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LEAVE IT TO THE FEDS—ELIMINATE THE STATE AND LOCAL  
INCOME TAX: PROPOSING A MOVE TOWARD A SINGLE-LAYER  
INCOME TAX SYSTEM

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*Shriram T. Eachambadi\**

I. INTRODUCTION

Unlike many other federalist democracies, the United States has a dual or triple-level taxation system—one each at the local, state, and federal government level. Specifically, in comparison to other former British colonies, the United States remains the only nation to have a state and/or local level income tax together with separate filing requirements. Australia and India, both of which represent large federalist systems and whose laws are also largely founded on the law of England, do not have state and/or local income tax, while Canada, with the exception of Quebec, has one authority collecting and administering income taxes.<sup>1</sup>

The Australian federal government, the sole collector of income tax in the country, distributes this income tax revenue to the states through funding grants.<sup>2</sup> However, much like the United States, the Australian states used to levy income taxes on their own before 1942.<sup>3</sup> The Canadian federal government is similarly the sole collector of income tax in Canada, with the exception of Quebec. However, unlike Australia, the Canadian federal

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<sup>1</sup> *In India, Taxes Are Divided into Six Groups*, YOUR ARTICLE LIBRARY, <http://www.yourarticlelibrary.com/tax/in-india-taxes-are-divided-into-the-following-six-groups/23401> [https://perma.cc/7PHQ-QZ3W] [hereinafter *Six Groups*]; *Uniform Tax Case 1942*, PARLIAMENTARY EDUC. OFFICE, <http://www.peo.gov.au/learning/closer-look/governing-australia/uniform-tax-case-1942.html> (last visited May 12, 2018) [hereinafter *Uniform Tax Case*]; *Provincial and Territorial Tax and Credits for Individuals*, CAN. REVENUE AGENCY (Jan. 3, 2018), <http://www.cra-arc.gc.ca/tx/ndvdl/tpcs/nem-tx/rtrn/cmpltng/prvncl/menu-eng.html>.

<sup>2</sup> *Uniform Tax Case*, *supra* note 1.

<sup>3</sup> *Id.*

government is more of a conduit; that is, the provinces still establish the tax rates, but the taxpayers only file one unified set of tax returns with a single entity.<sup>4</sup> The Canadian government then distributes the tax revenue to the provinces through various funding programs. In India, the national constitution empowers only the country's federal government to levy and collect income taxes, except for taxes on agricultural income. However, depending on the type of income, such tax revenue may have to be shared between the federal government and the states in accordance with the directives of the President of India and his/her Finance Commission.<sup>5</sup>

This Note proposes the elimination of the state and local income taxation system in the United States. This Note will first discuss the many complexities, inconveniences, inefficiencies, and unfairness that arise in connection with the state and local income tax. This Note will also discuss, at length, why uniformity agreements between the states are simply insufficient and ineffective in solving these problems. Having exposed such disadvantages associated with that system, this Note then directs attention to the question of why the U.S. income tax system developed the way that it did.

In this context, a brief history of the founding of the United States with a particular focus on state rights and federalism will be explored. The histories of the founding of Canada, India, and Australia, again with a particular focus on federalism and state/provincial rights, will also be discussed. This Note will then discuss Canada's single collecting authority system, followed by the single-layer income tax system prevalent in India and Australia. This Note then proposes an alternative, federal-only income tax system for the United States based on a hybrid model of the Australian and Indian systems where the goal is to remove the states from the income tax arena as a whole without significantly affecting their sovereignty. Such a system envisions the abolition of compliance, administrative, and income taxing powers at the state level.

This Note will then close with a discussion of the implementation of such a system including an incentive-based system, or at least an indirect manner of state regulation or power-grab, and analyze how to address the

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<sup>4</sup> CAN. DEP'T OF FIN., FEDERAL ADMINISTRATION OF PROVINCIAL TAXES: NEW DIRECTIONS 14-15 (2000) [hereinafter NEW DIRECTIONS].

<sup>5</sup> *Six Groups*, *supra* note 1.

potential challenges to congressional legislation giving the federal government virtually exclusive power to levy and collect income taxes. In this context, the relevance of the Spending Clause and Commerce Clause of the U.S. Constitution will be explored.

## II. STATE AND LOCAL INCOME TAX IN THE UNITED STATES TODAY

The current state and local income tax system in the United States is extremely complex. To begin with, the sheer number of jurisdictions that impose state or local income taxes, each with unique rules and applications, make perfect tax compliance a practical impossibility. Of the fifty states, approximately forty-three impose some form of income tax.<sup>6</sup> This is not including the District of Columbia and local government units such as counties, municipalities, and townships.<sup>7</sup> Consequently, problems inevitably arise because of the mechanism by which states tax income.

### A. Income Taxation of Individuals

States generally tax individuals based upon the residence of that individual and the source of the income.<sup>8</sup> Thus, a state can tax all of the income earned by its residents while additionally taxing the income of nonresidents to the extent that such income is derived from sources within that state.<sup>9</sup> The end result being that an individual's income can be subject to taxation in multiple states; that is, if the individual earns income in a state in which he or she does not reside.<sup>10</sup>

Granted, home states grant tax credits to their respective residents for taxes paid in another state, and some states grant tax credits to nonresidents

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<sup>6</sup> *How Do State and Local Individual Income Taxes Work?*, TAX POLICY CTR., <http://www.taxpolicycenter.org/briefing-book/how-do-state-and-local-individual-income-taxes-work> [<https://perma.cc/DJ3A-A7L4>] [hereinafter *State and Local Individual Income Taxes*].

<sup>7</sup> *Id.*

<sup>8</sup> JEROME HELLERSTEIN & WALTER HELLERSTEIN, *STATE TAXATION* ¶¶ 20.04–.05 (3d ed. 1999).

<sup>9</sup> *Id.*

<sup>10</sup> Kathryn L. Moore, *State and Local Taxation: When Will Congress Intervene?*, 23 J. LEGIS. 171, 173 (1997).

for taxes paid in an individual's home state.<sup>11</sup> But, that only works if there is a reciprocal arrangement between the two concerned states, and states do not necessarily apply identical rules.<sup>12</sup> Furthermore, credits only go so far, and they do nothing to alleviate the problem of multiple-state-filing requirements. Indeed, to avail themselves of the benefit of tax credits, one must first file that state's return. This, in turn, translates into unnecessary and burdensome compliance costs. These problems are especially visible in situations involving professional athletes such as NBA, NFL, or professional tennis players. However, ordinary individuals who commute to a neighboring state for work will also be affected, as they will at the very least face multiple filing requirements.

### *B. Income Taxation of Corporations*

Issues in corporate income tax arise primarily because of two factors concerning the differences in state practices. First, some states tax each corporate entity within a group separately and independently while others permit them to be taxed as one consolidated unit.<sup>13</sup> However, even among the states that do permit taxation as a consolidated unit or a "unitary business," there is neither a uniform formula between the states by which they can be consolidated nor a uniform definition among the states of what exactly a consolidated unit or unitary business is.<sup>14</sup>

Second, states use different rules and formulas for allocating corporate income between the states.<sup>15</sup> The two primary methods of allocation used by the states are formula apportionment and specific accounting. With specific accounting, states attempt to trace income such as rent from real and tangible personal property to sources within the state. Under formula apportionment, the portion of corporate income that cannot be traced separately to in-state or out-of-state sources is apportioned on the basis of a ratio comparing the

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<sup>11</sup> HELLERSTEIN & HELLERSTEIN, *supra* note 8, ¶ 20.10.

<sup>12</sup> Moore, *supra* note 10, at 174.

<sup>13</sup> *Id.* at 175.

<sup>14</sup> See HELLERSTEIN & HELLERSTEIN, *supra* note 8, ¶ 8.09.

<sup>15</sup> Ketrina G. Bakewell, Note, *State Taxation of Corporate Income: Formulary Apportionment of Income Earned in Interstate Commerce*, 48 MO. L. REV. 719, 742-43 (1983); see also HELLERSTEIN & HELLERSTEIN, *supra* note 8, ¶ 9.01.

taxpayer's economic activity within the taxing state to its economic activity outside of the state. Specific accounting is generally used in limited circumstances such as rents, royalties, and income not associated with a corporation's total business operations.<sup>16</sup> Although the formula apportionment method is generally common among the states, definitions of what does, or does not, constitute business income and how the apportionment formula is devised widely vary among the states, and this ultimately influences the state's imposition of the tax on income.<sup>17</sup>

### C. The Piggy-Backing Conundrum

Most, if not all, states use the federal system as a foundation upon which they impose numerous confusing additions, subtractions, or other adjustments. In other words, states do not start from scratch. They follow the federal income tax system with respect to many line items of income and deductions, but they deviate in some important respects through adjustments.<sup>18</sup> This is especially true of the corporate income tax.<sup>19</sup> Indeed, every state that imposes the corporate income tax today, with the exception of Arkansas, uses the federal income tax as a starting point upon which they make specific adjustments.<sup>20</sup> Even Arkansas predominantly conforms to federal definitions of gross income, net income, and certain expense and revenue items; and it additionally incorporates specific provisions of the Internal Revenue Code (Code).<sup>21</sup>

An example of these adjustments would be municipal bonds. Interest income from municipal bonds, which is exempt from the federal income tax, is added back at the state level in many states. A converse of this would be interest income from U.S. Treasury obligations. These are taxable at the federal level, but not so at the state level in many states. These types of

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<sup>16</sup> See Moore, *supra* note 10, at 175; see also Bakewell, *supra* note 15, at 721.

<sup>17</sup> See Moore, *supra* note 10, at 176; see also HELLERSTEIN & HELLERSTEIN, *supra* note 8, ¶ 9.01.

<sup>18</sup> See Mike Porter et al., *State Conformity to Federal Provisions: Exploring the Variances*, 85 STATE TAX NOTES 145, 146 (July 10, 2017).

<sup>19</sup> HELLERSTEIN & HELLERSTEIN, *supra* note 8, ¶ 7.02.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

adjustments primarily relate to the differing scope of the federal and state taxing powers.<sup>22</sup>

There are other adjustments, however, which have less to do with the taxing powers and more to do with the fiscal and economic policies of the states, which oftentimes sharply differ from those of the federal government.<sup>23</sup> Examples of these would be net operating losses, depletion and depreciation deductions, tax incentives such as deductions for qualified research and development expenses or targeted job expenditures provided by states for businesses to locate in that state, and so on.<sup>24</sup>

To explore these types of adjustments further, consider Code § 179. While Pennsylvania recognizes § 179 deductions, the state deduction is limited to a maximum of \$25,000 with a phaseout starting at \$200,000 in 2016;<sup>25</sup> in contrast, the federal limitation is \$500,000 and the phaseout starts at \$2,010,000 for the same year.<sup>26</sup> Similarly, consider Code § 1031 like-kind exchanges. Unlike the federal government, Pennsylvania requires that gain on these transactions be recognized for tax purposes.<sup>27</sup> This not only creates a divergence in terms of immediate income tax consequences as it relates to the gain on the like-kind exchange, but it also impacts later income tax consequences. This is because recognition of gain for state purposes but not for federal purposes would mean that the depreciable bases for state and federal purposes also differ, which in turn creates differing depreciation deductions and other income tax consequences for state and federal purposes in future years.<sup>28</sup>

It does not stop there. California, for instance, disallows “any amount otherwise allowable as a deduction which is allocable to one or more classes

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<sup>22</sup> See *id.* ¶ 7.03.

<sup>23</sup> See *id.*

<sup>24</sup> *Id.*

<sup>25</sup> Pa. Dep’t of Revenue, *Pass-Through Business Office Clarifies Key Areas Where Pennsylvania Law Differs from Federal Tax Rules*, PA. TAX UPDATE, Aug.–Sept. 2015, at 1.

<sup>26</sup> I.R.S. Pub. No. 946, *How to Depreciate Property 2* (2017).

<sup>27</sup> See Pa. Dep’t of Revenue, *supra* note 25, at 2.

<sup>28</sup> See *id.*

of income not included in the measure of the [income] tax.”<sup>29</sup> New York goes a step further in connection with investment income-related deductions by disallowing, “in the *discretion of the commissioner*, any interest deductions allowable in computing entire net income.”<sup>30</sup> The daunting complexity surrounding taxpayers who conduct business in different states was also especially visible with the bonus depreciation incentives introduced at the federal level by the Bush administration.<sup>31</sup> Sixteen states permitted bonus depreciation, 25 did not, and four spread it over five or more years.<sup>32</sup>

There are yet other adjustments that have little to do with taxing powers or economic policies but are more focused on social goals.<sup>33</sup> Examples of these would be deductions granted as state incentives for investments in energy conservation, recycling or other environmentally friendly projects, modification of structures for the disabled or elderly, low-income housing development projects, shelters for the homeless, and so on.<sup>34</sup>

All of these result in additional adjustments or modifications to the federal income tax base. Many of these adjustments can be viewed as somewhat needless, or at the very least, can simply be implemented at the federal level alone rather than having the state governments impose differing adjustments or modifications. There is no real important economic consideration behind state recognition of gain on like-kind exchanges, imposition of differing depreciation methods, or differing § 179 thresholds. And, while the logic of disallowing deductions allocable to nontaxable income discussed above makes logical and economic sense, there is neither logic nor sound economic reasoning behind imposing these disallowances in widely varying manners across state lines.<sup>35</sup> These adjustments to the tax base can be eliminated, or at least modified, to make them more consistent across state lines.

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<sup>29</sup> CAL. REV. & TAX. CODE § 24425(a) (West 2004).

<sup>30</sup> N.Y. TAX LAW § 208(6)(a)(i) (McKinney 2017) (emphasis added).

<sup>31</sup> See HELLERSTEIN & HELLERSTEIN, *supra* note 8, ¶ 7.02(1)(a).

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* ¶ 7.03.

<sup>34</sup> *Id.*

<sup>35</sup> See *id.* ¶ 7.11.

Likewise, energy conservation, recycling or other environmental initiatives, and social projects can be directly implemented from the federal level. Congress is most certainly capable of passing legislation providing tax incentives for such projects on a nationwide basis, thus eliminating the need to provide them or adjust them at the state level. States can simply stay out of this arena. Of course, there is always the possibility that federal legislators and state legislators may not necessarily agree on the importance of a specific social or economic goal. However, there is nothing that restricts Congress from passing legislation in such a manner as to provide tax incentives based on state priorities. In other words, so long as a state considers certain projects or activities as deserving of tax incentives, federal legislation can provide such incentives by incorporating those state considerations.

How does this benefit a taxpayer? The taxpayer would file one tax return based on one formula, only looking to some state-specific qualitative factors. At the very least, the taxpayer saves numerous compliance costs by filing one return and by dealing with one tax authority. With respect to this last aspect, the Canadian system is very relevant. The provincial governments still have some taxing powers but, with the exception of Quebec, the taxpayers manage their affairs with only one tax authority—the Canada Revenue Agency.

But we need not stop there. We can take it a step further by eliminating needless adjustments or modifications. This is neither an entirely novel idea nor is it impossible to accomplish. A few states have already accomplished substantial conformity of their corporate income taxes to the federal tax base, with Hawaii being the most prominent example of such a state.<sup>36</sup>

#### *D. The Post-Quill Era*

A large part of the argument against state and local taxes (“SALT”) in general, whether it is the income tax or any other tax such as the sales and use tax or the franchise tax, is based upon two clauses of the U.S. Constitution: the Commerce Clause and the Fourteenth Amendment’s Due Process Clause.<sup>37</sup> Both clauses deal with the idea of the entity’s “nexus” to a jurisdiction. The term “nexus” means different things under each of the two

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<sup>36</sup> See *id.* ¶ 7.02.

<sup>37</sup> U.S. CONST. art. I, § 8, cl. 3; *id.* amend. XIV.

clauses, and thereby leads to differing treatment. *Quill Corp. v. North Dakota*<sup>38</sup> is the landmark U.S. Supreme Court decision that bifurcated its analysis and clarified this distinction concerning the meaning of the term *nexus* under the two clauses.

*Quill* explained that while the term *nexus* in the Due Process Clause focuses on concerns of fairness or notice to the individual, the same term in the Commerce Clause focuses not so much on fairness concerns, but on the impact of state regulations on the national economy.<sup>39</sup> Against that backdrop, *Quill* held that physical presence is not required to obtain jurisdiction over an entity or individual under the Due Process Clause, but the same is required for jurisdiction under the Commerce Clause.<sup>40</sup> Thus, *Quill*'s holding can perhaps be summarized by its statement that "a corporation may have the 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce Clause."<sup>41</sup>

*Quill* dealt with the sales and use tax of North Dakota and never discussed the income tax. To date, the Supreme Court has not indicated whether it would extend the *Quill* decision to cover the income or franchise tax. Not surprisingly, state courts have taken advantage of this lack of action on the part of the Supreme Court to limit the *Quill* holding to the sales and use tax context only.<sup>42</sup> These limitations were so out of line with the *Quill* holding that it prompted Justice Benjamin of the Supreme Court of West Virginia to write a scathing dissent in *Tax Commissioner v. MBNA America Bank* stating that there were absolutely no significant differences between the sales and use tax and the income or franchise tax, that no legal precedent justified different treatment under the Commerce Clause, and that the *MBNA*

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<sup>38</sup> 504 U.S. 298, 313 (1992).

<sup>39</sup> *Id.*

<sup>40</sup> *See id.* at 309–17.

<sup>41</sup> *Id.* at 313.

<sup>42</sup> *See generally* Tax Comm'r v. MBNA Am. Bank, 640 S.E.2d 226 (W. Va. 2006); Geoffrey, Inc. v. S.C. Tax Comm'n, 437 S.E.2d 13 (S.C. 1993).

majority opinion is directly contradictory to the Supreme Court's *Bellas Hess* holding that *Quill* reaffirmed.<sup>43</sup>

Thus, while *Quill* eliminated the burden associated with being subject to the tax of a jurisdiction where an entity has no physical presence, these subsequent attempts at narrowing the *Quill* holding have served to increase the burden on entities at least from an income tax standpoint. It is important to note that while *Quill* spoke of Commerce Clause concerns over the national economy, it failed to account for the impact of globalization and massive geographic expansions of large corporations, which weaken the physical presence test.<sup>44</sup> Many entities now operate brick and mortar operations in multiple states, and some entities operate in all states and worldwide, notwithstanding the increasing prevalence of online shopping and e-commerce. This is especially true of the service industry. If physical presence is the sole determinative factor, entities with brick and mortar operations in multiple states will fail this test, and have the state taxes imposed upon them. In turn, the national economy would indeed be hurt.

Additionally, the requirement of physical presence for the imposition of sales and use tax has also resulted in significant loss of revenue to states looking to tax entities that primarily or solely conduct their operations online or through e-commerce. So much so, that many states have passed so-called "kill-*Quill*" laws that are being challenged.<sup>45</sup> Indeed, the U.S. Supreme Court heard oral arguments in April 2018 on overturning *Quill* and striking down the physical presence requirement in the Commerce Clause analysis of state income taxes.<sup>46</sup> Such a decision would certainly be considered a blow to the uniform tax law movement.<sup>47</sup>

In any event, the very fact that these adverse tax laws are being challenged is sufficient evidence that corporations and other entities are

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<sup>43</sup> *MBNA Am. Bank*, 640 S.E.2d at 236–41.

<sup>44</sup> *See Quill*, 504 U.S. at 298.

<sup>45</sup> *See* Adam Liptak, *Upholding Internet Sales Tax Law: A Justice Invites a New Case*, N.Y. TIMES (Mar. 3, 2015), <https://www.nytimes.com/2015/03/04/business/supreme-court-backs-trade-groups-challenge-to-internet-sales-tax-law.html>.

<sup>46</sup> *See* *South Dakota v. Wayfair, Inc.*, 901 N.W.2d 754 (S.D. 2017), *cert. granted*, 86 U.S.L.W. 3356 (U.S. Jan. 12, 2018) (No. 17-494).

<sup>47</sup> *See* Greg Stohr, *U.S. Supreme Court to Review Bid to Collect Internet Sales Tax*, BLOOMBERG POLITICS (Jan. 12, 2018), <https://www.bloomberg.com/news/articles/2018-01-12/bid-to-collect-internet-sales-tax-gets-u-s-high-court-review>.

willing to take the initiative and go through the trouble of challenging tax authorities rather than undergo the greater burden of paying double, triple, or quadruple taxes on a regular basis and filing returns with multiple states and localities. For these reasons, it may well be likely that the Supreme Court will not only extend *Quill* to cover the income tax, but also take further steps to protect the national economy; that is, rejecting physical presence as the sole determinative factor in deciding whether to impose taxes.

But, it would be unwise to hope, or wait for, a Supreme Court decision in favor of national economic interests. Congressional intervention calling for a comprehensive nationwide tax reform is needed. Congress must speak out, in loud and clear terms, that the federal government will have exclusive jurisdiction over matters concerning the income tax.

#### *E. The Origins of the Dual-Layer Income Tax System*

The preceding section might make one wonder why the income tax system developed the way it did in the United States in comparison to the United Kingdom, or many of the other European nations where only one layer of income tax is imposed. One might think that the answer flows from something as simple as the geopolitical size of the respective nations. But a simple look back into the history of the nation's founding would reveal that this was more a consequence of the struggle between states' rights and the desire for a stronger federal government. In fact, nearly a century would go by with no federal system of taxing income.<sup>48</sup>

After the Revolutionary War ended in 1781, there were mixed feelings among the people concerning the vision for the new nation.<sup>49</sup> On the one hand, some wanted a strong nation powerful enough to withstand foreign attacks or any reprisals from Great Britain.<sup>50</sup> On the other hand, some were not comfortable with the idea of creating a strong centralized national government because of fears that it would result in the very tyranny that they

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<sup>48</sup> See JEROLD L. WALTMAN, POLITICAL ORIGINS OF THE U.S. INCOME TAX 3 (1985).

<sup>49</sup> See Robert Middlekauff, *Articles of Confederation*, in THE READER'S COMPANION TO AMERICAN HISTORY 53–54 (Eric Foner & John A. Garraty eds., 1991).

<sup>50</sup> *Id.*

had fought against.<sup>51</sup> Fueled by such fears, the Articles of Confederation (the “Articles”) called for a weak union of politically independent states.<sup>52</sup>

The Articles backed a loosely organized federal government with no extensive powers at the federal or national level.<sup>53</sup> Furthermore, the Articles vested executive authority in a congressional committee as opposed to a single individual.<sup>54</sup> Consequently, the federal government lacked the power to regulate trade and commerce, whether domestic or foreign, or to levy taxes. It simultaneously faced significant restrictions on its powers to impose tariffs, control foreign affairs, or authorize the design and issuance of a uniform currency.<sup>55</sup> This virtual absence of a central authority created an absurd situation wherein the national government lacked the power to raise and support an army of its own, and foreign countries conducted their affairs with the various states, in their respective individual capacities, and lost confidence in federal treaties.<sup>56</sup>

As the weaknesses of the Articles became apparent, two groups of individuals found themselves at opposite ends of a spectrum, and they both had very different visions concerning the fate of the new nation.<sup>57</sup> One group, called the Federalists, advocated a strong national federal government while

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<sup>51</sup> See MERRILL JENSEN, *THE ARTICLES OF CONFEDERATION: AN INTERPRETATION OF THE SOCIAL CONSTITUTIONAL HISTORY OF THE AMERICAN REVOLUTION 1774–1781*, at 16 (1940).

<sup>52</sup> *Articles of Confederation, 1777–1781*, U.S. DEP’T OF STATE: OFFICE OF THE HISTORIAN, <https://history.state.gov/milestones/1776-1783/articles> (last visited Sept. 4, 2017); *History Now: The Articles of Confederation, 1777*, GILDER LEHRMAN INST. OF AM. HISTORY, <https://www.gilderlehrman.org/history-by-era/war-for-independence/resources/articles-confederation-1777> (last visited Dec. 31, 2017).

<sup>53</sup> *Primary Documents in American History: The Articles of Confederation*, LIBR. OF CONG. (Apr. 25, 2017), <https://www.loc.gov/rr/program/bib/ourdocs/articles.html>.

<sup>54</sup> Saikrishna B. Prakash & Christopher H. Schroeder, *Common Interpretation: The Vesting Clause*, NAT’L CONSTITUTION CTR., <https://constitutioncenter.org/interactive-constitution/articles/article-ii/the-vesting-clause-common-interpretation/clause/35> (last visited Dec. 31, 2017).

<sup>55</sup> Middlekauff, *supra* note 49, at 54–55.

<sup>56</sup> See GORDON S. WOOD, *THE CONFEDERATION AND THE CONSTITUTION: THE CRITICAL ISSUES* 3–8 (1973); DANIEL A. FARBER & SUZANNA SHERRY, *A HISTORY OF THE AMERICAN CONSTITUTION* 23–25 (1990).

<sup>57</sup> See WILSON CAREY MCWILLIAMS & MICHAEL T. GIBBONS, *THE FEDERALISTS, THE ANTIFEDERALISTS, AND THE AMERICAN POLITICAL TRADITION* 1–12 (1992).

the other, who may be termed the Anti-Federalists, wanted the opposite result.<sup>58</sup>

And, this is only part of the story. Another significant issue during the Revolutionary War revolved around the question of whether the British Parliament had the right to impose taxes on the colonies when they were not represented in Parliament.<sup>59</sup> This experience with a system of taxation without representation, together with Anti-Federalist sentiment over giving the new national government more powers, resulted in the virtual absence of both a national-level income tax and a state-level income tax.<sup>60</sup>

Highlighting the limitations of the loosely organized, weak federal government (and, consequently, of the Articles), the Federalists made a push for a strong federal government backed by a newly drafted constitution.<sup>61</sup> Alexander Hamilton and James Madison, two of the leading Federalists at the time, were among the strongest backers of the U.S. Constitution.<sup>62</sup> Hamilton was particularly critical about what he termed “Anti-Federalist alarmism” and expressed his frustration over the federal government being

held up to the people in all the exaggerated colors of misrepresentation as the pernicious engines by which their local governments were to be destroyed and their liberties exterminated; as the hideous monster whose devouring jaws would spare neither sex nor age, nor high nor low, nor sacred nor profane . . . .<sup>63</sup>

Hamilton also used the drafting of the new constitution as the perfect opportunity to push for taxing powers at the federal government level. Indeed, he devoted a large portion of his discussion in the *Federalist Papers* to argue that Congress *must* be empowered to legislate in the area of

<sup>58</sup> *History Now: Differences Between Federalists and Antifederalists*, GILDER LEHRMAN INST. OF AM. HISTORY, <https://www.gilderlehrman.org/history-by-era/creating-new-government/resources/differences-between-federalists-and-antifederalists> (last visited Dec. 31, 2017) [hereinafter *Differences*].

<sup>59</sup> *Magna Carta: Muse and Mentor*, LIBR. OF CONG., <https://www.loc.gov/exhibits/magna-carta-muse-and-mentor/no-taxation-without-representation.html> (last visited Sept. 17, 2017).

<sup>60</sup> Sheldon D. Pollack, *The First National Income Tax, 1861–1872*, 67 TAX LAW. 311, 312 (2014); *Resource Center: State and Local Taxes*, U.S. DEP’T OF TREASURY, <https://www.treasury.gov/resource-center/faqs/Taxes/Pages/state-local.aspx> (last updated Dec. 5, 2010).

<sup>61</sup> *Differences*, *supra* note 58.

<sup>62</sup> See THE FEDERALIST NO. 11 (Alexander Hamilton).

<sup>63</sup> THE FEDERALIST NO. 33, at 223 (Alexander Hamilton) (Isaac Kramnick ed., 1987).

taxation.<sup>64</sup> Hamilton allayed fears concerning complete federal control over the system of taxation by pointing out that states were not precluded from imposing their own taxes. Hamilton stated that this concurrent jurisdiction over taxation would alleviate fears concerning total federal government dominance.<sup>65</sup>

Hamilton's views regarding concurrent federal and state tax jurisdiction could arguably be seen as a compromise empowering the federal government to impose taxes while at the same time preserving states' rights to tax. Consequently, the Constitution itself contains restrictions on the federal government's ability to impose taxes; for example, the clause providing that "[n]o Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or enumeration herein before directed to be taken."<sup>66</sup>

In any event, as noted earlier, nearly a century would go by without a federal income tax, and very few, if any, states imposed a tax on income.<sup>67</sup> The outbreak of the Civil War led to the enactment of legislation in 1861 that created the first-ever federal income tax.<sup>68</sup> The legislation—enacted to raise revenue for the Union's war efforts—was short-lived,<sup>69</sup> but the war itself highlighted the continuing struggle over states' rights. After all, the Confederate states were fighting to preserve their rights to continue the system of slavery, with the seceding Southern states forming a new, loose union with a weak federal government as envisioned in the Articles.<sup>70</sup>

This brief review of U.S. history reveals why the dual-layer income tax system originated in the United States. The answer lies in states' rights, including the right to tax income. Taking away that right is no easy task given this history. This history, in conjunction with the histories of the founding of

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<sup>64</sup> THE FEDERALIST NOS. 30–36 (Alexander Hamilton).

<sup>65</sup> See FEDERALIST NO. 33, *supra* note 63, at 226.

<sup>66</sup> U.S. CONST. art. I, § 9, cl. 4.

<sup>67</sup> See Pollack, *supra* note 60.

<sup>68</sup> *History of the US Income Tax*, LIBR. OF CONG. (Feb. 27, 2018), [https://www.loc.gov/rr/business/hottopic/irs\\_history.html](https://www.loc.gov/rr/business/hottopic/irs_history.html).

<sup>69</sup> CHRISTOPHER SHEPARD, THE CIVIL WAR INCOME TAX AND THE REPUBLICAN PARTY 1861–1872, at 96 (2010); Pollack, *supra* note 60, at 330.

<sup>70</sup> See WILFRED BUCK YEARNES, THE CONFEDERATE CONGRESS 24–27 (1960); see also ANNE SARAH RUBIN, A SHATTERED NATION: THE RISE AND FALL OF THE CONFEDERACY, 1861–1868, at 1–2, 11 (2005).

Canada, India, and Australia recounted in the following sections help explain why these countries, despite also being large, federalist nations that inherited their legal system from the British Empire, have only a single-layer income tax system; or at least in the case of Canada, a single collecting authority.

### III. INCOME TAXATION IN CANADA, INDIA, AND AUSTRALIA

The idea of the single, national-level income tax should not be very shocking to the senses. This is not an alien concept, although it may seem like one to a layperson or one who is not well-versed in the international tax arena. Federalist countries impose a single-layer national income tax, and at least three of these countries, much like the United States, are former colonies of Great Britain. Canada, India, and Australia, like the United States, inherited the taxation and legal systems of the British Empire, which they then modified to suit their own particular needs.

#### A. *Income Tax in Canada*

##### 1. Origins of the Single Income Tax Administrative System

To understand why Canada largely enjoys a single income tax administrative system, a look back to some segments of Canada's history and political structure will be useful. Canada has a federalist system of government, similar to that of the United States. Powers are shared between three branches of government at the federal level: the executive branch, the legislature, and the judiciary.<sup>71</sup> However, unlike the United States, Canada is not a republic. Rather, Canada is a constitutional monarchy with the queen or king of England as its executive head, albeit only in a ceremonial capacity.<sup>72</sup> The governor general and the prime minister primarily carry out executive functions.<sup>73</sup> The legislative branch is the Parliament, composed of

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<sup>71</sup> PARLIAMENT OF CAN., OUR COUNTRY, OUR PARLIAMENT 14 (2009), <https://lop.parl.ca/About/Parliament/Education/OurCountryOurParliament/pdfs/Booklet-e.pdf>.

<sup>72</sup> See *Canada's Constitutional Monarchy*, CBC NEWS (June 25, 2010, 1:03 PM), <http://www.cbc.ca/news/canada/canada-s-constitutional-monarchy-1.911958>.

<sup>73</sup> See *Role and Responsibilities: Constitutional Duties*, THE GOVERNOR GEN. OF CAN., <https://www.gg.ca/events.aspx?sc=1&lan=eng> (last visited Sep. 24, 2017); see also *Government: The Prime*

the House of Commons and the Senate. The House of Commons is the lower house, similar to the U.S. House of Representatives, while the Senate is the upper house, similar to the U.S. Senate.<sup>74</sup> Canada's judiciary is functionally similar to that of the United States, although there are significant differences in structure and mode of judicial appointment.<sup>75</sup>

Unlike the United States, Canada has largely maintained its ties to Britain. And while provincial autonomy is broader in Canada in some respects, in comparison to that of the several states in the United States, U.S. state law operates with more independent force than Canadian provincial law does.<sup>76</sup> Furthermore, Canada's Constitution was not drafted with compromises for safeguarding provincial rights, unlike its U.S. counterpart.<sup>77</sup> Also, none of the provinces have their own independent constitution, at least not written ones.<sup>78</sup> Rather, the division of powers between the federal government and the provinces was defined along functional lines.<sup>79</sup>

Under section 91 of Canada's Constitution Act, foreign relations, defense, copyright, patent, citizenship matters, aboriginal affairs, interprovincial commerce, printing of currency, and creation of general courts of appeals and other courts, among others, are federal prerogatives.<sup>80</sup> Exclusive functions of the provinces include management of nonrenewable resources, property rights, civil rights, forestry resources, electric utility

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*Minister of Canada*, CAN. GUIDE, <http://www.thecanadaguide.com/government/the-prime-minister> [<https://perma.cc/W79B-RKT3>].

<sup>74</sup> *How Parliament Works: The Structure of Parliament*, PARLIAMENT CAN., <https://lop.parl.ca/About/Parliament/Publications/index-e.html> (last visited Apr. 21, 2018).

<sup>75</sup> *Canada's System of Justice: About Canada's System of Justice*, GOV'T OF CAN.: DEP'T OF JUSTICE, <http://www.justice.gc.ca/eng/csjsjc/just/07.html> (last modified Oct. 16, 2017).

<sup>76</sup> Martha A. Field, *The Differing Federalisms of Canada and the United States*, 55 LAW & CONTEMP. PROBS. 107, 107–13 (1992).

<sup>77</sup> *Id.* at 119–20.

<sup>78</sup> BRIAN LEE CROWLEY ET AL., NORTHERN LIGHT: LESSONS FOR AMERICA FROM CANADA'S FISCAL FIX 48 (2012) (ebook); F.L. Morton, *Provincial Constitutions in Canada*, CTR. FOR STUDY OF ST. CONSTS. (Apr. 4, 2004), <http://statecon.camden.rutgers.edu/sites/statecon/files/subpapers/morton.pdf>.

<sup>79</sup> See PARLIAMENT OF CAN., *supra* note 71, at 16.

<sup>80</sup> See Constitution Act, 1867, 30 & 31 Vict., c 3, § 91 (U.K.).

management, and education administration.<sup>81</sup> Agriculture, pension administration, immigration, prison administration, and taxation are among the few areas that fall under concurrent jurisdiction.<sup>82</sup> The Constitution Act further contains provisions explaining when federal legislation prevails over provincial legislation, and vice versa. Thus, in the area of pension administration, federal legislation may not displace provincial laws while in the area of immigration and agriculture, provincial legislation may not displace federal laws.<sup>83</sup>

Most importantly, in the area of taxation, the Constitution Act significantly restricts provincial powers over the imposition of taxes. Specifically, section 92(2) and section 92(9) of the Constitution Act restrict the taxation powers of the provinces to “Direct Taxation within the Province in order to the raising of a Revenue for Provincial purposes”<sup>84</sup> and “Shop, Saloon, Tavern, Auctioneer, and other Licences in order to the raising of a Revenue for Provincial, Local, or Municipal purposes.”<sup>85</sup> Thus, the provincial powers are primarily limited to income tax and property tax, as opposed to taxes on trade activities and other indirect taxes.<sup>86</sup>

As observed, the caveat noted above is that the provinces have broad powers over the income tax and other direct taxes. And so, by the end of the Great Depression, all provinces were taxing corporate income, and all but two of the provinces were also taxing personal income.<sup>87</sup> The federal government raised revenues primarily through customs and excise duties,

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<sup>81</sup> See *id.* § 92.

<sup>82</sup> *Canada’s Legal System—Sharing of Legislative Powers in Canada*, U. OF OTTAWA: SITE FOR LANGUAGE MGMT. IN CAN., [https://slmc.uottawa.ca/?q=laws\\_canada\\_legal](https://slmc.uottawa.ca/?q=laws_canada_legal) (last visited Sept. 24, 2017).

<sup>83</sup> Gerald A. Beaudoin, *Distribution of Powers*, THE CANADIAN ENCYCLOPEDIA: GOV’T (Feb. 7, 2006), <http://www.thecanadianencyclopedia.ca/en/article/distribution-of-powers>.

<sup>84</sup> See Constitution Act § 92, cl. 2.

<sup>85</sup> See *id.* § 92, cl. 9.

<sup>86</sup> See CITY SOLICITOR, CITY OF TORONTO, POWERS OF CANADIAN CITIES: THE LEGAL FRAMEWORK § 5 (2000).

<sup>87</sup> George E. Carter, *Taxation in Canada*, THE CANADIAN ENCYCLOPEDIA: ECON. (Jan. 1, 2007), <http://www.thecanadianencyclopedia.ca/en/article/taxation>.

and imposed little or no income tax.<sup>88</sup> However, during the period of World War II, all of the provinces agreed to surrender their powers to tax personal and corporate income to the federal government for the duration of the war, plus one year, so as to enable it to distribute the financial burden of the war more equitably, and to also enable it to more efficiently raise revenue and tackle inflation.<sup>89</sup> In exchange for giving up their power to tax income, the provinces received fixed annual payments in the form of federal grants.<sup>90</sup>

By 1946, more than half of federal revenue came from income taxes.<sup>91</sup> In 1947, the federal government extended its power over the income tax indefinitely, and the provinces reluctantly continued to accept federal grants as opposed to imposing their own direct taxes.<sup>92</sup> However, as mentioned earlier, the Constitution explicitly makes room for provincial powers over the income tax. And so, Quebec and Ontario opted out of this arrangement in 1947 and began to operate their own respective corporate income tax systems.<sup>93</sup> By 1954, Quebec started operating its own independent system for both personal and corporate income taxes.<sup>94</sup> Thanks to a series of federal concessions and tax collection agreements (TCA), in the approximately twenty-year period between 1962 and 1981, all provinces were back in the

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<sup>88</sup> *See id.*

<sup>89</sup> Paul Berg-Dick et al., *Tax Coordination Under the Canadian Tax System*, in *FISCAL FEDERALISM AND POLITICAL DECENTRALIZATION: LESSONS FROM SPAIN, GERMANY AND CANADA* 172–73 (Nuria Bosch & José M. Durán eds., 2008).

<sup>90</sup> *Id.*

<sup>91</sup> *See Carter, supra* note 87.

<sup>92</sup> Claude Bélanger, *Canadian Federalism, the Tax Rental Agreements of the Period of 1941–1962 and Fiscal Federalism from 1962 to 1977*, MARIANOPOLIS COLLEGE: QUEBEC HISTORY, <http://faculty.marianopolis.edu/c.belanger/quebechistory/federal/taxrent.htm> (last updated Feb. 19, 2001) [<https://perma.cc/PQ3H-JYJS>].

<sup>93</sup> GIANLUIGI BIZIOLI & CLAUDIO SACCHETTO, *TAX ASPECTS OF FISCAL FEDERALISM: A COMPARATIVE ANALYSIS* 110 (2011).

<sup>94</sup> Odette Madore, *The Transfer of Tax Points to Provinces Under the Canada Health and Social Transfer*, PARLIAMENT OF CAN. (Oct. 1997), <https://lop.parl.ca/Content/LOP/ResearchPublicationsArchive/bp1000/bp450-e.asp>.

income tax game, although largely under a single administrator: the Canada Revenue Agency (CRA).<sup>95</sup>

This discussion helps explain why it was relatively easy for Canada to develop a single administrative system for filing income tax returns and for collecting federal and provincial income taxes. While there may be some tension between the provincial and federal governments concerning jurisdictional power, the country itself was not formed with provincial rights or autonomy as a central focus.<sup>96</sup> Furthermore, with the exception of Quebec, the provinces have largely cooperated with the federal government in a relatively harmonious manner since the beginning of the Canadian confederation. There was no civil war or strife of the magnitude or significance seen in the United States, despite the heavy influence of both French and British culture in early Canadian history.

And as noted earlier, the division of powers was carefully defined along functional lines in the Constitution Act, and it has largely remained unchallenged to this day. Even where modifications were made, they were done with the mutual consent of the provinces and the federal government, as in the case of the surrendering of the power to tax income during World War II. Thus, it is hardly unimaginable that, excluding Quebec, Canada only has a single administrative system for income tax.<sup>97</sup>

## 2. Canadian Income Tax Today

Canada has a somewhat hybrid system of income tax whereby the various provinces still impose an income tax, but the CRA is entrusted with the authority and responsibility to collect and administer income taxes.<sup>98</sup> This structure was the result of the previously mentioned TCAs between the provinces and the federal government in 1962.<sup>99</sup> Furthermore, there are other restrictions on the provinces with respect to the income tax. For example, the

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<sup>95</sup> MARC LEBLANC, LIBRARY OF PARLIAMENT, TAX COLLECTION AGREEMENTS AND TAX COMPETITION AMONG PROVINCES 2-3 (2004).

<sup>96</sup> See Field, *supra* note 76, at 107-08.

<sup>97</sup> See LEBLANC, *supra* note 95, at 2-3.

<sup>98</sup> NEW DIRECTIONS, *supra* note 4, at 26-27. Prior to December 12, 2003, the Canada Revenue Agency was called the Canada Customs and Revenue Agency.

<sup>99</sup> See *id.* at 1-2.

provinces are required to abide by the federal government's definition of taxable income and may not ignore federal deductions in computing provincial taxable income.<sup>100</sup>

A single unified return is filed with the CRA.<sup>101</sup> Only Quebec collects all income taxes on its own, while Alberta and Ontario only collect corporate income taxes on their own.<sup>102</sup> The provinces still retain constitutional authority to impose income taxes through their own respective and independent systems, but have to withdraw from the TCA to do so.<sup>103</sup> The TCA only requires an individual to pay income tax in a province where he or she was a resident on December 31 of the tax year.<sup>104</sup>

While the CRA has acknowledged that it is possible for an individual to be a resident of more than one province, tax is still owed only to the province where the taxpayer has the most significant residential ties (e.g., location of home, spouse or partner, and family).<sup>105</sup> If this is not determinable, CRA looks to the taxpayer's "most secondary residential ties," such as where the taxpayer has a driver's license, where his or her car is registered, and where the taxpayer has insurance.<sup>106</sup> As for business income, a province imposes tax only on income earned in that province. If income is earned in more than one province, then the income is apportioned based on an apportionment formula prescribed by tax regulations.<sup>107</sup>

A hybrid system such as Canada's, where authority exists for the provinces to tax income, is not the best system to model a federal-only U.S. income tax system on, although efficiencies could still be achieved using a system such as Canada's. After all, a system where one files everything with

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<sup>100</sup> *Id.* at 18–19.

<sup>101</sup> *Id.* at 18.

<sup>102</sup> *Id.* at 14–15.

<sup>103</sup> *See id.*

<sup>104</sup> NEW DIRECTIONS, *supra* note 4, at 14.

<sup>105</sup> Jamie Golombek, *Tax Residence Planning: What You Need to Know*, FIN. POST (Dec. 9, 2010), <http://www.financialpost.com/residence+planning+what+need+know/3953132/story.html>.

<sup>106</sup> *Id.*

<sup>107</sup> NEW DIRECTIONS, *supra* note 4, at 42; *see also Which Province Gets Your Tax?*, GRANT THORTON: TAX PLANNING GUIDE 2016–2017, <http://www.taxplanningguide.ca/tax-planning-guide/section-1-businesses/which-province-gets-tax> [<https://perma.cc/D48Y-N97Q>].

the same agency and handles disputes with that single agency is certainly advantageous. But why allow provinces to withdraw from TCAs? And, why the exceptions for Quebec for all income and Alberta and Ontario for corporate income? Surely, this is not the best model of reference when the objective is to have a single federal income tax. It is a good model, and perhaps better than the current U.S. model, but it does not adequately address the objectives of uniformity and would continue to give too much leeway to the states to withdraw from agreements or set their own income tax rates as they please.

## *B. Income Tax in India*

### 1. Evolution of India's Income Tax and Legal Systems

As in the case of Canada, a brief review of certain segments of India's history, especially since the time of British rule, will be useful. While everyone speaks of India as a single nation since even before British rule, the fact remains that India never was a single nation before the British arrived.<sup>108</sup> Many are shocked to learn that India is a land of 29 different languages. This would be less shocking if one were to realize that there were hundreds of kingdoms in India, each representing a separate and independent nation.<sup>109</sup>

Much like any other kingdom or country in the world, each had its own unique taxation, financial, economic, and military systems. With the arrival of the British, two forms of governmental structures emerged under a larger structure, popularly termed in modern times as the "British Raj."<sup>110</sup> These two governmental structures were called presidencies or provinces (collectively, "provinces") and princely states.<sup>111</sup> To put in simple terms, the

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<sup>108</sup> See RANGANATHAN MAGADI, *India Rises in the West*, in THE LITERARY WORKS OF RANGANATHAN MAGADI 366, 566 (2006); see also WENDY DOBSON, GRAVITY SHIFT: HOW ASIA'S NEW ECONOMIC POWERHOUSES WILL SHAPE THE 21ST CENTURY, at 3–32 (2009).

<sup>109</sup> See *Indian Languages Map*, MAPSOFINDIA.COM, <https://www.mapsofindia.com/culture/indian-languages.html> (last updated Dec. 9, 2016) [https://perma.cc/67RV-2U5G].

<sup>110</sup> Chandrika Kaul, *From Empire to Independence: The British Raj in India 1858–1947*, BBC: HIST., [http://www.bbc.co.uk/history/british/modern/independence1947\\_01.shtml](http://www.bbc.co.uk/history/british/modern/independence1947_01.shtml) (last updated Mar. 3, 2011) [https://perma.cc/KK7E-Z2FU].

<sup>111</sup> See *Administration of British Empire, British India*, INDIANETZONE, [https://www.indianetzone.com/39/administration\\_british\\_empire.htm](https://www.indianetzone.com/39/administration_british_empire.htm) (last updated Mar. 11, 2014) [https://perma.cc/QJ7F-H9FE].

provinces were under direct British rule while princely states represented kingdoms within India<sup>112</sup> that retained some level of sovereignty under the British Raj through agreements with Britain.<sup>113</sup>

As part of these agreements, in many cases, the princely states were required to pay or cede a portion of the taxes they collected from their citizens to Great Britain.<sup>114</sup> Britain had the final say on important policy matters governing the princely states, especially as they concerned the external affairs of a princely state.<sup>115</sup> Also, as part of this arrangement, Britain would provide military protection to the princely states from external conquests.<sup>116</sup> Essentially, the kingdoms representing the princely states owed their allegiance to the British Crown, while also retaining some of their own autonomy.<sup>117</sup>

Under the British Raj, there were approximately 565 princely states<sup>118</sup> and seventeen provinces<sup>119</sup> at the time of independence on August 15, 1947.<sup>120</sup> Two things happened at the time of independence: (1) India was

<sup>112</sup> The reference here is simply to the Indian subcontinent as a region and not to India as a country. The Indian subcontinent includes the modern-day nations of India, Pakistan, and Bangladesh.

<sup>113</sup> See *Presidencies in British India*, INDIANETZONE, [https://www.indianetzone.com/39/presidencies\\_british\\_india.htm](https://www.indianetzone.com/39/presidencies_british_india.htm) (last updated Mar. 16, 2012) [<https://perma.cc/S5JM-8KBE>]; see also *Princely States of India*, INDIANETZONE, [https://www.indianetzone.com/59/princely\\_states\\_india.htm](https://www.indianetzone.com/59/princely_states_india.htm) (last updated Mar. 12, 2012) [<https://perma.cc/SR2J-6Q8S>].

<sup>114</sup> Amardeep Singh, *Hyderabad and the Princely States (Guha Part 2)*, LEHIGH U. (Oct. 10, 2007, 12:50 PM), <http://www.lehigh.edu/~amsp/2007/10/hyderabad-and-princely-states-guha-part.html> [<https://perma.cc/DA6Y-GYA7>].

<sup>115</sup> See *The Princes of India*, MERRYN ALLINGHAM, <https://merrynallingham.com/20th-century/the-princes-of-india> [<https://perma.cc/M8LA-GQSW>].

<sup>116</sup> See Maurya Simon, *A Princess Remembers the Fall of British India*, L.A. TIMES, Apr. 9, 1989, at 10 (reviewing GITA MEHTA, RAJ (1989)).

<sup>117</sup> ROZINA VISRAM, *AYAHS, LASCARS AND PRINCES: THE STORY OF INDIANS IN BRITAIN 1700–1947*, at 172 (2015).

<sup>118</sup> *Princely State*, WORLD HERITAGE ENCYCLOPEDIA, [http://www.worldheritage.org/articles/Princely\\_state](http://www.worldheritage.org/articles/Princely_state) (last visited May 24, 2018).

<sup>119</sup> *Presidencies and Provinces of British India*, WORLD HERITAGE ENCYCLOPEDIA, <http://www.worldheritage.org/article/WHEBN0003574003/Presidencies%20and%20provinces%20of%20British%20India> (last visited May 24, 2018).

<sup>120</sup> August 15, 1947, is the date India, as we call it today, attained independence. Pakistan, which then included Bangladesh as a province, attained independence on August 14, 1947. These separate independences were planned as part of the partition of the British Raj. See Crispin Bates, *The Hidden*

divided along religious lines into two separate nations—one an Islamic nation now known as Pakistan, and the other a socialist,<sup>121</sup> Hindu-majority democracy<sup>122</sup> now known as India; and (2) India developed into a federalist republic<sup>123</sup> dividing powers between a national government and several state governments.<sup>124</sup>

The union of the former princely states and provinces into a single nation in 1947 was surprisingly similar to the union of the American colonies nearly two centuries earlier, although it occurred in very different ways and under very different circumstances.<sup>125</sup> After all, the current union of India as a single nation represents the collection of several former countries that decided to unite, and the new nation retained the English legal system after molding it to its own specific needs.<sup>126</sup>

Specifically, during the three-year period between 1947 and 1950, India's government functioned very much like that of Canada. It had as its executive head the queen or king of England who was represented by a governor general in India.<sup>127</sup> The governor general, together with the prime minister, carried out the day-to-day affairs of the new nation.<sup>128</sup> On

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*Story of Partition and Its Legacies*, BBC: HIST., [http://www.bbc.co.uk/history/british/modern/partition1947\\_01.shtml](http://www.bbc.co.uk/history/british/modern/partition1947_01.shtml) (last updated Mar. 3, 2011) [<https://perma.cc/KDC8-G7LJ>].

<sup>121</sup> Sam Staley, *The Rise and Fall of Indian Socialism: Why India Embraced Economic Reform*, REASON (June 2006), <http://reason.com/archives/2006/06/06/the-rise-and-fall-of-indian-so> [<https://perma.cc/LVA8-DFFV>].

<sup>122</sup> Kuldeep Kumar, *India's Aspirations 70 Years Ago and Now*, DEUTSCHE WELLE (Aug. 15, 2017), <http://p.dw.com/p/2iEL1>.

<sup>123</sup> *On This Day: 26 January*, BBC, [http://news.bbc.co.uk/onthisday/hi/dates/stories/january/26/newsid\\_3475000/3475569.stm](http://news.bbc.co.uk/onthisday/hi/dates/stories/january/26/newsid_3475000/3475569.stm) (last visited May 24, 2018) [<https://perma.cc/6PD6-XPVW>].

<sup>124</sup> *India: Constitution and Politics*, THE COMMONWEALTH, <http://thecommonwealth.org/our-member-countries/india/constitution-politics> (last visited Apr. 22, 2018).

<sup>125</sup> *Political Integration of India*, NEW WORLD ENCYCLOPEDIA (May 10, 2015), [http://www.newworldencyclopedia.org/entry/Political\\_integration\\_of\\_India](http://www.newworldencyclopedia.org/entry/Political_integration_of_India) [<https://perma.cc/NPJ4-JYKN>].

<sup>126</sup> B.N. Srikrishna, *The Indian Legal System*, 36 INT'L J. LEGAL INFO. 242, 242 (2008).

<sup>127</sup> See VALMIKI CHOUDHARY, PRESIDENT AND THE INDIAN CONSTITUTION 176 (1985).

<sup>128</sup> See *Viceroy and Governor-General of India*, REVOLVY, <https://www.revolvy.com/main/index.php?s=Viceroy%20and%20Governor-General%20of%20India> (last visited May 24, 2018) [<https://perma.cc/W2WF-W8DT>].

January 26, 1950, India enacted its Constitution and became a republic,<sup>129</sup> borrowing features of both the British parliamentary style of democracy and the American presidential style of democracy.<sup>130</sup> At the national level, much like in the United States, India's powers are divided between executive, legislative, and judicial branches.<sup>131</sup>

India's executive head, after becoming a republic, is the president who also serves as the commander-in-chief of India's military, much like his or her U.S. counterpart.<sup>132</sup> The president also has the responsibility to sign federal legislation before it becomes effective, similar to the president's role in the United States.<sup>133</sup> However, unlike in the United States, the president's veto powers are significantly restricted and may only be exercised on the advice of the prime minister or council of ministers, if it is inconsistent with the Constitution.<sup>134</sup> However, the president can indefinitely delay signing a bill, and there is no specific remedy in the law should the president refuse to give his assent to a bill.<sup>135</sup> The president also has no other significant executive powers except during emergencies, and his or her role is largely ceremonial.<sup>136</sup> Most executive functions and day-to-day affairs are carried

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<sup>129</sup> *On This Day*, *supra* note 123.

<sup>130</sup> See TARIQ AHMAD, LIBRARY OF CONG., NATIONAL PARLIAMENTS: INDIA 1 (2017), <https://www.loc.gov/law/help/national-parliaments/pdf/india.pdf>; see also Raghav Bahl, *How India Borrowed from the US Constitution to Draft Its Own*, THE QUINT, <https://www.thequint.com/news/politics/how-india-borrowed-from-the-us-constitution-to-draft-its-own> (last updated Nov. 27, 2015) [<https://perma.cc/XP59-2795>]; Krishan S. Nehra, *India*, in LIBRARY OF CONG., THE IMPACT OF FOREIGN LAW ON DOMESTIC JUDGMENTS 47 (2010), <https://www.loc.gov/law/help/domestic-judgment/Impact-of-Foreign-Law-on-Domestic-Judgments.pdf>.

<sup>131</sup> *India Government, Indian Democracy*, INDIA QUICK FACTS, <https://www.indiaquickfacts.com/content/india-government-indian-democracy> (last visited May 24, 2018) [<https://perma.cc/5PVE-JPML>].

<sup>132</sup> Viji Athreye, *Role of the President of India*, MAPSOFINDIA.COM (June 10, 2017), <https://www.mapsofindia.com/my-india/india/role-of-the-president-of-india> [<https://perma.cc/5VK9-PTX2>].

<sup>133</sup> *Id.*

<sup>134</sup> See INDIA CONST. art. 74.

<sup>135</sup> V.P. Gupta, *The President's Role*, TIMES OF INDIA (Aug. 26, 2002, 00:56 IST), <https://timesofindia.indiatimes.com/home/education/news/The-Presidents-role/articleshow/20154333.cms> [<https://perma.cc/9DSZ-VD83>].

<sup>136</sup> STANLEY A. KOCHANNEK & ROBERT L. HARDGRAVE, INDIA: GOVERNMENT AND POLITICS IN A DEVELOPING NATION 84 (7th ed. 2007).

out by the prime minister.<sup>137</sup> India's bicameral Parliament, which is the legislative branch, is divided into a lower and upper house, much like in the United States.<sup>138</sup> Finally, there is the judiciary, whose structure is different from that of the United States, apart from having a high court that is also referred to as the Supreme Court.<sup>139</sup> Nevertheless, the judiciary's functions are broadly similar to those of the judiciary in the United States.<sup>140</sup>

The U.S. Constitution and U.S. federalist system heavily influenced India when it developed its own Constitution and federalist system.<sup>141</sup> As a consequence, India's powers were divided between a federal government<sup>142</sup> and (now 29) state governments.<sup>143</sup> However, much like the Canadian provinces, none of the states have their own independent constitutions. The boundaries of these states were drawn along linguistic lines, especially in the southern, western, and northeastern parts of India, where each state has its own respective official language(s).<sup>144</sup> English and Hindi serve as the official languages at the national level, while English also serves as an additional official language in some states.<sup>145</sup> There are seven small territories that are

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<sup>137</sup> MAHENDRA SALUNKE & ANJALI BAGAD, HUMANITIES AND SOCIAL SCIENCES 36 (1st ed. 2009).

<sup>138</sup> *Constitution of India*, NAT'L PORTAL OF INDIA, <https://www.india.gov.in/my-government/constitution-india> (last visited May 24, 2018) [<https://perma.cc/9XWW-RNHG>].

<sup>139</sup> *Judiciary of India*, MAPSOFINDIA.COM, <https://www.mapsofindia.com/government-of-india/judiciary> (last updated Jan. 9, 2015) [<https://perma.cc/7DGW-742F>].

<sup>140</sup> *See Jurisdiction of the Supreme Court*, SUPREME COURT OF INDIA, <https://sci.gov.in/jurisdiction> (last visited May 24, 2018) [<https://perma.cc/VU6Q-NQS2>].

<sup>141</sup> *See Bahl*, *supra* note 130.

<sup>142</sup> The term *federal government* is used here for convenience. The more prevalent usage in India to refer to the national government is "central government" or "centre."

<sup>143</sup> *Indian States and Capitals*, TESTBOOK, <https://testbook.com/blog/wp-content/uploads/2016/05/Indian-States-and-Capitals-GK-in-PDF.pdf> (last visited May 24, 2018) [<https://perma.cc/C6VF-TBRW>] [hereinafter *Indian States*].

<sup>144</sup> *See* Sudepto Adhikari & Ratan Kumar, *Linguistic Regionalism and the Social Construction of India's Political Space*, in 2 CITY SOCIETY AND PLANNING: SOCIETY 374, 383 (Baleshwar Thakur et al. eds., 2007); *Official Languages of India, States and Their Languages*, QUICKGS, <http://www.quickgs.com/official-languages-of-india> (last visited May 24, 2018) [<https://perma.cc/4Q84-BRX4>] [hereinafter *Official Languages of India*].

<sup>145</sup> *Official Languages of India*, *supra* note 144; *see also* INDIA CONST. art. 343; The Official Language Act, No. 19 of 1963, A.I.R. MANUAL (1967).

under the direct rule of the union, much like the District of Columbia in the United States.<sup>146</sup>

Because these states represent former countries and because their languages, cultures, and even cuisines are very different, the union of these former countries was never, and still is not, a perfect one. Indeed, in 1965 (and again later in 1986) massive protests came from the southern states, especially the State of Tamil Nadu, when the federal government attempted to end the use of English for official purposes, thereby making Hindi the sole official language.<sup>147</sup> In 1967, the southern states halted protests after legislation was passed that guaranteed that English would remain a second official language, although many were still not fully satisfied with the text of the new legislation.<sup>148</sup>

On the other hand, because of India's experience with Muslim conquests, European occupations, and postrepublic conflict with China, many measures were taken and a tradition has developed in India to protect the integrity of the union.<sup>149</sup> Thus, state governments have traditionally not had their own flags, with the exception of Jammu and Kashmir.<sup>150</sup> The drafters of India's Constitution wanted to ensure that India's unity would not be threatened, and consequently added many provisions to protect the

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<sup>146</sup> *Indian States*, *supra* note 143.

<sup>147</sup> See World Heritage Encyclopedia, *Anti-Hindi Agitations*, PROJECT GUTENBURG SELF-PUB. PRESS, [http://self.gutenberg.org/articles/Anti-Hindi\\_agitations](http://self.gutenberg.org/articles/Anti-Hindi_agitations) (last visited May 24, 2018) [<https://perma.cc/832F-8EKR>]; see also Prathibha Nandakumar, *No Means Nahi!*, BANGALORE MIRROR (July 3, 2017, 04:00 IST), <http://bangaloremirror.indiatimes.com/opinion/views/no-means-nahi/articleshow/59413527.cms>? [<https://perma.cc/7RRS-UG34>].

<sup>148</sup> See Abdul Ruff Colachal, *India's Linguistic Imperialism: Tamil Nadu Resents Central Imposition of Hindi on Them!*, ASIAN TRIB. (Apr. 2, 2017, 08:41), <http://www.asiantribune.com/node/90293> [<https://perma.cc/7WG3-M5CM>].

<sup>149</sup> See Vern Cleary, *Independent India (1947 to Present)*, MOD. WORLD HIST., [http://webs.bcp.org/sites/vcleary/modernworldhistorytextbook/imperialism/section\\_4/independentindia.html](http://webs.bcp.org/sites/vcleary/modernworldhistorytextbook/imperialism/section_4/independentindia.html) (last visited May 24, 2018) [<https://perma.cc/CU2M-B87A>].

<sup>150</sup> This trend, however, is changing. See *Why Does India's Karnataka State Want Its Own Flag?*, BBC NEWS (July 19, 2017), <http://www.bbc.com/news/world-asia-india-40653553> [<https://perma.cc/2R9L-2Q68>]; see also *States Can Have Own Flag, with Certain Conditions: Shashi Tharoor*, TIMES INDIA (July 23, 2017), <https://timesofindia.indiatimes.com/india/states-can-have-own-flag-with-certain-conditions-shashi-tharoor/articleshow/59722754.cms> [<https://perma.cc/BQ2W-3WKC>].

integrity of the union.<sup>151</sup> This action primarily stems from the fear that a divided India would be unable to defend itself against another foreign invasion or occupation. That fear continues to persist to this day, especially in northern India.<sup>152</sup>

Thus, India's Constitution also has specific provisions, like its Canadian counterpart, that specifically define the boundaries of federal and state government jurisdiction.<sup>153</sup> Taxation is one such area where there are clearly defined jurisdictional boundaries.<sup>154</sup> This is reminiscent of India's national politics of the time, where the federal government and the union were viewed as being supreme, and the drafters did not want many challenges to the federal government's authority.<sup>155</sup>

## 2. The Single-Layer Income Tax System of India

One of the most important features of India's income tax system that is especially relevant to this Note's proposal is the fact that India's Constitution specifically reserves the right to tax income as an exclusive prerogative of the federal government.<sup>156</sup> The first clause of article 270 of India's Constitution states:

All taxes and duties referred to in the Union List, except the duties and taxes referred to in articles 268 and 269, respectively, surcharge on taxes and duties referred to in article 271 and any cess levied for specific purposes under any law made by Parliament shall be levied and collected by the Government of India and

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<sup>151</sup> See *Cooperative Federalism in India*, IAS SCORE, <http://iasscore.in/national-issues/cooperative-federalism-in-india> (last visited May 24, 2018) [<https://perma.cc/A9VJ-GC6N>] [hereinafter *Cooperative Federalism*].

<sup>152</sup> See Long Xingchun, *India Breaks International Law over Unwarranted Fears*, GLOBAL TIMES (July 9, 2017), <http://www.globaltimes.cn/content/1055612.shtml> [<https://perma.cc/4HE9-2Q7S>]; see also *Islam from the Beginning to 1300*, WORLD HIST. PROJECT (2002), <http://history-world.org/islam6.htm> [<https://perma.cc/6HJE-88A4>].

<sup>153</sup> Negi Mohita, *7 Main Federal Features of the Indian Constitution*, YOURARTICLELIBRARY, <http://www.yourarticlelibrary.com/indian-constitution/7-main-federal-features-of-the-indian-constitution/24924> (last visited May 24, 2018) [<https://perma.cc/Y9TS-T6L9>].

<sup>154</sup> See INDIA CONST. art. 270, cl. 1–3; *id.* art. 246, cl. 1; *id.* at Seventh Schedule, List I, entry 85.

<sup>155</sup> See *Cooperative Federalism*, *supra* note 151.

<sup>156</sup> INDIA CONST. art. 270, cl. 1–3; *id.* art. 246, cl. 1; *id.* at Seventh Schedule, List I, entry 85.

shall be distributed between the Union and the States in the manner provided in clause (2).

Entry 82 of the Union List referred to above qualifies the phrase “[a]ll taxes and duties” by excluding taxes on agricultural income.<sup>157</sup> Thus, the distribution mechanism referred to above does not apply to agricultural income. Furthermore, entry 46 of the State List together with the third clause of article 246 point directly to agricultural income as an exclusive prerogative of the states.<sup>158</sup> Articles 268 and 269 noted above relate to sales taxes on goods and services. Clause 2 of the same article provides that “the net proceeds in any financial year of any such tax” shall be distributed between the union and the states “in such manner and from such time” as may be prescribed in clause 3. Clause 3 further provides that the percentage is to be prescribed by the order of the President of India in the absence of a Finance Commission; or if a Finance Commission is established, by the order of the President of India in consultation with the Finance Commission.

As seen above, the Constitution of India explicitly reserves the right to tax income to the federal government.<sup>159</sup> As far as distribution of the net proceeds is concerned, it is the federal government that determines the percentage of apportionment and not any state or local governmental unit.<sup>160</sup>

There is an important twist to bear in mind. To this day, tax on agricultural income is an exclusive prerogative of the states.<sup>161</sup> Other taxes such as sales taxes, electrical consumption or use taxes, vehicle taxes, property taxes, taxes on mineral rights, tolls, and taxes on professions, trades, and employment are also the exclusive prerogative of the states.<sup>162</sup> Moreover, clause 1 of article 246 gives the federal government the exclusive power to make laws over any item in “List I in the Seventh Schedule” to India’s Constitution. Entry 85 of this list, referred to as the “Union List,” is the corporate income tax. Thus, these two provisions taken together give the

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<sup>157</sup> *Id.* at Seventh Schedule, List I, entry 82.

<sup>158</sup> *Id.* art. 246, cl. 3; *id.* at Seventh Schedule, List II, entry 85.

<sup>159</sup> *Id.* art. 270, cl. 1–3.

<sup>160</sup> *Id.* cl. 2–3.

<sup>161</sup> *Id.* art. 246, cl. 1; *id.* at Seventh Schedule, List II, entry 46.

<sup>162</sup> *Id.* at Seventh Schedule, List II, entries 47–60.

federal government the exclusive right to levy and collect taxes on corporate income.<sup>163</sup>

However, the qualification on agricultural income noted above applies equally well here. For one thing, the provisions noted above with agricultural income by themselves indicate that only states have power over agricultural income in general.<sup>164</sup> Additionally, to leave no doubt, the Constitution confirms this understanding specifically in the corporate income tax context as well. The definition of corporate income tax in clause 6(a) of article 366 expressly states that this tax “is not chargeable in respect of agricultural income.”<sup>165</sup>

The above discussion of the various articles and clauses of India’s Constitution leaves little doubt that the Constitution of India has reserved special privileges for the federal government in the area of income taxation. Even article 270, which requires that tax revenue be distributed to the states according to a prescribed percentage, gives the federal government the nearly exclusive right to levy and collect taxes and establish said percentage.<sup>166</sup> As a result, it should not be surprising that both individuals and corporations in India file a single tax return—the federal income tax return. There is no occasion to file state income tax returns, unless the income is derived from agriculture.<sup>167</sup>

India has a powerful constitution that grants the federal government solid, unquestionable powers. However, for the proposal under consideration here (i.e., a federal-only income tax), this is far too ambitious a model to adopt for two reasons. First, the U.S. Constitution simply does not contain remotely similar provisions to afford an exclusive right of the federal government to tax income. Second, a constitutional amendment to insert such a right is quite simply an unrealizable fantasy, at least for the foreseeable future—two-thirds of all state legislatures must approve a constitutional amendment, and it is simply unlikely that many states will freely surrender their right to tax income to the federal government. However, specific

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<sup>163</sup> *Id.* art. 246, cl. 1; *id.* at Seventh Schedule, List I, entry 85; *Six Groups, supra* note 1.

<sup>164</sup> *See* INDIA CONST. art. 246, cl. 3; *id.* at Seventh Schedule, List I, entries 82, 85.

<sup>165</sup> *Id.* art. 366, cl. 6(a).

<sup>166</sup> *Id.* art. 270, cl. 1–3.

<sup>167</sup> *Id.* cl. 1.

provisions of India's Constitution, such as article 270's method of distribution or apportionment, may still be relevant to the model proposed here.

### C. *Income Tax in Australia*

#### 1. Origins of Australia's Federalist Legal Structure and Policy

Australia's legal system is almost identical to that of Canada, with a few major exceptions. Powers are divided between three branches of government at the federal level—the executive branch, the legislature, and the judiciary—and much like Canada, Australia is not a republic.<sup>168</sup> Australia is also a constitutional monarchy with the queen or king of England as its executive head, represented by the governor general.<sup>169</sup> However, the governor general only acts on the advice of the ministers, except in limited circumstances such as when an election has resulted in a hung Parliament, and is himself or herself appointed by the queen or king upon the recommendation of the prime minister.<sup>170</sup> The real executive head is the prime minister.<sup>171</sup> The legislative branch is the Australian Parliament, composed of a House of Representatives and Senate.<sup>172</sup> This bicameral legislative structure is identical to that of the United States. Australia's judiciary, although structured differently, is functionally similar to those of all the previously discussed federalist systems, including that of the United States.<sup>173</sup>

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<sup>168</sup> *How Government Works*, AUSTL. GOV'T 1, 2, <http://www.australia.gov.au/about-government/how-government-works> (last visited Apr. 22, 2018).

<sup>169</sup> *Australia's Political System*, ABC: RADIO AUSTL., [http://www.abc.net.au/ra/federasi/tema/aus\\_pol\\_chart\\_e.pdf](http://www.abc.net.au/ra/federasi/tema/aus_pol_chart_e.pdf) (last visited May 25, 2018) [<https://perma.cc/F7MS-DRUC>].

<sup>170</sup> *Governor-General's Role*, GOVERNOR-GEN. OF THE COMMONWEALTH OF AUSTL., <http://www.gg.gov.au/governor-generals-role> (last visited Apr. 22, 2018).

<sup>171</sup> *The Australian System of Government*, PARLIAMENT OF AUSTL., [http://www.aph.gov.au/About\\_Parliament/House\\_of\\_Representatives/Powers\\_practice\\_and\\_procedure/00\\_-\\_Infosheets/Infosheet\\_20\\_-\\_The\\_Australian\\_system\\_of\\_government](http://www.aph.gov.au/About_Parliament/House_of_Representatives/Powers_practice_and_procedure/00_-_Infosheets/Infosheet_20_-_The_Australian_system_of_government) (last visited Apr. 22, 2018).

<sup>172</sup> *Parliament an Overview*, PARLIAMENT OF AUSTL., [http://www.aph.gov.au/About\\_Parliament/Work\\_of\\_the\\_Parliament/Forming\\_and\\_Governing\\_a\\_Nation/parl](http://www.aph.gov.au/About_Parliament/Work_of_the_Parliament/Forming_and_Governing_a_Nation/parl) (last visited Apr. 22, 2018).

<sup>173</sup> *The Courts*, AUSTL. GOV'T: ATT'Y GEN.'S DEP'T, <https://www.ag.gov.au/LegalSystem/Courts/Pages/default.aspx> (last visited Oct. 1, 2017).

While Australia has largely maintained its ties to Britain, the relationship between the two countries is somewhat strained.<sup>174</sup> Indeed, while Australia still has Queen Elizabeth II as its ceremonial head of state, it has even friendlier relations with the United States than it does with Britain.<sup>175</sup> Additionally, there was significant support for Australian republicanism in the past few decades, with the support reaching its peak in 2016.<sup>176</sup>

Australia's formation into a union is largely similar to that of the United States. Australia, formally called the Commonwealth of Australia, was formed in 1901 when six British colonies united to become a single nation.<sup>177</sup> These six colonies, much like the thirteen former U.S. colonies, would thereafter become states of the Australian union.<sup>178</sup> However, there was no revolutionary war, and as mentioned earlier, Australia has maintained its ties to the British Crown to this day. Apart from maintaining its ties to Britain, however, Australia has remained completely independent, and like Canada, has moved toward a federalist system of government where powers are divided between the federal government and the six state governments.<sup>179</sup>

Like the U.S. states, each of the Australian states has its own constitution<sup>180</sup> and each has the power to make its own laws "over matters not controlled by the Commonwealth under section 51 of the

<sup>174</sup> See Paola Totaro & Robert Wainright, *The Odd Strain in an Unbreakable Bond with Britain*, AUSTRALIAN (Feb. 7, 2015, 12:00 AM), <https://www.theaustralian.com.au/news/inquirer/the-odd-strain-in-an-unbreakable-bond-with-britain/story-e6frg6z6-1227210926552> [<https://perma.cc/WM6N-6CZ9>].

<sup>175</sup> See John Holmes & Michael Fullilove, *Australia Isn't as Close to Britain as it Should Be*, GUARDIAN (July 12, 2014), <https://www.theguardian.com/commentisfree/2014/jul/12/australia-britain-close-asia> [<https://perma.cc/58HG-FSNA>].

<sup>176</sup> Deborah Snow, *Malcolm Turnbull Reaffirms Support for Republic in Passionate Speech*, SYDNEY MORNING HERALD (Dec. 18, 2016, 1:50 AM), <https://www.smh.com.au/politics/federal/malcolm-turnbull-reaffirms-support-for-republic-in-passionate-speech-20161217-gtddoy.html> [<https://perma.cc/C8VG-5PCZ>].

<sup>177</sup> *Federation*, AUSTL. GOV'T, <http://www.australia.gov.au/about-government/how-government-works/federation> (last visited Apr. 22, 2018).

<sup>178</sup> *Id.*

<sup>179</sup> Parliamentary Educ. Office, *Governing Australia: Three Levels of Law-Making* 1, 1–3, [https://www.peo.gov.au/uploads/peo/docs/closer-look/CloserLook\\_Three\\_Levels.pdf](https://www.peo.gov.au/uploads/peo/docs/closer-look/CloserLook_Three_Levels.pdf) (last visited Oct. 1, 2017) [hereinafter *Three Levels of Lawmaking*].

<sup>180</sup> *State and Territory Government*, AUSTL. GOV'T, <http://www.australia.gov.au/about-government/how-government-works/state-and-territory-government> (last visited Apr. 22, 2018).

Constitution.”<sup>181</sup> In other words, states were left with residual powers, with the remaining powers being restrained by the Australian Constitution’s supremacy clause.<sup>182</sup> Australia’s Senate, much like the U.S. Senate, provides equal representation to the states regardless of differences in the size of each state’s population.<sup>183</sup> Thus, states are given a voice, as in the United States, in directing national policy.

The framers of the Australian Constitution envisioned what is termed as “coordinate federalism” for the country wherein the federal and state governments would operate as financially and politically independent units.<sup>184</sup> However, it took barely a quarter of a century before Australia could reasonably be stated to have strayed from this vision.<sup>185</sup> With the coming of World War I followed by the Great Depression in the 1920s and 1930s, a system of “co-operative federalism” began to emerge.<sup>186</sup> The turning point in Australia’s history was *Amalgamated Society of Engineers v Adelaide Steamship Co.*, where the High Court of Australia conclusively rejected the “reserved state powers doctrine.”<sup>187</sup>

At the outset, the court rejected references to U.S. Supreme Court cases, including the landmark case *Gibbons v. Ogden*, stating:

[W]e conceive that American authorities, however illustrious the tribunals may be, are not a secure basis on which to build fundamentally with respect to our own Constitution. While in secondary and subsidiary matters they may, and sometimes do, afford considerable light and assistance, they cannot, for reasons we are about

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<sup>181</sup> *Australian Constitution* s 51.

<sup>182</sup> See *Three Levels of Lawmaking*, *supra* note 179, at 5; see also *Australian Constitution* s 109.

<sup>183</sup> *About the Senate*, AUSTL. GOV’T, [https://www.aph.gov.au/About\\_Parliament/Senate/About\\_the\\_Senate](https://www.aph.gov.au/About_Parliament/Senate/About_the_Senate) (last visited Oct. 21, 2017).

<sup>184</sup> See Michael Olds, *Spheres of Power: The High Court as Custodian of Co-ordinate Federalism*, 6 W. AUSTL. JURIST 241, 241–44 (2015); *Trick or Treaty? Commonwealth Power to Make and Implement Treaties*, PARLIAMENT OF AUSTL., [https://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate/Legal\\_and\\_Constitutional\\_Affairs/Completed\\_inquiries/pre1996/treaty/report/c08](https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Legal_and_Constitutional_Affairs/Completed_inquiries/pre1996/treaty/report/c08) (last visited Apr. 22, 2018).

<sup>185</sup> See Olds, *supra* note 184, at 245–47.

<sup>186</sup> *Id.*

<sup>187</sup> *Amalgamated Soc’y of Eng’rs v Adelaide SS Co* (1920) 28 CLR 129 (Austl.).

to state, be recognized as standards whereby to measure the respective rights of the Commonwealth and States under the Australian Constitution.<sup>188</sup>

The term “reserved state powers” implies exactly what it says—certain powers under the Constitution are specifically reserved to the states, and the federal government was initially thought to be lacking the powers needed to encroach into these areas.<sup>189</sup> Nevertheless, despite the reserved state powers doctrine and despite rejecting U.S. authority favoring the federal government’s position, the court in *Amalgamated Society of Engineers* ruled against any idea of reserved powers to the states:

[I]t is a fundamental and fatal error to read s. 107 as reserving any power from the Commonwealth that falls fairly within the explicit terms of an express grant in s. 51, as that grant is reasonably construed, unless that reservation is as explicitly stated. The effect of State legislation, though fully within the powers preserved by s. 107, may in a given case depend on s. 109. However valid and binding on the people of the State where no relevant Commonwealth legislation exists, the moment it encounters repugnant Commonwealth legislation operating on the same field the State legislation must give way.<sup>190</sup>

The court went on to add that the supremacy clause of the Constitution distinguishes Australia’s federalist system from that of Canada’s by quoting section 109 of the Australian Constitution:

“When a *law* of a State is inconsistent with a *law* of the Commonwealth, the latter shall prevail, and the former shall, to the extent of the inconsistency, be invalid,” gives supremacy, not to any particular class of Commonwealth Acts but to every Commonwealth Act, over not merely State Acts passed under concurrent powers but all State Acts, though passed under an exclusive power . . . .<sup>191</sup>

Thus, with the above ruling, the Australian High Court conclusively distinguished Australia’s Constitution and federalist system from those of Canada and the United States. Indeed, the broad interpretation of the Australian Constitution’s supremacy clause significantly diminishes Australian states’ rights to an extent unheard of in the context of the United States federal-state relationship. As such, the *Amalgamated Society of*

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<sup>188</sup> *Id.* at 146.

<sup>189</sup> See Olds, *supra* note 184, at 244.

<sup>190</sup> *Amalgamated Soc’y of Eng’rs*, 28 CLR at 154.

<sup>191</sup> *Id.* at 154–55 (alteration in original).

*Engineers* court left no doubt as to the broad scope of the supremacy clause and federal authority to intervene in state matters.

The *Amalgamated Society of Engineers* decision was just one decision, however, and it involved a dispute between an engineers' union and 844 employers across Australia concerning whether an arbitration award granted under federal law by the Commonwealth Court of Conciliation and Arbitration could bind those employers.<sup>192</sup> More than twenty years later, the High Court once again addressed the question of federalism and states' rights. This time, it was in the area of income tax, and the court once again left no doubt as to the broad scope of the Australian federal government's authority.<sup>193</sup>

## 2. Evolution of the Australian Income Tax System

Before World War II, both the federal and state governments of Australia levied and collected income taxes separately.<sup>194</sup> But in 1942, to help raise funds more efficiently for the war effort, the federal government passed legislation making it the sole collector of income tax in the country and raising the federal income tax rate.<sup>195</sup> Essentially, the legislation conditioned federal funding grants to states from the income tax revenue on the state governments' agreement to withdraw from the income tax field.<sup>196</sup>

The legislation did not go unchallenged. In what is termed the "First Uniform Tax Case," four states challenged the legislation in 1942.<sup>197</sup> The High Court of Australia ruled in the federal government's favor, stating that section 51(ii) of the Constitution gives the federal Parliament power to make laws relating to taxation and that section 96 of the Constitution empowers the federal government to attach conditions to funding grants.<sup>198</sup> Thus, it was

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<sup>192</sup> *See id.* at 131–32.

<sup>193</sup> *S Austl v Commonwealth* (1942) 65 CLR 373 (Austl.).

<sup>194</sup> *Uniform Tax Case*, *supra* note 1.

<sup>195</sup> *Id.*

<sup>196</sup> *Id.*

<sup>197</sup> *Id.*

<sup>198</sup> *S Austl*, 65 CLR at 374.

held that the federal government could legally deny funding to states that refused to drop the income tax.

A Second Uniform Tax Case arose in 1957, but this time the challenge to the legislation was brought by only two of the states, one of which was also a plaintiff in the first case. Once again, the High Court ruled largely in favor of the federal government, except for certain insignificant matters unrelated to the federal taxing powers.<sup>199</sup> To date, none of the states has launched a third challenge, and as such, the only income tax in place since 1942 is the federal income tax.<sup>200</sup>

Thus, while the court did not revisit the supremacy clause in the First and Second Uniform Tax Cases, it left no doubt as to the federal government's broad scope of powers over matters of taxation and funding. However, it is important to bear in mind that there is no prohibition on state income tax—states can still impose an income tax, but only at the cost of foregoing federal funding grants.<sup>201</sup> Furthermore, since the federal government considerably increased the federal income tax rate in 1942, states have feared that imposing a state income tax would be unpopular.<sup>202</sup>

The manner in which the federal government distributes the revenue generated from income tax is through its section 96 funding grants.<sup>203</sup> Under this section, the federal government established general purpose grants and specific purpose payments. With general purpose grants, states are free to use the proceeds that they receive from the federal government in any manner that they see fit. With specific purpose payments, the federal government

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<sup>199</sup> *Victoria v Commonwealth* (1957) 99 CLR 575, 576 (Austl.); Brian Galligan, *Parliament's Development of Federalism*, PARLIAMENT OF AUSTRALIA (June 26, 2001), [http://www.aph.gov.au/About\\_Parliament/Parliamentary\\_Departments/Parliamentary\\_Library/pubs/rp/rp0001/01RP26](http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/rp0001/01RP26).

<sup>200</sup> *Uniform Tax Case*, *supra* note 1.

<sup>201</sup> *Id.*

<sup>202</sup> *Id.*

<sup>203</sup> *Id.*

grants funding to states on the condition that those funds be used for a specific purpose; for example, building schools or constructing a roadway.<sup>204</sup>

This is a unique system of income taxation that differs from those of both Canada and India. While Australia's Constitution does not explicitly grant the federal government any special privileges in taxing income, it has empowered the federal government to manipulate its funding powers in such a manner as to prevent the states from continuing to impose an income tax.<sup>205</sup> However, as noted in *Amalgamated Society of Engineers*, such an explicit grant of powers is not required. State laws must simply give way to federal law wherever there is a conflict.<sup>206</sup> Thus, unlike the United States, the Australian states do not collect income taxes; and unlike Canadian provinces, Australian states do not even impose an income tax. Essentially, much like the Indian states, the Australian states have been effectively excluded from the income tax arena.<sup>207</sup>

This model of manipulation of the funding grants has great potential to work in the United States because of the similarities between the two countries in terms of the constitutional powers and privileges of taxation. However, the differences should not be forgotten. After all, there is no comparable authority in the United States to *Amalgamated Society of Engineers*, which gives such a broad scope of powers to the federal government. Nevertheless, the congressional purse powers together with the Commerce Clause may provide some leeway to the federal government to indirectly restrict states' rights over taxation of income.

Combining some of the features of India's and Australia's income tax in a hybrid model that conditions funding grants to states on their agreement to forgo their power to tax income would be the best approach. However, this model must strive to retain many of the current features of the U.S. federal income tax system and not impose needless changes.

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<sup>204</sup> Scott Bennett & Richard Webb, *Specific Purpose Payments and the Australian Federal System* 2–5 (Parliamentary Library Research Paper No. 17, 2008), <https://www.aph.gov.au/binaries/library/pubs/rp/2007-08/08rp17.pdf>.

<sup>205</sup> *Uniform Tax Case*, *supra* note 1.

<sup>206</sup> *Amalgamated Soc'y of Eng'rs v Adelaide SS Co* (1920) 28 CLR 129, 154 (Austl.).

<sup>207</sup> *Id.*

#### IV. TOWARD A SINGLE-LAYER U.S. INCOME TAX SYSTEM

As discussed above, Australia's Constitution bears the closest resemblance to the U.S. Constitution in the context of this Note's proposal. The United States also has federal funding grant programs that divert resources to the states, thus giving it leeway to envision conditions similar to those that Australia adopted in 1942. And India's method of distributing tax revenue to its states is also a useful point of reference. However, before discussing a new income tax model, it would be useful to analyze why eliminating the state income tax is the best available option.

##### *A. State Uniformity Agreements Are Not an Option*

As discussed above, the widely divergent methods of allocating income, the varying definitions of items or categories of income among the states, and the different state policies concerning taxing residents and nonresidents has meant increased confusion, cost, and unnecessary complications—and this even occurs without considering filing requirements. One might ask why we cannot rely on uniformity agreements between the states to resolve this problem, as opposed to having the federal government intervene. There are a number of reasons for this, as explained below.

##### 1. Impossibility of Reaching an Agreement

First, as a general matter, it is virtually impossible to bring all forty-six states that currently impose some form of an income tax to the table to discuss the idea of uniformity without a push from federal legislation. Some states are likely to dismiss the idea at the outset. Take the simple example of the so-called Multistate Bar Examination, which is only adopted in roughly half of the states and the District of Columbia.<sup>208</sup> As another example, consider Certified Public Accountants and other professionals, who are subject to different state licensing requirements.<sup>209</sup> And in the field of estates and trusts law where the Uniform Probate Code is prominent, many states have either

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<sup>208</sup> Kelly S. Taylor, *The Uniform Bar Exam: An Unclear Hurdle to Licensure*, ABA FOR L. STUDENTS (Aug. 1, 2016), <https://abaforlawstudents.com/2016/08/01/uniform-bar-exam-unclear-hurdle-licensure> [<https://perma.cc/59ZH-3AB5>].

<sup>209</sup> *How to Get Licensed*, NAT'L ASS'N OF ST. BDS. OF ACCT. <https://www.nasba.org/licensure/gettingacpalicense/howtogetlicensed> (last visited Apr. 20, 2018).

not adopted the code or adopted it only in part.<sup>210</sup> Income taxation is a source of revenue for the states, and where revenue is concerned, states are highly likely to protect their own interests fiercely. Furthermore, getting local counties, cities, and townships to agree on uniformity is an incredible mountain to climb.

## 2. The Impossibility of Enforcing State Uniformity Agreements

Second, there is a question of binding the states to a uniformity agreement, which is far more difficult than it sounds. There is no guarantee that a state will comply with an agreement or not withdraw from it. A new government in a state may decide that the uniformity agreement is simply not in its best interest, and one state's withdrawal might prompt other states to withdraw.

### *a. UDITPA and the Multistate Tax Compact*

As an example, consider the Multistate Tax Compact (the "Compact") and the *Gillette* series of cases. In 1957, the Uniform Law Commission drafted the Uniform Division of Income for Tax Purposes Act (UDITPA), which was intended to encourage uniformity in state laws and practices concerning multistate business taxation and to prevent taxation in multiple jurisdictions.<sup>211</sup> But UDITPA was largely ignored by the states because the states felt that they had no incentive to enter into a uniformity agreement benefitting multistate corporations.<sup>212</sup> Then in 1959, the U.S. Supreme Court, in a controversial decision, held "the entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs."<sup>213</sup>

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<sup>210</sup> UNIF. PROB. CODE (UNIF. LAW COMM'N 2010).

<sup>211</sup> *Gillette Co. v. Franchise Tax Bd.*, 363 P.3d 94, 96 (Cal. 2015).

<sup>212</sup> *Id.* at 97.

<sup>213</sup> *Nw. States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959).

That decision prompted Congress to enact Public Law 86-272,<sup>214</sup> a statute that set forth limits on the exercise of that power and authorized a study to recommend further legislation regulating state taxation of interstate business income.<sup>215</sup> Termed the Willis Report, the study recommended “a uniform two-factor apportionment formula based on the amount of property and payroll in each state, as well as a blanket nexus standard that limited income tax jurisdiction to states in which a business had either real property or payroll.”<sup>216</sup> Beginning in 1965, several congressional bills were proposed that advocated for a comprehensive tax scheme for interstate business income.<sup>217</sup>

Fearing loss of state sovereignty over tax and revenue generation matters, the states went into panic mode and called for an unprecedented special meeting of the National Association of Tax Administrators in January 1966, where the Compact was envisioned.<sup>218</sup> The Compact contains twelve articles and covers a broad range of matters including but not limited to definitions, division of income, interstate audits, uniform regulations and forms, and tax controversy and arbitration.<sup>219</sup> More importantly, the Compact does not just cover income tax but also sales and use taxes.<sup>220</sup>

Interestingly, the Compact sets out some of its primary purposes as: (1) promoting uniformity or compatibility between the different state tax systems, (2) facilitating taxpayer convenience and compliance as they relate to filing of returns and general tax administration, and (3) avoiding

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<sup>214</sup> Act of Sept. 14, 1959, Pub. L. No. 86-272, §§ 101–102, 73 Stat. 555, 555–56 (codified at 18 U.S.C. § 381); CHARLES A. TROST, FEDERAL LIMITATIONS ON STATE AND LOCAL TAX § 10:20 (2d ed. 2016).

<sup>215</sup> *Gillette*, 363 P.3d at 97.

<sup>216</sup> *Id.*

<sup>217</sup> *Id.*

<sup>218</sup> *Id.*

<sup>219</sup> See generally MULTISTATE TAX COMPACT (MULTISTATE TAX COMM’N 1967).

<sup>220</sup> *Id.* art. IV.

duplicative taxation.<sup>221</sup> Section 1 of Article III of the Compact further provides:

Any taxpayer subject to an income tax whose income is subject to apportionment and allocation for tax purposes pursuant to the laws of a party State or pursuant to the laws of subdivisions in two or more party States may elect to apportion and allocate his income in the manner provided by the laws of such States or by the laws of such States and subdivisions without reference to this compact, or may elect to apportion and allocate in accordance with Article IV.<sup>222</sup>

In other words, Article III allows a taxpayer to elect to use the state apportionment formula or the Article IV apportionment formula. Article IV predominantly adopted UDITPA and includes a three-factor, weighted formula for apportioning income to a state. This formula has as its numerator a property factor, a payroll factor, and a receipts factor multiplied by two while the denominator is simply the number four.<sup>223</sup> The property factor is a fraction of the average value of the taxpayer's real and tangible personal property owned or rented and used in a state over the property value total that is owned or rented and used everywhere during a given tax period.<sup>224</sup> The payroll factor is a fraction of the total compensation paid by the taxpayer in a state and the total paid by the taxpayer everywhere during the tax period.<sup>225</sup> The receipts factor is a similar fraction of the total receipts of the taxpayer in a state and the total receipts everywhere during the tax period.<sup>226</sup>

Of course, in order to use this formula to apportion income to a state, the income must first be *apportionable*.<sup>227</sup> In other words, only apportionable income is apportioned. Indeed, sections three through eight of Article IV extensively cover income that is not apportionable but is specifically *allocated* to a state.<sup>228</sup> Income that is specifically allocable includes, among

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<sup>221</sup> *Id.* art. I.

<sup>222</sup> *Id.* art. III, § 1.

<sup>223</sup> *Id.* art. IV, § 9 (as amended in 2015).

<sup>224</sup> *Id.* § 10.

<sup>225</sup> *Id.* § 13 (as amended in 2015).

<sup>226</sup> *Id.* § 15.

<sup>227</sup> *See id.* § 9 (reference to all "apportionable" income).

<sup>228</sup> *See id.* §§ 3–8.

other things, interest and dividends when a taxpayer's commercial domicile is in a state, net rents and royalties from real property, capital gains and losses from sales of real property, and patent and copyright royalties in some circumstances.<sup>229</sup>

It goes without saying that these articles, and in fact the entire Compact, are moot if a state has not adopted it in the first place or has adopted it in a significantly modified form. A draft of the Compact was adopted by nine states within six months in 1967 and California later adopted the Compact in 1974.<sup>230</sup> As of today, that number has grown to a paltry sixteen, which means that less than one-third of the states have adopted the Compact in its full form,<sup>231</sup> and as discussed below, the legislatures and courts of California, Minnesota, and Michigan in rather quick succession undermined the Compact. Thus, the stated purposes of the Compact—that is, promoting uniformity, compatibility, convenience, and compliance, and avoiding duplicative taxation—admirable as they are, become meaningless when so few states adopt the Compact and when the Compact both lacks the authority to enforce its provisions upon a state and contains no internal enforcement mechanism.

#### *b. The Gillette Cases: A Blow to the Compact*

The story changed course in 1993 when the California legislature passed legislation stating, “Notwithstanding Section 38006 [the provisions of the Compact], all business income shall be apportioned to this state . . .” using the state's own prescribed formula, which resulted in double-counting of in-state sales.<sup>232</sup> Between 1993 and 2005, six multinational corporations including the Gillette Company paid the tax under the new California law and then applied for a refund, invoking the Compact, which was promptly denied.<sup>233</sup> The corporations filed suit and the California Court of Appeals

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<sup>229</sup> *Id.*

<sup>230</sup> *Gillette Co. v. Franchise Tax Bd.*, 363 P.3d 94, 97–98 (Cal. 2015).

<sup>231</sup> See HELLERSTEIN & HELLERSTEIN, *supra* note 8, ¶ 9.01.

<sup>232</sup> See *Gillette*, 363 P.3d at 98.

<sup>233</sup> *Id.*

decided in their favor stating that “the Legislature could not unilaterally repudiate mandatory terms of the Compact, which permitted election.”<sup>234</sup>

The California Supreme Court reversed stating that the Compact was not a binding agreement for purposes of the Compact Clause of the U.S. Constitution, and that “[t]here is no delegation of sovereign power to the Uniform Law Commission; each state retains complete freedom to adopt or reject the rules and regulations of the commission.”<sup>235</sup> The court added that the Compact “does not encroach on federal authority in any way that would require congressional approval under the Compact Clause.”<sup>236</sup>

Minnesota had already passed similar legislation in 1987 undermining the Compact.<sup>237</sup> And, in what can perhaps be considered the final nail in the coffin for the Compact, in another *Gillette* case, a Michigan court approved much more extreme state legislation that repealed the Compact in the state retroactively.<sup>238</sup> In other words, Michigan withdrew from the Compact and denied refunds or imposed additional liabilities for all Compact years based on the new post-Compact apportionment formula. These decisions essentially sent a message to taxpayers, both corporate and individual that state governments cannot be trusted to abide by uniformity agreements, at least in matters involving taxation. Thus, federal action in the form of legislation that either enforces the Compact or similar regulations is the only plausible solution.

### *B. Implementing and Defending a New Federal Legislation*

As discussed above, states cannot realistically be expected to honor their uniformity agreements, especially in the long run. Simply put, when there is no enforcement authority to police the states, uniformity agreements are meaningless and ineffective. In such a scenario, the only solution to the many

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<sup>234</sup> *Id.*

<sup>235</sup> *Id.* at 103 (quoting *U.S. Steel Corp. v. Multistate Tax Comm’n*, 434 U.S. 452, 473 (1978)).

<sup>236</sup> *Id.* at 102–03.

<sup>237</sup> See *Kimberly-Clark Corp. v. Comm’r of Revenue*, No. 8670-R, 2015 Minn. Tax LEXIS 33, at \*13–14 (Minn. T.C. June 19, 2015).

<sup>238</sup> *Gillette Commercial Operations N. Am. & Subsidiaries v. Dep’t of Treasury*, 878 N.W.2d 891 (Mich. Ct. App. 2015).

complexities found in the state income tax systems is action by the federal government.

The first question that then comes to mind is how can the federal government act? It can either offer a constitutional amendment or enact federal legislation. Although the former option is tempting because of its effectiveness, it is simply impractical for reasons stated earlier—getting two-thirds of the states to agree to give up their power to tax income is simply a utopian fantasy, at least for the next several decades. So, realistically speaking, federal legislation is the only viable option. The next question then is how to frame the legislation? That leads to two other questions: (1) What are the mechanics envisioned in the legislation? and (2) How should the legislation be drafted to fend off a constitutional challenge that is all but certain to occur?

#### 1. Mechanics of the Legislation and Subsequent Steps

The first step, of course, is the federal legislation itself. This must be carefully crafted so that it is not viewed as being excessively coercive and a blatant violation of constitutional principles. As a second step, the federal government must raise federal tax rates to make up for loss of the state income tax revenue. The final step would need to account for distribution of a portion of the revenue back to the states.

##### *a. The Legislation Restricting State Income Taxing Powers*

The legislation must be designed closely along the lines of Australia's 1942 legislation; that is, the legislation should condition its funding grants and other incentives to the states on their agreement to withdraw from the income tax arena. This must be carefully crafted so that it is not viewed as excessively coercive. That way, the federal government will not be imposing its will on the states by forcing them to forgo their power to tax income but will merely be cutting funding and incentives that it is not obligated to provide in the first place. The federal government can also provide additional incentives to encourage states to opt into a single-income-tax regime. The key, in other words, would be to use indirect and soft coercion, as opposed to hard and direct federal strong-arming.

One of the ways in which this can be accomplished is by playing with incentives—both present and future incentives. One might propose that an opt-in regime like Canada's might be the right course of action. However, the Canadian opt-in system gives too much leeway for the provinces to opt-

out of the system. While that is certainly soft coercion, it may be *too* soft. As evident from Canadian history, such an option would give the states an option to back out partially or completely anytime they wanted, creating a situation somewhat similar to the failed Compact.

What is needed is a powerful and balanced incentive-based regime that offers attractive options for taxpayers that the state governments cannot ignore, yet at the same time, contain strict enforcement mechanisms. This regime must also carry hefty negative consequences that make it difficult, if not impossible, for states to back out at a later time as in the case of the Canadian provinces of Quebec, Alberta, and Ontario.

One such incentive could be by way of utilizing the state and local income tax deduction. As it stands today, the federal government allows an itemized deduction for either state and local income taxes or state and local general sales taxes, but not both.<sup>239</sup> The SALT deduction is nothing more than a form of revenue sharing between the federal and state and local governments and has been available since the beginning of the federal income tax in 1913 in one form or another.<sup>240</sup> As an example, consider a taxpayer in a 30% federal tax bracket. If Pennsylvania were to raise its state income tax by \$100, the taxpayer's overall effective tax increase is not \$100 but \$70. This is because the federal government allows a deduction for \$30 (or 30% x \$100). Viewed this way, the federal government is subsidizing the state and local governments by paying a share of the taxpayer's state and local taxes.<sup>241</sup>

This offers an avenue that the federal government might exploit. Although the deduction is more than one hundred years old, nothing in the U.S. Constitution *requires* that the federal government offer such a deduction in the first place. The federal government can remove this incentive at any time, and in fact, it has already considered this as a possible option.<sup>242</sup> In

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<sup>239</sup> I.R.C. § 164 (LEXIS though Pub. L. No. 115-172).

<sup>240</sup> See Michael Leachman & Iris J. Lav, *Eliminating State and Local Tax Deduction to Pay for Tax Cuts for Wealthy a Bad Deal for Most Americans*, CTR. ON BUDGET & POL'Y PRIORITIES (Oct. 19, 2017), <https://www.cbpp.org/research/state-budget-and-tax/eliminating-state-and-local-tax-deduction-to-pay-for-tax-cuts-for> [<https://perma.cc/BQV5-U6WR>].

<sup>241</sup> CONG. BUDGET OFFICE, *OPTIONS FOR REDUCING THE DEFICIT: 2014 TO 2023*, at 118 (2013) [hereinafter *REDUCING THE DEFICIT*].

<sup>242</sup> See *id.*

November 2013, the Congressional Budget Office proposed the elimination of the deduction for state and local taxes. Some of the arguments put forth in favor of removing the deduction were:

- 1) state and local taxes are “analogous to spending on other types of consumption,” because they are primarily paid in return for public services, which are nondeductible;
- 2) “the deduction largely benefits the wealthier localities” and those in high-income brackets who itemize their deductions; and
- 3) the deduction deters “states and localities from financing services with non-deductible fees, which could be more efficient.”<sup>243</sup>

Of course, taking such a drastic step as removing the deduction would not be popular with the general electorate. Also, removing the deduction completely would not be the smart move from a federalism-oriented strategic standpoint. A better option for the federal government would be to use this power and discretion to remove the deduction as a tool to influence the state governments to do something that the federal government wants. In this context, that would be having the state governments give up their power to tax income. In other words, the federal government can dangle this deduction in front of the states through legislation and say, “We are taking this away from your residents, but they will not face any meaningful burden so long as you give up your right to tax their income.”

By playing it this way, the federal government is using soft coercion techniques effectively. Rather than strong-arming the state by saying, “Stop taxing income or else,” the government is merely exploiting an incentive that it had no obligation to grant in the first place. By combining this strategy with the highlighting of reduced compliance burdens for the electorate and corporate taxpayers (i.e., no more state and/or local tax returns to file, no more dealing with multiple state tax authorities, no longer worry about figuring out state residency matters, no concerns over potential increases in the income tax rates of various states, etc.), the federal government may have better luck at not only directly influencing the state governments to give up their power to tax income, but it also might indirectly influence them through a push from their own populations.

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<sup>243</sup> *Id.*

The SALT deduction, of course, is just one example. This itself can be utilized in a different way. For instance, the federal government could remove the “either or” restriction of providing a deduction either for the state income tax or the state sales tax to those states that give up the power to tax income. In other words, under a “no-state-income-tax” regime, the federal government can make up for the income tax deduction component through a reduced federal rate or simply provide the state sales tax deduction to all taxpayers, or both.

There are yet other incentives that the federal government can pull back or grant. One discussed in more detail below would be funding. The federal government can of course envision numerous other new incentives such as extended bonus depreciation, increased Code § 179 deductions, additional or extended income deferral mechanisms only for the residents of those states that have withdrawn from the income tax arena, and so on.

One could argue that rather than doing away with the state income tax system entirely, the federal government could simply establish a uniform apportionment formula and condition its funding grants to the states on their agreement to use that formula. But, this does not solve many of the other problems such as each state’s own unique definitions of residency, separate filing requirements, and each state’s own criteria for what does or does not constitute a unitary business. Thus, the best approach is to eliminate the state income tax system completely and have a single income tax system with one return to file and one set of definitions regarding various aspects affecting the income tax. That would not only resolve many of the problems associated with state income taxes, but would also result in tremendous cost savings for individuals, businesses, and the overall national economy. Resources that would otherwise be spent on state income tax compliance could then be invested in more productive areas.

#### *b. Subsequent Steps*

Of course, as a second step, the legislation must be followed-up by higher income taxes at the federal level to make up for the near 33% loss of state and/or local income tax revenue.<sup>244</sup> But, these higher taxes will only replace income taxes at the state level, and the SALT deduction subsidy in

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<sup>244</sup> *State and Local Individual Income Taxes*, *supra* note 6.

the old regime would be accounted for in the new federal rate—a point that must be made clear to constituents.

As a third step, the federal government must adopt a mechanism by which it mandatorily distributes part of the revenue generated to the states. Here, the federal government can use a modified version of India's approach; that is, it could empower an agency of the federal government, like the Finance Commission for India, to devise a formula for distributing revenue to the states. This could potentially be the Department of Treasury or the Internal Revenue Service. As a fourth and final step, there is the collateral loss of payroll tax revenue for the states that needs to be accounted for—here, the states can simply be permitted to make up for the loss through a corresponding increase in their other taxes not imposed on income such as property taxes or nondeductible fees for public services.

Of course, it must not stop there. The federal government must envision an enforcement mechanism for those states that decided to opt-in to the single-layer system. Those states that have opted in must not be allowed to go the California or Michigan way, as in the case of Gillette, or the Quebec, Alberta, or Ontario way, as in Canada. The regime must be designed in such a manner that there are heavy economic, political, and possibly social repercussions for those that attempt to do so. Only such an enforcement mechanism would cause state legislators, and other government officials, to think twice before removing their state from such a regime.

## 2. Defending the New Legislation Restricting State Income Taxing Powers

Passing such comprehensive legislation with far-reaching consequences is only half the battle. Defending it against a constitutional challenge that is virtually certain to arise is an uphill task. But, if Australia's federal government could accomplish such a feat, there is no reason to think that the United States cannot. Conditioning federal funding grants is nothing novel—it has been done before.

In 1987, the U.S. Supreme Court, in a 7-2 decision, upheld the National Minimum Drinking Age Act, a statute that withheld federal highway funding from states whose legal drinking age did not conform to federal policies.<sup>245</sup> In reaching that decision, the Court established a five-factor test for

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<sup>245</sup> South Dakota v. Dole, 483 U.S. 203, 212 (1987).

determining the constitutionality of conditioning federal funding grants to states. To pass muster, a condition must: (1) be in pursuit of general welfare, (2) be unambiguous, (3) relate to the federal interest in particular national projects or programs, (4) not be otherwise unconstitutional, and (5) not be coercive.<sup>246</sup> Finding that the statute met all five factors, Chief Justice Rehnquist concluded that the statute was a valid exercise of congressional authority under the Spending Clause—the U.S. equivalent of Australia’s section 96.<sup>247</sup>

Successfully attaching conditions to funding grants largely depends on proving that they are not coercive, but merely an influencer. Thus, in 2012, the Court held that conditioning the states’ receipt of the entirety of federal Medicaid funds was excessively coercive and an unconstitutional exercise of Congress’s spending power.<sup>248</sup> But in *Dole*, the conditions were not viewed as coercive because the federal government withheld only five percent of federal highway funds.<sup>249</sup>

The Uniform Interstate Family Support Act (UIFSA), drafted in 1996, is another example of conditions attached by the federal government to state funding. In 1996, Congress passed a law mandating that the states adopt UIFSA by January 1, 1998 or face the loss of federal funding for child support enforcement.<sup>250</sup> All of the states adopted the legislation within the mandated timeframe.<sup>251</sup> Granted, the condition attached to funding in the UIFSA context is directly tied to child support itself. However, that should not stop the federal government from attaching conditions that lack such direct functional connection. After all, the highway funding in *Dole* had no functional connection to the subject of the legal age for alcohol consumption; and as stated before, the federal government can condition tax credits to residents of a state based on that state’s agreement to withdraw from the income tax field.

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<sup>246</sup> *Id.* at 207–08, 211.

<sup>247</sup> U.S. CONST. art. I, § 8, cl. 1; *Dole*, 483 U.S. at 211–12.

<sup>248</sup> *National Fed’n of Indep. Bus. v. Sebelius*, 567 U.S. 519, 579–85 (2012).

<sup>249</sup> *Dole*, 483 U.S. at 211.

<sup>250</sup> See UNIF. INTERSTATE FAMILY SUPPORT ACT prefatory note (UNIF. LAW COMM’N 2008); see also 42 U.S.C. § 666(f) (2012).

<sup>251</sup> UNIF. INTERSTATE FAMILY SUPPORT ACT prefatory note.

Based on the two decisions discussed above, one can confidently conclude that the Supreme Court is receptive to arguments made in favor of conditioning federal funding grants to states so long as the conditions are not excessively coercive and pass the remaining factors of the *Dole* test. Thus, carefully crafted legislation cutting federal grants to states that do not agree to abolish their income tax systems by a reasonable percentage has a good likelihood of passing the five-factor test established by the *Dole* Court.

Hard facts on current state income tax compliance costs and the effect of the same on the national economy, together with failed attempts at state uniformity agreements such as the Compact, would provide the solid footing needed to set up a Spending Clause defense. The Court has broadly interpreted the General Welfare Clause, since the Great Depression, to include national economic interests. The text of that clause reads: “[P]rovide for the . . . general welfare of the United States.”<sup>252</sup> Surely, highlighting massive cost savings to businesses, which in turn cause those businesses to invest their savings in productive enterprises that create jobs and/or raise the national standard of living should be viewed as contributing to the “general welfare of the United States.”

Finally, an additional avenue of defense against a constitutional challenge can be found in the Commerce Clause.<sup>253</sup> As discussed earlier, the *Quill* Court clarified that nexus for purposes of the Commerce Clause refers not to notice or fairness concerns, but to the impact of state regulation on the national economy.<sup>254</sup> Highlighting the high costs of compliance, the inconsistent laws mentioned above, and the failures of state uniformity agreements would drive home the argument concerning the adverse impact of the state income tax systems on the national economy.

One difficulty that will be encountered in this context is the physical presence test of *Quill*, which held that physical presence is a “bright line” criterion that can bring an entity under the jurisdiction of a state.<sup>255</sup> One potential line of defense that can be used here would be to reiterate the size

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<sup>252</sup> U.S. CONST. art. 1, § 8, cl. 1.

<sup>253</sup> *Id.* cl. 3.

<sup>254</sup> *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 (1992).

<sup>255</sup> *Id.* at 317–18.

and scope of operations of large corporations, which still own property in multiple (if not all) states and worldwide, and consequently why physical presence alone should not guarantee jurisdiction, at least in the income tax arena. However, it is unclear how exactly the Supreme Court will rule in the matter of state taxes in general in 2018.<sup>256</sup> Of course, should the Supreme Court rule in favor of states in striking down the physical presence test for the imposition of sales and use tax, the primary argument to keep states out of the income tax field remains and can so be argued.

For better or for worse, the *Quill* Court said nothing of the relevance of the Commerce Clause to the income tax arena, which provides some flexibility to introduce additional arguments. Consequently, there should be no reason not to raise the Commerce Clause argument as an additional line of defense.

## V. CONCLUSION

The state income tax systems simply impose too many burdens and heavy compliance costs on businesses and the overall national economy. They also create an unnecessary burden for some individuals who find themselves in the precarious position of needing to file multiple state tax returns. The only practical solution to eliminating these costs is eliminating the state income tax systems altogether. State uniformity agreements are not an option due to the lack of commitment from the states and a lack of an appropriate mechanism of enforcement. The federal government must act through legislation that allows Congress to use its funding powers as a tool to influence the states to withdraw from the income tax arena. Such legislation can be defended against constitutional attack.

Of course, there are very real concerns about such legislation because it provides the federal government powers over a rather important source of revenue for the states. States are known to use their income and payroll tax revenue as collateral to obtain financing from private parties for various projects. With income tax cutoff as a direct source of revenue, the states will now have to look to the federal government for funding and may have no other source of revenue to pledge as collateral. Furthermore, what if the

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<sup>256</sup> See *South Dakota v. Wayfair, Inc.*, 901 N.W.2d 754 (S.D. 2017), *cert. granted*, 86 U.S.L.W. 3356 (U.S. Jan. 12, 2018) (No. 17-494).

federal government uses this as a tactical or strategic advantage to strong-arm the states into accepting its policies? We are already seeing such threats from the federal government in the context of state sanctuary laws for “Dreamer” and other undocumented immigrants, which personally touches the author of this Note.<sup>257</sup>

That said, the federal government is unlikely to immediately go back on its word after the passage of the legislation proposed in this Note. However, the danger does persist somewhere in the future, especially when a new administration unconnected to this legislation—or worse, opposed to this legislation—comes to power. Still, carefully crafted legislation with adequate protections embedded within it can prevent such strong-arm tactics and provide the states with reassurance that their sovereignty will not be threatened. One such protection would be the mandatory distribution of a state’s share of the federally collected tax revenue with no conditions attached, as is done by the federal government in India. This would assuage state concerns over funding and the lack of collateral. Rather than pledge state income and payroll tax revenue as collateral, states can use the federal government guarantee of tax revenue distribution to obtain financing from private lending institutions.

It must be reiterated that the goal here is to achieve a single income tax system at the federal level with a single tax rate and compliance procedures complimented by a corresponding distribution mechanism for the states. The Canadian model where the states retain the ability to set their own income tax rates is not the target goal. The goal rather is to remove the states from the income tax arena while simultaneously preserving their respective sovereignty. As such, the key here is to influence the states, as opposed to strong-arming them, to accept federal policy. If done correctly, and if federal legislators can get the backing of the various taxpaying constituents, then the legislation to eliminate the state income tax can pass muster and be successfully defended in the courts should a challenge arise. This can then be followed up with the third step, mentioned earlier,<sup>258</sup> concerning mandatory distribution of the collected tax revenue. Of course, the twist in the United

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<sup>257</sup> The author of this Note has personal experience with the personal and professional challenges faced by an immigrant, albeit being a documented immigrant. Some of these experiences and/or struggles are similar to those of an undocumented immigrant.

<sup>258</sup> See *supra* Part IV.B.1.b.

States must be heavier pressure and influence to persuade the states to abolish their income tax systems and attaching severe repercussions for their reestablishment.