# Top 5 Guiding Principles for State Tax Laws and Administration

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When states and localities consider tax legislation and regulations and their tax administrators administer their state's tax laws, the following principles gleaned from best practices as articulated in our constitutions, in tax cases, and from other respected sources can assist them in bettering the tax climates in their jurisdictions. While there are other common sense principles that should likewise be honored, like predictability, states and localities whose legislators and administrators consistently honor the principles below can be anticipated to be considered to have the best tax climates.

## CLARITY AND SIMPLICITY

State and local tax statutes and regulations should be clear. "Taxing laws should be plain and precise, for they impose a burden upon the people." *George v. Scent*, 346 S.W.2d 784, 789 (Ky. 1961). As such, ambiguous taxing statutes are strictly construed against the government. *Id.* In contrast, ambiguous exemption statutes are strictly construed against the taxpayer, which is sometimes said to preserve equality in the burden of taxation. *Panther II Transp., Inc. v. Seville Bd. of Income Tax Rev.*, 8 N.E.3d 904, 910 (Ohio 2014). These rules of strict construction, however, do not apply when the statutory language is plain and unambiguous. *Columbia Gas Transm. Corp. v. Levin*, 882 N.E.2d 400, 409 (Ohio 2008). As such, clear tax laws are applied as written and not in any party's favor. Accordingly, it is best when tax laws are written as clearly as possible so that the legislature's intent governs.

Clarity goes hand in hand with simplicity. So, with state and local income taxes for example, it is best that the starting point for the tax base, i.e., federal taxable income, conform with the most current version of the Internal Revenue Code of 1986, as amended (the "Code"), with any differences required for budgetary reasons (*e.g.*, depreciation) specifically enumerated. Likewise, simplicity may be achieved when a state's tax laws conform with uniform laws, like the Uniform Division of Income for Tax Purposes Act (UDITPA) which provides a uniform method of dividing income between states for state and local income tax purposes and like the Streamlined Sales and Use Tax Agreement (SSUTA) which, among other things, provides for uniform definitions for state and local sales and use tax purposes. The SSUTA also provides for central administration and filing of local sales and use taxes which simplifies and thus encourages and facilitates compliance. Filing one return for hundreds of local sales and use taxes is obviously much simpler than the alternative. Indeed, the simplicity provided by SSUTA played a large part in the United States Supreme Court's decision in *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018), which overturned the previous "physical presence" nexus requirement.

States and localities should avoid becoming outliers, which creates complexity especially for multistate taxpayers. Being an outlier creates a disproportionately heavy burden on taxpayers, which have to put in compliance processes for just one jurisdiction. Moreover, the tax administrator of an outlier provision has to create compliance guidance from scratch. There are often unintended and unforeseen consequences when a state opts to adopt an outlier tax. An example illustrates when states have considered becoming an outlier and then opted not to after more in depth consideration. In the sales tax context, states generally do not tax professional services due to the complexities involved with such a tax, and while several states like Florida, Michigan and Maryland have proposed such taxes, each state ultimately rejected the idea of imposing sales tax on professional services. None of these states wanted to become an outlier.

## DUE PROCESS

As to disputed state and local taxes, the best practice is that "[t]axpayers should not be required to post bond or pay a disputed tax before an initial hearing. It is unfathomable that taxpayers may still be denied a fair hearing before being deprived of property (*i.e.*, disputed taxes)." *COST Scorecard on State Tax Appeals & Procedural Requirement: The Best and Worst of State Tax Administration* (Dec. 2019). Indeed, the United States Supreme Court has recognized that, "Because exaction of a tax constitutes a deprivation of property, [a] State must provide procedural safeguards against unlawful exactions in order to satisfy the commands of the Due Process Clause." *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco, Dept. of Business Regulation of Florida*, 496 U.S. 18, 36 (1990). The same goes for localities.

Not only must a taxpayer be provided with "a fair opportunity to challenge the accuracy and legal validity of their tax obligation" but that remedy must be "clear and certain". Id. at 39. States and localities should communicate to taxpayers what the clear path is to dispute a tax obligation. There should be no ambiguity or guesswork.

And, and when taxpayers overpay their taxes, they should get a refund. "An honorable government would not keep taxes to which it is not entitled...." *Pittsburgh & Midway Coal Min. Co. v. Arizona Dept. of Revenue*, 776 P.2d 1061, 1065 (Ariz. 1989).

## FAIR TREATMENT (UNIFORMITY AND EQUAL PROTECTION)

Tax laws should foster fair, uniform and equal treatment among taxpayers and tax burdens, especially in the property tax area. Many federal and state constitutional provisions were put in place to protect taxpayers from disparate treatment. For example, the Equal Protection Clause of the United States Constitution entitles owners of similarly situated property to roughly equal tax treatment. *Allegheny Pittsburgh Coal Co. v. Cty. Comm'n*, 488 U.S. 336 (1989); *A.F. Moore & Associates, Inc., et al. v. Cook County Treasurer, et al.*, 948 F.3d 889 (7th Cir. 2020). In addition to the state-equivalent of the federal Equal Protection Clause, states typically also have constitutional provisions requiring uniformity. For example, in *Steager v. Consol Energy, Inc.*, 832 S.E.2d 135 (W. Va. 2019), the West Virginia Supreme Court held that, that there was a violation of uniformity, not due to an over-valuation of the therein involved gas wells per se, but rather due to the use of two differing formulas to calculate

operating expenses, which resulted in some wells receiving the full benefit of a deduction in calculating their values and others being denied it.

The administration of tax laws and the enactment of tax laws that create disparate treatment among taxpayers should be avoided.

## AVOID UNDUE BURDEN ON INTERSTATE COMMERCE (COMMERCE CLAUSE)

Taxes should not impose a burden on interstate commerce in violation of the Commerce Clause or the Due Process Clause of the United States Constitution. The four-part test for whether a state tax statute or regulation is constitutional under the Commerce Clause as articulated by the United States Supreme Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) asks whether the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state. *Comptroller of Treasury of Maryland v. Wynne*, 575 U.S. 542, 547 (2015); Wayfair, 138 S. Ct. at 2091. The Due Process Clause also imposes limitations on states as well with regard to state taxes; first, there must be some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax; and, second, the tax base attributed to the taxing state must be rationally related to values connected with the taxing state. *North Carolina Dept. of Revenue v. The Kimberley Rice Kaestner 1992 Family Tr.*, 139 S. Ct. 2213, 2220 (2019).

State and local tax laws and regulations that either facially or as administered violate the Commerce Clause or the Due Process Clause are invalid. So, it is important for legislators and administrators to consider these limitations before enacting or administering tax laws.

## AVOID DOUBLE TAXATION AND PYRAMIDING

Double taxation and pyramiding, *i.e.*, a tax on a tax…, – which have each been referred to as an "evil", a somewhat severe but fair value judgement – should be avoided. See, *e.g.*, *Burnet v. Chicago Portrait Co.*, 285 U.S. 1, 7 (1932); *Indiana Dept. of Revenue v. Interstate Warehousing, Inc.*, 783 N.E.2d 248, 251 n. 2 (Ind. 2003). Double taxation, especially with an interstate component, generally indicates that there may be a Commerce Clause violation. *Maryland v. Wynne*, 575 U.S. at 561-62. Pyramiding of taxes is essentially a cousin of double taxation. Avoiding sales tax pyramiding is why states provide for resale exemptions, including traditional sale for resale, manufacturing, etc. Given the evils of pyramiding, in construing an ambiguous tax statute, a construction that causes a pyramiding of taxes should be avoided. *George v. Scent*, 346 S.W.2d at 790.

When considering tax legislation, proposed tax regulations, and tax administration practices, legislators and tax administrators should consider the above guiding principles for the good of the jurisdiction's tax system.

This is a modified version of Mark A. Loyd's regular column, *Tax in the Bluegrass*, "Top 5 Guiding Principles for State Tax Laws and Administration" which appeared in Issue 5, 2021 of the Kentucky CPA Journal.

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