability. However, for the reasons outlined below, those concerns are not enough to overcome the proposal's benefits.

Because expenditure authority location may indirectly affect the desirability of some tax-assignment solutions, arguments favoring expenditure decentralization are important when evaluating this Article's proposed centralized-taxation approach. Traditionally, fiscal

192. Oates, *Essay*, *supra* note 5, at 1121–22; Ter-Minassian, *supra* note 65, at 8–9.

federalism scholars have taken the position that governmental benefits should be provided by the lowest government level fully encompassing those benefits (and the attendant costs) because that approach is expected to produce the best alignment between the residents' appetite for governmental benefits and the benefits that they actually receive.¹⁹³ An assignment of expenditure authority to a more centralized level of government that covers a larger number of residents runs the risk of unnecessarily washing out regional preferences regarding the appropriate level of governmental benefits that would have increased overall welfare if they had been identified and satisfied more locally.¹⁹⁴ In short, more centralized governmental benefit decision-making is likely to decrease the social welfare created by those benefits—if they have localized effects—because the central government is more likely to overlook local preferences.

Even when a central government is aware of regional variations in preferences, for political reasons that government is more likely to provide uniform benefits that are not customized to reflect local preferences.¹⁹⁵ Unfortunately, that loss of specificity has the potential to be quite costly from a welfare perspective when significant regional variations in demand for governmental benefits are present and localized demand for those benefits is inelastic.¹⁹⁶ Because there is reason to believe that that demand is relatively inelastic, welfare losses from expenditure decentralization are a serious concern.¹⁹⁷ Even if demand for governmental benefits is relatively elastic and local preferences are uniform, uniform benefits may still cause welfare losses when there are significant regional variations in the marginal cost of providing those benefits.¹⁹⁸ For those reasons, traditional fiscal federalism scholarship generally endorses expenditure decentralization. That, in turn, leads to support for decentralized taxation.

Although the proposal would centralize taxation, it would not alter the United States' current approach of mixing centralized and decentralized governmental expenditures because the unconditional intergovernmental transfers used to shift federal tax revenue to the states would leave each state free to tailor the governmental benefits it pro-

193. Oates, *Essay*, *supra* note 5, at 1122.

194. Under this line of reasoning, the perfect government would maximize overall welfare by delivering customized governmental benefits to each resident that exactly align with that resident's preferences. Of course, as a practical matter such a government would be unworkable.

195. Wallace E. Oates, *On the Welfare Gains from Fiscal Decentralization*, 2–3 J. PUB. FIN. & PUB. CHOICE 83, 83 (1997) [hereinafter Oates, *Welfare Gains*].

196. *Id.* at 84–86.

197. Oates, *Essay*, *supra* note 5, at 1122 (recognizing that preferences and cost differentials must be considered when adjusting governmental benefits to maximize overall social welfare).

198. Oates, *Welfare Gains*, *supra* note 195, at 86–89.

vides to local preferences. That result should be true regardless of whether the transferred tax revenue exceeds or falls short of what the state needs to provide those benefits because the state would retain the ability to fine tune its revenue by raising the taxes that remain under its control (e.g., real property taxes) or distributing the unused excess amounts to its residents. The net effect of those features somewhat weakens traditional fiscal federalism's decentralization objection to the proposal.

Perhaps more importantly, the welfare-maximization argument favoring expenditure decentralization loses much of its potency when the localized variations in preferences for governmental benefits, and in the marginal cost of those benefits, are arguably just as present at the state level as they are at the federal level. For example, the localized governmental benefits provided by the State of California reflect a blend of approximately 39.1 million different individual preferences, which is only slightly more likely to accurately reflect the views of individual Californians than the benefits that would have been provided by the United States (a population of approximately 321 million).¹⁹⁹ Arguably, regional variations in residents' preferences within the states dwarf any differences between those states and the United States as a whole. In particular, the division between benefit preferences and the cost of acquiring those benefits is larger between high-density urbanites and low-density rural denizens.²⁰⁰ In the absence of neatly concentrated clusters of like-minded residents that happen to align nicely with the jurisdictions of the state governments that are making localized governmental-benefit decisions affecting those re-

199. U.S. CENSUS BUREAU, ANNUAL ESTIMATES OF THE RESIDENT POPULATION: APRIL 1, 2010 TO JULY 1, 2015 (2017), <https://factfinder.census.gov/faces/nav/jsf/pages/searchresults.xhtml?refresh=t> (follow the link to the Bureau's website and copy and paste the "Annual Estimates of the Resident Population: April 1, 2010 to July 1, 2015" into the search bar) [hereinafter ANNUAL ESTIMATES OF THE RESIDENT POPULATION].

200. See Jack Healy, *Fed Up on the Prairie, and Voting on Seceding from Colorado*, N.Y. TIMES, Oct. 6, 2013, at A1, http://www.nytimes.com/2013/10/07/us/fed-up-on-the-prairie-and-voting-on-seceding-from-colorado.html?_r=0 [<https://perma.unl.edu/6FEM-TGVY>] (telling the story of eleven low-density, rural counties in Colorado who took steps to secede from the rest of the state to form "a prairie bulwark against the demographic changes and urbanization that are reshaping politics and life across [Colorado] and other Western states"); Claire Cain Miller, *Liberals Turn to Cities to Pass Laws and Spread Ideas*, N.Y. TIMES, Jan. 26, 2016, at A3, <http://www.nytimes.com/2016/01/26/upshot/liberals-turn-to-cities-to-pass-laws-and-spread-ideas.html> [<https://perma.unl.edu/T9CD-U7XA>] (reporting on the political and legal tensions between state governments, which must answer to urban and rural voters, and local urban governments because "[t]he demographics of big urban centers [are] often more liberal and diverse than other parts of the country"). It goes without saying that the costs of providing many governmental benefits, like clean water, electricity, police, and firefighting, are lower per capita in denser areas.

sidents, decentralization benefits will decrease because preferences measured at the state level should not vary much from the national average. Certainly, any improvement in fit gained by shifting expenditure authority from the federal level to the states cannot be sufficient on its own to justify the economic efficiency, fairness, and administrative-complexity costs that accompany decentralized taxation.

Increased governmental experimentation is another benefit that many fiscal federalists assert to support decentralized expenditure authority.²⁰¹ The idea here is that a group of state governments independently working on the same set of societal problems should find an optimal solution more quickly because the states can carry out a diverse set of experiments in parallel.²⁰² The development of Massachusetts' health-insurance reform after a number of failed attempts by various other state governments, and its subsequent spread throughout the United States in the Affordable Care Act, is a recent, prominent example of this federalism benefit.²⁰³ Although in principle the federal government could accomplish the same result by engaging in a coordinated experimental study that varies governmental approaches to a particular problem on a state-by-state basis, that approach would likely be politically untenable because it would require the federal government to forcibly assign long-shot solutions to particular areas of the country. For that reason, decentralized expenditure authority is probably the only practical means of obtaining this diversification benefit. Because the proposal would not prevent the states from exercising control of their governmental expenditures, and the states would have some ability to raise tax revenue using real property taxes, the benefits of laboratory federalism should not be lost.

The same independent control over governmental benefit expenditures that drives laboratory federalism allows the states to compete with each other for businesses and residents.²⁰⁴ Many fiscal federalist scholars believe that that intergovernmental competition among the states encourages them to optimize the combination of taxes and governmental benefits that they offer to mobile businesses and individu-

201. OATES, FISCAL FEDERALISM, *supra* note 74, at 12–13.

202. Supreme Court Justice Louis Brandeis famously explained this federalism benefit in 1932: “It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.” *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

203. *King v. Burwell*, 135 S. Ct. 2480, 2481–82 (2015) (recounting how the Affordable Care Act “grew out of a long history of failed health insurance reform” at the state level and how Massachusetts finally developed the state-level program that provided a template for federal legislation).

204. For a general economic discussion of tax competition and its benefits, see John Douglas Wilson, *Theories of Tax Competition*, 52 NAT'L TAX J. 269 (1999).

als for fear of losing them.²⁰⁵ Other scholars view that competition as a vital restraint on the creation of a Leviathan-sized government built to serve the needs of the politicians who run it instead of the welfare of its residents.²⁰⁶ Regardless of how one describes the main benefits derived from intergovernmental competition, those benefits are only present if alternative governmental options exist, most businesses and individuals accurately assess the mix of taxes and governmental benefits that each government offers, and those businesses and individuals are able to move between government jurisdictions without incurring significant transaction costs.²⁰⁷ While the current decentralization of taxing power does provide more opportunities for tax competition among alternative governments than would the proposed centralization approach, that fact is of little consequence if the remaining two conditions are not met as well. Arguably, they are not.

The fiscal federalism arguments in favor of decentralized government generally assume that residents are better able to properly assess and monitor the relative taxes and governmental benefits offered by their governments when both are handled at the local level because the connection between those taxes and the resulting benefits should be easier for the residents to perceive.²⁰⁸ Undoubtedly, that is true of benefit taxes that are directly tied to the programs they fund because

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205. Wallace E. Oates, *Toward a Second Generation Theory of Fiscal Federalism*, 12 INT'L TAX & PUB. FIN. 349, 354 (2005) (explaining how mobile residents may gravitate toward the mix of taxes and governmental benefits that suits them, which is only possible when there is variation among governmental offerings); see also McLure, *Tax Assignment*, *supra* note 175, at 627 ("Competition in the supply of public services and in taxation disciplines politicians and bureaucrats . . . to provide the services citizens want.").
206. Liberati, *supra* note 172, at 375–76 (explaining how proponents of this theory of competitive federalism view "the central government [as] a monopolistic revenue-maximizing Leviathan, which exploits scarce mobility of tax bases at a national level").
207. The classic formulation of this competition is known as the Tiebout model after its originator. Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956). In the Tiebout model, individuals reveal their preferences for taxes and governmental benefits when they choose where to live. *Id.* at 419. The individuals are assumed to have perfect information about each government's approach to taxation and benefits, and are able to move between jurisdictions without incurring any costs. *Id.* Furthermore, the model assumes that they cannot take advantage of benefits provided by a neighboring government. *Id.* Under those conditions, providing smaller governmental units would allow individuals to geographically sort themselves into homogenous groups with shared preferences. *Id.* at 420. Thus, according to the Tiebout model, more decentralized state-level taxation and governmental benefits should be superior to their centralized counterparts.
208. Ter-Minassian, *supra* note 65, at 8 (claiming that arrangements that pair centralized taxation with decentralized expenditures "obscure the link between the benefits of public expenditures and their price, namely, the taxes levied to finance them").

the taxpayer must decide whether to incur the benefit tax by participating in the governmental program. However, most federal and state taxes are nonbenefit taxes that fund unrelated programs, making the state tax–benefit connection that residents are supposed to perceive tenuous at best.²⁰⁹

Focusing strictly on the taxation side of the states' fiscal equations, it seems unrealistic to assume that many residents have an accurate picture of the extent of their individual contributions to their state's tax revenue.²¹⁰ While some taxes that residents pay directly to their state government in one or two lump sums each year are highly salient (e.g., real property taxes), others are much less noticeable because they are indirectly collected through withholding agents in small increments (e.g., sales taxes, payroll taxes, and individual income taxes). As Table 1 demonstrates, the vast majority of state tax revenue comes from the latter, less salient, types of taxes. Corporate income taxes suffer from a different problem—even if the amount of income taxes that a state collects from a corporation is known to its residents, those residents have little hope of accurately assessing the impact of those taxes because experts are not certain who ultimately bears this tax cost (e.g., employees or shareholders).²¹¹ Faced with these difficulties, the argument that decentralized taxation at the state level is somehow easier for residents to properly assess and monitor than centralized federal taxation withers. Indeed, one could argue that easily quantifiable intergovernmental transfers from the federal government to a state would actually increase that state's residents' ability to monitor whether the state is efficiently and effectively delivering a desirable mix of governmental benefits using the resources available to

209. See *supra* Table 1 (showing that only a tiny percentage of the federal, state, and local taxes for fiscal year 2015 were benefit taxes).

210. A similar problem arises with respect to residents' abilities to accurately value governmental benefits. In some cases, direct benefits like police protection or the ability to drive on government-provided roads are so commonplace that they are overlooked. Furthermore, because they are shared, it is often difficult to assign an individual value to them that one can use to compare to one's taxes. Then there are positive externalities, like the educated citizenry created by public education, that indirectly benefit all of us in ways that are almost impossible to assign a specific value to. Because these valuation difficulties are present regardless of whether the benefits involved are provided using federal- or state-level taxes, they are not relevant when comparing the current fiscal system with the proposed one.

211. For a sampling of the tax incidence literature dealing with corporate income taxes, see, for example, Alan J. Auerbach, *Who Bears the Corporate Tax? A Review of What We Know*, 20 TAX POL'Y & ECON. 1 (2006); Jane G. Gravelle, *Corporate Income Tax: Incidence, Economic Effects, and Structural Issues*, in TAX REFORM IN THE 21ST CENTURY: A VOLUME IN MEMORY OF RICHARD MUSGRAVE 355 (John G. Head & Richard Krever eds., 2009); Arnold C. Harberger, *The Incidence of the Corporation Income Tax*, 70 J. POL. ECON. 215 (1962).

it.²¹² Certainly, it would be no worse than the currently available approach of evaluating a state's performance using its total tax-revenue data.

That said, a fiscal system that relies on federal taxes to fund state-provided governmental benefits could still interfere with the accurate assessment of whether a state's mix of taxes and governmental benefits aligns with its residents' preferences for each by creating the perception that the benefits are paid for using taxes paid by out-of-state taxpayers. For residents in some states, that perception would be reality if the allocation method used to divide the total federal intergovernmental transfer amount among the states is not the relative total tax revenue paid by residents of each state.²¹³ Whether the perception is true or not, the resulting free-rider problem in states where it is widely believed would inflate demand for governmental benefits, which would in turn undermine assessment of the state's performance satisfying its residents' preferences. Arguably, the free-rider problem could also contribute to the creation of the Leviathan-sized governments that some fiscal federalist scholars believe will arise in the absence of intergovernmental competition among the states.

Even if alternative state government options exist, and most businesses and individuals are able to accurately assess the mix of taxes and governmental benefits that each government offers, intergovernmental competition among the states will not yield many benefits if those businesses and individuals are unable to move between government jurisdictions without incurring significant transaction costs. Without that low-cost mobility, unhappy residents whose preferences regarding taxes and benefits are disregarded, perhaps by politicians exploiting their power within the state government to substitute their own preferences for those of their constituents, will not be able to reject that undesirable tax and benefit mix by relocating. Given the considerable hurdles that typically accompany an interstate move (e.g., finding a new job, buying and selling houses, leaving friends and acquaintances, relocating business operations), intergovernmental competition among the states is not likely to yield the hoped-for optimized

212. Note that, under the proposal, benefit taxes and one of the most salient nonbenefit taxes—real property taxes—will remain at the state level.

213. Of course, interstate redistribution of this sort already occurs in the U.S. system. See John Tierney, *Which States Are Givers and Which Are Takers? And Is That Even the Correct Way to Frame the Question?*, THE ATLANTIC, May 5, 2014, <http://www.theatlantic.com/business/archive/2014/05/which-states-are-givers-and-which-are-takers/361668> [<https://perma.unl.edu/3H7K-CDUA>] (reporting that federal government spending per dollar of federal taxes in 2014 ranged from \$7.87 for South Carolina to approximately \$0.50 for Delaware).

combination of taxes and governmental benefits or to restrain the creation of a Leviathan-sized government.²¹⁴

Of course, unhappy residents could try to achieve those two goals, without moving, by voting for politicians that actually deliver the residents' optimized combination of taxes and governmental benefits. There are two obvious problems with the voting solution as an alternative to actual relocation. First, the relocating resident can improve upon her mix of taxes and governmental benefits without the approval, or even agreement, of her fellow residents by moving to an already-existing alternative that is more to her liking. The voting resident cannot unilaterally achieve a similar improvement and may find that the more localized elections at the state level are no easier to influence than the federal ones because, either way, she is merely one voter among millions of others who do not share all of her preferences.²¹⁵ Second, while intergovernmental competition among the states would not directly aid these immobile voters, the ability to observe alternative approaches carried out in other states might indirectly aid them by helping them identify potentially superior options that they could push their states to adopt. This indirect aid is nothing more than the laboratory federalism concept discussed above.²¹⁶

Finally, it is also worth noting that, as with laboratory federalism, the proposed combination of centralized taxation and decentralized governmental expenditures would not eliminate intergovernmental competition benefits because states could still adopt a unique blend of government benefits and real property taxes, and use that blend to attract businesses that are considering relocation. Nevertheless, much of the interstate tax competition that exists under the current system would be lost with the consolidation of taxing power at the federal level. Indeed, reducing that economically inefficient competition, which often sacrifices overall welfare at the national level for localized

214. Despite the public perception of Americans being always on the move, in reality "fewer and fewer Americans are loading up the moving van in search of opportunity." Patricia Cohen, *Fewer Americans Strike Out for New Jobs, Crimping the Recovery*, N.Y. TIMES, May 24, 2016, at B1, http://www.nytimes.com/2016/05/25/business/economy/fewer-workers-choose-to-move-to-new-pastures.html?_r=0. If residents will not move in pursuit of jobs, which yield a concrete and direct benefit to them, they are not likely to move to capture less direct, less tangible benefits like a better suited mix of taxes and governmental benefits.

215. See ANNUAL ESTIMATES OF THE RESIDENT POPULATION, *supra* note 199 and accompanying text (comparing an individual's voting power in California and in the United States).

216. See *supra* notes 201–03 and accompanying text (concluding that laboratory federalism would not be compromised under the proposed solution to the tax-assignment problem).

economic gain in a particular state, is one of the main reasons for centralizing taxes.²¹⁷

3. *Behavioral Economics and the Benefits of Interstate Governmental Competition*

As the preceding discussion makes clear, the most common and strongest arguments against centralized taxation assume that the choices created by interstate governmental competition lead to better alignment between residents' preferences and the actions of their government. That critical assumption depends, in turn, on three other assumptions—(1) that the residents will dutifully gather all the relevant information necessary to evaluate the various governments' tax and benefit offerings, (2) that the residents are able to accurately assess how their government's tax and benefit decisions match up against those offered by other governments, and (3) that the residents will act on that information in a rational manner. Unfortunately, these latter assumptions are belied by advances in the field of behavioral economics.

Although behavioral economics' development as a subfield of economics is relatively recent, it fits comfortably within the commonly accepted broad definition of economics as "the science which studies human behavior as a relationship between ends and scarce means which have alternative uses."²¹⁸ Behavioral economics deviates from traditional economics by rejecting economic-utility theory as the sole "normative model of rational choice" describing human economic behavior.²¹⁹ Instead of assuming "a world populated by calculating, unemotional maximizers" who are perfectly rational in their pursuit of ever-greater utility,²²⁰ behavioral economists take into account the real-world limitations affecting human decision-making that effectively prevent those humans from achieving perfect rationality.²²¹ At least three of those decision-making limitations are relevant when as-

217. See *supra* notes 120–27 and accompanying text (outlining the inefficient economic and political distortions that result from interstate tax competition and tax misalignments among the states).

218. LIONEL C. ROBBINS, *ESSAY ON THE NATURE AND SIGNIFICANCE OF ECONOMIC SCIENCE* 15 (1932). Although the quoted language is a commonly accepted definition, there are many others. See Roger E. Backhouse & Steven G. Medema, *On the Definition of Economics*, 23 *J. ECON. PERSP.* 221, 221–22 (2009) (listing numerous, and varying, textbook definitions).

219. Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decisions Under Risk*, 47 *ECONOMETRICA* 263, 263 (1979).

220. Richard H. Thaler & Sendhil Mullainathan, *How Behavioral Economics Differs from Traditional Economics*, *CONCISE ENCYCLOPEDIA ECON.*, <http://www.econlib.org/library/Enc/BehavioralEconomics.html> [https://perma.unl.edu/EE8R-C4H6].

221. THALER, *supra* note 4, at 9 ("[Behavioral economics] is still economics, but it is economics done with strong injections of good psychology and other social sciences.").

sessing the validity of the assumptions that underlie the claimed benefits of interstate governmental competition.

Daniel Kahneman, winner of the 2002 Nobel Memorial Prize for Economic Sciences for his foundational work on behavioral economics, refers to the first relevant decision-making limitation as “WYSIATI,” or “what you see is all there is.”²²² Unlike traditional economics’ rational maximizers, who meticulously gather all the relevant information necessary to make a utility-maximizing decision, actual humans tend to make decisions using the WYSIATI assumption.²²³ Obviously, that WYSIATI approach violates the first underlying assumption outlined above—that the residents will dutifully gather all the relevant information necessary to evaluate the various governments’ tax and benefit offerings. Residents’ choices that are based on incomplete information are less likely to result in better alignment between residents’ preferences and the actions of their government.

Kahneman attributes the WYSIATI tendency to the division of mental work between two distinct modes of thought that he and other psychologists have labeled “System 1” and “System 2.” System 1 thinking involuntarily occurs automatically and is impulsive, intuitive, and associative in nature. System 2 thinking requires concentrated effort and relies on logic and reason. It is “the conscious, reasoning self that has beliefs, makes choices, and decides what to think about and what to do.”²²⁴ In many ways, System 2 thinking is the rational maximizer that economic utility theory assumes drives human behavior. Unfortunately, humans are naturally lazy when it comes to System 2 thinking, leaving System 1 thinking often driving the bus.²²⁵ System 1 thinking’s dominance is obvious when we make impulsive, intuitive decisions based on limited information. But, it has almost as much influence when we engage in more controlled System 2 thinking because it “effortlessly originat[es the] impressions and feelings that are the main sources of the explicit beliefs and deliberate choices” shaping our System 2 thinking.²²⁶ Whether we like it or not, System 1 thinking is quite influential.

The WYSIATI decision-making limitation is a direct result of System 1 thinking. By its very nature, associative thinking can only work

222. DANIEL KAHNEMAN, THINKING, FAST AND SLOW 85–86 (2011).

223. Despite the problems that WYSIATI decision-making creates for economic-utility theory, it is not actually irrational human behavior. Rather, the reliance on incomplete information and use of heuristics make perfect sense when confronted with humankind’s “bounded rationality” (i.e., its “lack of cognitive ability to solve complex problems”). THALER, *supra* note 4, at 23. Before the rise of behavioral economics, traditional economics simply “brushed aside bounded rationality as a ‘true but unimportant’ concept” and assumed rationality was unbounded. *Id.*

224. KAHNEMAN, *supra* note 222, at 21.

225. *Id.* at 44–46.

226. *Id.* at 21.

with activated information and ideas when constructing a coherent narrative or line of reasoning.²²⁷ For that reason, System 1 thinking barely notices when the conclusions it reaches for complex problems are based on insufficient or low-quality data.²²⁸ When a resident must decide whether the current government's tax and benefit offerings are sufficiently aligned with the resident's preferences, System 1 thinking is likely to limit the resident's analysis to the readily available information, without further data gathering, if a coherent answer is possible using that information. That the unknown data might invalidate the resident's analysis and conclusions will not matter. In that way, the resident's reliance on System 1 thinking, and the WYSIATI limitation that results, undercuts traditional fiscal federalism's argument in favor of interstate governmental competition.

System 1 thinking is also responsible for substitution, the second relevant decision-making limitation that calls into question the value of the choices created by interstate governmental competition. Substitution occurs when we respond to a hard, target question that is not readily answerable by replacing it with a related, heuristic question that is easier to solve.²²⁹ According to Kahneman, humans easily fall into substitution because our lazy brains seek to avoid the onerous System 2 thinking necessary to tackle the target question.²³⁰ Instead, our brains use System 1 thinking to helpfully generate a heuristic question that is related to the difficult target question and may produce an approximate answer to it.²³¹ If needed, more System 1 thinking closes the loop by matching the intensity of the answer to the heuristic question with the range of possible answers to the more difficult target question.²³² The end result is a readily available heuristic answer that seems to resolve the difficult target question and, if that answer is then endorsed by lazy System 2 thinking, may be used without much rational thought regarding whether the answer is appropri-

227. *Id.* at 85.

228. *Id.*

229. *Id.* at 97.

230. *Id.* The situation is actually worse than it appears. Not only do we resist burdensome System 2 thinking, the cognitive ease afforded by System 1 thinking actually feels good! *Id.* at 65–67.

231. *Id.* at 97–98.

232. *Id.* at 99. A straightforward example is useful for understanding how the two steps function. When confronted with the difficult question of “How much would you contribute to save an endangered species?” you might substitute the heuristic question “How much emotion do I feel when I think of dying dolphins?” in its place. Armed with your easily determined emotional attitude toward dying dolphins, System 1 thinking easily maps the intensity of your response to a dollar amount that feels comparable. *Id.* at 98–99.

ate for the target question.²³³ Often, the person involved may not even realize that the actual target question raised was not addressed.²³⁴

In the context of evaluating the benefits derived from the choices created by interstate governmental competition, the target question confronting residents is whether their government's tax and benefit decisions are better or worse than those offered by other governments. Unfortunately, producing a well-reasoned answer to that complex question requires the sort of difficult, critical analysis that our lazy brains seek to avoid through substitution. Most residents are likely to come up with an easier, heuristic question that System 1 thinking can readily answer. Some possibilities include: "Which state's governor looks more competent?" or "Which state handles the current hot issue better (e.g., transgender bathroom issues)?"²³⁵ Whatever the resident's substituted heuristic question, unless the resident is quite vigilant, the comparative evaluation of state policies will stop there. Needless to say, if residents do not actually attempt to accurately assess how their government's tax and benefit decisions match up against those offered by other governments, then the presence of interstate governmental competition will not necessarily lead to improved alignment between residents' preferences and the actions of their government. Sadly, behavioral economics' findings regarding the impact of substitution on human decision-making give little reason to believe that many residents engage in that sort of methodical analysis. For that reason, the second assumption underlying the benefits of interstate governmental competition—that the residents involved will be able to accurately compare their government's tax and benefit decisions with those offered by other governments—also fails.

The third underlying assumption suffers the same fate. Even if residents gathered all the relevant information and performed the required comparisons, behavioral economics' endowment effect will likely prevent those residents from acting on that information in a rational manner. A person's endowment is the physical and intangible stuff that person owns. The endowment effect recognizes that people assign greater value to an item when they own it than they do when

233. *Id.* at 99.

234. *Id.*

235. Not only are these heuristic questions much easier to intuitively answer, they are also appealing to a brain engaged in System 1 thinking because they deal with highly salient issues or people who are most likely to be covered by the media and readily come to mind in connection with state governments. WYSIATI, yet again. *Id.* at 85–86. Another possible heuristic question that is only loosely related to the governmental taxes and benefits present in the target question is "How happy/successful am I living in my current state?" The intensity of the answer to that question is easily matched to the state government's contribution toward that level of happiness or success. In other words, if a person is doing very well in a state, then the state must also be doing very well.

they are considering acquiring it.²³⁶ Put differently, “we are driven more strongly to avoid losses than to achieve gains.”²³⁷ Studies indicate that people assign twice the weight to a loss as that they do an equivalent gain.²³⁸

The endowment effect and the resulting asymmetric treatment of gains and losses can heavily influence decision-making. Our “[l]oss aversion is a powerful conservative force that favors minimal changes from the status quo in the lives of both institutions and individuals.”²³⁹ That strong status-quo bias means that residents will hold on to their current bundle of governmental taxes and benefits long after the rational maximizer of traditional economic theory would have jumped to a different jurisdiction where the government’s policies better fit the resident’s preferences. Loss-averse residents may eventually consider moving when they perceive the gain from acquiring another state’s better-aligned mix of taxes and benefits significantly outweighs the associated loss from foregoing the mix provided by their current state. However, the benefits derived from that interstate governmental competition are considerably less than are often assumed by fiscal federalists under the traditional economic theory because of the endowment effect.

Taken together, WYSIATI, substitution, and the endowment effect effectively undercut the three assumptions that fiscal federalists use to support their overarching belief that interstate governmental competition necessarily leads to better alignment between residents’ preferences and the actions of their government. In fact, the WYSIATI limitation causes residents not to bother gathering the relevant information necessary to evaluate the various governments’ tax and benefit offerings. Substitution causes the residents to avoid a methodical comparison of those alternative offerings by diverting them toward easier-to-answer heuristic questions. And, even if WYSIATI and substitution are avoided, the residents’ inherent loss aversion from the endowment effect will cause them to maintain the status quo much longer than they should if the asserted interstate governmental benefits are to be realized. In short, behavioral economics’ more nuanced understanding of how people make decisions significantly weakens, or even eliminates, the most common and strongest arguments against centralized taxation. Once those arguments are largely neutralized, the remaining tax-specific and tax-coordination fiscal federalism con-

236. THALER, *supra* note 4, at 18.

237. KAHNEMAN, *supra* note 222, at 302.

238. *Id.* at 296 (summarizing the results from “studies of diverse economic domains”) (“[I]n contrast to the predictions of economic theory, the effect of price increases (losses relative to the reference price) is about twice as large as the effect of gains.”); THALER, *supra* note 4, at 59 (“Losses hurt about twice as much as gains make us feel good.”).

239. KAHNEMAN, *supra* note 222, at 305.

siderations discussed above, which generally support centralized taxation, amount to a strong argument in favor of this Article's proposed answer to the tax-assignment problem.

IV. OTHER ALTERNATIVES

Whatever the merits of arguments promoting decentralized interstate governmental competition, centralized uniformity has its benefits when it comes to taxation. Not surprisingly, tax law and fiscal federalism scholars have occasionally championed taxation approaches aimed at increasing uniformity. This Part briefly describes two of the more common recommendations involving multistate business income and compares them to this Article's proposed solution to the tax-assignment problem.

A. Uniform Taxpayer Nexus and Apportionment

A recent law review article by Quinn Ryan proposed increasing income tax uniformity by having the federal government "establish[] a nationwide standard for income tax jurisdiction based on economic presence, coupled with the imposition of a uniform method of income apportionment."²⁴⁰ Ryan's proposal was prompted, in part, by Congress's repeated unsuccessful attempts to pass various versions of the Business Activity Tax Simplification Act ("BATSA").²⁴¹ The BATSAs would have forced states to use a uniform physical-presence jurisdiction test without imposing uniform income apportionment.²⁴² Ryan's two-pronged proposal would leave intact the states' lack of uniformity on tax base and tax rates. It was also largely silent on tax-administration consolidation.

Although the partial state-tax alignment resulting from Ryan's proposal would be an improvement over the status quo, the problems it would leave unaddressed are still formidable. For example, the states' use of different tax bases would still create unnecessary rules-complexity compliance costs.²⁴³ Misalignment among the states' tax bases would also leave intact the possibility that part of a multistate business's tax base would unintentionally escape taxation entirely or be taxed multiple times.²⁴⁴ Furthermore, state control over tax base and, in particular, tax rates would encourage states to continue com-

240. Quinn T. Ryan, Comment, *Beyond BATSA: Getting Serious About State Corporate Tax Reform*, 67 WASH. & LEE L. REV. 275, 277-78 (2010).

241. *Id.* at 277.

242. *Id.*

243. *See supra* notes 146-51 and accompanying text (explaining how the current tax system's patchwork approach creates rules-complexity costs).

244. *See supra* notes 126-30, 145 and accompanying text (describing the inefficient behavioral distortions resulting from unintentional misalignment of the states' tax systems).

peting for economic development using tax incentives.²⁴⁵ Thus, Ryan's proposal fails to eliminate the economically inefficient behavioral distortions present in the current system and the transactional-complexity costs those distortions create. Tax-base and tax-rate variations also leave open the possibility of horizontal- and vertical-equity violations.²⁴⁶ Finally, the continued existence of fifty-one tax administrations operating in parallel does little to reduce compliance complexity.²⁴⁷

Those significant costs would be justified if the non-uniform tax bases and tax rates causing them were necessary to achieve larger compensating benefits. Unfortunately, they are not. At most, Ryan's proposal reduces the likelihood of constitutional challenge by leaving states in charge of most aspects of their tax systems²⁴⁸ and leaves intact the dubious benefits of interstate governmental competition.²⁴⁹ Although those benefits have some value, they do not justify the non-uniformity costs embedded in Ryan's proposal because an alternative approach exists in the literature that eliminates many of those costs without foregoing either benefit.

B. Full Uniformity Except Tax Rates

In his assessment of Ryan's proposed multistate business income-tax system, Charles McLure endorsed the proposal's uniform jurisdictional standard and apportionment method.²⁵⁰ But, McLure implied that the proposal did not go far enough toward uniformity when he noted that his "ideal system" would also have uniform "definition[s] of the potential taxpayer" (e.g., separate legal entities or combined group) and the "income that is potentially subject to tax."²⁵¹ Taken together, McLure's four uniformities would create a uniform tax base

245. See *supra* notes 120–25, 141–44 and accompanying text (recounting the efficiency and transaction costs connected to the states' pursuit of economic development using tax incentives and of the taxpayers' pursuit of those tax incentives).

246. See *supra* notes 163–67 and accompanying text (exploring the horizontal and vertical equity problems created by the current tax system).

247. See *supra* notes 134–40 and accompanying text (outlining the substantial aggregate compliance costs shouldered by taxpayers and tax administrators under the current tax system).

248. See *supra* notes 107–16 and accompanying text (discussing the federalism-based constitutional argument against Congress possessing the ability to completely preempt the states' taxing power).

249. See *supra* notes 201–07 and accompanying text (explaining the benefits of laboratory federalism and the restraints that proponents of interstate competition argue prevent politicians from subverting the government's proper role to benefit themselves).

250. Charles E. McLure, Jr., *The Difficulty of Getting Serious About State Corporate Tax Reform*, 67 WASH. & LEE L. REV. 327, 329–30 (2010) [hereinafter McLure, *The Difficulty*].

251. *Id.* at 328–30.

for each taxpayer that the states would divide among themselves using a uniform set of rules. Those commonly applied apportionment rules would ensure that all income is exposed to taxation in only one state. Only the tax rates applied to that apportioned tax base would vary among the states. If a state chose not to tax income, it could set the tax rate to zero. McLure's full-uniformity-except-tax-rates approach is arguably the best alternative to this Article's proposed solution to the tax-assignment problem.²⁵²

The full-uniformity-except-tax-rates approach has a storied history that was well established at least fifty years ago when the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary issued *State Taxation of Interstate Commerce* (the "Willis Report").²⁵³ The Willis Report recommended a number of substantive and procedural changes that "essentially eliminated diversity in state corporate income taxes, except with regard to rates."²⁵⁴ That general approach was also championed by Daniel Shaviro, a prominent tax-law scholar, in 1992.²⁵⁵ More recently, McLure has discussed its merits on numerous occasions.²⁵⁶ Proponents of the full-uniformity-except-tax-rates approach assert that extending uniformity to tax rates goes too far because the costs of doing so purportedly outweigh the accompanying benefits.²⁵⁷

As with Ryan's two-pronged proposal, the main benefits achieved by leaving states in control of tax rates are a reduced likelihood of successful constitutional challenge and the benefits derived from interstate governmental competition. Regarding the former, the main constitutional concern with a federally imposed uniform tax system is that it would be equivalent to destroying the states' sovereignty by denying them revenue-raising autonomy.²⁵⁸ Permitting the states to retain control over tax rates empowers them to select which types of

252. McLure did not select a particular method for attaining his ideal system. Instead, he noted that either multilateral action from the states or federal action would work, but that neither was likely to happen any time soon. *Id.* at 335–39.

253. H.R. REP. NO. 89–952 (1965).

254. McLure, *The Difficulty*, *supra* note 250, at 336.

255. Shaviro, *supra* note 50, at 897.

256. McLure, *Tax Assignment*, *supra* note 175, at 627–28; McLure, *The Difficulty*, *supra* note 250, at 328; McLure, *The Nuttiness*, *supra* note 41, at 843.

257. *See* McLure, *The Nuttiness*, *supra* note 41, at 843 ("There is generally no persuasive case for requiring uniformity of tax rates, which eliminates subnational fiscal autonomy, as well as any possibility of tax competition, without much affecting complexity."); *see also* Shaviro, *supra* note 50, at 897, 985 ("In addition to being relatively unnecessary, constraining tax rate variations plainly would move closer to the point where the costs of increased uniformity begin to exceed the benefits.").

258. *See supra* notes 107–16 and accompanying text (discussing the federalism-based constitutional argument against Congress possessing the ability to completely preempt the states' taxing power).

taxes to use in their pursuit of revenue and how much to use them.²⁵⁹ As Shaviro noted when analyzing whether the Constitution permits Congress to adopt the full-uniformity-except-tax-rates approach, “[a]s a practical matter . . . there may be outside limits . . . on how far Congress can go in the state and local tax area” but that “addressing coordination problems between states’ tax systems and conforming tax bases to reduce burdens on interstate commerce . . . should be well within any such limits.”²⁶⁰ Put differently, state control over tax rates should effectively eliminate any concern that the federal government’s imposition of an otherwise uniform tax system upon the states violates the federalism structure built into the Constitution. For that reason, the full-uniformity-except-tax-rates approach should be preferred over the proposal in this Article if the Supreme Court rejects the constitutional viability analysis in section II.C. Of course, constitutional arguments in favor of leaving control of tax rates with the states lose their force if the Supreme Court holds that the Commerce and Supremacy Clauses elevate Congress’s responsibility for regulating the national economy above the states’ ability to raise revenue using one or more specific taxes.

The second argument for leaving states in control of setting tax rates is that the resulting interstate governmental competition improves government. In McLure’s words, “[c]ompetition in the supply of public services and in taxation disciplines politicians and bureaucrats to be efficient and to provide the services citizens want.”²⁶¹ These two competition benefits—restraint on politicians’ tendencies to build a Leviathan-sized government that serves them instead of their constituents and improved alignment between government’s activities and its residents’ preferences—were discussed in detail in subsection III.B.2.²⁶² As noted there, and in subsection III.B.3, there are good reasons to question whether either benefit is really significant in light of the difficulty residents have in accurately assessing whether the mix of taxes and governmental benefits offered by competing states and the hurdles they face changing state governments in the event that a competitor is deemed to be better. Limiting interstate governmental competition to one area—tax rates—does simplify the residents’ assessment task by focusing it on one salient set of numbers

259. As noted earlier, a state can choose not to use a particular type of tax (e.g., the corporate income tax) by setting the relevant tax rate to zero.

260. Shaviro, *supra* note 50, at 988.

261. McLure, *Tax Assignment*, *supra* note 175, at 627; *see also* McLure, *The Nuttiness*, *supra* note 41, at 843 (“Tax competition among states can be beneficial, by protecting taxpayers from the tendency of politicians to levy taxes that exceed benefits provided to taxpayers.”).

262. *See supra* notes 206–17 and accompanying text (raising and refuting the main alleged benefits of interstate governmental competition).

that are readily comparable among the states.²⁶³ However, to compare state taxation systems residents will still need to translate those tax rates into tax payments using the various tax bases employed by the competing states (e.g., property values for property taxes and total annual purchases for sales taxes). The relative size of the various tax bases for each resident will determine which tax-rate comparisons are most important for that resident. Thus, the actual comparisons, while simplified, will still be more than many residents can handle. Many will fall prey to WYSIATI by focusing exclusively on the tax rates themselves, without regard to the relative weights each should be given,²⁶⁴ or to question substitution that allows them to avoid the difficult target comparison.²⁶⁵ In addition, the endowment effect will distort their decisions in favor of the status quo, which should weaken the competition's ability to impact government.²⁶⁶ In the end, narrowing the scope of interstate governmental competition to tax rates mitigates, but does not eliminate, the reasons why intergovernmental competition among the states is not likely to yield the hoped-for optimized combination of taxes and governmental benefits or to restrain the creation of a Leviathan-sized government.

Interstate governmental competition using tax rates has its downsides, too. Most importantly, states can continue using tax incentives to compete for mobile economic development opportunities. As a result, the full-uniformity-except-tax-rates approach preserves some of the economically inefficient behavioral distortions present in the current system. Multistate businesses that contort themselves in pursuit of those state tax savings will continue to experience transactional-complexity costs. Furthermore, the varying taxes and tax rates may lead to horizontal- and vertical-equity violations when multistate businesses face differing state tax landscapes. Thus, limiting state control over taxation to setting tax rates eliminates many, but not all,

263. See Shaviro, *supra* note 50, at 985 (“Issues of what type of tax to use—for example, whether to rely on income taxes or sales taxes for revenue—tend to be more visible and salient than the details of particular tax bases . . .”). The tax rate issue is functionally equivalent to deciding which type of tax to use because a state selects a particular tax type for use by setting its tax rate to a nonzero number.

264. See *supra* notes 222–28 and accompanying text (explaining how the “what you see is all there is,” or WYSIATI, assumption spurred by System 1 thinking causes people to make impulsive, intuitive decisions based on limited information).

265. See *supra* notes 229–35 and accompanying text (discussing the System 1 thinking process that causes people to substitute an easier heuristic question for a more complicated target question—often without realizing that the substitution occurred).

266. See *supra* notes 236–39 and accompanying text (describing how our strong aversion to losses creates an endowment effect that places outsized importance on preserving our stuff (e.g., our set of governmental benefits) simply because it is ours).

of the problems present in the current system. Those that remain arguably outweigh the minimal constitutional and competition advantages that the full-uniformity-except-tax-rates approach has over this Article's proposal.

V. CONCLUSIONS

Denizens of Middle Earth rejoiced when the One Ring's power to find, bind, and rule them all perished in the fires of Mount Doom.²⁶⁷ Residents of the United States should not feel the same way about the centralized tax system proposed here as a solution to fiscal federalism's tax-assignment problem. Creating "one tax to rule them all" by consolidating most taxing power at the federal level and replacing most state and local taxes with unconditional intergovernmental transfers that are funded out of the incremental federal-level taxes should preserve the current system's customization benefits derived from decentralized governmental responsibilities while shielding the states' provision of governmental benefits from localized economic ebbs and flows.

More importantly, the proposed centralized tax system would capture significant new uniformity benefits. As the discussion in this Article demonstrates, the proper assignment of taxes among the federal government and the fifty state governments is largely driven by the tradeoff between the benefits of having a uniform tax system and those created by interstate governmental competition in a decentralized system. Increased uniformity should improve the efficiency, cost-effectiveness, and fairness of the overall tax system. Increased interstate governmental competition is believed to promote improved alignment between residents' preferences and the actions of their government.

Unfortunately, the benefits of interstate governmental competition are mostly a mirage because the conditions necessary for them to be realized do not exist. Behavioral economics has demonstrated that the world is not populated by the rational maximizers who would be responsible for turning interstate governmental competition into an optimal mix of taxes and governmental benefits. Instead, real people often make irrational decisions when confronted with complex issues like the assessment of taxes and governmental benefits. Their decision-making is limited by cognitive errors like (1) assuming that "what you see is all there is;" (2) substituting a related, but simpler, question in place of the target question; and (3) overvaluing the status quo provided by their current state because it is part of their endowment. This more nuanced understanding of how people make decisions sig-

267. TOLKIEN, *supra* note 1, at 925–26, 931–33.

nificantly weakens, or even eliminates, interstate governmental competition's benefits.

In the end, solving fiscal federalism's tax-assignment problem requires recognizing that the uniformity benefits achieved by this Article's proposed solution are real and significant. They should not be sacrificed to preserve decentralization's largely illusory competition benefits. Although it may be politically untenable at this time, the United States should move toward a fiscal system built upon centralized taxation carried out by the federal government.