Winn definition of the scope of what an assessment is by reading the term 'assessment' in the TIA broadly, and the Court needs to clean up the case law," he said.

"Since federal courts need jurisdiction before comity issues can come into play, the U.S. Supreme Court needs to clarify its *Commerce Energy* decision and explain that federal courts should first address whether jurisdiction exists under the TIA and then discuss whether comity supports declining jurisdiction," Newmark said.

Because the TIA turns on the definition of assessment, levy, or collection, the Court needs to define the word "assessment" either narrowly or broadly, Newmark said. It defined the term narrowly in *Winn* but the Tenth Circuit defined the term broadly in *Direct Marketing*. "The Court needs to address whether the Tenth Circuit's broad interpretation of assessment is an incorrect expansion of the definition of assessment expressed in *Winn* and thereby address how broadly applicable the TIA is," he said.

In *Commerce Energy*, the Court acknowledged that comity is a prudential doctrine that does not demand that courts force a case into state court when a state has consented to submit to the federal forum. Sicilian said a state can voluntarily submit to federal jurisdiction if the case is not barred by the TIA. Comity does not force a state out of federal court if the state chooses to be there.

Barnett agreed that states may sometimes want to consent to the federal forum, even in tax-related matters. In *Direct Marketing*, for example, it seemed that Colorado wanted to proceed in federal court in order to get an answer as quickly as possible, but that goal was frustrated when the court raised the TIA, he said.

That raises the practical problem the Court can address with *Direct Marketing*. With a reading of the TIA that expands to the bounds of comity, almost no cases even remotely involving state taxation will be able to be heard in federal court, even when a state agrees to submit itself to federal jurisdiction.

With *Direct Marketing*, a state's ability to submit to a federal forum is impeded because the TIA deprives federal courts of the ability to hear the case, even if comity is waived. In *Direct Marketing*, neither party raised the TIA as a bar to the court's jurisdiction, but the court extended the act to the bounds of comity expressed in *Commerce Energy* to preclude the case from federal court.

By granting certiorari, the Court has an opportunity to clarify that the TIA's jurisdictional bar is narrower than comity and to ensure that comity remains a relevant tool federal courts can use to respect state authority to decide both internal matters and whether to submit to federal jurisdiction. ✰

ECONOMIC ANALYSIS

The Pros and Cons of Federal-State Corporate Tax Harmonization

by Martin A. Sullivan — martysullivan@comcast.net

In Canada, 11 of 13 provinces and territories allow the federal government to collect and administer their corporate income taxes. When Ontario agreed to join that group in 2006, its government estimated that the benefit of "one tax form, one tax administration and one set of rules" would reduce annual compliance costs for corporations by C $100 million.[1] Under Canada's system, the corporate tax base is "almost completely harmonized" at the federal and provincial levels, and the provinces use a uniform allocation formula in which gross revenue and payroll are equally weighted.[2]

While federal/subfederal harmonization of corporate tax is a long-established reality for our neighbor to the north, in the United States it is only a tax reformer's dream. States do not have enough collective discipline to maintain a voluntary agreement that would coordinate their taxation. And although Congress has the authority under the commerce clause to control taxation of interstate business, it has little interest and even less of the functional agility necessary to enact such politically complex legislation.

That's too bad. The economic gains of a federal-state corporate tax system would be substantial. The simplification benefits would dwarf those under most stand-alone federal corporate reforms. Savings from reduced compliance costs would be large. Businesses would interact with only one tax authority and comply with just one set of tax rules. Tax planning costs would plummet because elaborate and expensive planning strategies would no longer be viable. Similarly, the cost to state governments of administering their corporate taxes would shrink. Under a harmonized federal-state corporate tax system, there would be no double taxation of corporate profits and far less opportunity to shift income into states with no corporate tax.

Many authors have commented on the problems of the lack of conformity and the benefits of harmonization. "Linking federal and state taxation systems makes inherent sense. . . . Reducing differences between the two systems saves resources for taxpayers and states alike, while also improving compliance," wrote David A. Super. "Saddling multistate businesses with this level of interstate complexity is a difficult policy to defend," according to Carolyn Joy Lee. "The administrative and compliance costs imposed by

[1] Ontario Ministry of Finance, "2006 Ontario Economic Outlook and Fiscal Review" (Oct. 26, 2006).

[2] Martha O'Brien, "Corporate Group Taxation: The Slow Lane to New Policies in Canada and the EU" (Feb. 2013).

seemingly trivial variations between tax systems present powerful grounds for desiring greater uniformity," said Daniel Shaviro. "The economic cost of the lack of uniformity . . . is hard to quantify, but it exists. The large number of persons who make their livings helping multistate companies comply with their differing tax obligations among the states proves the point," argued Peter L. Faber.[3]

The arguments against harmonization have little to do with economics. They are based on theories of government. If states mechanically adhered to corporate tax legislation written by Congress, they would lose the ability to regulate business behavior with their own tax credits, deductions, and definitions of taxable income. They would not be able to remove the effect of federal changes in corporate tax from their corporate regimes. That would reduce autonomy and diversity and increase federal power. It would give states fewer methods of engaging in corporate tax competition with other states.

States would, however, still be able to compete by adjusting their corporate tax rates. In one respect, harmonization could promote tax competition because businesses could assess relative corporate tax burdens simply by comparing statutory corporate tax rates.[4]

To get further perspective on what a harmonized corporate tax system would mean for the United States, this article presents estimates of what state corporate revenues would have been from 2001 through 2013 if the calculation of states' corporate tax liability were based almost entirely on federal corporate tax liability. In these estimates, each state gets a fraction of corporate tax revenue proportionate to its share of U.S. GDP, and then each state scales that fraction down to adjust for the difference between the federal rate and its own.

When compared with actual state revenues, the estimates reveal two aspects of harmonization — one favorable and one unfavorable. The favorable aspect is that adopting a harmonized system would allow states on average to reduce their corporate tax rates without revenue losses. In other words, the federal corporate tax base on average is broader than the state tax base. The second and unfavorable revelation is that adopting a harmonized system would make state corporate tax receipts significantly more volatile.

Same Basic Starting Point

Almost all states with corporate taxes require corporations to begin their calculation of taxable profit with profits reported on federal tax returns. So, expansions of the federal tax base (for example, during tax reform) or contractions (for example, in stimulus legislation) can have significant effects on state revenue. However, conformity is far from complete. States often decouple federal tax law changes from their tax rules. Under pressure to balance their budgets, states' decoupling usually expands their tax bases.

On the other hand, state lawmakers often make targeted changes that shrink their state's tax base. Those changes are often motivated by "the desire of politicians to tell their constituents that they succeeded in passing legislation that provided tax benefits," even though that legislation "often significantly complicates the law without producing positive economic and social consequences," according to Faber.

State tax planning adds to complexity and to revenue losses. The classic example of that is placing patents and trademarks in tax-free Delaware holding companies. That maneuver allows corporations to deduct royalties paid to the holding company against income in high-tax states. Many states have been able to counter that with throwback rules and combined reporting. But other, more complex strategies have been developed. In particular, the shift toward single- or double-weighting sales — which are more easily subject to manipulation than payroll and property — and uncertainty regarding apportionment of electronic commerce are making new planning techniques available.[5]

Not Much Reform

Between 2001 and 2013, 42 states consistently levied a corporate income tax similar to that levied by the federal system. Nevada, South Dakota, Washington, and Wyoming did not have a corporate tax during that period and are not included in the calculations that follow.

Four other states were excluded because their business taxes do not consistently resemble corporate taxes. New Hampshire imposes a business profits tax and a type of VAT on corporate and noncorporate businesses. Ohio began phasing out its corporate tax in 2005 and replaced it with a gross receipts tax. Texas enacted legislation in 2006 to replace its franchise tax with a low-rate margin tax that gave businesses the choice of three different tax bases. Michigan has a complicated history of oscillating between a VAT and a corporate tax, and since 2012 has had a 6 percent corporate tax. The District of Columbia, with a 9.75 percent corporate tax, is excluded from the calculation because of the difficulty in obtaining historical data.

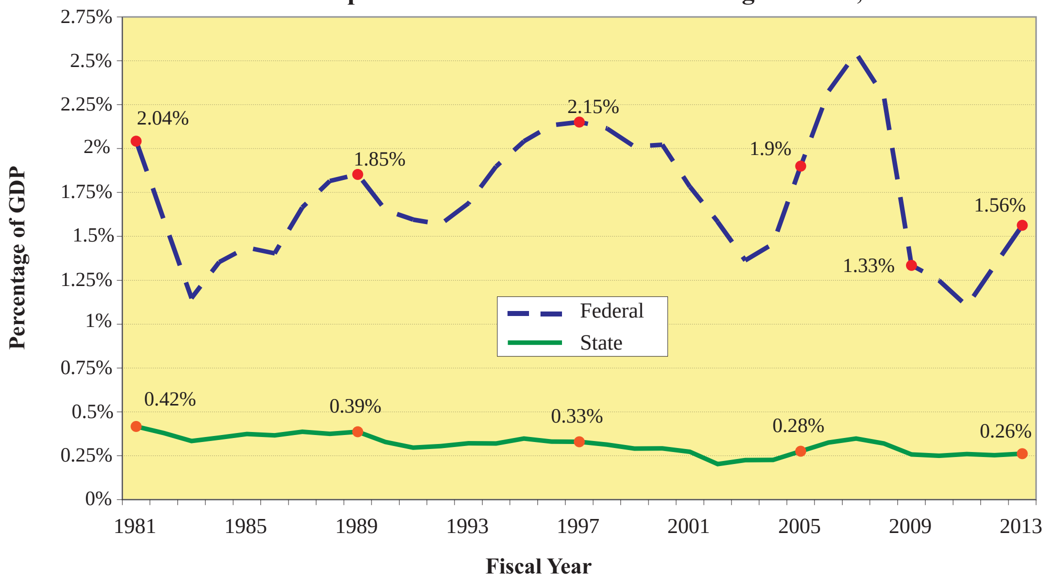
Figure 1 shows aggregated corporate revenue collections of those 42 states as a percentage of GDP from 2001 to 2013 as well as federal corporate tax receipts as a percentage of GDP over the same period. It illustrates two important facts about state corporate taxes. First, state corporate taxes are declining as a percentage of GDP. Second, they are less volatile over the business cycle than federal corporate taxes.

[3] *See* Super, "Rethinking Fiscal Federalism," 118 *Harv. L. Rev.* 2544 (June 2005); Lee, "State Corporate Income Taxes No Longer Make Sense," *State Tax Notes*, Apr. 17, 2006, p. 197; Shaviro, *Federalism in Taxation 3* (1993); Faber, "Should the States Determine Their Own Tax Destinies? Federalism in the 21st Century," *State Tax Notes*, Apr. 10, 2006, p. 111.

[4] *See* Ruth Mason, "Delegating Up: State Conformity With the Federal Tax Base," 62 *Duke L.J.* 1267 (Apr. 2013).

[5] *See* Charles F. Barnwell Jr., "State Tax Planning — What's Left?" *State Tax Notes*, Dec. 21, 2009, p. 857.

Figure 1.
Federal and State Corporate Tax Revenues as a Percentage of GDP, 1981-2013



Sources: U.S. Census Bureau, past issues of the "Monthly Treasury Statement," and historical data from the fiscal 2015 Budget of the United States. State data are for 42 states with corporate income taxes through the period. See text and notes for details.

Table 1 reports the simple and weighted average state statutory corporate tax rates. The weighted average rate is the average of state top statutory rates in each year, weighted by each state's share of U.S. total GDP in that year. In these calculations, states not in the group of 42 have a corporate tax rate of zero. Surprisingly, given all the clamor about state corporate tax reform during the last decade, the weighted average corporate tax rate of those states has hardly changed.

Welcome Rate Reduction

To see the potential impact of a harmonized federal-state system in the United States, the calculations below compute corporate state tax revenues, assuming corporations figure out their state tax liabilities by making two simple adjustments to reported federal tax liability.

First, to apportion federal liability to each state, that liability is multiplied by an apportionment fraction. The apportionment formula implemented under that system is not specified here. It is assumed that if each state had the same tax rate, the sum of each state's estimated revenue would be proportional to each state's GDP. Under that harmonized system, exactly 100 percent of income is allocated to each of the 50 states and the District. Thus, there is neither stateless income nor double taxation.

Second, to account for the difference between the federal and state corporate tax rates, the apportioned federal tax liability is multiplied by the ratio of the top state tax rate to the federal tax rate of 35 percent. That fraction is the same for all corporations reporting in each state in each year.

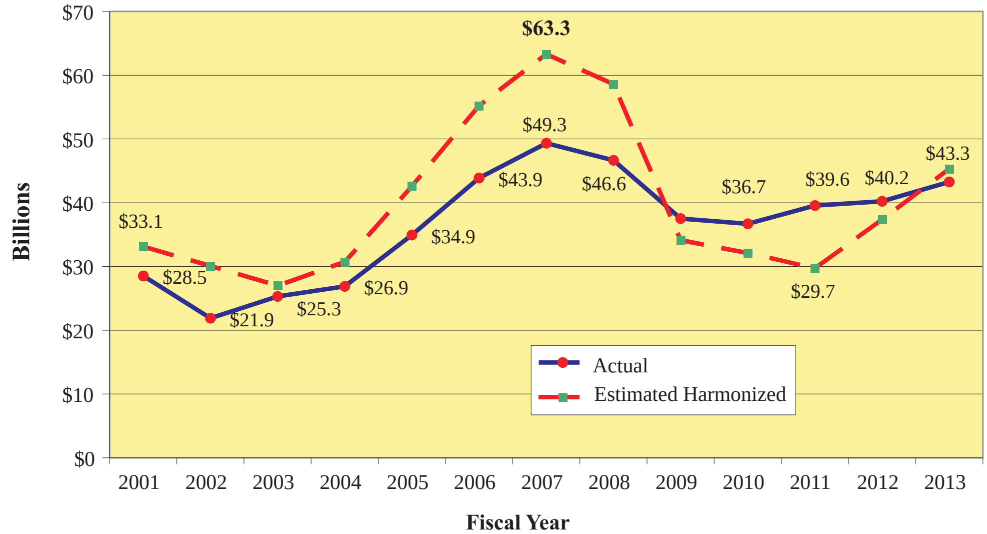
The assumption that whatever profit allocation is used will result in taxable profits being proportional to state GDP is far from bulletproof. If, for example, the allocation factor or factors adopted put proportionately more income in high-tax states — like California, Illinois, and New York — the estimates would understate the tax collected under a

Table 1. National Average State Corporate Tax Rate, 2001-2013

Year	Simple Average	Weighted-Average Corporate Rate*
2001	6.25%	6.22%
2002	6.21%	6.16%
2003	6.21%	6.16%
2004	6.26%	6.20%
2005	6.19%	6.19%
2006	6.17%	6.16%
2007	6.15%	6.15%
2008	6.12%	6.12%
2009	6.14%	6.14%
2010	6.12%	6.13%
2011	6.15%	6.19%
2012	6.13%	6.17%
2013	6.11%	6.14%

*Excludes Washington, D.C. Including the District adds approximately 0.06% to the weighted average corporate tax rate. Assumes a zero rate for Nevada, South Dakota, Washington, Wyoming, Texas, Ohio, Michigan, and New Hampshire. Weighted by state shares of GDP.

Figure 2.
Aggregate Corporate Tax Revenues of 42 States, 2001-2013



Source: U.S. Census Bureau and author's calculations of revenues from state corporate taxes harmonized with the federal corporate tax.

harmonized system. On the other hand, in the absence of data on corporate shares of traditional apportionment factors, it does not seem unreasonable to assume that if there is no double taxation and no income escapes tax (except in those states without corporate tax) that allocation of aggregate profits is proportionate to broad economic aggregates like state GDP.

Table 2. State Corporate Tax Receipts For 42 States, 2001-2013

Fiscal Year (ending June 30)	Actual (billions)	Estimated Under a Harmonized System (billions)
2001	$28.5	$33.1
2002	$21.9	$30.1
2003	$25.3	$27
2004	$26.9	$30.7
2005	$34.9	$42.6
2006	$43.9	$55.2
2007	$49.3	$63.3
2008	$46.6	$58.6
2009	$37.5	$34.1
2010	$36.7	$32.1
2011	$39.6	$29.7
2012	$40.2	$37.4
2013	$43.3	$45.3
Total	**$474.6**	**$519.1**

Sources: See notes at the end of this article.

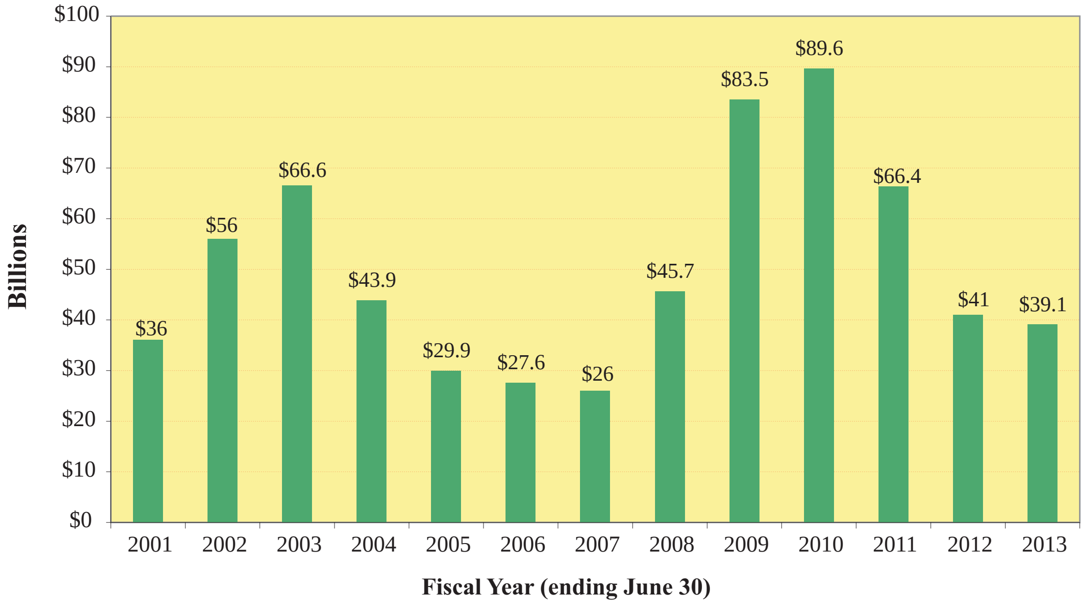
Table 2 shows actual state corporate tax receipts for 42 states and estimated receipts for those states under the harmonized system described above. From 2001 through 2013, those states collected $474.6 billion in corporate tax revenue. Under a harmonized system, estimated state revenue would have been $519.1 billion, approximately 9 percent larger. Thus, adoption of a federal corporate tax base would have allowed states to raise the same amount of revenue by reducing their average corporate rate by a little more than half a percentage point, from 6.16 percent to 5.63 percent.

Unwelcome Volatility

Figure 2 illustrates the differences between actual state receipts and estimated receipts if states adopted the federal corporate tax base. The most striking difference between the two is far greater volatility of tax receipts when the federal tax base is used. As noted above, the harmonized tax system on average would have raised more revenue than was actually raised. But on a year-to-year basis, the relationship between the two estimates varies greatly. When the economy is weak, receipts from state corporate taxes harmonized with the federal corporate tax drop close to, or even fall below, actual receipts. As seen in Figure 2, harmonized receipts almost equaled actual receipts after the relatively mild recession of 2002, and harmonized receipts were below actual receipts in the four years immediately following the financial crisis.

One factor that contributes to the muted volatility of state corporate tax receipts is the generally more restrictive state tax rules on the use of net operating losses. More than

Figure 3.
Federal Corporate Tax Refunds, 2001-2013



Source: Prior issues of U.S. Treasury's "Monthly Treasury Statement."

30 states prohibit NOL carrybacks entirely.[6] Figure 3 shows that federal corporate tax refunds are large in the same years the excess of harmonized tax receipts over actual tax receipts (shown in Figure 2) is small or negative. In those years, net state receipts would not recede as much as federal receipts because corporations with losses have more restrictions on their ability to carry those losses back to prior years and obtain refunds.

A second factor contributing to reduced volatility of state corporate tax revenue is the practice by many states of decoupling from federal corporate tax cuts enacted to provide stimulus. During the last two recessions, the federal government allowed extremely generous depreciation schedules in order to encourage businesses to quickly expand capital expenditures. But many states, hard-pressed by reduced tax revenues and the enlarged costs of social programs and hemmed in by balanced budget requirements, gave priority to fiscal probity over stimulus.

Of the 42 states considered in this article, 25 completely (or almost completely) decoupled from the bonus depreciation enacted by Congress in 2008 (and extended in 2009, 2010, and 2012). The remaining 17 allowed corporations to use bonus depreciation to calculate profits taxable under their corporate taxes. The data in Table 3 indicate that states that decoupled experienced less revenue volatility than states that did not. States that decoupled had average revenue reductions of 25.2 percent between 2007 and 2010. States that did not decouple had an average reduction in corporate revenue of 37.4 percent over that period.

Table 3. Average Change in Corporate Tax Revenues, 2007-2010

25 states that decoupled from bonus depreciation	-25.2%
17 states that allowed bonus depreciation	-37.4%

Sources: Data from prior tables. Information about state laws from Jessica Lechuga, "State Conformity with Federal Bonus Depreciation Rules," Bloomberg BNA, Aug. 31, 2013.

Conclusion

Between 2001 and 2013, the revenue-raising effects of decoupling have not completely offset the revenue-losing effects of state-level tax expenditures and state tax planning. Thus, in addition to significant reduction of administration and compliance costs and increased economic efficiency resulting from removing the differences in the computation of taxable income, harmonization would yield all the classic benefits of corporate rate reduction.

The biggest economic problem with a harmonized federal-state system would be an exacerbation of already problematic state revenue volatility. During recessions, the federal government typically passes legislation that reduces corporate taxes in order to stimulate business spending. That creates big swings in federal corporate tax revenue. State corporate receipts have been much steadier because states often do not adopt federal anti-recession tax cuts and because state laws have built-in automatic revenue stabilizers. Under a harmonized federal-state corporate tax system,

[6]Karen Nakamura et al., "Beware of State-Federal NOL Differences," *J. Acct.* (Aug. 2010).

the federal government could alleviate the problems of state revenue volatility by providing more aid to states during recessions in tandem with any corporate tax cuts.

Notes

State revenue data are reported on a fiscal-year basis for fiscal years ending June 30. GDP data (reported on calendar-year basis) and federal government receipts (usually reported for fiscal years ending September 30) are adjusted for the calculations here to line up with state fiscal years.

The Tax Foundation maintains historical corporate tax rate information. The reported rates are those in effect on January 1 of the year indicated, which is the middle of state's fiscal years.

State corporate tax revenues are from the U.S. Census Bureau historical data on state government tax collections. Those data do not include corporate tax revenue collected by the District and are reported for fiscal years ending June 30 of the year indicated.

Federal corporate tax revenues for 12-month periods ending June 30 for 1999 through 2013 were collected from back issues of "Monthly Treasury Statement" from the U.S. Treasury Department Bureau of the Fiscal Service. For 1980 though 1998, corporate tax receipts for the 12-month period ending June 30 of any year were estimated by adding (1) the product of 0.75 and federal government fiscal-year figures (ending September 30) of that year and (2) the product of 0.25 for the fiscal-year total of the prior year.

National GDP data are from Table 1.1.5, "Gross Domestic Product," of the National Income and Product Accounts of the Bureau of Economic Analysis of the U.S. Commerce Department. State GDP figures are from the Regional Economic Accounts of the Bureau of Economic Analysis. For both national and state GDP, in order to approximate GDP during fiscal years ending June 30, GDP for the indicated fiscal year equals one-half of the GDP of the calendar year indicated and the calendar year before the year indicated.

Harmonized state tax revenue is calculated in two steps. First, an amount equal to federal tax revenue is divided among the states in proportion to each state's GDP in each year. Then, that amount is multiplied by the ratio of the state's statutory rate in that year to the federal rate of 35 percent. For the purposes of these calculations, the eight states not included and the District are assumed to have corporate tax rates of zero. ✰

Qui Tam *Troubles, Part IV: Does New York Have the Answer?*

by Amy Hamilton — amy_hamilton@tax.org

This is the final article in a series on qui tam *suits. The first two discussed suits in Illinois that have generated national discussion regarding potential abuses of state false claims acts that extend to taxes. The third article shared a practitioner's thoughts on* qui tam *and whistleblower statutes generally. This article discusses New York's approach to tax fraud suits, which is being heralded as a possible model for both state and federal regimes.*

Randall Fox is the former bureau chief of the New York attorney general's Taxpayer Protection Bureau, which enforces the state's expanded False Claims Act and works with whistleblowers filing *qui tam* cases. Before he moved into private practice at Kirby McInerney LLP in April, Fox's responsibilities included handling New York's nearly $400 million sales tax case against Sprint Nextel Corp.

But Fox is no stranger to big-ticket False Claims Act cases. Before the creation of the Taxpayer Protection Bureau in 2011, Fox worked in the AG's Medicaid fraud unit, where he represented New York in its False Claims Act case against pharmaceutical giant Merck & Co. The government argued that it was defrauded when it paid Merck for prescriptions for the pain medication Vioxx after the company allegedly misrepresented the dangers the drug posed to users; the case settled nationwide for $980 million.

Fox says states should follow New York's example and apply their false claims acts to alleged tax fraud. While a series of *qui tam* tax suits in Illinois is dominating national discussion regarding potential abuses of state false claims acts that extend to taxes, whistleblowers and their advocates have praised New York's approach as a possible model for both state and federal lawmakers. Fox said the *qui tam* process is important because it enables the government to leverage the assistance of insiders with knowledge about tax fraud perpetrated at the highest levels.

"Financial incentives are essential to encouraging whistleblowers to disclose corporate fraud that otherwise might go undetected by the government," Fox said. It's not easy to be a whistleblower, "so there has to be a reward to encourage people to take that step," he said. In addition to treble damages for those found guilty of fraud in a False Claims Act case, whistleblowers in New York suits can receive up to 25 percent of any revenue collected by the state as a result of the information they provide. "It's basic capitalism, really, to use a whistleblower's profit motive to fight against a tax cheat's profit motive," Fox said.

Keys to *Qui Tams*

Then a state senator, New York AG Eric Schneiderman (D) four years ago spearheaded the expansion of the state's False Claims Act to tax matters. According to a source at the AG's office, officials consider three components of the