

COMMENTS

“COMPARING TAX BURDENS ACROSS STATES: THE ROLES OF FEDERAL DEDUCTIBILITY AND THE AMT” BY ANNE CHRISTENSEN AND DOUGLAS J. YOUNG

*Jan Vosswinkel**

ANNE CHRISTENSEN AND DOUGLAS J. YOUNG compare tax burdens across states in the United States. They calculate the combined burden of federal income taxes plus state and local income, property, sales, and auto taxes for hypothetical families at various income levels. They conclude that the deductibility of some state/local taxes on federal income tax returns has significant effects on the overall progressivity of the tax system. Since the AMT does not allow any deductibility of state and local taxes on federal income tax returns, it has a positive effect on tax progressivity in this context. The deductibility of mortgage interest on federal and many state income tax returns has a significant effect on tax burdens in states with high home values.

“A distinct group of problems immanently arise when a single political unit possessing financial authority in its own right contains within its geographical limits smaller political units also possessing financial authority.” (Buchanan, 1950, p. 583) The incidence of tax measures is almost never what it appears at first sight. Every loss in generality creates an adapting behavior that works against the original intention of the exemption. The more complex the tax structure is, the harder it is to figure out what effects actually emerge. We lack both theoretical and empirical knowledge of these effects (Ballard and Menchik, 2005) and so I appreciate the work of Christensen and Young.

In all federal states, with some sort of fiscal autonomy on the subnational level, we face a trade-off between matching preference heterogeneity on the one hand and consistency of the tax system on the other hand. A compromise has to be found in this context and there is a variety of answers across the world. In Germany we have a high degree of centralization of the tax system and only a limited number of instruments to reflect the preference

heterogeneity of citizens across the states, called the Bundesländer. In the United States the tax system is highly decentralized and the states act very autonomously in matching the preferences of its citizens. The highly decentralized tax system of the United States, as presented by Christensen and Young, would be accused of being against social justice in Germany, whatever that means in detail.

The deductibility of state and local taxes on federal income tax returns follows from horizontal equity concerns. If the federal income tax should reflect something like the “ability to pay,” taxation has to recognize that this is only a “one-time ability.” The moderating effect of federal income taxation on tax differentials across states is by no means a sort of subsidy or a redistributive measure for citizens in high taxing states (Scott and Triest, 1993; Feenberg and Poterba, 2004), but a systematic correction due to horizontal equity. While the order of deductibility cannot be derived from the ability to pay principle, there should be the same order in the whole federation due to horizontal equity. As we have a highly decentralized tax system in the United States, this system cannot guarantee perfect horizontal equity between all citizens in all states. Christensen and Young mention the problem of the structure of state and local taxes. In particular, sales taxes are deductible at the federal level only if they exceed state and local income taxes. Thus some taxpayers in some states bear a larger combined tax burden than their equals in other states, *ceteris paribus*. Obviously, it seems to be unclear, whether deducting state and local taxes on federal income tax returns does actually promote horizontal equity or discrimination. One might argue that everyone is free to choose her place of residence, so it might be misleading to mull over equity concerns because of an endogenous sorting process called “voting by feet.” But being taxed is by no means a voluntary decision and residential choice is a multidimensional problem, not only

*Ruhr-Universität Bochum, Germany

driven by tax burden and public expenditures. So equity concerns remain important in the evaluation of federal tax systems.

The AMT is an unsystematic element in the tax system (Leiserson and Rohaly, 2006). The lack of deductibility of state and local taxes in the AMT cannot be justified by means of horizontal or vertical equity. You cannot guarantee compliance to these principles by applying two tax codes and two measures of income at the same time. Consequently, its effects in a federal tax system with a remarkable degree of decentralization are even worse compared to a unitary tax system.

The deductibility of mortgage interest on federal and many state income tax returns (Brady et al., 2003) should lead to capitalization effects. So it would be an interesting topic for further research, how these effects could be identified.

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