

Article

Fiscal federalism in the United States of America



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ABSTRACT:

The author explains the functioning of the decentralized system of the United States of America and its legal bases in the concept of federalism. He emphasizes that the tax authority is one of the most formidable powers of government. Such power is shared among the Federal government, the states, and local communities, as described in the federal constitution and the constitutions of each state. The article begins with a general discussion of the tax authority, its nature, its purposes, and its use. This follows with an explanation of the legal bases of Federalism in the Federal Constitution and the jurisprudence of the federal courts. Later, the author exposes about the tax system of the Federal government and the legal bases for the distribution of the resources collected among the states. He ends with some general observations. These include observations on aspects of the system that have generated critical comment and observations on the factors responsible for the well-functioning of the US tax system..

PALABRAS CLAVES:

constitución política;
sistema tributario;
principios tributarios;
federalismo fiscal;
jurisprudencia
constitucional.

RESUMEN:

El autor explica el funcionamiento del sistema descentralizado de los Estados Unidos de América y sus bases jurídicas en el concepto de federalismo. Pone de relieve que la potestad tributaria es uno de los poderes más formidables del gobierno. Dicho poder se comparte entre el gobierno Federal, los estados, y las comunidades locales, según se describe en la constitución federal y las constituciones de cada estado. El artículo comienza con una discusión general de la autoridad tributaria, su naturaleza, sus fines, y su uso. Este sigue con una explicación de las bases jurídicas del Federalismo en la Constitución Federal y la jurisprudencia de los tribunales federales. Después, el autor expone sobre el sistema impositivo del gobierno Federal y las bases jurídicas para la repartición de los recursos recaudados entre los estados. Finaliza con algunas observaciones generales. Entre ellos, se incluyen observaciones sobre los aspectos del sistema que han generado comentarios críticos y observaciones sobre los factores responsables por el bien funcionamiento del sistema tributaria estadounidense.

MOTS CLES :

constitution politique;
régime fiscal; principes
fiscaux; fédéralisme
fiscal; jurisprudence
constitutionnelle.

RESUME :

L'auteur explique le fonctionnement du système décentralisé des États-Unis d'Amérique et ses bases juridiques dans le concept de fédéralisme. Il souligne que l'administration fiscale est l'un des pouvoirs les plus redoutables du gouvernement. Ce pouvoir est partagé entre le gouvernement fédéral, les États et les communautés locales, comme décrit dans la constitution fédérale et les constitutions de chaque État. L'article commence par une discussion générale sur l'administration fiscale, sa nature, ses objectifs et son utilisation. Suit une explication des bases juridiques du fédéralisme dans la Constitution fédérale et la jurisprudence des tribunaux fédéraux. Plus tard, l'auteur expose le système fiscal du gouvernement fédéral et les bases juridiques de la répartition des ressources collectées entre les États. Il se termine par quelques observations générales. Il s'agit notamment d'observations sur des aspects du système qui ont suscité des commentaires critiques et des observations sur les facteurs responsables du bon fonctionnement du système fiscal américain.

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1 INTRODUCTION

1.1 ORGANIZATION OF THE PRESENTATION

The purpose of this presentation is to explain the functioning of the decentralized system of the United States of America and its legal bases in the concept of federalism. It is estimated that within the US experience, there are some elements that other countries may use in the effort to decentralize the taxation process.

The tax authority is one of the most formidable powers of government. Through this authority, a government can create and it can destroy.

In the United States of America, tax authority is shared between the Federal government, the states, and local communities. This separation of authority between these governments is called “Federalism”, what is enshrined in the Federal Constitution and the individual constitutions of the fifty states.

We begin with a general discussion of the tax authority – its nature, its purposes, and its use. We continue with an explanation of the legal bases of Federalism in the Federal Constitution, how taxation competence is divided between the Federal government and the states. We end with some general thoughts. These include observations on aspects of the system that have generated critical comment and observations on the factors responsible for the well-functioning of the US tax system.

1.2 BASIC CONCEPTS

1.2.1 Nature of a tax:

It is defined as a mandatory payment to a government authority by persons within the authority's jurisdiction. (A mandatory financial social charge imposed by a government authority.) Oliver Wendall Holmes ¹commented that the obligation to pay taxes is "the price we pay for a civilized society"

The tax is an economic charge on individuals or property in order to support the government. It should not be confused with the power of eminent domain (which is the government's power to seize property for public purposes) (See: [New Jersey v. Anderson, 1906](#)); [Houck v. Little River Drainage, 1915](#)). It is not a fee paid in exchange for specific benefits, but rather a modality for the distribution of the burden of government costs. The only benefit that the taxpayer enjoys from paying taxes is the privilege of living in an organized society, established and secured by the dedication of taxes to public purposes ([Cotton Petroleum Corp v. New Mexico, 1989](#)).

1.2.2 Tax Authority

In a democracy, the government's taxing authority derives from the people. In other words, it is the people who train their governments with the tax power. By their nature, taxes can only be used for public purposes.

Limitations on the power to tax are provided in the United States Constitution (the “Constitution”) and in the constitutions of all 50 states (the “Constitutions”), both in the text of the clauses that specifically enshrine this power in the government authorities as in the other provisions, as well as those that pertain to the rights of substantive due process, due process, and equal protection under the laws.

¹A highly respected former Supreme Court Justice during the first third of the twentieth century.

1.2.3 Purpose of Taxes

The main objective of a tax system is simply to finance the cost of government and the corresponding services. But, it is used for other purposes as well. They include:

(a) *Implement social policy.* Examples: redistribution of wealth – social leveling through a system of progressive rates. Well, in theory, those with more resources not only pay more but they pay a higher percentage of what they have than the percentage paid by the less fortunate; encourage marriage – more favorable rates and deductions for married couples; stimulate the number of children – deductions and credits based on number of children; encourage a homeowners association; stimulate investment in housing for the less fortunate; discourage gambling: gains taxed, but losses are not deductible; Historic Preservation: Credits and Exemptions; support charities, scientific institutions, amateur sports associations, religious institutions, and private educational institutions – special NGOs, except political and commercial ones; support a retirement and private social security system through deductions for contributions from the employer and employee, and from professionals and independent businessmen (own account); high rates on cigarettes, alcohol, to discourage these activities; encourage higher education with credits and deductions for expenses incurred.

(b) *Implement economic policy.* For example: lower rates or suspend them to put more money in the consumer's pocket to stimulate the economy: stimulate some industries: credits for investment; tax exemptions for businessmen and industrialists who establish or invest in some specialized areas; interest exemption from taxes accrued on special bonds for industrial development

(c) *Implement environmental policy.* For example: Credits and deductions with respect to investments in equipment to eliminate emissions of carbon, sewage, etc.; Lower rates for properties left in their natural state; High rates on the use of some fuels, cars that eat a lot of gasoline, etc.; Forest conservation: credits and deductions.

(d) *Implement Policy for Policy System.* For example: Fundraising for political parties; Fundraising for causes (Salvation of the Chesapeake Bay); Vote use tax (now illegal as a result of the 24th Amendment); Deductions and credits for special industries provided by relevant politicians (often disguised as economic policy); Exemption from interest earned on state bonds sold to the public to strengthen state and municipal governments

1.2.4 Tax Types

The main categories of taxes are the following:

(a) *On income:* What a person -- individual and entity -- earns from his work in a year, from his investments, and from his other work activities (buying and selling his residence, etc.);

(b) *On the value of the property of the Taxpayer:* Property of the deceased that passes to others in successions; Donor property given away or donated to others; he; Estate; Personal property, such as -- cars, boats, other equipment, luxuries; Intangibles (sometimes called "Excise Tax"; the value of imported products (generally federal, with limited exceptions for states authorized by Federal Congress); Real Estate (mainly imposed by local governments)

(c) *On the Use² or Sale* of goods based on the sale price paid (mainly taxed by states and local jurisdictions): “Excise Tax” instead of or in addition to the regular use or consumption taxes that are imposed on the sale of specific items, which include – tires, alcohol, cigarettes, restaurant food, fuel, hotel services (federal, state, and local)³;

(d) *On Government Transactions*: Examples are: registration of titles of real estate and personal property; Professional and business licensing (mainly state and local).

2 THE LEGAL BASIS OF FEDERALISM

2.1 BASIC CONCEPTS

A Constitution is an agreement between the people by means of which a government is established and these powers are assigned to it. Within the Constitution, the people define the breadth or scope of these powers, as well as their limitations.

In the United States, there are various governmental authorities established in accordance with the United States Constitution (Constitution) and state constitutions. The most significant are: The Federal Government, also known as the “United States Government,” the governments of the fifty states and the District of Columbia and the Commonwealth of Puerto Rico (hereinafter the states); and local governments, which typically include counties, municipalities, incorporated towns, and special districts. The authority of the Federal Government to Tax is found specifically in Article 1, Section 8 cl.1, and the XVI amendment. Its place as the first of the 18 powers delegated to Congress in Section 8 of Article I attests to its importance.

It is widely known that the US Constitution provides for a system of checks and balances. The Constitution, of 1787, together with its 27 amendments adopted since then, is the Federal Constitution. The challenge for the framers of the Constitution in 1787 was to find a formula that would give the government sufficient power to govern without unduly limiting the fundamental rights and liberties of the people and the powers of state governments. Therefore, the Constitution divides powers among various actors through a system of checks and balances. In this way, the accumulation of excessive power in a single person or institution is avoided. Well, there are three main themes in this Constitution:

(a) *Federalism* -- The nature of states; the relationship between the states, and more importantly, the relationship between the states and the Federal government.

(b) *Separation of Powers*: The distribution of authority and functions between a legislative power, an executive power, and a judicial power.

(c) *Civil Rights*: The fundamental rights of the people against their government and the balance between these rights and the needs of governance.

Like the Federal government, each state is governed by its own constitution. State constitutions address the issues of separation of powers and civil rights. They also contain provisions on the decentralization of authority between the central government of the state and the subdivisions of the state, that is, the local governments.

² Use tax is imposed by a state on the sale price of a product purchased in a state where a sales tax was not imposed and used in the taxing state.

³ VAT – Value Added Tax for each phase of product production is not very common. Only one state is known to have adopted it, Michigan in 1989.

2.2 THE FEDERAL CONSTITUTION -- FEDERALISM: AN OVERVIEW

2.2.1 The Nature of States.

According to Article IV of the Constitution, the states must be republics. That is, they are democratic governments -- of the people, for the people, and by the people. They all have their own governor and legislature elected by their citizens, and their own court system with judges elected by the citizens or appointed by the governor and/or legislature. Most laws in the United States are state laws, not Federal. In fact, states retain many of the characteristics of sovereign countries. However, their sovereignty is a sovereignty limited by specific provisions of the Constitution.

2.2.2 Relations between States:

Article IV, Section 1 provides that each state must grant "full faith and credit" to the legal orders and administrative acts of the other. That is, for example, they must recognize marriages and divorces granted by others; they must recognize and participate in the execution or fulfillment of sentences of the courts of the other states; must recognize driver's licenses from other states; and must recognize corporations established under the laws of other states.

Likewise, Article IV, Section 2, requires that each state grant to the citizens of the others the same privileges and immunities that it grants to its own citizens. This provision does not prohibit, for example, a state from charging citizens of other states a special fee for studies at its state universities, but requires that the state discriminating in such a way have a justifiable reason -- OR have a substantial objective or purpose within the scope of its legitimate powers and that the measure imposed is substantially related to the legitimate objective.⁴

2.2.3 Relationship between Federal Government and State Government

The initial scheme as explained in *Federalist Papers* N° 45 and N°46, drafted by Alexander Hamilton and James Madison. The purpose of these "papers" was to serve as the social media of the time. In other words, propaganda to sell the concept of a federal government to the people in 1787. They provide: "The powers enshrined in the federal government by the Constitution are few and well defined. Those that replace in the states are many and indefinite. Principally, the powers of the federal government are directed to external objects -- war, peace, international negotiation, and commerce The powers reserved for the states extend to all ordinary objects of daily life -- liberty, property, public order, improvement and prosperity of the people (police powers)".

2.2.4 Dual Sovereignty Concept

According to *Federalist Paper* 46: The federal and state governments are not adversaries. They are simply different agents or trustees of the people, constituted with different powers and designed for different purposes... By its nature, it is true that the town will be more tied to its own state government. However, if this were to change, there would be no reason to perceive dominance by the federal government because its jurisdiction is well circumscribed."

⁴ In the case of assistance to universities, the justification is that outsiders do not pay all the taxes paid by citizens of the state that are allocated to state support for the institution. Therefore, the higher rate is a way to ensure that students from abroad support the university in a more or less equal way.

2.2.5 Supremacy of Federal Law in When the Faculties Overlap

There are areas in which the powers of the Federal Government and those of the states overlap. The General rule, enshrined in the second clause of Article VI of the Constitution, known as the "Supremacy Clause", is that in case of conflict of powers, federal law is supreme. The judges of the courts, both those of the Federal Government like those of the states, they are obliged to recognize the supremacy of federal law in these cases (*Martin v. Hunter Lessee*, 1816).

2.2.6 Structural Tensions Over the Division of Authority Between the Federal Government and the States: The Commerce Clause

Notwithstanding Madison's words, beginning in the third decade of the twentieth century, the intervention of the federal government in daily life became quite widespread through a legislative and judicial interpretation of the so-called commerce clause. This Clause, found in clause 3 of Article I Section 8 of the Constitution, assigns to the Federal government, through Congress, the power to regulate trade between states, with foreign states, and with indigenous tribes. Pursuant to Supreme Court case law, any economic activity within a state that has a substantial impact on or substantially affects interstate commerce may be regulated by the Federal Government (*Wickard v. Filburn*, 1942). Based on this interpretation, Congress adopted, and the courts approved, federal laws that prohibit discrimination and violation of civil rights by individuals in all states, laws (*Katzenbach v. McClung*, 1964) that regulate employment relationships within the States, as well as security conditions, hours maximums, minimum wage, and relations between unions and employers (*United States v. Darby*, 1941). By virtue of this expansion of federal power into these areas previously reserved for the states in accordance with Madison's and Hamilton's initial design of federalism, dual sovereignty was all but over. But due to changes in the composition of the Supreme Court in the 1980s, this expansion of Federal power was halted with the *United States v. Lopez* (1995).⁵ Since then, the Supreme Court has issued a series of rulings that recognize and strengthen the sovereignty of states. Today the concept of "dual sovereignty" is well revived.

2.2.7 Concurrent Powers

In practice, the line between what is the responsibility of the state and what is the responsibility of the Federal Government is not always very clear. What is certain is that during the last 233 years, the courts have handed down hundreds of sentences in order to clarify it. History proves that the definition changes according to the political/legal philosophy of the members of the Supreme Court, and it will continue to change.

There are concurrent competitions that muddy the waters. For example, today, a state decision to regulate trade within its territory or adopt an environmental or public health measure may have an impact on interstate commerce. In these cases, if the state interest in the measure is substantial and legitimate and the impact of the state action is not substantial on federal interest or policy, it is highly likely that a court will not find it unconstitutional. But if a state takes an intentional act to impede interstate commerce in order to favor its

⁵ In *Lopez*, the Court ruled that a federal law that made it a federal offense to carry weapons in a local school was not justified in the Commerce Clause because what happens in schools is within the exclusive purview of state and local governments pursuant to the design of Federalism contemplated by Madison, Hamilton, and the other founders of the United States. (National Federation of Independent Business v. Sebelius, 2012) (The imposition of a federally imposed penalty for failing to purchase health insurance was not supported by the commerce clause because a decision not to purchase is not engaging in commerce or an economic act). (United States v. Morrison, 2000) (a federal law making rape of women a civil offense does not rely on the commerce clause because rape is not an economic activity, nor was rape proven to impede interstate commerce, and more importantly, development of tort law for application in the states is traditionally a power left to the states under the X Amendment of the Constitution.).

producers and merchants within its territory, it is very likely that a court will declare this act unconstitutional and strike it down, unless the state can prove that it has a legitimate and substantial interest in implementing the act and has used the least discriminatory measure with respect to interstate commerce to achieve that interest.⁶

3 THE TAX FACULTY WITHIN THE CONTEXT OF FEDERALISM

3.1 THE FEDERAL FACULTY:

As previously explained, the federal government's power to tax is established in Section (8)(i) of Article I of the Constitution and in the XVI Amendment. The power to legislate the tax is the responsibility of Congress.⁷

The power to collect is within the powers of the executive branch in Article II of the Constitution. That is, the power to execute and enforce the laws of the United States to execute the laws the power to establish and collect resources pursuant to section 8(1), Article I and the XVI Amendment. This power is fulfilled mainly through the Internal Revenue Service (IRS), which is a dependency of the Department of the Treasurer, and other dependencies of the same Department, the Department of Justice, and the Department of Homeland Security.⁸

3.2 LIMITATIONS ON THE FEDERAL TAX FACULTY

The power to tax is not without limitations. Some of these limitations are expressly found in the text of the Constitution. Others derive from the application of the general principles of due process and equality, application and protection of the laws enshrined in the Constitution. More specifically:

(a) *Article 1, Section 9*: Cannot impose exports; may not impose direct taxes per capita, unless they are allocated among the states with kisses in their proportional population, and except for the exception that allows a direct tax without this restriction on income pursuant to the XVI amendment of the Constitution.

⁶ See *Granholm v. Heald*, (2005); *West Lynn Creamery v. Healy*, (1994); See, for example, *Geier v. American Honda Motor Co.*, (2000) (*District of Columbia courts cannot compel manufacturers of used automobiles in the District of Columbia to equip those automobiles with airbags because this requirement will preclude a policy on matter approved in a Federal law.*) *Minnesota v. Clover Leaf Creamery Co.*, (1981) (*state law requiring the sale of milk in cartons instead of plastic for environmental reasons affects interstate commerce but the impact is very minor -- that is, not substantial; therefore, the law does not infringe on federal jurisdiction and is sustainable.*)

⁷Pursuant to this power, Congress has established about 41 different taxes in the IRC. Those that generate the most revenue are the income tax (individuals the furthest) and entities (less than 10% of individuals) and the social security tax, followed by the inheritance and gift tax. Others include, among others, taxes on the sale of expensive luxury cars; of airplanes; of jewels; of skins, of fuels; of heavy trucks and trailers; of cars that consume a lot of fuel; of tires; coal; of inoculations; of sports equipment, bows, and arrows; of weapons; telecommunication; of alcoholic beverages; of some chemicals; of cigarettes and other tobacco products; of submachine guns and other weapons and destructive instruments. There are also taxes on gambling, shipping, imports of ozone-depleting chemicals; excessive expenses for political management, private foundations, and the use of planes and any port.

⁸*It should be noted that there are other agencies of the Federal government that have the authority and responsibility to collect taxes that are not on income or estate value, as well as the Alcohol Tobacco Tax and Trade Bureau of the Treasurer's Department, which collects taxes on alcohol and tobacco, and US Customs and Border Protection of the Department of Homeland Security (Homeland Security), which collects the fees.*

(b) *Equal Protection of Laws*. They cannot impose a tax based on the taxpayer's race, religion, gender, or national origin. Likewise, it cannot implement an arbitrary and capricious tax – that is, one that is not reasonable by virtue of its purpose.

(c) *Substantive Due Process*. It must not hinder the exercise of fundamental rights, as well as the rights of free expression, suffrage (to vote), exercise of religion, and civic action. This does not imply that the government cannot tax the press, churches, or pressure groups, but rather that it cannot impose them in a way that destroys them or with the purpose of hindering their free expression or, in the case of religious institutions, with the intention to prevent the exercise of religion.

(d) *May Not Confiscate*. The taxing power shall not completely seize the property of the taxpayer. If you seize all or most of the property, it constitutes an exercise of "eminent domain" by the government. Pursuant to the V Amendment to the Constitution, the exercise of eminent domain requires just compensation from the owner of property expropriated by the state. Unless a tax seizes all or a large portion of an owner's property, the courts do not consider it an act of eminent domain.

(i) Double taxation (taxation of the same property by two or more taxes) is allowed, as long as the tax levied does not result in forfeiture). Examples are the taxation of income with taxes on social security and the general treasury of the nation.

(ii) Likewise, the imposition of a federal tax on an asset does not prohibit the imposition of a state tax on the same, as long as it does not result in a total forfeiture of the asset. For example, the states and the Federal Government tax income. Also, both impose consumption and use taxes on the same merchandise.

(e) *Suffrage*. The XXIV Amendment prohibits a tax on the exercise of the right to vote.

(g) *Uniformity of Application in All States*: Federal rates in one state cannot be higher than those imposed in another; the Federal government cannot impose a tax in one state and not in another. However, the uniformity does not prohibit the imposition of different tax rates for different groups or classes of activities or companies, as long as the rates within the groups or classes are uniform and reasonable and as long as there is no discrimination based on race, religion, gender, and national origin.

(h) *Reasonableness*: There is a presumption that all taxes are reasonable, provided they do not exceed the limitations already stated -- that is, they do not result in an exercise of eminent domain, they do not discriminate on the basis of race, religion, and national origin, and they are not arbitrary and capricious.

(i) *Due Process*: In compliance with tax law, the Federal government may not seize a taxpayer's property for failure to pay taxes due without observing due process requirements. The Constitution, through the V and XIV Amendments, prohibits the seizure of property by governmental authorities without due process, which requires the opportunity for a prior hearing in some sufficient way.

3.3 THE STATES TAX COLLEGE: THE EXAMPLE OF THE COMMONWEALTH OF VIRGINIA

The states' power to tax is enshrined in their respective constitutions. The state of Virginia is used as an example of the typical state below.⁹

⁹ Under Virginia law, there are 30 separate taxes administered by the Virginia Department of Taxation. The taxes that produce the most revenue for the state are the income tax and the retail sales tax.

The power to pay taxes rests with the legislature. Article IV, Section 14, of the Virginia constitution states: "The authority of the Virginia General Assembly shall extend to all subjects of legislation not expressly prohibited by this constitution."¹⁰

The power to collect taxes is that of the Executive branch, which is the Governor. The Governor exercises this power primarily through the Virginia Department of Taxation (VDT). Likewise, there are 95 counties, and 223 municipalities and towns, and 193 special districts within Virginia. They are all state agencies. They participate in the collection of state taxes and have the authority to establish and collect other "local taxes" to finance their operations, in accordance with the state constitution.¹¹ State courts assist VDT and local governments in enforcing the collection of taxes from those who do not voluntarily pay.¹²

3.4 LIMITATIONS OF THE STATE TAXING POWER

Just as there are limitations on the federal government's power to tax, there are similar restrictions on the states' taxing authority. Some are specifically expressed in the text of the Constitution and the Virginia constitution; others derive from more general provisions on due process and equal protection and application of the law. They include:

(a) *Article I, section 10*. You may not impose exports not imports; however, with respect to imports, you may charge a fee to defray the cost of the inspection. If the fee exceeds this cost, it violates this provision of the Federal Constitution and is illegal.

(b) *Equal Protection of Laws*: Same with Federal limitation.

(c) *Substantive Due Process*: Same with federal limitation.

(d) *No Confiscate*. Same with the federal limitation, based on the 14th amendment and the state constitution.

(e) *Suffrage*: Same with federal limitation.

(f) *Uniformity*: Article X.1 of the Virginia constitution provides:

i) "All taxes... will be uniform with respect to the same class of objects within the territorial limits of the authority that imposes the tax..." except for some very specific exceptions. Just like the Federal case, it does not allow differences in tax rates based on race, religion, gender and national origin.

ii) "The General Assembly is empowered to define and classify objects of taxation. Except for object classifications already made by means of this Constitution, the General Assembly may segregate some categories of property in order to specify and determine which will be objects of state taxation and which will be subject to local taxation."

(g) *Reasonableness*: Same with federal limitation.

(h) *Due Process*: Same with federal limitation.

¹⁰ *The taxes that generate the lion's share of Virginia's revenue are the individual income tax and the general sales and use tax. There is a tax on the income of entities called Corporate Franchise Tax, but compared to these other taxes, it generates relatively little. There is no estate value tax in Virginia, but most other states impose this tax in addition to the Federal government's estate tax. In addition, there are more than 30 more specific taxes on specific sales and uses. They include, among others, taxes on the sale of peanuts, soybeans, eggs, slaughter of hogs, corn, tires, planes, fuel, personal property, mechanical vending machines, boats; cotton, grain, lamb, grain: use tax on products purchased out of state; the use of airplanes, the use of ships; taxes on fees for operating public utilities, on insurance premiums; on performance and payment bonds, on highways.*

¹¹ *For those dependencies, the tax that yields the most by far is the property tax, followed by the tax on certain pieces of furniture, such as vehicles, tools, and desktop machines and other for-profit businesses. Among others, some counties, such as Arlington County, also impose a tax of between .002 and .0036% on the gross income of professional entrepreneurs and other businesses.*

¹² *Also, there are some taxes collected directly by the Department of Transportation and the Department of Labor.*

(i) *Other specific limitations provided in the state constitution.* The General Assembly cannot:¹³

i) Adopt a private law that exempts a person from tax liability.

ii) Tax the property of the state itself and its subdivisions and dependencies (departments, counties, municipalities, special districts);

iii) Tax real estate used for religious purposes, intangibles, cemeteries, property of non-profit educational institutions, etc.

iv) Pay taxes on the automobile of a disabled veteran due to his military service;

iv) Pay taxes and collect, through the VDT, more than the amount necessary to pay government expenses and the public debt.¹⁴

(j) *Federalism (Federal Institutions.* A state cannot tax an institution or activity of the Federal Government, based on *McCulluch v. Maryland*, 1819).

ii) *Interstate Commerce:* A state shall not tax in order to hinder commerce between the states. That is, companies from outside the state (foreign) cannot be taxed more than those from within the state to give a material advantage to those that are within the state.

iii) *Sovereignty of other states:* A state may not tax objects that are not within the state (as well as real estate and tangible furniture), and objects that pass through the state but have a greater presence in other states must be taxed in a manner proportional to their presence in the taxing state to avoid the imposition of a confiscating tax and to avoid undue discrimination against interstate commerce.

It should be noted that the Virginia constitution gives the General Assembly the authority to limit the taxation of local governments from taxing through legislated exemptions on certain classes of property and activities. Examples are equipment and tools used in agricultural production and equipment used to combat climate change and to clean up the environment.¹⁵

3.5 TAX FACULTY AND TAX LIMITATIONS OF COUNTIES AND MUNICIPALITIES

Because counties are divisions of the state,¹⁶ their power to tax is enshrined in the state constitution. The Virginia constitution gives municipalities exclusive authority to tax real estate, tangible personal property, coal, and other mineral lands. Because counties are divisions of the state, the limitations on their taxing power are the same as those that apply to the state. The General Assembly has also adopted additional limitations on the taxing powers of counties and other local government divisions.¹⁷

¹³ See, for example, *VA Constitution, Article X.6.*

¹⁴ *VA Constitution, Article X.8*

¹⁵ See *VA Constitution, Art. X.6(d)-(e)*

¹⁶ *Although they are operating divisions of the state, their officers, which in the case of Arlington, are the members of the County Council (Council), the sheriff, the prosecutor, the Treasurer, the Commissioner of Taxation, and the local Clerk of Courts they are appointed through popular elections of the residents of the same county.*

¹⁷ *In Arlington County, VA, for example, the main local taxes are property, vehicle, and business equipment taxes. There are also specific taxes on hotels, food sold in restaurants in addition to the state sales tax, the gross income of each company, the sale of cigarettes; short-term rentals, and the consumption of utilities – gas, electricity, telecommunications.*

3.6 EXEMPLARY CASES OF THE LIMITATIONS OF FEDERALISM ON THE STATE POWER TO TAX PROPERTY AND FOREIGN PERSONS¹⁸

(a) *Complete Auto Transit v. Brady* (1977).

The State of Mississippi imposed a 5% tax on the gross receipts of each person who operates a commercial transportation vehicle in the State for the privilege of doing business in the State. Tax is added to state sales tax. The appellant, who was headquartered in Illinois, transported with his expensive new GM trucks that he had moved in interstate trade from the railroad terminal in Jackson, Mississippi, to retailers in the same state. The appellant stated that the tax was illegal because it affected the goods that had moved in commerce between states and because it was a foreign company.

The Court stated that the fact that the appellant was a foreign company and the tax was assessed in relation to its activities in interstate commerce were not sufficient considerations to declare the tax unfounded and illegal. In reaching this conclusion the Court developed and applied a new standard (assessment methodology or "test") to be used in determining the legality of state taxes of this nature against the "latent commerce clause" doctrine -- that is, the principle that a state may not take measures that unduly hinder or discriminate against commerce between states. According to the test established in the judgment, a state, in order to defend the constitutionality of its tax in response to a claim of unconstitutionality based on the latent commerce clause, must demonstrate to the satisfaction of the Court that (there is a significant link between the taxed activity or object and the taxing state):

ii). The tax is allocated on the activity so as not to tax the activities of the company outside the state;

iii). The tax does not discriminate against foreign trade. In other words, the company abroad does not charge more proportionally than the company domiciled in the taxing state; and

iv). The amount of the tax has a fair relationship to the services provided by the state.

This "test" is called *the Complete Auto-Transit Test*.

(b) *American Trucking Association v. Sheiner* (1987).

The state of Pennsylvania imposed special annual fees on trucks from out of state (foreign trucks). He charged the same rates for trucks registered in the state (domestic trucks) but lowered the price of the annual license fee for domestic trucks. These actions had the impact of significantly increasing the cost per mile of foreign trucks operating in Pennsylvania compared to the cost per mile of domestic trucks.

The Court found that the tax violates the latent commerce clause because it does not satisfy all the requirements for legality set forth in the *Complete Auto Transit Test*. Although there are "ties," the measure discriminates against foreign trucks because the rebate granted to state-registered trucks imposed a heavier burden on foreign trucks. Also, the Court concluded, the discrimination against foreign trucks was unfair because it charged foreigners more because the state failed to prove a reasonable relationship between the higher charge and the services provided by the state to foreign roads.

(c) *Goldberg v. Sweet* (1989).

¹⁸ The term "foreign persons" refers to persons – individuals and entities that are residents of other states of the United States and of foreign countries.

Illinois has adopted an excise tax of 5% of the amount charged for a telephone call that originates or terminates in Illinois and is also billed to an Illinois address (two requirements). The plaintiffs in this class action, all Illinois citizens, challenged the tax on the basis of the latent commerce clause. He argued that the tax, by its nature, taxed activity in other states because many calls that appear to be intra-state actually go through out-of-state routes before returning to the state, and inter-state calls have a long out-of-state component. Illinois granted users a credit for taxes paid to other states for the same call. However, the appellants claimed that the state did not have the right to enforce the part of the telephone transmission that happened outside the state.

The tax was constitutional. In applying the *Complete Auto Transit Test*, the Court determined. (i) that there was a sufficient nexus - the billed address and the initiation and termination of the call; (ii) it was impossible to measure discrimination, if any; (iii) that the tax did not discriminate between calls from other states and was fair because the state offered the credit, and (iv) that the tax was well related to the statutory service provided by the state with respect to the calls, as well as "all the benefits provided by the state that affect commerce between the states, which include public highways, fire services, public transportation, and all the other advantages of a civilized society".

(d) *Trinova Corp. v. Michigan Dept. of Transportation (1991)*

Michigan adopted a VAT and applied it to the appellant, which is a company based in Toledo, Ohio, on the Michigan border. The appellant challenged the formula through which the VAT was allocated between his businesses in Ohio and his businesses in Michigan, where he maintained 14 employees and made 26.5% of his sales.

Based on the *Complete Auto Transit Test*, the Court dismissed and dismissed the claim. It concluded that there was a substantial link between the taxing state and the taxpayer; that the tax was applied in a fair manner; that it did not discriminate against interstate commerce; and that it was related to the services provided to the appellant by the state. In addition, in the jurisprudence, the Court established that the role of the courts is to defend "against state taxes that, by their nature or inadvertence, result in double taxation that confiscates or captures tax resources that, by law, correspond to another state." He noted that his role in the judicial review was to ensure that each state only levies the taxes that it is entitled to with respect to interstate commerce.

4 FINAL THOUGHTS

This summary essay has addressed only the issue of the distribution of taxing authority and the corresponding limitations in the context of Federalism. He has not touched perhaps more difficult and interesting topics, as well as:

(a) Equity in establishing property, income, transaction, and income tax rates. Should they be uniform for all, rich and poor? Or should they be progressive – that is, people with more income and property pay a higher percentage than people with less? And if so, up to what percentage can you tax until it becomes an impermissible forfeiture without compensation from the confiscator?

(b) The effectiveness and equity in the system of collecting and paying taxes. In other words, is a more regulated system for the payment and declaration of taxes equitable for people who work as employees of others, which is the current case in the US? Is it effective to count and trust that those who operate their own businesses will honestly declare all their income and pay the corresponding taxes on their business income, investments, and/or income from other countries? What is the reasonable balance between the privacy right of the citizen to be free from frequent and intrusive tax audits and the government's need to establish an intrusive system that ensures that everyone pays their fair share?

These issues are well discussed in political forums, in the press, and in academia. However, they are beyond the limited scope of this writing.

Regarding the exercise of the authority to tax within the framework of the Constitution of the United States, the conclusions and reflections are presented:

(a) The system is complicated due to the number of various taxes and the various levels and government institutions that collect them.

(b) The various instances of taxation result in double, and sometimes triple taxation of income, inheritance, transactions, and property.

(c) Multiple instances and double taxation results in duplication of administration and compliance costs.

(d) In general, the system works because the majority of citizens comply with the obligation to declare and pay their taxes. The reasons are various. They include, but are not limited to, civic culture along with the well-publicized and well-known application of onerous penalties on non-coverers, including imprisonment for intentional non-payers.

(e) The system requires simplification. Because it is used to promote certain social and economic policies, the statements are very complicated and cumbersome. While it promotes welcome work for lawyers and accountants, it can be incomprehensible to the common citizen who does not specialize in the matter.

There are a multitude of exemptions, deductions, and numerous credits, each tied to a different policy, including: encouraging home buying; buying electric cars instead of fuel-guzzling ones; encourage investment in various areas of the economy, such as alternative energy sources, oil production, agricultural products; support families with children; encouraging higher education and the families that take advantage of it, the purchase of health insurance, the restoration of historic buildings; support for veterans and others in the civil service. These exemptions, credits, and deductions manifest themselves in various forms at the Federal, state, and local levels. But because each of these deductions, exemptions, and credits responds to political interests, some broader and or more powerful than others, simplification is eluded.

If there is something positive in the maze of preferences for categories of people and diverse interests reflected in the credits, deductions, and exemptions of the Code, it is this. There is something for almost everyone. And this is one reason why the system is so resistant to change.

(f) Despite the complications, the system is very transparent. Authorities, the Federal Government, states like Virginia, and counties like Arlington, Virginia, annually publish reports that detail the funds collected by tax category and their distribution or allocation to various government programs. This transparency provides the public with a measure of confidence in the integrity of the system and promotes the belief that the taxes they pay are used to pay the legitimate costs of government.¹⁹

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