SPECIAL REPORT

TAX ANALYSTS

IMPLICATIONS OF A FEDERAL CONSUMPTION TAX FOR STATE & LOCAL TAX ADMINISTRATION

by Robert P. Strauss

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In this report, Strauss examines the potential impact either the Nunn-Domenici USA Tax or the Hall-Rabushka flat tax would have on state and local tax administration.

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I. Introduction

Discussion continues this fall about the possibility of replacing the federal system of income and wealth taxes with a federal flat tax that would be based primarily on consumption. Variants of the Hall-Rabushka plan continue to attract attention in Congress, and some elected officials promise to eliminate the Internal Revenue Service as we currently know it.

For state tax administrators, such proposals may complicate their jobs, because cooperation between the IRS and state tax administrators has continued to grow. Tax return information flows increasingly not only from the IRS to the states to assist in state tax administration, but from the states to the IRS, which assists the IRS in doing its federal tax administration tasks.

My purpose here is to elaborate on how and where such changes in the federal tax system would affect the states, and how such changes might affect what we can know about the overall economy. These remarks build on an earlier paper,[1] and are part of a larger study under way for a conference on this subject in January 1997 for the American Tax Policy Institute in Washington.[2]

II. Implications of Consumption Tax Variants

Three types of consumption taxation have been discussed periodically at the national level to replace the current federal income taxes on households and businesses: (1) a consumption-based VAT that could be credit-invoice, subtraction, or addition method; (2) a household income tax with a deduction for savings (Nunn-Domenici or unlimited savings allowance tax) and a subtraction-method VAT; and (3) a household wage tax and subtraction-method value added tax collected from business (Armey I and II). Currently, options (2) and (3) are mentioned most frequently when national consumption taxation is raised, although Rep. Bill Archer, R-Texas, chair of the House Ways and Means Committee, has publicly endorsed a national sales tax, which would represent a fourth option.[3]

A. State Implications of Nunn-Domenici

For the states, a household income tax with a deduction for savings[4] would have the least impact on their current administrative relationships between the IRS

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[1]*See* Strauss (1995).

[2]There are a number of recent papers dealing with various aspects of federal consumption taxation and the states. *See* Bucks (1995), Duncan and Alt (1993), Duncan and McLure (1996), Gold (1995), and Shannon (1995).

[3]While a national sales tax has not generally been considered likely by observers of the federal tax policy process, one did pass the Ways and Means Committee during the early years of the Great Depression.

[4]*See* S. 722, introduced by Sens. Nunn and Domenici on April 25, 1995.

and themselves, because income would continue to need to be defined in the Internal Revenue Code, from which savings, newly defined in the Internal Revenue Code, would be subtracted to arrive at taxable consumption. Also, it seems likely that current definitions of exclusions from income, deductions from income, and exemptions and standard deductions would continue to be in the code, so that state reliance on federal tax law, regulations, and court decisions, as well as information exchanges, could continue to administer a range of tax bases, from their current household income bases to the newly defined federal household consumption tax base. Of course, state-level policy questions would arise about whether or not any state would prefer to move its household income tax base to the federal household consumption tax base, but from an administrative point of view this would not seem to create any insurmountable difficulties.

The Nunn-Domenici (USA) tax would eliminate the federal corporate income tax and replace it with a subtraction-method value added tax with a deduction or expensing of investment. This business tax base would be considerably broader than the current income tax base. Also, because depreciation would be eliminated and only external costs deductible, the current state reliance on line 28 of federal form (or pro forma federal form) 1120 for information and the underlying constructs in the code would be difficult to maintain.

As Auten and Toder (1996) have emphasized, business would become more significant as a point of collection of federal taxes under the USA tax scheme. Should the states follow both new federal household and business tax bases, they would find that business would be the larger point of collection, which in turn would put greater emphasis on nexus and apportionment issues. Thus, while the USA tax would allow the states to continue to administer a household income tax, it is unlikely that movement by the federal tax system to the value added taxation of business would permit the states to use the new federal business value added tax return information to continue to impose state-level corporate income taxes.

B. State Implications of Hall-Rabushka

The Hall-Rabushka plan, as expressed through Armey's proposals, would be sufficiently different from both federal household and business income taxes, however, to have major implications for state household and business taxation. Under the Hall-Rabushka plan, the federal household and business income taxes would be replaced by a household tax on wage income and pension benefits and a modified subtraction-method VAT on business:

household tax = t (wages + employer-provided pension benefits) (1)

business tax = t (gross receipts − investment − employee compensation − employer pension contributions − external purchases) (2)

Equation (1) indicates that income from capital (interest, dividends, capital gains, rents, and royalties) would no longer be in the household tax base. Equation (2) indicates that investment would be expensed, to make the value added tax a consumption tax, that employee compensation would be deductible, because it is taxed progressively in Equation (1), and that external purchases would be deductible to make the business tax base a VAT base.

Some measure of the importance of capital income to state household income tax bases can be obtained by examining, by state, the ratio of interest, dividends, and rent to personal income before transfers.[5] Table 1 shows these calculations for four years, and sorts the states by the 1994 percentage of capital income (highest to lowest). Capital income ranges from about 10 to 20+ percent per state using Bureau of Economics Analysis (BEA) data, and displays the secular growth for the states in the importance of capital income as a percentage of pretransfer personal income (1969-94).

Because most federal proposals to eliminate or modify the federal income tax do not change federal *employment* taxes (notably for the social security trust funds and unemployment insurance system), it is reasonable to assume that the IRS would continue its role as the administrator of these employment taxes, and that federal withholding on wages would continue. On the other hand, if household income from capital were no longer directly measured per the Hall-Rabushka approach, then the states would find that they would know considerably less about households than before. Certainly they would cease to have an independent check on household declarations of capital income. As long as capital income received by households must be deducted per Nunn-Domenici to arrive at household consumption, then the states could maintain their household income taxes if they chose to.

A second way to look at the potential impact on particular states of federal movement to a federal household tax on wages, vis-á-vis the current federal household tax on income, is to look at the composition of state tax revenues. Table 2 displays this for 1990 using Census Bureau data on state tax collections. Among state governments, Oregon relies most heavily (65.5 percent of state tax revenues are from the state individual income tax) on the individual income tax; New York relies the second most heavily on state individual income taxes (53.5 percent). Thirty-one states rely at least 30 percent on their state individual income taxes among own-source state tax revenues. Thus, a significant fraction of state tax collections could be involved if the *form* of the federal consumption tax precluded continued state use of their household income taxes. While a national sales tax may not be as likely in terms of federal adoption at this juncture, we can resort to the states in Table 2 by reliance on general sales tax to see which might be most affected. Here the notion of "affect" means the multiple administration (federal and state) of the same tax base.[6]

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[5]Data are from the Bureau of Economic Analysis, U.S. Department of Commerce, Regional Economic Information System (CD-ROM), June 1996.

[6]*See* Mikesell (1996) for an analysis of the most recent federal retail sales tax proposal.

Table 1
Ratio of Capital Income (Interest, Dividends, Rent) to Personal Income Before Transfers (BEA Concepts) by State, Selected Years

State	1969	1979	1989	1994
Florida	19.9%	22.0%	27.0%	24.2%
Wyoming	14.8%	13.5%	20.2%	19.4%
Montana	14.1%	17.0%	21.6%	19.0%
Delaware	16.8%	13.6%	18.7%	18.3%
New Jersey	14.4%	15.3%	19.8%	18.0%
Vermont	14.6%	15.5%	19.7%	18.0%
Nebraska	14.9%	16.4%	19.1%	17.6%
Oregon	14.3%	15.1%	19.2%	17.5%
Missouri	13.6%	15.1%	20.1%	17.5%
Connecticut	16.9%	16.7%	19.4%	17.4%
New Hampshire	14.7%	14.6%	18.8%	17.3%
Iowa	14.5%	17.1%	19.5%	17.2%
Arizona	15.6%	15.9%	19.5%	17.1%
New York	16.7%	16.5%	19.9%	17.0%
Pennsylvania	13.0%	13.0%	18.5%	16.8%
Kansas	13.2%	15.0%	19.6%	16.7%
Illinois	13.9%	14.6%	19.0%	16.5%
Colorado	15.0%	14.4%	18.3%	16.5%
Idaho	13.8%	16.4%	19.7%	16.5%
Michigan	12.1%	12.3%	17.6%	16.3%
South Dakota	13.0%	15.8%	19.1%	16.3%
Massachusetts	16.5%	14.9%	18.5%	16.3%
Rhode Island	14.3%	14.4%	18.7%	16.2%
Virginia	11.2%	12.7%	17.4%	16.0%
Washington	13.4%	13.9%	17.4%	16.0%
Maine	13.9%	13.6%	17.8%	15.9%
Wisconsin	13.6%	13.7%	17.7%	15.9%
Nevada	12.8%	13.8%	17.3%	15.7%
California	14.7%	15.2%	16.9%	15.4%
Minnesota	13.4%	14.1%	17.2%	15.3%
Idaho	11.9%	14.2%	16.4%	15.2%
Maryland	12.1%	12.9%	16.5%	15.0%
Ohio	12.6%	12.8%	17.1%	15.0%
New Mexico	11.8%	12.4%	17.1%	14.8%
Oklahoma	12.6%	13.0%	17.5%	14.8%
District of Columbia	13.4%	12.7%	17.1%	14.7%
Kentucky	10.3%	11.3%	16.7%	14.3%
Indiana	11.2%	12.9%	16.5%	14.2%
Georgia	10.4%	11.2%	15.5%	13.8%
Texas	12.6%	12.7%	16.9%	13.8%
Arkansas	11.3%	12.5%	16.4%	13.7%
Louisiana	11.1%	11.3%	16.7%	13.6%
North Carolina	9.7%	10.9%	15.6%	13.6%
Hawaii	13.6%	13.8%	14.4%	13.4%
South Carolina	9.0%	10.0%	12.8%	13.2%
Alabama	9.6%	10.1%	14.7%	12.8%
Utah	11.4%	11.2%	14.2%	12.5%
Tennessee	10.2%	11.1%	15.1%	12.3%
Mississippi	9.1%	9.8%	14.2%	11.7%
Alaska	7.4%	7.9%	11.2%	10.9%

Table 3 indicates that, in 1990, Florida derived 61.6 percent of its state tax revenues from its general sales and use tax, while Washington derived 60.2 percent.[7] Again, 31 states derived at least 30 percent of their own-source tax revenues from general sales and use taxes. Because the states do not rely on federal administration in the collection of their current general sales and use taxes, they would not be directly affected by federal adoption of a national sales tax. On the other hand, it is likely that considerable political pressure would grow for state-federal conformity in the provision of exemptions.

C. Local Government Implications

Because local income and sales taxes are the constitutional creatures of state government, the impact of the alternative federal consumption taxes on local governments would depend entirely on how state policy evolved. We can diagnose potential fiscal effects on local governments by looking at their use of local income and sales taxes by state. Tables 4 and 5 display analogous information for reliance on local income taxes and local sales and use taxes.

Few states' localities would be affected by movement from a federal household income tax to a federal household consumption tax, but a fair number of states' localities would be affected should the federal government move to a national sales tax. Only the localities in Maryland raise 30 percent of their total local taxes from the individual income taxes; only five states' localities (Maryland, D.C., Kentucky, Ohio, and Pennsylvania) raise more than 10 percent of total own-source taxes from the individual income tax. This suggests that the impact of the federal government vacating the personal income tax would be far more modest on local governments.

On the other hand, local government reliance on the general sales and use tax is far more significant; local governments in 21 states derived more than 10 percent of their own-source tax revenues from general sales and use taxes. Four states' localities derived more than 30 percent, and another five states' localities derived between 20 and 30 percent.

III. Federal Disclosure of Information

Under section 6103 of the Internal Revenue Code, state tax administration agencies can, if they maintain nondisclosure procedures comparable to those of the federal government, enter into an agreement with the IRS that permits them to receive federal tax returns to help them administer their tax systems. All states currently are signatories to such agreements; thus non-income-tax states receive federal tax return information to help them administer their systems of gross receipts and sales and use taxes.

As a consequence of amendments to section 6103 in 1976, the Internal Revenue Service is required to make annual reports to the Joint Committee on Taxation about the extent and nature of their disclosures of tax return information. Besides the aforementioned dis-

(Text continued on p. 612.)

[7] If one adds to Washington's sales and use tax the fraction of tax revenues derived from gross receipts taxes, the reliance on consumption taxes rises to better than 80 percent.

Table 2
States Ranked by Individual Income Taxes as Percentage of State Taxes in 1990

State	Property	Gen. Sales	Household Inc.	Business Inc.	Other Taxes
Oregon	0.0%	0.0%	65.5%	5.2%	29.1%
New York	0.0%	20.9%	53.5%	6.6%	19.0%
Massachusetts	0.0%	20.9%	52.4%	9.3%	17.3%
Virginia	0.2%	20.4%	46.7%	4.6%	27.8%
Maryland	2.6%	24.3%	44.3%	4.5%	24.1%
Colorado	0.2%	26.9%	43.7%	4.0%	25.0%
North Carolina	1.3%	22.6%	43.2%	0.8%	25.3%
Minnesota	0.2%	27.4%	42.3%	7.1%	23.2%
Georgia	0.3%	37.3%	40.4%	6.8%	15.2%
Delaware	0.0%	0.0%	40.4%	10.4%	49.2%
Wisconsin	0.7%	30.3%	40.0%	6.7%	22.4%
California	4.9%	31.4%	38.8%	11.3%	13.6%
Iowa	0.0%	28.5%	38.4%	6.0%	27.1%
Vermont	0.0%	20.4%	37.6%	4.1%	37.6%
Maine	2.0%	32.7%	37.2%	3.6%	24.5%
Utah	0.0%	39.9%	36.5%	5.4%	18.2%
Missouri	1.8%	38.5%	36.2%	4.5%	20.6%
Ohio	0.0%	31.4%	36.1%	5.6%	26.9%
Idaho	0.0%	33.6%	35.4%	6.3%	24.5%
South Carolina	0.2%	36.8%	35.0%	3.9%	23.9%
Rhode Island	0.8%	32.3%	34.7%	5.6%	26.8%
Michigan	3.0%	28.1%	34.5%	16.0%	18.4%
Indiana	0.0%	41.8%	34.2%	5.6%	18.2%
Illinois	1.8%	31.7%	33.3%	7.3%	26.0%
Nebraska	0.2%	33.6%	32.8%	4.7%	28.7%
Arkansas	0.4%	37.2%	32.7%	5.7%	24.1%
Montana	12.2%	0.0%	32.6%	9.4%	45.8%
Kansas	1.1%	32.7%	32.0%	7.9%	26.1%
Hawaii	0.0%	50.3%	29.8%	4.1%	15.8%
Alabama	2.4%	27.1%	29.2%	4.7%	36.4%
Oklahoma	0.0%	24.2%	28.7%	2.7%	44.2%
Kentucky	7.1%	25.5%	28.4%	6.6%	32.4%
New Jersey	0.2%	31.6%	28.2%	10.7%	29.3%
Pennsylvania	1.3%	31.9%	24.4%	8.3%	34.1%
Arizona	5.4%	43.9%	24.2%	4.1%	22.3%
West Virginia	0.0%	34.2%	23.2%	9.9%	32.5%
Louisiana	1.1%	31.0%	18.1%	9.6%	40.2%
New Mexico	1.2%	41.4%	18.0%	3.0%	36.2%
Mississippi	3.0%	45.5%	17.9%	5.1%	28.5%
North Dakota	0.2%	34.1%	15.6%	7.0%	43.0%
Connecticut	0.0%	46.4%	11.6%	13.0%	29.2%
New Hampshire	1.0%	0.0%	6.8%	21.3%	70.6%
Tennessee	0.0%	55.2%	2.4%	7.9%	34.7%
Nevada	1.7%	50.6%	0.0%	0.0%	47.6%
Texas	0.0%	51.9%	0.0%	0.0%	48.1%
Washington	14.9%	60.2%	0.0%	0.0%	24.9%
Florida	2.3%	61.6%	0.0%	5.3%	30.7%
Wyoming	12.5%	26.6%	0.0%	0.0%	61.0%
Alaska	6.0%	0.0%	0.0%	11.9%	82.4%
South Dakota	0.0%	50.0%	0.0%	6.0%	44.0%

Table 3
States Ranked by General Sales Taxes as Percentage of State Taxes in 1990

State	Property	Gen. Sales	Household Inc.	Business Inc.	Other Taxes
Florida	2.3%	61.6%	0.0%	5.3%	30.7%
Washington	14.9%	60.2%	0.0%	0.0%	24.9%
Tennessee	0.0%	55.2%	2.4%	7.9%	34.7%
Texas	0.0%	51.9%	0.0%	0.0%	48.1%
Nevada	1.7%	50.6%	0.0%	0.0%	47.6%
Hawaii	0.0%	50.3%	29.8%	4.1%	15.8%
South Dakota	0.0%	50.0%	0.0%	6.0%	44.0%
Connecticut	0.0%	46.4%	11.6%	13.0%	29.2%
Mississippi	3.0%	45.5%	17.9%	5.1%	28.5%
Arizona	5.4%	43.9%	24.2%	4.1%	22.3%
Indiana	0.0%	41.8%	34.2%	5.6%	18.2%
New Mexico	1.2%	41.4%	18.0%	3.0%	36.2%
Utah	0.0%	39.9%	36.5%	5.4%	18.2%
Missouri	1.8%	38.5%	36.2%	4.5%	20.6%
Georgia	0.3%	37.3%	40.4%	6.8%	15.2%
Arkansas	0.4%	37.2%	32.7%	5.7%	24.1%
South Carolina	0.2%	36.8%	35.0%	3.9%	23.9%
West Virginia	0.0%	34.2%	23.2%	9.9%	32.5%
North Dakota	0.2%	34.1%	15.6%	7.0%	43.0%
Idaho	0.0%	33.6%	35.4%	6.3%	24.5%
Nebraska	0.2%	33.6%	32.8%	4.7%	28.7%
Kansas	1.1%	32.7%	32.0%	7.9%	26.1%
Maine	2.0%	32.7%	37.2%	3.6%	24.5%
Rhode Island	0.8%	32.3%	34.7%	5.6%	26.8%
Pennsylvania	1.3%	31.9%	24.4%	8.3%	34.1%
Illinois	1.8%	31.7%	33.3%	7.3%	26.0%
New Jersey	0.2%	31.6%	28.2%	10.7%	29.3%
California	4.9%	31.4%	38.8%	11.3%	13.6%
Ohio	0.0%	31.4%	36.1%	5.6%	26.9%
Louisiana	1.1%	31.0%	18.1%	9.6%	40.2%
Wisconsin	0.7%	30.3%	40.0%	6.7%	22.4%
Iowa	0.0%	28.5%	38.4%	6.0%	27.1%
Michigan	3.0%	28.1%	34.5%	16.0%	18.4%
Minnesota	0.2%	27.4%	42.3%	7.1%	23.2%
Alabama	2.4%	27.1%	29.2%	4.7%	36.4%
Colorado	0.2%	26.9%	43.7%	4.0%	25.0%
Wyoming	12.5%	26.6%	0.0%	0.0%	61.0%
Kentucky	7.1%	25.5%	28.4%	6.6%	32.4%
Maryland	2.6%	24.3%	44.3%	4.5%	24.1%
Oklahoma	0.0%	24.2%	28.7%	2.7%	44.2%
North Carolina	1.3%	22.6%	43.2%	0.8%	25.3%
New York	0.0%	20.9%	53.5%	6.6%	19.0%
Massachusetts	0.0%	20.9%	52.4%	9.3%	17.3%
Vermont	0.0%	20.4%	37.6%	4.1%	37.6%
Virginia	0.2%	20.4%	46.7%	4.6%	27.8%
Oregon	0.0%	0.0%	65.5%	5.2%	29.1%
Alaska	6.0%	0.0%	0.0%	11.9%	82.4%
Montana	12.2%	0.0%	32.6%	9.4%	45.8%
Delaware	0.0%	0.0%	40.4%	10.4%	49.2%
New Hampshire	1.0%	0.0%	6.8%	21.3%	70.6%

Table 4
States Ranked by Local Individual Income Tax as Percentage of Total Local Taxes in 1990

State	Property (2)	Gen. Sales (3)	Household Inc. (4)	Business Inc. (5)	Other Taxes (6)
Maryland	58.1%	0.0%	30.2%	0.0%	11.9%
District of Columbia	31.5%	20.2%	27.7%	6.1%	14.7%
Kentucky	50.2%	0.0%	27.4%	0.0%	22.5%
Ohio	67.8%	6.5%	22.0%	0.0%	3.5%
Pennsylvania	67.2%	0.0%	21.3%	0.0%	11.4%
Delaware	84.0%	0.0%	9.9%	0.0%	5.7%
New York	61.1%	16.8%	8.5%	5.6%	8.1%
Indiana	88.8%	0.0%	8.4%	0.0%	2.5%
Missouri	57.7%	21.4%	7.0%	0.0%	13.6%
Michigan	92.7%	0.0%	5.0%	0.0%	2.5%
Alabama	36.7%	38.1%	3.5%	0.0%	21.8%
Iowa	95.8%	1.6%	0.3%	0.0%	2.4%
Alaska	86.0%	9.6%	0.0%	0.0%	3.5%
Arizona	78.6%	15.7%	0.0%	0.0%	5.7%
Arkansas	72.6%	18.1%	0.0%	0.0%	9.6%
California	69.4%	15.1%	0.0%	0.0%	15.8%
Colorado	68.7%	25.8%	0.0%	0.0%	5.5%
Connecticut	98.4%	0.0%	0.0%	0.0%	1.6%
Florida	81.8%	0.3%	0.0%	0.0%	18.2%
Georgia	69.0%	18.9%	0.0%	0.0%	11.8%
Hawaii	78.8%	0.0%	0.0%	0.0%	21.4%
Idaho	96.6%	0.0%	0.0%	0.0%	3.7%
Illinois	75.3%	13.8%	0.0%	0.0%	10.7%
Kansas	83.8%	10.8%	0.0%	0.0%	5.6%
Louisiana	43.4%	48.3%	0.0%	0.0%	8.3%
Maine	99.0%	0.0%	0.0%	0.0%	1.0%
Massachusetts	96.9%	0.0%	0.0%	0.0%	3.1%
Minnesota	94.9%	0.3%	0.0%	0.0%	4.7%
Mississippi	94.0%	0.0%	0.0%	0.0%	6.0%
Montana	96.9%	0.0%	0.0%	0.0%	3.1%
Nebraska	88.8%	6.6%	0.0%	0.0%	4.4%
Nevada	66.3%	1.1%	0.0%	0.0%	32.6%
New Hampshire	99.3%	0.0%	0.0%	0.0%	0.7%
New Jersey	98.1%	0.0%	0.0%	0.0%	1.9%
New Mexico	56.1%	34.4%	0.0%	0.0%	9.4%
North Carolina	69.0%	27.2%	0.0%	0.0%	3.8%
North Dakota	93.2%	3.9%	0.0%	0.0%	3.0%
Oklahoma	59.0%	35.3%	0.0%	0.0%	5.7%
Oregon	89.6%	0.0%	0.0%	0.0%	10.6%
Rhode Island	98.6%	0.0%	0.0%	0.0%	1.4%
South Carolina	91.8%	0.0%	0.0%	0.0%	8.2%
South Dakota	80.0%	15.6%	0.0%	0.0%	4.4%
Tennessee	60.8%	28.0%	0.0%	0.0%	11.2%
Texas	81.7%	12.0%	0.0%	0.0%	6.2%
Utah	77.5%	15.3%	0.0%	0.0%	7.2%
Vermont	99.3%	0.0%	0.0%	0.0%	0.5%
Virginia	71.9%	9.7%	0.0%	0.0%	18.6%
Washington	54.2%	19.2%	0.0%	0.0%	17.4%
West Virginia	79.9%	0.0%	0.0%	0.0%	19.7%
Wisconsin	97.3%	0.5%	0.0%	0.0%	2.2%
Wyoming	85.7%	11.0%	0.0%	0.0%	3.3%

Table 5
States Ranked by Local General Sales Tax as Percentage of Local Taxes in 1990

State	Property (2)	Gen. Sales (3)	Household Inc. (4)	Business Inc. (5)	Other Taxes (6)
Louisiana	43.4%	48.3%	0.0%	0.0%	8.3%
Alabama	36.7%	38.1%	3.5%	0.0%	21.8%
Oklahoma	59.0%	35.3%	0.0%	0.0%	5.7%
New Mexico	56.1%	34.4%	0.0%	0.0%	9.4%
Tennessee	60.8%	28.0%	0.0%	0.0%	11.2%
North Carolina	69.0%	27.2%	0.0%	0.0%	3.8%
Colorado	68.7%	25.8%	0.0%	0.0%	5.5%
Missouri	57.7%	21.4%	7.0%	0.0%	13.6%
District of Columbia	31.5%	20.2%	27.7%	6.1%	14.7%
Washington	54.2%	19.2%	0.0%	0.0%	17.4%
Georgia	69.0%	18.9%	0.0%	0.0%	11.8%
Arkansas	72.6%	18.1%	0.0%	0.0%	9.6%
New York	61.1%	16.8%	8.5%	5.6%	8.1%
Arizona	78.6%	15.7%	0.0%	0.0%	5.7%
South Dakota	80.0%	15.6%	0.0%	0.0%	4.4%
Utah	77.5%	15.3%	0.0%	0.0%	7.2%
California	69.4%	15.1%	0.0%	0.0%	15.8%
Illinois	75.3%	13.8%	0.0%	0.0%	10.7%
Texas	81.7%	12.0%	0.0%	0.0%	6.2%
Wyoming	85.7%	11.0%	0.0%	0.0%	3.3%
Kansas	83.8%	10.8%	0.0%	0.0%	5.6%
Virginia	71.8%	9.7%	0.0%	0.0%	18.6%
Alaska	86.0%	9.6%	0.0%	0.0%	3.5%
Nebraska	88.8%	6.6%	0.0%	0.0%	4.4%
Ohio	67.8%	6.5%	22.0%	0.0%	3.5%
North Dakota	93.2%	3.9%	0.0%	0.0%	3.0%
Iowa	95.8%	1.6%	0.3%	0.0%	2.4%
Nevada	66.3%	1.1%	0.0%	0.0%	32.6%
Wisconsin	97.3%	0.5%	0.0%	0.0%	2.2%
Minnesota	94.9%	0.3%	0.0%	0.0%	4.7%
Florida	81.8%	0.3%	0.0%	0.0%	18.2%
Connecticut	98.4%	0.0%	0.0%	0.0%	1.6%
Delaware	84.0%	0.0%	9.9%	0.0%	5.7%
Hawaii	78.8%	0.0%	0.0%	0.0%	21.4%
Idaho	96.6%	0.0%	0.0%	0.0%	3.7%
Indiana	88.8%	0.0%	8.4%	0.0%	2.5%
Kentucky	50.2%	0.0%	27.4%	0.0%	22.5%
Maine	99.0%	0.0%	0.0%	0.0%	1.0%
Maryland	58.1%	0.0%	30.2%	0.0%	11.9%
Massachusetts	96.9%	0.0%	0.0%	0.0%	3.1%
Michigan	92.7%	0.0%	5.0%	0.0%	2.5%
Mississippi	94.0%	0.0%	0.0%	0.0%	6.0%
Montana	96.9%	0.0%	0.0%	0.0%	3.1%
New Hampshire	99.3%	0.0%	0.0%	0.0%	0.7%
New Jersey	98.1%	0.0%	0.0%	0.0%	1.9%
Oregon	89.6%	0.0%	0.0%	0.0%	10.6%
Pennsylvania	67.2%	0.0%	21.3%	0.0%	11.4%
Rhode Island	98.6%	0.0%	0.0%	0.0%	1.4%
South Carolina	91.8%	0.0%	0.0%	0.0%	8.2%
Vermont	99.3%	0.0%	0.0%	0.0%	0.5%
West Virginia	79.9%	0.0%	0.0%	0.0%	19.7%

closures for state tax administration purposes, section 6103 authorizes disclosure to the Joint Committee on Taxation (and the GAO on behalf of the Joint Committee), other federal agencies for law enforcement purposes, disclosures to foreign tax authorities under Treasury tax treaty agreements, and the Bureau of the Census and Bureau of Economic Analysis for federal statistical purposes.[8]

Reports for calendar years 1980 through 1994 indicate that federal tax return information to state tax authorities and to Census and BEA for statistical purposes were far and away the two largest categories of recipients of federal income tax information. Total disclosures of federal tax return information grew from about 200 million disclosures in 1980 to about 900 million disclosures in 1994; they have been as high as 1.1 billion disclosures in 1992 and 1993. The state share of these disclosures has grown from as little as 20+ percent in 1982 to as high as 85 percent in 1990. Disclosure of federal tax return information for statistical purposes has averaged about 150 million disclosures until 1994, when it fell to 34 million disclosures. See Figures 1, 2, and 3.[9]

The FTA is currently surveying its membership to identify the revenue importance to the states of the current exchange agreement. Increasingly, large amounts of state tax return and other administrative information is being shared to the IRS to assist them with their administrative activities. New York has indicated that better than $250 million in additional state revenues has resulted from the receipt of various IRS records.

Federal income tax return information on households and business are used in the development of our quarterly GNP accounts, and are used to help benchmark a large variety of Census Bureau activities, from the accurate measurement of the size and composition of high-income households to the construction of small area estimates of inter-Censual population counts.

Were such household and business income information no longer available to the states, it is unclear the extent to which state revenues might be affected, but it easily could be substantial.

With regard to what we know about the national and regions' economic position as a consequence of the use of federal tax return information by federal statistical agencies, it is likely that in the short run there could be a major information loss. However, as long as the measurement of the subtraction VAT captured all equipment expensing, then certain kinds of capital outlays could continue to be tracked; however, the nonmeasurement of the household receipt of various kinds of capital income could create a "hole" in the current flow of funds. Presumably as focus on the form of the federal consumption tax grows, the manner in which we would be able to measure capital flows from such administrative records would become more important. Foreign experience could prove helpful, although it should be recalled that all industrialized countries with consumption VATs also have household and business income taxes, which in some countries are fairly substantial as well.

IV. Conclusions

From an administrative point of view, the current state reliance on household income taxes could continue under the USA tax proposed by Senators Nunn and Domenici, but not under a flat consumption tax of the Hall-Rabushka variety endorsed by Rep. Armey. Federal tax law, regulations, court decisions, and administrative infrastructure would continue to enable the application of state household income taxes even if the federal government moved to a household consumption tax defined as income-savings.

Both the USA and Hall-Rabushka taxes would tend to collect greater revenues from businesses than before, and, because the new federal business-level tax would be a subtraction VAT, the states would not have the federal legal and administrative infrastructure in place to easily continue to impose business income taxes.

Because federal employment taxes for funding the social security and unemployment trust funds would continue, it is likely that the withholding system on wages would continue as we know it. On the other hand, the withholding and reporting systems represented by the various federal Forms 1099 and processes would disappear under a Hall-Rabushka form of consumption tax (but not under a USA form of consumption tax), which would likely seriously impede the ability of the states to continue to tax capital income if they chose to.

The rapid growth in federal disclosure of tax return information to the states is likely due to the improved 1099 process. The revenue impacts of this are not yet understood, though New York estimated that its use of federal tax return information resulted in an additional $275 million per year.

The impact on the federal statistical system of the elimination of the federal income tax could turn out not to be trivial, and materially affect what we know about ourselves and our society. Both quarterly gross domestic product and distributional data problems could arise were capital income not captured via the federal tax system. Also, because the states use such information in their own forecasting, there could be secondary administrative repercussions that could affect state-level budgeting.

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[8]Federal tax return information is also shared to the states to assist child support enforcement activities under section 6103(l)(6).

[9]Data are from the annual disclosure reports prepared by the IRS and provided by the Joint Committee on Taxation.

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Figure 1
Total Number of Federal Tax Return Disclosures (Tape and Nontape) by Calendar Year

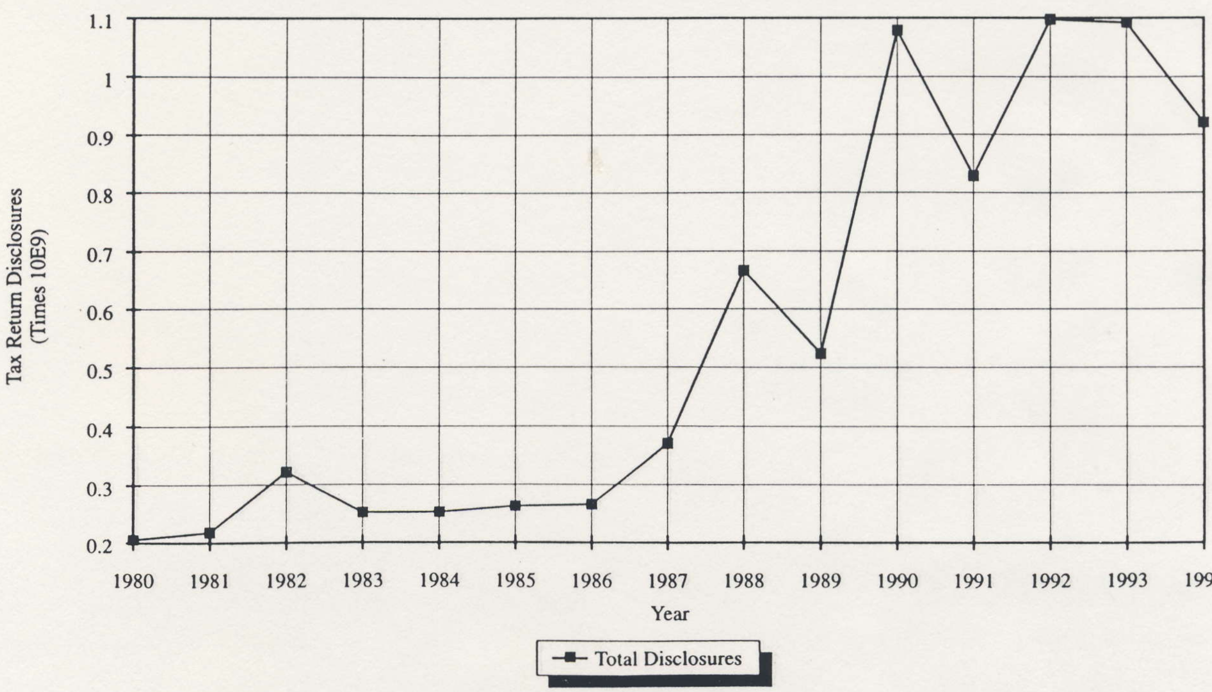

Figure 2
Number of Federal Tax Return Disclosures (Tape and Nontape) to States and Federal Statistical Uses by Calendar Year

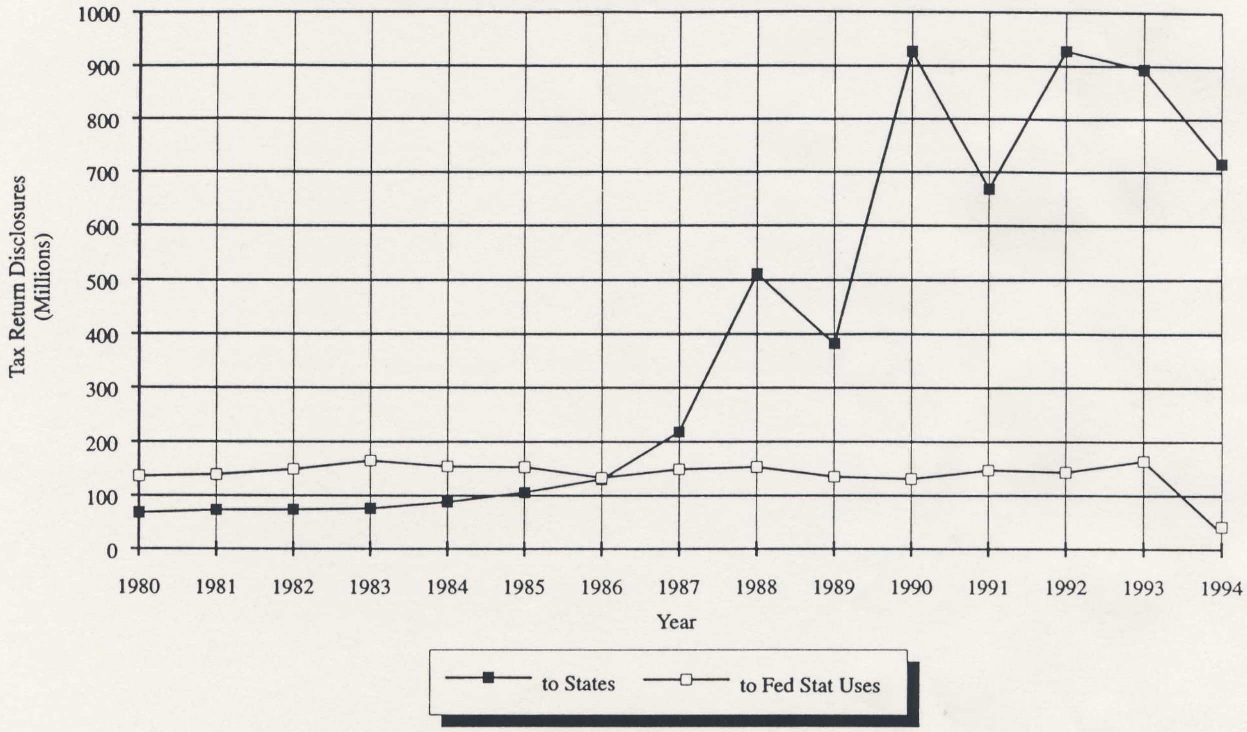

Figure 3
Share of Federal Tax Return Disclosures (Tape and Nontape) to States and Federal Statistical Uses by Calendar Year