Tax, Incorporated: Dynamic Incorporation and the Modern Fiscal State

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INTRODUCTION

The U.S. federal structure tasks the states with providing many of the critical services on which individuals rely for their basic needs.[1] State fiscal stability is therefore critical to state residents' health, economic security, and physical safety, especially in times of macroeconomic hardship. It is unfortunate in this regard that prevailing economic conditions heavily impact states' revenue streams and that periods of economic recession can be met with state spending that lags recovery.[2] It is also unfortunate that states'

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1. ROBERT P. INMAN & DANIEL L. RUBINFELD, DEMOCRATIC FEDERALISM 33 (2020); John R. Brooks II, *Fiscal Federalism as Risk Sharing: The Insurance Role of Redistributive Taxation*, 68 TAX L. REV. 89, 89 (2014) ("One major proposition of the fiscal federalism literature is that redistribution, and the closely related progressive income tax, should be assigned exclusively to the most central level of government in a federal system, leaving subnational governments to focus on allocation of public goods, funded with taxes tied closely to benefits."); David A. Super, *Rethinking Fiscal Federalism*, 118 HARV. L. REV. 2544, 2549 (2005) (noting that "[o]ne of the most important aspects of contemporary fiscal federalism is the transfer of responsibility for [low-income assistance] programs from the federal government to the states."); CTR. ON BUDGET & POL'Y PRIORITIES, POLICY BASICS: WHERE DO OUR STATE TAX DOLLARS GO? (2018), https://www.cbpp.org/sites/default/files/atoms/files/policybasics-statetaxdollars-rev4-24-17.pdf [https://perma.cc/BC8C-KS96].

2. Recent recessions have shown clearly that states cut spending—and jobs—in response to economic downturns and that it can take a long while for state spending to recover. After the Great Recession of 2007–2009, it took until 2015 for tax revenue to recover in one half of the states. Barb Rosewicz et al., *COVID-19 Abruptly Ends Decade of State Tax Revenue Growth*, PEW (Sept. 4, 2020), https://www.pewtrusts.org/en/research-and-analysis/articles/2020/09/04/covid-19-abruptly-ends-decade-of-state-tax-revenue-growth [https://perma.cc/2E8B-JUUB]. It took until the last quarter of 2018 for tax revenues to recover in most of the remaining states. *Id.* State spending on education, specifically, had not even returned to pre-Great Recession levels in most states before they again made cuts due to the

exposure to these downturns is partly attributable to their own policy choices. Virtually all states have enacted balanced budget requirements of some form, with the result that states cannot easily smooth their spending with borrowing during economic downturns.[3] Most states also rely to a large degree on the personal income tax, which is well known for its volatility.[4] And states even increase the unpredictability of that stream of tax revenue by delegating tax-writing authority to Congress through the incorporation of the federal tax code (the "Tax Code") into states' own laws.

The practice of incorporation—also referred to as conformity, piggybacking, or delegating up[5]—frees states from having to craft an income tax from scratch and from deciding how to handle many questions of tax policy. For example, instead of using state legislative time to determine whether gifts should be taxable, how tax basis is calculated, or the extent to which business meal expenses should be deductible, most states just let Congress decide by starting their own tax calculations by statutorily referencing federal "adjusted gross income," a measure that already takes into account Congress' work on those issues.[6] Roughly half of the states even incorporate the Tax Code on a dynamic basis, which means that they automatically incorporate changes made by Congress as well.[7]

The effects of state incorporation practice are significant, as seen during the COVID-19 pandemic. At the outset of that public health crisis, Congress realized that it would need to act boldly to protect individual health and to

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COVID-19 pandemic. VICTORIA JACKSON & MATT SAENZ, CTR. ON BUDGET & POL'Y PRIORITIES, STATES CAN CHOOSE BETTER PATH FOR HIGHER EDUCATION FUNDING IN COVID-19 RECESSION (2021), https://www.cbpp.org/sites/default/files/2-17-21sfp.pdf [https://perma.cc/JC65-7UQB].

3. David Gamage, *Preventing State Budget Crises: Managing the Fiscal Volatility Problem*, 98 CALIF. L. REV. 749, 755 (2010) (noting that "[f]orty-nine of the U.S. states have some form of balanced-budget requirements"); NAT'L CONF. OF STATE LEGISLATURES, NCSL FISCAL BRIEF: STATE BALANCED BUDGET PROVISIONS 2 (2010), https://www.ncsl.org/documents/fiscal/StateBalancedBudgetProvisions2010.pdf [https://perma.cc/DRF2-K4M8] ("Most states have formal balanced budget requirements with some degree of stringency, and state political cultures reinforce the requirements."); *What Are State Balanced Budget Requirements and How Do They Work?*, TAX POL'Y CTR.: BRIEFING BOOK (May 2020), https://www.taxpolicycenter.org/briefing-book/what-are-state-balanced-budget-requirements-and-how-do-they-work [https://perma.cc/Q4EP-GTXP].

4. Kirk J. Stark, *The Federal Role in State Tax Reform*, 30 VA. TAX REV. 407, 419–23 (2010); Gamage, *supra* note 3, at 759–60.

5. *See generally* Ruth Mason, *Delegating Up: State Conformity with the Federal Tax Base*, 62 DUKE L.J. 1267 (2013).

6. *See, e.g.*, ME. REV. STAT. ANN. tit. 36, § 5142 (2019).

7. *See infra* Part I.A. The other half of states incorporate the Tax Code on a static basis instead, which means that they incorporate the Tax Code as it exists on a particular date and have to affirmatively update that date or pick individual federal tax changes that they want to adopt. *See infra* Part I.A.

protect the country from an extended economic recession.[8] One of Congress' responses was to enact the Coronavirus Aid, Relief, and Economic Security ("CARES") Act through which it provided over $2.2 trillion of federal assistance in the form of grants to individuals, businesses, and U.S. state and local jurisdictions.[9] The CARES Act also got money into the hands of certain taxpayers by making some limited, retroactive changes to the Tax Code.[10]

Congress' efforts to provide this large assistance package seems to have been impacted by the prolonged Great Recession and a Congressional response that was criticized by many as too conservative.[11] But whether or not Keynesian stimulus makes sense at the federal level where the government can deficit spend to protect the nation's citizens and economic interests, that approach will rarely, if ever, make sense at the state level because states operate under very different financial constraints.[12] In this light, dynamic incorporation became especially problematic for states in 2020 when Congress provided tax cuts in the CARES Act. The nature of dynamic incorporation and the structure of those federal tax cuts meant that states were paying out tax refunds before their legislatures could determine whether those cuts made sense or were even affordable. Colorado estimated revenue losses from conformity with the CARES Act's tax cuts at nearly $100 million over fiscal years 2021 and 2022.[13] Montana estimated revenue losses of just under $150 million, and Michigan estimated losses of over $400 million.[14] The financial effects on states of the CARES Act's Paycheck Protection Program were even greater and, although still being determined, will be in the tens of billions of dollars in the aggregate.[15]

The state experience with the CARES Act very clearly demonstrated the dangers of dynamic incorporation for the states, but the problem with that practice extend well beyond that one piece of legislation. Federal tax reforms

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8. Derek Kilmer, *'Action Is Urgently Needed': How Congress Can Help Workers During the Pandemic*, AM. INDEP. (Mar. 24, 2020, 1:09 PM), https://americanindependent.com/derek-kilmer-coronavirus-american-workers-house-democrats-washington-congress-covid-19/ [https://perma.cc/WA3M-FZ9C].

9. *What's in the $2 Trillion Coronavirus Relief Package?*, COMM. FOR A RESPONSIBLE FED. BUDGET (Mar. 25, 2020), https://www.crfb.org/blogs/whats-2-trillion-coronavirus-relief-package [https://perma.cc/5SZV-JVT9].

10. *See infra* Part II.B (explaining this lack of fit in greater detail).

11. Neil Irwin, *How America's Pandemic Economic Response Fought the Last War*, N.Y. TIMES (Nov. 16, 2021), https://www.nytimes.com/2021/11/15/upshot/pandemic-economic-response.html [https://perma.cc/H8JQ-S39H].

12. *See* JACKSON & SAENZ, *supra* note 2.

13. MICHAEL MAZEROV, CTR. ON BUDGET & POL'Y PRIORITIES, FIRST, DO NO HARM: STATES CAN PRESERVE REVENUE BY DECOUPLING FROM CARES ACT TAX BREAKS FOR BUSINESS LOSSES (2021), https://www.cbpp.org/sites/default/files/atoms/files/12-17-20sfp.pdf.

14. *Id.*

15. *See infra* Part II.C.

often fail to consider states' interests or to reflect tax policy that makes sense at the state level. And while the tax and nontax literature have referenced these costs in the abstract, they have not grappled with the full impact of modern federal tax legislative practice on the states.[16] This Article addresses that weakness in the literature by providing an in-depth qualitative assessment of the costs of incorporation for the states over recent years. The Article also provides and analyzes new data from a fifty-state survey on incorporation across six different tax changes. Those data evidence that the form of state incorporation is indeed correlated with how states ultimately responded to the tax changes surveyed. That data collection and analysis respond to a noted need in the literature and build the case for more intentional state practice going forward. In addition, the Article's review of actual state practice allows it to build a framework of best practices for states to consider as they modernize their incorporation procedures. States can incorporate the Tax Code better, and this Article shows them why and how.

The Article starts in Part I by providing a brief background on the state practice of incorporation and discusses its recognized costs and benefits. Part II then evaluates incorporation and the state experience with the CARES Act, the Tax Cuts and Jobs Act of 2017 (TCJA), and the Consolidated Appropriations Act, 2021 (CAA). That discussion provides concrete examples of the ways in which incorporation has become problematic for states in the modern fiscal state. Quite simply, even if the federal Tax Code represents an efficient starting place for states to define their own tax codes, the different functions of the federal and state governments and the existing political climate at the federal level have resulted in federal tax legislation that often fails to reflect good state tax policy or that is protective of state interests. A default of conforming to those changes, then, makes little sense and can hurt the most vulnerable of state residents.

Part III then evaluates the extent to which states that conform to the Tax Code can and do deviate from provisions that seem ill-fit as state tax policy. This Part starts from the basic observation that no state irrevocably binds itself to the Tax Code, so every state can reject federal tax changes that they do not like. Professor Michael Dorf has gone as far as to suggest that state tax incorporation is innocuous because it can be undone with a "simple legislative act."[17] This Article disagrees with that assessment, and Part III explains why that is the case by cataloging the variety of transaction costs

16. *See* Mason, *supra* note 5, at 1288–1309 (discussing the costs of state incorporation practice); Stark, *supra* note 4, at 423–25 (2010) (same); Amy B. Monahan, *State Individual Income Tax Conformity in Practice: Evidence from the Tax Cuts and Jobs Act*, 11 COLUM. J. TAX L. 57, 66–67 (2019) (same).

17. Michael Dorf, *Dynamic Incorporation of Foreign Law*, 157 PA. L. REV. 103, 114 (2008).

that make tax legislation difficult in a way that impedes optimal tax deviations. That Part not only offers this theory of tax incorporation, it also provides the results of a fifty-state survey of states' responses to selected provisions of the TCJA, the CARES Act, and the CAA. The results of that survey show that "dynamic" states decoupled from recent tax changes to a much lesser degree than "static" states, which suggests that defaults are indeed powerful in state tax legislation and aligns the state tax literature with the broader academic literature on defaults. That analysis also suggests that tax incorporation is more problematic than may be expected from a tax-revenue standpoint and from the perspective of the preservation of democratic principles at the state level. Largely immutable delegations of authority from state legislatures to Congress undermine principles of democratic self-rule at the state level, and the lessons of this piece add to the growing literation on tax and democracy as well.[18]

Part IV of the Article concludes by providing recommendations for the states on how they can better protect their own interests while leveraging the benefits of incorporation. Many of the proposals are drawn from the states themselves and from the different protective approaches taken by states across the country as revealed in the survey of state responses noted above. Some suggestions are drawn from the successes of states and some from their errors. All are motivated by an effort to help states make better decisions regarding tax incorporation so that they can make appropriations choices that help to further the basic health, education, and security of the population.

I. INCORPORATION AND THE STATE INCOME TAX

Incorporation refers to the practice of one legislative body integrating the work of another into its own laws and is a practice that occurs throughout the world, in many areas of the law, and in multiple directions. In the U.S., state legislatures often incorporate federal law into their own statutes,[19] and the

18. *See* Clinton G. Wallace, *Tax Policy and Our Democracy*, 118 MICH. L. REV. 1233, 1249 n.79 (2020) (referencing a number of articles assessing the "interplay between taxes and democratic institutions").

19. *See e.g.*, CAL. CIV. CODE § 1785.3(h) (West 2022) (incorporating concepts from the Fair Credit Reporting Act related to offers of credit); N.J. STAT. ANN. § 56:11-30 (West 2022) (incorporating many definitions from the federal FCRA); NEB. REV. STAT. § 85-1802 (2022) (incorporating portions of the Higher Education Act); S.C. CODE ANN. § 39-6-40 (2022) (directly incorporating the Federal Trade Commission Act for purposes of identifying unlawful conduct under state law); WASH. REV. CODE § 69.50.101(g) (2022) (incorporating the federal definition of a "controlled substance").

federal government incorporates state law into its own law as well.[20] The reason for legislatures to incorporate the law of another body are multiple, but largely attributable to the fact that legislating is just flat out hard. Crafting, negotiating, and enacting legislation takes time and energy, and all of those resources can be in short supply.[21] Those challenges are especially acute for the U.S. states because state legislatures often meet for a small fraction of the year, term limits regularly apply, and legislators are often paid very little for their service.[22]

It is no surprise that these conditions lead state governments to rely on the work of outside experts, and even other sovereigns, in determining the content of their own laws. In the context of state taxation, this occurs in the form of states overwhelmingly incorporating the Tax Code into their own laws for purposes of imposing state income taxes.[23] State practice in this area is not entirely uniform though, and the differences matter. The most important difference of note for this Article is that roughly half of the states incorporate the Tax Code on a dynamic basis, which means that they automatically conform to changes enacted by Congress.[24] The other half of states incorporate the Tax Code on a static basis, which means that they conform to the Tax Code as it exists on a set date.[25] For example, states often incorporate the provisions of the Tax Code as it exists on December 31st of a particular year, and then update that date annually or when there are significant federal tax changes. Regardless of the form of incorporation adopted at the state level and regardless of its costs, the practice is highly beneficial and widely utilized.[26]

The following sections introduce tax incorporation in more detail for those who are less familiar with the practice or the existing literature. Section A discusses the practice of incorporation across the U.S. and the differences in practice that exist between the states. Section B then discusses the case for incorporation, both in the tax and nontax academic literature. Section C then

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20. Aquilino v. United States, 363 U.S. 509, 512–13 (1960) (using state property law for purposes of federal taxation); 28 U.S.C. § 1346(b)(1) (allowing suits "under circumstances where the United States, if a private person, would be liable to the claimant in accordance with the law of the place where the act or omission occurred").

21. *See* Dorf, *supra* note 17, at 133–35.

22. *2020 Legislator Compensation*, NCSL (June 17, 2020), https://www.ncsl.org/research/about-state-legislatures/2020-legislator-compensation.aspx [https://perma.cc/MM98-JPQH].

23. *See infra* Part I.A.

24. Monahan, *supra* note 16, at 63.

25. *Id.*

26. *Id.* at 64–66.

introduces the costs that states bear when they delegate lawmaking power to Congress through incorporation.

A. Tax Incorporation in the U.S. States

Decisions about the composition of the tax base may seem technical or based on competing economic philosophies, but those factors do not represent nearly the entire range of considerations that are involved in setting tax policy. Decisions about the tax base include a wide range of factors, and political, administrative, and social considerations all limit the pursuit of any optimally "pure" tax code.[27] In the state tax context, decisions are also specifically made with consideration and concern for tax competition and migration.[28] Nationally, there is a growing awareness and acceptance of the racial dynamics of tax choices as well.[29]

The fact that the design of the tax base involves so many different considerations and judgments is all the more important because of how critically important the state tax base is to the funding of social services in America.[30] State and local jurisdictions' largest expenditures are for social

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27. Alice G. Abreu & Richard K. Greenstein, *Rebranding Tax/Increasing Diversity*, 96 DENV. L. REV. 1, 18 (2018) (arguing that "social values are necessarily intrinsic to the tax system"); Bryan T. Camp, *Taxation of Electronic Gaming*, 77 WASH. & LEE L. REV. 661, 703–04 (2020) (arguing that "the legal meaning of income is not ontological but operational, limited by operational rules written both in other tax statutes and by courts"); Charlotte Crane, *The Income Tax and the Burden of Perfection*, 100 NW. U. L. REV. 171, 185 (2006) (noting that "there is not—and probably cannot be—an ideal concept of an income tax" because "[t]here are simply too many compromises that must be made in translating any concept into a workable tax base, and too much room for arguing about which are expedients necessary to make the tax administrable and which are the result of a perceived need to respond to political pressure to lower tax burdens"); Michael Hatfield, *Privacy in Taxation*, 44 FLA. ST. U. L. REV. 579, 615 (2017) ("There is no Platonic form of 'taxable income' determining what information is tax relevant. Tax law embodies many competing policies and compromises.").

28. Brooks II, *supra* note 1, at 112–14 (discussing state taxation and taxpayer mobility); Ilya Somin, *Closing the Pandora's Box of Federalism: The Case for Judicial Restriction of Federal Subsidies to State Governments*, 90 GEO. L.J. 461, 468–71 (2002) (discussing horizontal competition between states and the role of state taxation); *see also* Jeffrey A. Cooper, *Interstate Competition and State Death Taxes: A Modern Crisis in Historical Perspective*, 33 PEPP. L. REV. 835, 873–875 (2006) (discussing the impact of state tax competition on the state tax base). Notwithstanding this concern, the data are far from clear that taxpayers are largely responsive to tax policy in that way, and it seems that the concern of tax-induced migration may play more on legislators' fears, or may be simply opportunistic. Brooks II, *supra* note 1, at 117–19; Daniel J. Hemel, *Federalism as a Safeguard of Progressive Taxation*, 93 N.Y.U. L. REV. 1, 17–20 (2018).

29. *See generally* DOROTHY A. BROWN, THE WHITENESS OF WEALTH (Penguin Random House 2021).

30. The link between state taxation and state expenditures is not always appreciated. *See* Jeremy Pilaar, *Starving the Statehouse: The Hidden Tax Policies Behind States' Long-Run Fiscal Crises*, 37 YALE L. & POL'Y REV. 345, 362–63 (2018).

services, like medical care—including payments to Medicaid providers—for primary and secondary education, for highways and roads, and for public safety.[31] States receive money from the federal government to help fund many of these expenses, especially Medicaid,[32] but states also fund the majority of spending on things like K-12 education.[33] In this light, it is important to recognize just how critical the state income tax is to funding those expenditures. Forty-one states and the District of Columbia currently impose a broad personal income tax,[34] and forty-four states and the District of Columbia impose a corporate income tax.[35] In states with an income tax, the revenue generated represents roughly 20 to 30% of state revenues.[36] When taking out transfers from the federal government and local taxes, the state income tax raises just over 40% of state revenues—the largest source of state tax revenue overall.[37] The majority of those funds come from the personal income tax, but some come from the corporate income tax as well.[38]

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31. *Public Welfare Expenditures*, URB. INST., https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/state-and-local-backgrounders/public-welfare-expenditures [https://perma.cc/Y4CC-6RBX].

32. The federal government funds about two thirds of Medicaid spending, and these states fund the remainder. CONG. RSCH. SERV., R42640, MEDICAID FINANCING AND EXPENDITURES 2 (2020) (reporting that the federal government paid about 65% of the total Medicaid spending in fiscal year 2019).

33. *Public Welfare Expenditures*, *supra* note 31.

34. *Individual Income Taxes*, URB. INST., https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/projects/state-and-local-backgrounders/individual-income-taxes [https://perma.cc/F78B-TQRT].

35. *Corporate Income Taxes*, URB. INST., https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/projects/state-and-local-backgrounders/corporate-income-taxes [https://perma.cc/M8VJ-KUAT].

36. *State and Local Revenues*, URB. INST., https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/state-and-local-backgrounders/state-and-local-revenues [https://perma.cc/84U3-3SKC]. The other three-quarters of state revenue comes from a combination of intergovernmental transfers, state sales taxes, and miscellaneous charges and fees. Local governments also raise significant revenue from property taxes. *Property Taxes*, URB. INST., https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/projects/state-and-local-backgrounders/property-taxes [https://perma.cc/P6QC-6QH9].

37. SARAH ANDERSEN ET AL., U.S. CENSUS BUREAU, STATE GOVERNMENT TAX COLLECTIONS SUMMARY REPORT: 2019 1–2 (2020) https://www.census.gov/content/dam/Census/library/publications/2019/econ/g19-stc_summary.pdf [https://perma.cc/2RRT-4SN8]. State income taxes outpace sales taxes in every region of the United States but for the South, as defined by the Census Bureau. In that region, state income taxes make up approximately 30% of state tax revenues and sales taxes make up nearly 40% of state tax revenues. *Id.* at 2.

38. *Id.* States could also increase their corporate tax collections with relatively little effort. David Gamage et al., *Weathering State and Local Budget Storms: Fiscal Federalism with an Uncooperative Congress*, U. MICH. J.L. REFORM (forthcoming 2022).

Tax revenues are especially important to the states because states are also very limited in how they can utilize debt. Nearly every state has some sort of balanced budget rule that restricts them from borrowing to fund general expenditures.[39] As noted by the National Conference of State Legislatures, "[t]he stringency of state requirements varies substantially,"[40] but most states have very strict requirements either under the law or as applied by the states and local political processes.[41] States cannot freely carry operating deficits into another year to make up for revenue shortfalls.

The end result is a system in which states rely on the income tax to a great degree and in which losses of revenue directly result in losses of services or jobs. It is in this context that the practice of incorporation takes center stage in this Article because states nearly universally incorporate the Tax Code into their own laws. Specifically, of the forty-one states with a broad personal income tax—and the District of Columbia—most explicitly incorporate taxpayers' "adjusted gross income" as defined in the Tax Code.[42] A handful of those states incorporate taxpayers' "taxable income" instead.[43] Taxable income is determined after subtracting a wide range of deductions from a taxpayer's adjusted gross income, so states that start with federal adjusted gross income protect themselves from federal tax changes to a greater degree.[44] State practice with regard to the corporate income tax is a little more evenly split, but states still generally use one of two different starting points taken from federal law. Some states conform to federal taxable income and others to federal taxable income before net operating losses and special

39. *See* NAT'L CONF. OF STATE LEGISLATURES, *supra* note 3, at 2–3.

40. *Id.* at 5.

41. *Id.* at 5–6.

42. KATHERINE LOUGHHEAD, TAX FOUND., STATE INDIVIDUAL INCOME TAX RATES AND BRACKETS FOR 2021 3 (2021), https://files.taxfoundation.org/20210722161949/State-Individual-Income-Tax-Rates-and-Brackets-for-2021..pdf [https://perma.cc/D2LG-BPL9] (listing eight states with no personal income tax and one, New Hampshire, that only taxes a limited subset of income); FED'N OF TAX ADMINS., STATE PERSONAL INCOME TAXES: FEDERAL STARTING POINTS 1 (2021), https://www.taxadmin.org/assets/docs/Research/Rates/stg_pts.pdf [https://perma.cc/R7F4-7VMF].

43. FED'N OF TAX ADMINS., *supra* note 42; RICHARD C. AUXIER & FRANK SAMMARTINO, TAX POL'Y CTR., THE TAX DEBATE MOVES TO THE STATES: THE TAX CUTS AND JOBS ACT CREATES MANY QUESTIONS FOR STATES THAT LINK TO FEDERAL INCOME TAX RULES 2 (2018) https://www.taxpolicycenter.org/publications/tax-debate-moves-states-tax-cuts-and-jobs-act-creates-many-questions-states-link [https://perma.cc/3267-E3SU] (noting District of Columbia is considered in the thirty-one states that incorporate taxpayers' "taxable income"). The handful of states that technically do not conform to the federal Tax Code, do incorporate many of the same provisions and practices. *See* Mason, *supra* note 5, at 1278.

44. I.R.C. § 63; *see* Mason, *supra* note 5, at 1334–35 (explaining this difference between conformity to adjusted gross income and taxable income).

deductions.[45] The latter is more protective of states because, again, it includes fewer federal tax choices.

The other large distinction between states' incorporation practices involves whether they incorporate the Tax Code on a dynamic basis or on a static basis. Here, states split nearly evenly, although the precise numbers can be difficult to determine because of state practices that straddle the line between these approaches.[46] For purpose of state personal income taxes, twenty-one states generally conform to the Tax Code on a dynamic basis.[47] Another seventeen states generally conform on a static basis.[48] State practice is largely the same in the context of the corporate income tax, but a slightly higher proportion of states conform on a dynamic basis in the corporate tax context.[49] Some of this balance in approach is due to the fact that many states

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45. HELLERSTEIN ET AL., STATE TAXATION ¶ 7.02 n.14 (3d ed. 2021).

46. Oregon, for example, conforms on a static basis, but also conforms to all changes impacting taxable income. Oregon calls this a "rolling reconnect." *See* OR. LEGIS. REVENUE OFF., OREGON INCOME TAX CONNECTION TO FEDERAL LAW (2020), https://www.oregonlegislature.gov/lro/Documents/Federal%20Connection.pdf [https://perma.cc/UW79-CN4S]; *see also infra* note 47.

47. The list includes Alabama, Colorado, Connecticut, Delaware, Illinois, Iowa, Kansas, Louisiana, Maryland, Michigan, Missouri, Montana, Nebraska, New Mexico, New York, North Dakota, Oklahoma, Oregon, Rhode Island, Utah, and the District of Columbia. Of this list, several present some complications in categorization and cause a different listing than might be found elsewhere. *See, e.g.*, Nicole Kaeding, *Does Your State's Individual Tax Code Conform With the Federal Tax Code?*, TAX FOUND. (Dec. 13, 2017), https://taxfoundation.org/state-individual-income-tax-code-conform-federal-tax-code/ [https://perma.cc/RV8M-WLT4]. Alabama technically uses its own definition of taxable income, but the state conforms to a long list of provisions in the Tax Code and state law provides that those provisions are updated on a dynamic basis. ALA. CODE § 40-18-1.1(a) (2022); ALA. ADMIN. CODE r. § 810-3-1.1-.01(2) (2022). Iowa is sometimes listed as a static state, but it adopted dynamic conformity for tax years beginning on or after January 1, 2020. IOWA CODE § 422.3(5)(b). Michigan allows taxpayers to choose. MICH. COMP. LAWS § 206.12(3). Oregon is also sometimes listed as a static conformity state, but that state's statute is more complicated. Under Section 317.010 of the Oregon Revised Statutes, the state conforms to the Tax Code as of December 31, 2018, but the statute goes on to provide that the state conforms on a dynamic basis to any changes affecting taxable income. OR. REV. STAT. § 317.010(7)(b) (2022).

48. Those include: Arizona, California, Georgia, Hawaii, Idaho, Indiana, Kentucky, Maine, Massachusetts, Minnesota, North Carolina, Ohio, South Carolina, Vermont, Virginia, West Virginia, and Wisconsin. I have included Massachusetts on this list because the state generally conforms on a static basis. The state also, however, conforms to many provisions on a dynamic basis under state law. MASS. GEN. LAWS ch. 62, § 1(c) (2022). The other four states that impose broad personal income taxes—Arkansas, Mississippi, New Jersey, Pennsylvania—impose those taxes on a figure other than one explicitly defined in the Tax Code so they are excluded from this count. *See* Kaeding, *supra* note 47.

49. Massachusetts and Pennsylvania have adopted dynamic conformity for purposes of their corporate income taxes and not for their personal income taxes, so that adds two states to the list. Alaska and Tennessee also adopt dynamic conformity for purposes of their corporate income

are prevented from dynamically incorporating the Tax Code due to anti-delegation clauses in their state constitutions.[50]

In general, then, we see that states largely conform to the Tax Code for purposes of their own income taxes and about half of those states do so on a dynamic basis. There are clearly large benefits to states from adopting those practices, and this Article does not disagree. Section B thus provides the traditional account of the benefits of incorporation for the states.

B. The Case for Incorporation

The primary benefit of incorporation is simple efficiency.[51] Piggybacking on the work of another lawmaking body allows a legislature to "free-rid[e] on th[os]e lawmaking efforts,"[52] to "avoid reinventing the wheel"[53] on the involved issue, and to dedicate time to other matters. In the state-tax context specifically, Professor David Super has noted that "[l]inking federal and state taxation systems makes inherent sense" because it "saves resources for taxpayers and states alike, while also improving compliance."[54] Incorporation also gives states "more flexibility to shape their own revenue policies [rather than] wasting taxpayers' time and their own administrative resources implementing idiosyncratic definitions of basic concepts."[55] Professor Ruth Mason similarly notes that "relying on the federal tax base [allows] states [to] avoid expending scarce legislative resources on devising and maintaining their own bases."[56]

The efficiency benefits of incorporation go beyond legislative efficiencies as well, as Professor Mason explains in *Delegating Up: State Conformity*

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taxes, but neither impose a personal income tax. In all, then, twenty-five states use dynamic conformity for purposes of corporate income taxes. For static conformity states, we add Florida which does not impose a personal income tax, but remove Ohio, which does not impose a corporate income tax, so the number of static conformity states for purposes of corporate income taxes is seventeen again. *See* Nicole Kaeding, *Does Your State's Corporate Income Tax Code Conform with the Federal Tax Code?*, TAX FOUND. (Dec. 20, 2017), https://taxfoundation.org/state-corporate-income-tax-code-conformity/ [https://perma.cc/SA67-SU6W] (providing a summary of states' practices in this area).

50. Jim Rossi, *Dynamic Incorporation of Federal Law*, 77 OHIO ST. L.J. 457, 469–70 (2016) (discussing these state limitations).

51. *See* Dorf, *supra* note 17, at 132.

52. *Id.*

53. JAMES A. GARDENER & JIM ROSSI, NEW FRONTIERS OF STATE CONSTITUTIONAL LAW: DUAL ENFORCEMENT OF NORMS 138 (2011).

54. Super, *supra* note 1, at 2646.

55. *Id.*

56. Mason, *supra* note 5, at 1281; *see also* Rossi, *supra* note 50, at 465 (noting that "[t]here is also a more general efficiency to relying on the incorporation of federal law, insofar as this avoids needless[ ] duplication of decision-making processes.").

With the Federal Tax Base.[57] States and their residents also experience efficiencies in the administration of the laws when states incorporate federal law.[58] These efficiencies are very clear in the tax context where the amount of data that is required to implement the income tax, as it currently exists, is immense.[59] A state that implemented its own income tax would need to generate its own forms—like state-specific Forms W-2 for the reporting of wages or an entirely new form to report some other type of income or deductible expense. States that broadly incorporate federal law need not take on those tasks. Taxpayers also save time and resources if they are not required to track and report vastly different transactions to state governments than they report to the federal government.[60]

Taxpayers who engage in interstate commerce also benefit from the horizontal harmonizing effects of conformity.[61] Those taxpayers are required to file returns in many states, and filling out state tax returns that materially differ from a federal return and one another could make interstate commerce much more costly than would be ideal. The existence of the same rules, or at least general framework for taxation, across many states brings efficiencies and helps to secure the benefits of our common national market. Harmonization of state tax systems also reduces the possibility of "double taxation" of multistate taxpayers' incomes.[62]

States that broadly incorporate federal tax laws also obtain efficiencies in the enforcement of their taxes. States require that taxpayers who are audited by the federal government report any resulting changes to the state as well.[63] States also share information about taxpayer reporting and enforcement

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57. Mason, *supra* note 5, at 1279–88.

58. Ruth Mason, *Federalism and the Taxing Power*, 99 CALIF. L. REV. 975, 1019 (2011) (recognizing the administrative benefits of conformity for states); Mason, *supra* note 5, at 1321 (noting that state deviations "increase[] state tax enforcement costs by reducing states' ability to free ride on federal administration and enforcement.").

59. Adam B. Thimmesch, *Tax Privacy?*, 90 TEMP. L. REV. 375, 382–89 (2018); Hatfield, *supra* note 27, at 616–29.

60. Mason, *supra* note 5, at 1279–80; Dorf, *supra* note 17, at 135–36 (noting that "[t]he time savings for state taxpayers are substantial, although less so now than a generation ago given the widespread availability of inexpensive computer software that can use the same raw data to generate both federal and state returns.").

61. Mason, *supra* note 5, at 1281–88; Rossi, *supra* note 50, at 464 (noting that uniformity between jurisdictions is a valuable aspect of dynamic incorporation in the state-tax area).

62. Mason, *supra* note 5, at 1282.

63. All states with an income tax require taxpayers to report federal changes to their state taxing agencies within some period of time, evidencing that this benefit is recognized and significant. *Corporate Income Tax—Federal Changes—Amended Return Required*, 27 J. MULTISTATE TAX'N & INCENTIVES 32, 32 (2017) (providing chart); HELLERSTEIN ET AL., *supra* note 45, ¶ 7.02[4] (discussing state requirements to report federal adjustments to state revenue authorities).

actions among themselves—another benefit of the horizontal harmonization that occurs when multiple states incorporate the same federal laws.[64]

As this discussion evidences, incorporation serves as a coordination and commitment device by sovereigns,[65] which is particularly helpful in the U.S. fiscal context. The disparate tax treatment of transactions between states provides tax arbitrage opportunities for taxpayers. States strengthen their tax bases and avoid administrative and enforcement costs if they can harmonize by simultaneously incorporating up, ideally on a dynamic basis to eliminate temporal differences. The interstate marketplace—and thus the national economy—benefit as well. Reducing the transaction costs of multistate regulation is a core goal of the Court's current dormant Commerce Clause doctrine, which is intended to protect the negative implications of the Constitution's grant of affirmative power to Congress to regulate matters impacting interstate commerce.[66] Incorporation that leads to harmonization thus should serve to move the nation closer to the Jacksonian ideal of a common national market.[67]

The U.S. federal government also benefits from state incorporation, if and to the extent that the amplification of its policy choices by states is welfare enhancing. Consider, for example, the federal promotion of savings for retirement through the provision of tax exemptions and deferrals.[68] The incorporation of those benefits by states gives taxpayers an even greater incentive to engage in that behavior. That result is likely desirable to the federal government except in the case where state incorporation results in the over subsidization of the involved activity.

The sum of this discussion is that incorporation in the tax context is highly beneficial in many ways and to many parties. Incorporation is not free of cost though, as discussed below.

C. The Costs of Incorporation

Despite the wide range of benefits that incorporation provides, the practice is not perfect. From a national perspective, incorporation comes with a loss

64. *See* Mason, *supra* note 5, at 1280–81.

65. Dorf, *supra* note 17, at 146 ("Dynamic incorporation of foreign law can be a powerful mechanism for solving coordination problems and ensuring reciprocal compliance with agreements among sovereigns or quasi-sovereigns.").

66. Adam B. Thimmesch, *The Unified Dormant Commerce Clause*, 92 TEMP. L. REV. 331, 336–37 (2020).

67. H. P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525, 539 (1949).

68. *See e.g.*, I.R.C. §§ 401–409.

of experimentation at the state and local level[69] and the cannibalization of federal revenues.[70] Within the tax literature, incorporation is also recognized as costly for states because it introduces another source of revenue volatility into the state budgeting process.[71] When states rely on the federal government to set their own tax policy, state revenues are subject to the whims of Congress to a degree. As Professor Kirk Stark has noted, the efficiencies of incorporation also cause states to use income taxes more than they might do otherwise, which causes even more state revenue instability because the income tax is a relatively volatile source of funds.[72]

Federal tax laws that flow down to the states can also result in *policy* volatility in ways that can subvert states' self-interests. Tax policy, and tax law, is not just about money. Federal tax laws incorporate a wide range of social policies and goals, as determined by Congress.[73] States that dynamically incorporate the Tax Code are thus also subjecting themselves to those decisions of Congress, which might conflict with state preferences.

Of course, the ultimate safeguard for states with regard to both revenue and policy volatility is their ability to simply decouple from any federal change with which they disagree or cannot afford. No state irrevocably binds itself to federal tax choices. But decoupling comes at a cost as well. State legislators must dedicate time to understand the federal law on which state law relies and how changes in that law will impact the state. Those legislators must then determine whether and how to respond, draft appropriate legislation, and then get it enacted. Those tasks are all difficult, and all take time from other matters. There is therefore a time-cost associated with incorporation.

These costs have all been recognized to an extent in the tax literature. Nevertheless, states seem unmoved to change their practices, which is undoubtedly partially due to inertia but also in part due to legislators' focus on other issues. But there are two key points that those in state government and politics need to realize in this regard and that form the basis for the focus of this Article. First, tax decisions are effectively appropriations decisions at

69. The role of states as "laboratories of democracy" is viewed as a key part of the American experiment and is a core benefit of our federal system. The broad state incorporation of the Tax Code almost certainly leads to less innovation in state tax policy and imposes a cost in that way. Mason, *supra* note 5, at 1304–05.

70. The harm that incorporation imposes on the federal treasury was recently explored by Professors David Gamage and Darien Shanske in their 2017 article. David Gamage & Darien Shanske, *Tax Cannibalization and Fiscal Federalism in the United States*, 111 NW. U. L. REV. 295 (2017).

71. *See* sources cited *supra* note 3.

72. Stark, *supra* note 4, at 423–24.

73. *See infra* Part II.B.

the state level due to states' balanced budget requirements. Second, states' tax decisions are often poor. More attention is thus warranted to tax incorporation and to its impact on the resources available to the states. To that end, Parts II and III discuss the costs of incorporation in the context of several recent pieces of federal legislation that made major changes to the Tax Code. That discussion provides a current account of the costs of incorporation as it is practiced by the states and shows how the method and content of the tax changes implemented by Congress over the last several years have put states in a particularly poor position. In Professor Ruth Mason's work on incorporation, she explained the need for more actual study and data on states' choices, and Professor Amy Monahan more recently suggested that more research be done on the impact of dynamic incorporation on the states.[74] The discussion below does just that.

Before turning to that tax-specific analysis, though, it is also helpful to note that the concerns voiced in this piece comport entirely with more general and theoretical accounts of dynamic incorporation provided outside of the tax literature. Specifically, in his 2008 article, *Dynamic Incorporation of Foreign Law*, Professor Michael Dorf broadly evaluated the practice of dynamic incorporation and provided additional reason to be wary of state tax incorporation.[75]

Professor Dorf started his article with what might seem like an extreme position, stating that "[a]ll acts of dynamic incorporation of foreign law pose a prima facie threat to democratic principles."[76] This position recognizes that the transfer of lawmaking power to an unaccountable body necessarily deprives the governed of their power to exercise real voice, a hallmark of democracy. Notably, though, Professor Dorf recognized that incorporation and the immutability of an act of incorporation exist on a spectrum and that the threat to democratic self-rule is lessened to the extent that a delegation of power is more easily revocable.[77] For Dorf, then, a critical factor in analyzing the cost of incorporation is the ease with which the delegating jurisdiction can decouple from a change in the incorporated law. This factor is particularly apt when we think about incorporation and the Tax Code. To the extent that states can easily decouple from problematic federal tax changes, much of the concern noted above is relieved.

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74. Mason, *supra* note 5, at 1345–47; Monahan, *supra* note 16, at 94.

75. Dorf, *supra* note 17. Professor Dorf did offer brief support for tax incorporation, although he did so with little analysis. *Id.*

76. *Id.* at 113.

77. *Id.* (noting that "as we move along the spectrum from easily revocable delegations to irrevocable cessions of sovereignty, the burden of justification for dynamic incorporation increases").

Professor Dorf also notes that *representation* is a factor that reduces the potential harm of incorporation.[78] That is, to the extent that the incorporated jurisdiction's residents have representation in the body to which law-making authority has been delegated, the cost to democratic self-rule is lessened because the delegating jurisdiction's residents can protect their interests through their representatives in that other body.[79] This makes incredible sense as well when thinking about tax incorporation. State residents have representation in Congress, which might mean that there is little to be concerned with in this realm. If Congress is negatively impacting the states, redress is available—in theory—through residents' Congressional representation.

This Article is largely focused on the financial costs of incorporation to the states, but these concerns about democratic self-rule should not be overlooked given that different focus. There is a growing discussion and concern in America about our national commitment to democratic principles and a growing awareness in the tax literature about the importance of civic participation and representation in tax policy making.[80] State tax laws and legislation often seem to be sterile topics, removed from discussions about health reform, police reform, or racial inequities, etc. But the reality is that tax decisions are appropriations decisions at the state and local level, and adopting taxing policies that further remove the people from the tax legislation that impacts them is particularly problematic along these metrics as well.

The general literature on incorporation is also not unaware of tax incorporation and seems to take a different view of that practice than seems warranted under current conditions. Professor Dorf specifically cited to tax incorporation favorably in his article, noting that "administrative convenience may be sufficient to justify a state's dynamic incorporation of federal income tax law, where that incorporation can be undone by a simple legislative act."[81] Professor Dorf also cited the double "savings" inherent in state-tax incorporation—the cost savings to the states and to their residents.[82]

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78. *Id.* at 113–14.

79. *Id.*; *see also* Rossi, *supra* note 50, at 487–88 (discussing participation in the national lawmaking process as a factor that mitigates the potential harms of dynamic incorporation).

80. *See* Wallace, *supra* note 18 (discussing the growing literature on tax and democracy); Steven A. Dean, *FATCA, the U.S. Congressional Black Caucus, and the OECD Blacklist*, TAXNOTES (July 2, 2020), https://www.taxnotes.com/special-reports/competition-and-state-aid/fatca-us-congressional-black-caucus-and-oecd-blacklist/2020/07/02/2cns4 [https://perma.cc/HY53-CFSK] (discussing the impact of diversity in representation on tax policy making in U.S. international tax policy making).

81. Dorf, *supra* note 17, at 114.

82. *Id.* at 135–36.

And while he recognized that incorporation could bring about unwanted revenue losses for states or unwanted tax increases for taxpayers, he concluded that "the widespread dynamic incorporation of federal tax law by state law shows that many states regard these risks as cost justified."[83]

The materials in Parts II and III suggest much more reason to be concerned about dynamic incorporation in the tax context for both very practical reasons and under the metrics identified by Professor Dorf. Although state legislatures can, and do, decouple from federal tax changes, a "simple legislative" act is not always so simple. In addition, although state residents do have representation in Congress that might serve to protect them from federal tax changes that result in undesirable state-tax policy shifts, the protective capacity of that representation is illusory. This is not just conjecture, but borne out in the experience of states over many years.

II. INCORPORATION IN PRACTICE

Much of the narrative surrounding tax incorporation seems to follow the general tone of Professor Dorf's work—tax incorporation, though causing some harm, is justified because of the efficiencies that states obtain from the practice. This Article is motivated by a different take. That is, although tax incorporation is highly beneficial, states can better manage the underappreciated costs while maintaining the efficiencies of that practice. This section draws together those lessons by discussing the state experience with three recent federal bills that have greatly impacted the states through their tax systems—the TCJA, the CARES Act, and the CAA. These bills certainly do not contain the entirety of the federal tax changes that have impacted the states in recent history, and the purpose of this section is not to cover the field. Instead, this section is intended to provide an overview of how recent federal legislation has impacted states in ways that call into question the state practice of incorporation, and dynamic incorporation specifically.

A. The Tax Cuts and Jobs Act of 2017

The story of tax incorporation over the last several years must start with a discussion about the bill commonly known as the Tax Cuts and Jobs Act of 2017.[84] That bill marked the biggest tax reform effort since the Tax Reform

83. *Id.* at 136.
84. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (codified as amended in scattered sections of I.R.C.).

Act of 1986 (the "1986 Act") and was likely the Trump administration's biggest legislative accomplishment.[85] It was certainly one of the administration's most urgent; President Trump was inaugurated on January 20, 2017, and a half-page outline of what would become the TCJA arrived in April of that year.[86] The bill was negotiated behind closed doors and publicly became a nine-page "unified framework" in September 2017.[87] Actual legislation was finally introduced on November 2, 2017 and enacted into law on December 22, 2017.[88]

The TCJA left many of the basics of the Tax Code intact but significantly shifted how individuals and corporations were taxed. In the personal income tax realm, the TCJA implemented over a trillion dollars of tax cuts, on net, over the ten-year budget window.[89] The cuts were accomplished through a variety of changes, including reduced tax rates, a doubling of the standard deduction, the expansion of the Child Tax Credit, and changes to the alternative minimum tax.[90] Offsetting revenue increases included the repeal of personal exemptions and the elimination of miscellaneous itemized deductions.[91] For individual taxpayers with pass-through income, the TCJA added a deduction for "Qualified Business Income" but also limited the utilization of "excess business losses."[92]

On the corporate tax side, the TCJA's biggest change was to reduce the corporate tax rate from 35% to 21%.[93] Congress also reduced corporate tax revenues by allowing for full expensing for most business assets.[94] To offset the negative revenue effects of those changes, the TCJA introduced a number of revenue-raising provisions, including an interest-deduction limitation under Section 163(j), changes to the net operating loss rules, and the required

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85. John Haltiwanger, *Trump's Biggest Accomplishments and Failures from His 1-term Presidency*, BUS. INSIDER (Jan. 20, 2021, 4:03 PM), https://www.businessinsider.com/trump-biggest-accomplishments-and-failures-heading-into-2020-2019-12 [https://perma.cc/9A8G-Z4ZD].

86. Michael J. Graetz, *Foreword – The 2017 Tax Cuts: How Polarized Politics Produced Precarious Policy*, 128 YALE L.J.F. 315, 316–18 (2018).

87. *Id.* at 316–18.

88. *Id.*

89. JOINT COMM. ON TAX'N, JCX-67-17, ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R. 1, THE "TAX CUTS AND JOBS ACT" 3 (2017), https://www.jct.gov/publications/2017/jcx-67-17/ [https://perma.cc/8EVE-B75F] (estimating revenue losses of $1.126.6 trillion from the individual tax reform provisions).

90. *See id.* at 1–3.

91. *Id.*

92. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, §§ 11011, 11012, 131 Stat. 2054, 2063–2061.

93. *Id.* § 13001(a).

94. *Id.* § 13201(a).

capitalization and amortization of certain research and development costs.[95] The TCJA also fundamentally changed how the Tax Code treated U.S. corporations with foreign affiliates. The bill eliminated the tax imposed when foreign subsidiaries "repatriated" their money to a U.S. parent—moving the Tax Code away from a worldwide system of taxation—but implemented a series of revenue raisers to offset that change.[96] The TCJA introduced a new tax on Global Intangible Low-Taxed Income (GILTI), a Base Erosion and Anti-Abuse Tax (BEAT), and a one-time transition tax on certain pre-TCJA earnings of foreign affiliates.[97]

The TCJA was obviously a complicated and multi-faceted bill, and the estimated revenue effects to individual states of the TCJA's changes ranged from tens of millions to over a billion dollars annually.[98] These revenue estimates were complicated for states to construct, and the ultimate impact of the TCJA on states' finances depended on whether and how states incorporated the Tax Code previously and on how they responded to TCJA's changes. Nevertheless, the revenue swings at the state level were large unless states decoupled. Those changes also had distributional effects for states to consider.[99]

The effects of the TCJA on the states were in many ways unavoidable. Any large-scale federal tax reform will meaningfully impact the states and their revenues. Nevertheless, analyzing the TCJA's impact on the states is instructive because it demonstrates some of the very practical costs of

95. *Id.* §§ 13301, 13302, 13206.

96. *Key Elements of the U.S. Tax System: What Is a Territorial Tax and Does the United States Have One Now*?, TAX POL'Y CTR. BRIEFING BOOK (May 2020), https://www.taxpolicycenter.org/briefing-book/what-territorial-tax-and-does-united-states-have-one-now [https://perma.cc/A9WF-ZTQ4].

97. *See* Susan C. Morse, *International Cooperation and the 2017 Tax Act*, 128 YALE L.J.F. 362, 366–70 (2018) (discussing these changes).

98. *State Tax Conformity: Revenue Effects*, TAX FOUND., https://taxfoundation.org/state-tax-conformity-revenue-effects/ [https://perma.cc/B4V2-DQ4X]; ARIZ. JOINT LEGIS. BUDGET COMM., STATE REVENUE ESTIMATES OF FEDERAL TAX LEGISLATION CONFORMITY 1 (2018), https://www.azleg.gov/jlbc/federaltaxconformity.pdf [https://perma.cc/9QLP-AL3Y] (estimating revenue gains of $133.5 million); MINN. DEP'T OF REV., FEDERAL UPDATE: THE TAX CUTS AND JOBS ACT OF 2017, at 9 (2018), https://www.revenue.state.mn.us/sites/default/files/2019-01/Federal%20update%20TCJA%2019.pdf [https://perma.cc/5YVS-NX9E] (reporting revenue gains of roughly $600 million a year); S.C. REVENUE & FISCAL AFFS. OFF., ESTIMATED SOUTH CAROLINA IMPACT OF FEDERAL "TAX CUTS AND JOBS ACT" OF 2017 AND "BIPARTISAN BUDGET ACT" OF 2018, at 1–2 (2018), https://rfa.sc.gov/media/4701 [https://perma.cc/9YB8-26EW] (estimating additional personal income tax collections of $180 million and corporate income tax collections of $25 million); *see also* Monahan, *supra* note 16, at 80 tbl.1 (discussing projected revenue increases among the states that conformed to taxable income for purposes of the state personal income tax);.

99. Monahan, *supra* note 16, at 81–86 (noting the distributional aspects of conformity with the TCJA).

incorporation and how those costs seem likely to become more severe as we move forward.

1. The TCJA and Policy Drift

The choice to incorporate a body of law like the Tax Code makes sense for many reasons, but the state experience with the TCJA demonstrates just how easily incorporation can result in policy mismatches rather than policy harmonization when incorporation is broad, but incomplete. As explained above, no state completely mirrors the federal tax system, which means that changes at the federal level can impact the states very differently than those same changes impact the federal government. Take, for example, the TCJA's modifications to the corporate income tax. Congress' major policy change in that area was to reduce the federal tax rate from 35% to 21%.[100] To offset that change from a revenue perspective, Congress implemented many different base-broadening provisions.[101] The effect of those changes at the state level was very different.

As introduced above, states largely piggyback on the federal corporate income tax *base*, but not on the federal *rates*.[102] The result was that the TCJA's changes caused corporate tax *increases* at the state level despite large corporate tax *cuts* at the federal level. State legislatures reconvening in 2018 were therefore required to act if they wanted to avoid that result. States were even still determining whether and how to respond to federal tax changes, like the addition of GILTI, in 2021.[103] In this context, dynamic incorporation created disconnect, not parity between state and federal tax policy.

A similar disconnect occurred in connection with the TCJA's changes to some of the key personal deductions and credits offered in the personal income tax. Prior to the TCJA, the Tax Code provided a mixture of personal exemptions, a standard deduction, and a somewhat limited child tax credit to help reflect some of the personal aspects of taxpayers' lives.[104] The TCJA

100. § 13001, 131 Stat. at 2096.

101. *See supra* Part II.A.

102. *See supra* Part I.A.

103. *See Hearing on HB 2421 Before the H. Tax'n Comm.*, 2021 Leg. (Kan. 2021) (testimony of Darien Shanske, Professor of Law, U.C. Davis School of Law), http://www.kslegislature.org/li/b2021_22/committees/ctte_h_tax_1/misc_documents/download_testimony/ctte_h_tax_1_20210317_19_testimony.html [https://perma.cc/RPZ7-CQ59].

104. Specifically, the Tax Code granted taxpayers a $4,150 personal exemption for themselves and for each qualifying dependent, Rev. Proc. 2016-55, § 3.24, 2016-45 I.R.B. 707, 713, a standard deduction of $12,700 for taxpayers filing married filing jointly, Rev. Proc. 2016-55, § 3.14, 2016-45 I.R.B. 707, 712, and a partially refundable Child Tax Credit in the amount of $1,000 for qualifying children, I.R.C. § 24(a).

fundamentally changed this approach by rebalancing those benefits—the TCJA effectively eliminated personal exemptions by reducing the exemption amount to zero,[105] nearly doubled the standard deduction,[106] and doubled the Child Tax Credit to $2,000.[107] Even if these policy changes effectively offset one another at the federal level—and that was highly dependent on the particulars of taxpayers' families—the effects at the state level varied widely.[108]

To start, most states do not automatically provide personal exemptions, a standard deduction, or a child tax credit via incorporation because none of those benefits are reflected in the measure of "adjusted gross income" to which most states conform.[109] Prior to the TCJA, however, states did largely opt into personal exemptions and the standard deduction, but few utilized child tax credits.[110] That variation in practice, along with variations in *how* states opted into those provisions,[111] created revenue and policy volatility for

105. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 11041, 131 Stat. 2054, 2082 (codified as amended in scattered sections of I.R.C.).

106. *Id.* § 11021.

107. *Id.* § 11022. The TCJA also increased the amount of that credit that was refundable and increased its phase-out amount. *Id.*

108. Changes to the standard deduction and the personal exemption represented the largest potential changes to state tax revenues out of all of the provisions of the TCJA. Erin Huffer et al., *Effects of the Tax Cuts and Jobs Act on State Individual Income Taxes*, 58 WASH. U. J.L. & POL'Y 205, 215 (2019).

109. All of those tax adjustments occur after the calculation of adjusted gross income in Section 62 of the Tax Code. *See* I.R.C. §§ 24, 62, 63, 151.

110. Huffer et al., *supra* note 108, at 208 (noting that only four states had a state-level child tax credit prior to the TCJA).

111. States had a wide variety of approaches on how they granted personal exemptions entering 2017. Richard C. Auxier, *The TCJA Eliminated Personal Exemptions. Why Are States Still Using Them?*, TAX POL'Y CTR. (Dec. 17, 2018), https://www.taxpolicycenter.org/taxvox/tcja-eliminated-personal-exemptions-why-are-states-still-using-them [https://perma.cc/PZ9U-JVFQ]; JARED WALCZAK, TAX FOUND., THE STATUS OF STATE PERSONAL EXEMPTIONS A YEAR AFTER FEDERAL TAX REFORM 3 (2019), https://files.taxfoundation.org/20190211153228/The-Status-of-State-Personal-Exemptions-a-Year-After-Federal-Tax-Reform-FF636.pdf [https://perma.cc/3FNY-6TYJ]. Kansas, for example, granted personal exemptions for "each exemption for which such individual is entitled to a deduction for the taxable year for federal income tax purposes." KAN. STAT. ANN. § 79-32,121 (2021). Maine worded its statute slightly differently, allowing state exemptions "for each exemption that the individual properly claims for the taxable year for federal income tax purposes." ME. STAT. tit. 36, § 5126 (2018). Wisconsin allowed personal exemptions for "each dependent, as defined under section 152 of the Internal Revenue Code." WIS. STAT. § 71.05(23)(b) (2021). Other states told taxpayers that their exemption amount was simply some dollar multiple of the number of personal exemptions claimed on their federal tax return. *See* Auxier, *supra* (listing a series of states that used this approach); *see also* Walczak, *supra* (discussing the wide variety of approaches used by states). Those differences in approach led to

states post-TCJA and meant that the effect of the TCJA on families' state-tax bills was uncertain. A family that saw a tax cut at the federal level may very well have seen a tax *increase* at the state level if the state conformed to the elimination of personal exemptions but not to the increased standard deduction or child tax credits.[112] In this context, incorporation did not result in policy harmonization because of the number of different components involved in the TCJA's changes.

Policy disunity can also result from more isolated substantive changes—like the TCJA's modifications to the bonus depreciation rules of Section 168(k).[113] Prior to the TCJA, Congress had used bonus depreciation as

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significant disparities, and sometimes uncertainty, about whether the state law would allow for personal exemptions after the TCJA.

States similarly had a range of practices with regard to state standard deductions. Some provided their own standard deductions untethered to the federal deduction. *See, e.g.*, ALA. CODE § 40-18-15(b) (2018); CAL. REV. & TAX. CODE § 17073.5(a) (West 2021); OKLA. STAT. tit. 68, § 2358(E)(2) (2021). Others provided standard deductions tied directly to the federal allowance, and some provided no standard deduction at all. *See, e.g.*, IDAHO CODE § 63-3022(j)(1) (2021); MO. REV. STAT. § 143.131(2) (2021); N.M. STAT. ANN. § 7-2-2(N)(1) (2021); Morgan Scarboro, *State Individual Tax Rates and Brackets for 2017*, TAX FOUND. (Mar. 9, 2017), https://taxfoundation.org/state-individual-income-tax-rates-brackets-2017/ [https://perma.cc/P45E-G7R8] ("Some states tie their standard deductions and personal exemptions to the federal tax code, while others set their own or offer none at all.").

State practice was much more uniform with respect to child tax credits because the vast majority just did not offer such a credit. Huffer et al., *supra* note 108, at 208 (noting that only four states offered child tax credits prior to the TCJA); *see also e.g.*, N.Y. TAX LAW § 606(c-1) (McKinney 2021); N.C. GEN STAT. § 105-153.10 (repealed by Current Operations Appropriations Act of 2017, No. 57, § 38.4(b)); OKLA. STAT. tit. 68, § 2357 (2021). Notably, none of the states that conformed directly to both the federal personal exemptions and standard deduction had child tax credits. RICHARD AUXIER & ELAINE MAAG, URB. INST., ADDRESSING THE FAMILY-SIZED HOLE FEDERAL TAX REFORM LEFT FOR STATES 3 (2018), https://www.taxpolicycenter.org/sites/default/files/publication/156164/addressing_the_family-sized_hole.pdf [https://perma.cc/V56B-6H4B].

112. States grappled with these issues to various degrees after the TCJA, but very few followed the federal lead of providing child tax credits, which means that state systems continue to deviate from the Tax Code in material ways that will impact them in the future. *See* AIDAN DAVIS ET AL., CTR. ON POVERTY & SOC. POL'Y, THE CASE FOR EXTENDING STATE-LEVEL CHILD TAX CREDITS TO THOSE LEFT OUT: A 50-STATE ANALYSIS 9 (2019), https://itep.sfo2.digitaloceanspaces.com/041719-Child-Tax-Credit_ITEP-CPSP.pdf [https://perma.cc/6S8H-2KQ7] (discussing the limited number of states that offer child tax credits); *see also State Tax Credits,* TCWF, https://www.taxcreditsforworkersandfamilies.org/state-tax-credits [https://perma.cc/9VE5-L73Q] (same); Monahan, *supra* note 16 (discussing the range of state responses to these issues); Walczak, *supra* note 111 (also discussing the range of state responses to these issues).

113. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 13201, 131 Stat. 2054, 2105 (codified as amended in scattered sections of I.R.C.).

stimulus many times, and not all states had followed that approach.[114] In the TCJA, Congress provided for 100% expensing of most purchases of business machinery and equipment through a modification of existing Section 168(k),[115] which meant that the impact of that change on states varied widely based on whether and how states had previously decoupled from that provision.

Arizona, for example, decouples from bonus depreciation by requiring an add-back of all depreciation deductions taken federally[116] and then allows a subtraction for depreciation as if bonus depreciation were not elected.[117] That approach is generally consistent with the state's use of static incorporation and insulates the state from changes to 168(k) unless the legislature desires to make a change. Connecticut gets to the same result within its general approach of dynamic incorporation by specifically stating that the state's deduction for depreciation is determined as if Section 168(k) just does not apply.[118] Changes in federal law therefore do not automatically change Connecticut's choice. Rhode Island has simply adopted static conformity for purposes of calculating depreciation.[119] Oklahoma, another dynamic state, does not so protect itself. Although Oklahoma has similarly decoupled from bonus depreciation allowances, it has done so by specifically referencing the particular bills in which those allowances were enacted.[120] That approach left the state vulnerable to future changes, like those in the TCJA. Finally, Wisconsin might have the most difficult approach to follow. That state, which generally incorporates the Tax Code on a static basis, specifically decouples from or conforms to tax changes by reference to the section of the public law in which they were enacted. So, for example, here is what the state statute says about depreciation:

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114. Sheila Leventhal, *States React to Economic Stimulus Bill*, 13 STATE & LOC. TAXES WKLY., Aug. 5, 2002, 2002 WL 1790570 (discussing the use of 30% bonus depreciation as economic stimulus in 2002); Rebecca Bertothy & Jon Belteau, *Stimulating the States—Are They Getting a Boost From the American Recovery and Reinvestment Act?*, 19 J. MULTISTATE TAX'N & INCENTIVES 8, 11–13 (2010) (discussing the use of bonus depreciation as economic stimulus in 2009); *See* Rebecca N. Morrow, *Accelerating Depreciation in a Recession*, 19 FLA. TAX REV. 465, 481–82 (2016) (discussing the history of bonus depreciation before the TCA).

115. § 13201, 131 Stat. at 2105.

116. ARIZ. REV. STAT. ANN. § 43-1121(4) (2022).

117. *Id.* § 43-1122(20).

118. CONN. GEN. STAT. § 12-217(b) (2019).

119. 44 R.I. GEN. LAWS § 44-61-1(a) (2022) (adopting a static incorporation date for purposes of depreciation).

120. *See* OKLA. STAT. tit. 68, § 2358.6(A) (2022) (decoupling from bonus depreciation provided in the Job Creation and Worker Assistance Act of 2002); *id.* § 2358.6(B) (decoupling from bonus depreciation provided in the Economic Stimulus Act of 2008 and the American Recovery and Reinvestment Act of 2009).

> For taxable years beginning after December 31, 2013, and for purposes of computing depreciation and amortization, the Internal Revenue Code means the federal Internal Revenue Code in effect for federal purposes on January 1, 2014, except that sections 13201(f), 13203, 13204, and 13205 of P.L. 115-97, section 2307 of division A of P.L. 116-136, and section 202 of division EE of P.L. 116-260 apply at the same time as for federal purposes.[121]

The default in Wisconsin, then, is nonconformity, but what depreciation does the state actually allow? The Wisconsin approach results in statutes that mean nothing unless one looks up the public laws referenced in state law or relies on secondary reporting, which can be inconsistent.

The particular policy choices made by states is not the focus of this piece, but this discussion does provide some important lessons on incorporation and how it is currently impacting the states. First, it is very clear that tax incorporation, even dynamic incorporation, does not result in state and federal tax law shifting in parallel when Congress amends the Tax Code. There are too many federal tax choices from which states deviate to assume that incorporation will result in policy harmonization through incorporation.

This discussion also shows that *the way* in which a state piggybacks on, or decouples from, federal law can matter a great deal. The slight disconnects that exist between state and federal law prior to the TCJA resulted in incorporating states having to act just to maintain parity with the federal regulatory structure on which state law was based.

2. The TCJA and the Federal Political Process

Review of the TCJA also exposes just how much states can be hurt by poor political processes at the federal level and how representation is not likely to counteract the negative aspects of incorporation. One useful frame of reference in this regard is the 1986 Act, the last major tax reform prior to the TCJA. That legislation was discussed in Congress for approximately a year and was preceded by a 600-page analysis of different tax reform options.[122] The final bill passed with the support of a majority of Republicans and Democrats in both the House and Senate.[123]

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121. WIS. STAT. § 71.98(3) (2022).

122. Graetz, *supra* note 86, at 318.

123. David E. Rosenbaum, *The Tax Reform Act of 1986: How the Measure Came Together; a Tax Bill for the Textbooks*, N.Y. TIMES (Oct. 23, 1986), https://www.nytimes.com/1986/10/23/business/tax-reform-act-1986-measure-came-together-tax-bill-for-textbooks.html [https://perma.cc/BXQ4-GZEK]; *Senate Vote #677 in 1986 (99th Congress)*, GOVTRACK, https://www.govtrack.us/congress/votes/99-1986/s677 [https://perma.cc/RDF5-G997].

The TCJA, in contrast, was enacted quickly, with no public hearings, and through reconciliation with no bi-partisan support.[124] An initial "framework" for that bill was introduced on September 27, 2017, and legislation was introduced in both the House and Senate in early November.[125] The final bill was signed into law the very next month, on December 22, 2017.[126] That rushed and partisan process meant that there was little to no opportunity for states to advocate for their interests and means that Democrats have no political capital invested in that bill or its long term success. Neither bodes well for the states.

Looking beyond a simple comparison of the TCJA and the 1986 Act, it is apparent that tax legislation has suffered from the same defects as legislation more generally in the last decade.[127] There is no shortage of scholarship lamenting the growing political polarization of Congress and its impact on the ability of Congress to legislate.[128] This reality seems to suggest that states can expect suboptimal federal tax legislative process at least into the foreseeable future and, more to the point, federal tax legislation that is done on an expedited basis while one party holds momentary control of Congress

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124. Jennifer Bird-Pollan, *Revising the Tax Law: The TCJA and Its Place in the History of Tax Reform*, 45 OHIO N.U. L. REV. 501, 504–09 (2019) (discussing the process behind the TCJA's enactment and noting that "[b]y contrast with the TCJA, the 1986 Act was a true exercise in bipartisanship"); Rebecca M. Kysar, *Tax Law and the Eroding Budget Process*, 81 LAW & CONTEMP. PROBS. 61, 69 (2018) (noting the unprecedented method by which the Republicans passed the TCJA).

125. Bird-Pollan, *supra* note 124, at 506–07.

126. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (2017) (codified as amended in scattered sections of I.R.C.); Graetz, *supra* note 86, at 319.

127. Michael Doran, *Tax Legislation in the Contemporary U.S. Congress*, 67 TAX L. REV. 555, 557 (2014) ("[T]he tax-legislative process has changed over the last decade and a half. The regular, highly particularistic legislation that formerly dominated the process has become increasingly uncommon since the late 1990s."); Clint Wallace, *The Troubling Case of the Unlimited Pass-Through Deduction: Section 2304 of the CARES Act*, U. CHI. L. REV. ONLINE (June 29, 2020), https://lawreviewblog.uchicago.edu/2020/06/29/cares-2304-wallace/ [https://perma.cc/KM2J-X3G6] (noting that "hastily enacted tax legislation . . . should perhaps be viewed as a regular mode of tax legislating.").

128. *See, e.g.*, Paul Frymer, *Debating the Causes of Party Polarization in America*, 99 CALIF. L. REV. 335, 336 (2011) (noting that "[i]n the last few decades, the number of moderates in Congress has declined and both Democrats and Republicans have become more internally unified and more externally opposed in legislative voting."); Gillian E. Metzger, *Agencies, Polarization, and the States*, 115 COLUM. L. REV. 1739, 1741 n.4 (2015) (referencing a wide variety of literature on the polarized federal political process); Samuel A. Marcosson, *Fixing Congress*, 33 BYU J. PUB. L. 227, 233–39 (2019) (noting that "[t]he United States Congress is a broken, dysfunctional mess[,]" and discussing the causes and extent of polarization in Congress); Jody Freeman & David B. Spence, *Old Statutes, New Problems*, 163 U. PA. L. REV. 1, 2 (2014) (noting that "Congress is more ideologically polarized now than at any time in the modern regulatory era, which makes legislation even harder to pass.").

and the Presidency.[129] States are unlikely to fare well in this reality, especially with a Congress that already ignores state interests in federal tax reform. Professor David Super noted over a decade ago that "Congress has shown little sensitivity" to the effect of federal tax legislation on the states, and that, as a result, "state-level remedies are urgently needed."[130] The TCJA provides a stark reminder for states that dynamic incorporation is a risky approach for them to take in modern times.

Of course, any discussion of the TCJA in this context would not be complete without mentioning that most of the TCJA's personal income tax changes will expire on their own terms beginning January 1, 2026.[131] Due to federal budget rules, bills passed through reconciliation cannot increase the deficit beyond a current ten-year budget window.[132] For the TCJA, that meant cutting off the individual tax cuts in 2026 and forcing a future Congress to deal with the ramifications of not extending those cuts.[133] That upcoming political fight has the potential to push negotiations deep into the year and states will again be at the mercy of Congress unless the states are proactive.

The end takeaway at this point, then, is that the TCJA showed just how complicated tax incorporation can be and how incorporation does not always result in parallel shifts in policy between jurisdictions given how states incorporate the Tax Code. The incorporation of a statutory structure as broad as the Tax Code will undoubtedly lead to these complications as states respond to reforms as meaningful as those contained in the TCJA, but analyses of the practice should recognize that tax incorporation brings about these issues. States should be especially mindful of these realities—and preemptively protect themselves—as Congress gets closer to the TCJA sunset.

B. The CARES Act

Additional significant federal tax changes as they relate to the states occurred in early 2020 as the COVID-19 pandemic reached and spread

129. *See* Richard L. Hasen, *Political Dysfunction and Constitutional Change*, 61 DRAKE L. REV. 989, 1004 (2013) (noting that "high polarization within Congress does not always mean legislative stalemate or gridlock[,]" but rather, "[i]n the relatively rare periods of united government . . . parties will act quickly to enact as much of their agenda as possible.").

130. Super, *supra* note 1, at 2646.

131. Bird-Pollan, *supra* note 124, at 509–12. The corporate tax changes, in contrast, are not scheduled to expire. *Id.*

132. Kysar, *supra* note 124, at 64–67 (discussing the Byrd rule and its impact on budget and tax matters in Congress).

133. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (2017) (codified as amended in scattered sections of I.R.C.).

throughout the United States. After an initial period of uncertainty regarding the federal government's willingness to admit the approaching crisis, Congress did respond. On March 18, 2020, Congress passed the Families First Coronavirus Response Act and increased the federal government's share of Medicaid expenses by 6.2 percentage points.[134] That legislation provided some relief for states, which were seeing increased demand for medical services by Medicaid recipients, but more help was needed.[135] Congress provided that assistance on March 27, 2020, when it passed the CARES Act.[136] That $2.2 trillion bill included a range of stimulus and protective measures, including the Paycheck Protection Program (PPP),[137] Economic Impact Payments of $1,200 to individuals and $500 for their qualifying children,[138] increased unemployment benefits,[139] and $150 billion in state and local aid.[140]

In addition to the significant grants provided in the CARES Act, Congress included some very targeted tax cuts. The most significant provisions in that regard were three provisions that relaxed some of the TCJA's revenue raisers—the Section 163(j) limitation to the business interest deduction, the modified net operating loss rules, and the excess business loss rules.[141]

As referenced above, the TCJA introduced a new business interest deduction limitation under Section 163(j), which limited business interest deductions to 30% of a taxpayer's adjusted taxable income.[142] That provision helped Congress to offset some of the revenue losses due to the corporate rate cut and fought against the existing debt preference contained in the Tax Code.[143] The CARES Act reversed course and loosened that limitation by

134. Families First Coronavirus Response Act, Pub. L. No. 116-127, § 6008, 134 Stat. 178, 208 (2020).

135. Bradley Corallo, *Analysis of Recent National Trends in Medicaid and CHIP Enrollment*, KAISER FAM. FOUND. (Jan. 10, 2022), https://www.kff.org/coronavirus-covid-19/issue-brief/analysis-of-recent-national-trends-in-medicaid-and-chip-enrollment/ [https://perma.cc/Q8G8-TPFG].

136. Coronavirus Aid, Relief, and Economic Security (CARES) Act, Pub. L. No. 116-136, 134 Stat. 281 (2020).

137. *Id.* § 1102.

138. *Id.* § 2201.

139. *Id.* § 2104.

140. *Id.* § 5001(a).

141. *Id.* §§ 2303–04, 2306.

142. I.R.C. § 163(j).

143. Robert E. Holo, Jasmine N. Hay & William J. Smolinski, *Not So Fast: 163(j), 245A, and Leverage in the Post-TCJA World*, 128 YALE L.J.F. 383, 385–89 (2018); David Kamin et al., *The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the 2017 Legislation*, 103 MINN. L. REV. 1439, 1515 (2019).

raising the threshold percentage from 30% to 50%.[144] Most notably, that change was retroactive to taxable years beginning after December 31, 2018.[145] The CARES Act thus allowed taxpayers to go back to prior years' tax returns and adjust their interest deductions upward if those deductions had previously been capped. That change gave the affected taxpayers some immediate liquidity by way of tax refunds.

The CARES Act also changed the TCJA's modified net operating loss rules, again retroactively. Prior to the TCJA, the Tax Code allowed taxpayers to carry back net operating losses ("NOL") two taxable years and to carry them forward for twenty years.[146] The TCJA eliminated the ability of taxpayers to carry back their NOLs but allowed an unlimited carryforward.[147] The TJCA also limited taxpayers' utilization of NOLs in any given year to 80% of their taxable income.[148] The CARES Act modified these rules again and allowed taxpayers to carryback losses that they incurred in taxable years ending after December 31, 2017 and before January 1, 2021 for five years, instead of the two years allowed under the TCJA.[149] The TCJA's 80% limitation was also suspended for taxable years beginning prior to January 1, 2021.[150] The CARES Act did not eliminate the indefinite carryforward allowed under the TCJA. The effect on states of the NOL changes was complicated by the fact that most states already decoupled from the federal NOL rules in one way or another and most do not allow any NOL carryback.[151]

One final CARES Act change of note was its change to the TCJA's limitation on so-called "excess business losses."[152] Excess business losses are losses from a trade or business that exceed the sum of the taxpayer's income from trade or business activity *and* another $250,000, or $500,000 in the case

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144. I.R.C. § 163(j)(10)(B). The CARES Act also allowed taxpayers to elect to use their 2019 adjusted taxable income for making their limitation calculations rather than their 2020 adjusted taxable income. That change was intended to reflect that taxpayers' 2020 incomes would likely be much lower due to the pandemic.

145. Coronavirus Aid, Relief, and Economic Security (CARES) Act, Pub. L. No. 116-136, § 2306, 134 Stat. 281, 358–59 (2020).

146. I.R.C. § 172(b)(1)(A) (2017), *amended by* Pub. L. No. 115-97, § 13302, 131 Stat. 2054, 2122 (2017).

147. I.R.C. § 172(b)(1).

148. *Id.* § 172(a)(2).

149. *Id.* § 172(b)(1)(D).

150. *Id.* § 172(a)(1).

151. *See* HELLERSTEIN ET AL., *supra* note 45, at ¶ 7.16; Katherine Loughead, *State Conformity to Federal Pandemic-Related Tax Provisions in CARES and ARPA*, TAX FOUND. (Apr. 1, 2021), https://taxfoundation.org/state-conformity-cares-act-unemployment/ [https://perma.cc/X3NY-SWBM].

152. I.R.C. § 461(*l*).

of a taxpayer filing jointly with a spouse.[153] Disallowed losses are carried forward to future years, so the limitation is effectively a timing provision.[154] The CARES Act changed this limitation retroactively and deferred its application of the TCJA provision until tax years beginning after December 31, 2020.[155] The result was again a retroactive loss of revenue for states.[156]

State estimates of revenue losses due to the CARES Act tax changes were not broadly calculated or made public—certainly in part due to the exigencies of the pandemic—but the losses were meaningful where calculated. Colorado and Nebraska estimated losses of nearly $100 million over two years, while Maryland estimated losses of over $200 million, and Michigan estimated losses of over $400 million.[157] Just as with the TCJA, though, the story of incorporation and the CARES Act goes beyond revenue volatility. The CARES Act demonstrated how incorporation can result in states adopting policies that make little sense at the state level and presented a particularly problematic threat for states—retroactive tax relief.

1. Incorporation and Policy Mismatch

To generalists or even those focused primarily on federal tax policy, it might be surprising to learn that state and federal tax policy differ—a lot. The Tax Code contains many provisions aimed squarely at goals other than measuring taxpayers' incomes, and the IRS has been tasked with administering many programs that go well beyond revenue collection. The Tax Code is not simply a tool for revenue collection; it is a complicated accumulation of statutory provisions that are aimed at a variety of revenue, social, and economic goals.[158] Congress uses the Tax Code to encourage savings for retirement, home ownership, and the use of fuel-efficient vehicles.[159] Some of the nation's most powerful anti-poverty programs—the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC)—are

153. *Id.* § 461(*l*)(3).

154. *Id.* § 461(*l*)(2).

155. Coronavirus Aid, Relief, and Economic Security (CARES) Act, Pub. L. No. 116-136, §§ 2304(a), (b)(3), 134 Stat. 281, 356 (2020).

156. *See* MAZEROV, *supra* note 13, at 4 tbl.1 (providing estimates of state revenue losses from this change in law).

157. *Id.*

158. *See* Kristin E. Hickman, *Administering the Tax System We Have*, 63 DUKE L.J. 1717, 1728–36 (2014) (discussing the expansion of the Tax Code well beyond a tool to raise revenue).

159. *Id*. at 1722.

administered through the Tax Code and by the IRS.[160] And the Tax Code is often used as a way of delivering economic stimulus in times of financial distress.[161]

State tax codes can certainly be used for all of the wide-ranging goals currently pursued in the Tax Code, but it is hard to argue that state tax codes *should* do so, at least to the same degree as does the Tax Code. To start, the responsibilities of state and federal governments are very different. The federal government has broad responsibility for ensuring the safety, health, and welfare of the country as a whole. In pursuit of that mission, the federal government spent over $6.6 trillion dollars in 2020, with over a trillion going toward social security, over a trillion spent on Medicare and Medicaid combined, and over $700 billion on national defense.[162] Much of the 2020

160. The EITC and the CTC are responsible for lifting millions of families out of poverty and for helping millions more who were already near the poverty level. *Policy Basics: The Earned Income Tax Credit*, CTR. ON BUDGET & POL'Y PRIORITIES, (Dec. 10, 2019), https://www.cbpp.org/research/federal-tax/the-earned-income-tax-credit [https://perma.cc/VPD5-KPRJ]. These numbers are based on difficult calculations with built-in assumptions that can cause estimations to differ, but the anti-poverty effect of the EITC is meaningful regardless. *See* Bruce D. Meyer & Derek Wu, *The Poverty Reduction of Social Security and Means-Tested Transfers*, 71 ILR REV. 1106 (2018); Maggie R. Jones & James P. Ziliak, *The Antipoverty Impact of the EITC: New Estimates from Survey and Administrative Tax Records* 1 (U.S. Census Bureau, Working Paper No. CES 19-14R, 2020).

161. Looking back before COVID-19 and the CARES Act, we see that Congress has pulled some very similar levers in the Tax Code during times of economic contraction. For example, the Job Creation and Worker Assistance Act of 2002 provided for bonus depreciation and expanded NOL utilization in response to the economic downturn related to the 9/11 attacks and the related U.S. response. Job Creation and Worker Assistance Act of 2002, Pub. L. No. 107-147, §§ 101, 102, 116 Stat. 21, 22–26 (current version at I.R.C. § 168); GAIL MAKINEN, CONG. RSCH. SERV., RL31617, THE ECONOMIC EFFECTS OF 9/11: A RETROSPECTIVE ASSESSMENT 45–46 (2002). The American Recovery and Reinvestment Act of 2009 (the "ARRA") again made a great number of changes to the Tax Code to provide stimulus funding in response to the pressures of the Great Recession. *See generally* SEN. MAX BAUCUS, FIN. COMM. TAX SUMM., AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009 (2009), https://www.finance.senate.gov/imo/media/doc/prg051909h.pdf [https://perma.cc/ZBF3-833M] (discussing a wide range of tax provisions enacted in the ARRA). Relief was provided to American workers largely through a range of tax credits, and the ARRA's business provisions included changes to the tax base like the allowance of 50% bonus depreciation, expanded NOL carryback rules, and deferred reporting for certain income from the cancellation of indebtedness. Linda Nelsestuen & Daphne Main, *New Law Provides Diverse Tax Relief for Individuals and Families*, 82 PRAC. TAX STRATEGIES 260 (2009); Jamey G. Rappis, *Tax Aspects of the American Recovery and Reinvestment Act of 2009: On the Road to Recovery?*, 82 WIS. LAW. 10 (2009); American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, §§ 1201, 1211, 1231, 123 Stat. 115, 212, 307 (2009) (current version at I.R.C. § 168).

162. *The Federal Budget in Fiscal Year 2020: An Infographic*, CONG. BUDGET OFF. (Apr. 30, 2021), https://www.cbo.gov/publication/57170 [https://perma.cc/T4ME-XHDS].

spending was also pandemic related and pushed federal spending well above 2019 and prior years, where spending was just over $4 trillion.[163]

State and local governments have much more limited responsibilities and spend less than half of that amount.[164] A majority of that spending is on items with more immediate and direct effects on the public—education, public welfare, health and hospitals, roads, and police.[165] As noted above, states also have a much more limited ability to deficit spend than does the federal government,[166] which means that stimulus measures enacted through the Tax Code can be highly problematic at the state level. The result is that states must act very differently than the federal government during downturns. When revenue drops, states don't borrow, they cut programs and fire people.[167]

In this context, the CARES Act's tax changes fare particularly poorly at the state level. As noted above, that legislation included a few different tax changes that were specifically intended to provide liquidity to taxpayers during the global pandemic. But none of those changes were broadly applicable or particularly well targeted to the taxpayers most in need, and the cuts certainly weren't targeted to the needs of taxpayers in any particular state. Nevertheless, states incorporated those provisions and dipped into state funds that could have been used for other purposes. It is simply fanciful to

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163. *The Federal Budget in 2019: An Infographic*, CONG. BUDGET OFF. (Apr. 15, 2020) https://www.cbo.gov/publication/56324 [https://perma.cc/T7EG-4VXK].

164. *Total State Expenditures (In Millions)*, KAISER FAM. FOUND., https://www.kff.org/other/state-indicator/total-state-spending/?currentTimeframe=0&sortModel=%7B%22colId%22:%22Location%22,%22sort%22:%22asc%22%7D [https://perma.cc/L8EY-KR4W] (last visited Feb. 27, 2022) (reporting total state spending of just over $2 trillion in fiscal year 2019); NAT'L ASS'N OF STATE BUDGET OFFICERS, 2020 STATE EXPENDITURE REPORT 1, (2020), https://higherlogicdownload.s3.amazonaws.com/NASBO/9d2d2db1-c943-4f1b-b750-0fca152d64c2/UploadedImages/SER%20Archive/2020_State_Expenditure_Report_S.pdf [https://perma.cc/GDA5-PJ5N] (reporting state spending of over $2 trillion in 2020); *State and Local Expenditures*, URB. INST., https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/state-and-local-backgrounders/state-and-local-expenditures [https://perma.cc/C24N-H9NM] (last visited Feb. 27, 2022) (reporting state and local spending of just over $3 trillion in 2018).

165. *State and Local Expenditures*, *supra* note 164.

166. *Id.* (discussing state balanced budget requirements).

167. *See* Gamage, *supra* note 3, at 756–59 (discussing state responses to fiscal volatility and concluding that "spending cuts have become the primary response to fiscal downturns"); Barb Rosewicz & Mike Maciag, *Nearly All States Suffer Declines in Education Jobs*, PEW CHARITABLE TR. (Nov. 10, 2020), https://www.pewtrusts.org/en/research-and-analysis/articles/2020/11/10/nearly-all-states-suffer-declines-in-education-jobs [https://perma.cc/H5FU-TE48] (noting states' spending and employment cuts during the first year of the pandemic); Michael Ettlinger & Jordan Hensley, *COVID-19 Economic Crisis: By State*, U.N.H. CARSEY SCH. OF PUB. POL'Y (Oct. 22, 2021), https://carsey.unh.edu/COVID-19-Economic-Impact-By-State [https://perma.cc/6565-8GA7] (noting that all but two states remain with fewer payroll jobs than in February 2020 and that twenty-one states still have over 5% fewer jobs than before the pandemic).

suggest that states would have adopted those tax cuts as a targeted stimulus measure in the beginning months of the pandemic of their own accord. But states reached that same end silently through incorporation.

Fortunately for states, it is the case that state tax revenues across the country appear to have fared much better than expected through the pandemic, no doubt in large part to the massive amounts of federal aid provided directly to their residents.[168] To some, then, it may seem that the concern about these tax cuts and their effects on state finances is unjustified. That conclusion would be wrong. The ultimate revenue position of states now is no reason to ignore these issues. First, it is the case that piggybacking on federal stimulus measures had both revenue *and distributional* effects. Money that was diverted to taxpayers impacted by the excess business loss rules, for example, was money that could have gone to individuals who had lost jobs or businesses due to the pandemic. Instead, the liberalization of those rules resulted in funds going disproportionately to those with high income levels without regard to need.[169] It is virtually impossible to imagine that states would have made interest free loans available to individuals at the outset of the pandemic—the equivalent of accelerating excess business loss deductions in the CARES Act. But that is exactly what conforming states did. Making that choice through incorporation merely hid what occurred.

The other reason that states' better-than-expected economic positions should not change how we think of incorporation is that states cannot be confident that future emergencies will be accompanied by federal aid to the extent provided during the COVID-19 pandemic. Congress responded to that emergency with incredible urgency and was willing to deficit spend to a great degree to stave off another long recession, but many Republicans disagreed

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168. Barb Rosewicz, Justin Theal & Alexandre Fall, *States Close Out 2020 with Widespread Tax Revenue Gains*, PEW CHARITABLE TR. (July 27, 2021), https://www.pewtrusts.org/en/research-and-analysis/articles/2021/07/27/states-close-out-2020-with-widespread-tax-revenue-gains [https://perma.cc/W6A4-LKLD]. As noted above, Congress did not just enact tax cuts in response to the pandemic. *Id.* It also gave trillions of dollars of grants and other funding to individuals, businesses, and state and local governments in 2020 and in 2021. *Id.*

169. The EBL provision, for example, applied only to single taxpayers with over $250,000 of non-business income and married taxpayers with over $500,000 of non-business income. In Rhode Island, this provision was estimated to affect a total of 692 tax returns and 70% of those returns had annual gross income of over one million dollars. Aaron Davis, *Rhode Island Governor Wants To Decouple from CARES Act Loss Provisions*, TAX NOTES ST. (Sept. 25, 2020) https://s3.amazonaws.com/pdfs.taxnotes.com/2020/2020-37274_STTDocs_RI_092320-Article8-GBATaxes.pdf (on file with author). Estimates from the Joint Committee on Taxation noted that the CARES Act changes would give 43,000 taxpayers earning over $1 million an average tax benefit of $1.6 million in 2020 alone. MAZEROV, *supra* note 13, at 8. The average income in that group would be greater than $4.3 million of ordinary income. *Id.* That is a tax change aimed squarely at those with high levels of income.

with the level of aid provided to the states.[170] It is far from certain that a future president and a future Congress will respond similarly. Further, this type of stimulus relief provided through the Tax Code will not only be provided in response to fiscal and public health emergencies as dire as the pandemic. States again need to be mindful of this way in which their tax base is threatened due to their incorporation practice and be proactive to prevent future fiscal shocks.

2. Retroactivity

The CARES Act's tax changes made little sense, substantively, for the reasons noted above. Those changes were made even worse for states because they were retroactive, which meant that dynamic states were paying refunds from prior budget periods before their legislatures even had time to consider the changes. This alone is highly problematic and worthy of changed practice for states with a relatively easy fix, as discussed below.[171] Most states produce budgets annually and some produce biennial budgets, but nearly all states are required in some form to have a balanced budget over those terms.[172] Those balanced budget requirements put a premium on accurate revenue estimation because states that experience shortfalls have to come up with the money from somewhere, whether from current year funds, from current year budget cuts, or from their rainy day funds.[173] This reality makes retroactive tax changes all the more problematic at the state level. Not only can those changes cause current and future revenue reductions, but they impact funding that has already been spent. States cannot go back and unspend prior year tax revenues.

In this light, the retroactive CARES Act changes were particularly problematic for the states. States had to use current revenues to pay tax refunds out of periods for which that money had been spent. States also had to come up with those funds right in the middle of 2020 before they knew what the full extent of the pandemic would be. As a result of their anticipated revenue challenges, many states anticipatorily cut funding and fired

170. Lisa Mascaro & Andrew Taylor, *Congress Stuck, McConnell Resists State Aid in COVID-19 Deal*, ASSOCIATED PRESS (Dec. 10, 2020), https://apnews.com/article/coronavirus-financial-aid-steven-mnuchin-d327eac762f3152899904ad67f442632 [https://perma.cc/77XR-UCL2].

171. *See infra* Part IV.

172. MEGAN RANDALL & KIM RUEBEN, URB. INST., SUSTAINABLE BUDGETING IN THE STATES: EVIDENCE ON STATE BUDGET INSTITUTIONS AND PRACTICES 33 (2017), https://www.taxpolicycenter.org/sites/default/files/publication/149186/sustainable-budgeting-in-the-states_0.pdf [https://perma.cc/4UC7-QC9E].

173. *See id.* at 46–48 (discussing different types of budget stabilization funds).

workers.[174] States did not have the luxury of knowing that state revenues would ultimately largely rebound, thanks in large part to federal assistance. And again, the technicalities of state budgeting should not get in the way of what this really meant. States' anticipatory funding cuts resulted in families losing jobs or access to health or other public services in the midst of a public health emergency. Those individuals cannot go back retroactively and find housing, food security, or healthcare now that the state revenue picture is better. Individuals do not have the luxury of the "long term" recovery of revenues. Current income matters a great deal, especially during economic downturns, which means that retroactive state tax refunds paid to a limited subset of taxpayers are deeply impactful. In this light, it bears repeating that it seems implausible that any state legislator would have stepped forward with an appropriations bill providing direct aid of the sort provided through the CARES Act's tax cuts in the midst of the pandemic. State legislatures that nevertheless conformed to those cuts effectively allowed Congress to determine which of their taxpayers were most in need of state assistance.

C. *The Consolidated Appropriations Act, 2021*

The final bill evaluated in this Article is the Consolidated Appropriations Act, 2021. That bill combined a $1.4 trillion omnibus spending bill with nearly another trillion dollars of stimulus relief related to the COVID-19 pandemic.[175] The bill contained a number of tax changes, including a reduction in the medical expense deduction floor,[176] the creation or extension of a number of credits,[177] the temporary allowance of full expensing for business meals,[178] and modifications to the charitable deduction.[179] The

174. Sally Mabon, Marissa Korn & Heather Howard, *State Budget Actions in Response to COVID-19 and the Impact on State Health Programs*, STATE HEALTH & VALUE STRATEGIES (July 31, 2020), https://www.shvs.org/an-early-look-at-state-budget-actions-in-response-to-covid-19-and-the-impact-on-state-health-programs/ [https://perma.cc/A5VL-ULLA]; Mary Williams Walsh, *With Washington Deadlocked on Aid, States Face Dire Fiscal Crises*, N.Y. TIMES (Sept. 7, 2020), https://www.nytimes.com/2020/09/07/business/state-budgets-coronavirus-aid.html [https://perma.cc/TU98-BKMP]; *State Actions To Close Budget Shortfalls in Response to COVID-19*, NAT'L CONF. OF STATE LEGISLATURES, (Jan. 11, 2021), https://www.ncsl.org/research/fiscal-policy/state-actions-to-close-budget-shortfalls-in-response-to-covid-19.aspx [https://perma.cc/64H9-WBGC].

175. Niv Elis, *Congress Unveils $2.3 Trillion Government Spending and Virus Relief Package*, THE HILL (Dec. 21, 2020), https://thehill.com/policy/finance/531164-congress-unveils-23-trillion-government-spending-and-virus-relief-package [https://perma.cc/5R6Y-VAA8].

176. Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, § 101, 134 Stat. 1182, 3039 (2020).

177. *See, e.g.*, *id.* §§ 104, 105, 112, 113, 131, 132, 134 Stat. at 3040–53.

178. *Id.* § 210, 134 Stat. at 3066.

179. *Id.* §§ 212, 213, 134 Stat. at 3067–68.

biggest tax provision in the CAA, though, was a provision related to the tax treatment of certain forgivable loans provided under the PPP, which was a key component of the CARES Act.[180]

The CARES Act provided certain tax breaks as discussed above, but its primary method of economic stabilization was its provision of grants. One such program was the PPP, which started as a $349 billion program that provided direct grants and tax breaks to program participants.[181] The PPP operated by giving qualifying taxpayers forgivable loans, the forgiveness of which was dependent on the recipient demonstrating an allowed use of the borrowed funds under the terms of the program.[182] Normally, the forgiveness of a loan would result in taxable income for a recipient under § 61 of the Tax Code, but Congress wanted taxpayers to be able to receive forgiveness without the payment of tax. Congress accomplished that result by including in the CARES Act a provision that explicitly allowed recipients an exclusion from gross income for forgiven PPP loans.[183] That legislative exclusion did not settle the tax treatment of PPP recipients, however, because usually taxpayers cannot deduct expenses paid with tax-exempt funds. The IRS quickly seized on that issue and published a notice after the passage of the CARES Act that explained that the IRS would deny deductions for PPP-funded expenses.[184]

Responses to the IRS Notice from Congress suggested that the IRS Notice had subverted Congressional will, but Congress did nothing on the matter legislatively until it passed the CAA in late 2020 and explicitly provided that all PPP-funded expenses would remain deductible by taxpayers who received PPP funding.[185] Depending on one's baseline, that year-end bill either effectuated the Congressional intent behind the program from the start or represented an undeserved and distortionary double tax benefit for PPP recipients.[186] Regardless of the frame chosen, allowing taxpayers to both

180. Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, § 276, 134 Stat. 1182, 1964 (2020).

181. Coronavirus Aid, Relief, and Economic Security (CARES) Act, Pub. L. No. 116-136, § 1102(a)–(b), 134 Stat. 281, 286–93 (2020).

182. *PPP Loan Forgiveness*, U.S. SMALL BUS. ADMIN., https://www.sba.gov/funding-programs/loans/covid-19-relief-options/paycheck-protection-program/ppp-loan-forgiveness [https://perma.cc/3YW9-BCWR] (last visited Feb. 27, 2022).

183. CARES Act § 1106(i), 134 Stat. at 297.

184. I.R.S. Notice 2020-32, 2020-21 I.R.B 837; *see also* Adam Thimmesch, *States, the PPP, and Planning for Future Fiscal Shocks*, 98 TAX NOTES ST. 1029 (2020) (discussing the PPP and the IRS Notice).

185. Consolidated Appropriations Act, 2021 § 276(a)(2) (providing that "no deduction shall be denied, no tax attribute shall be reduced, and no basis increase shall be denied, by reason of the exclusion from gross income provided by" the CARES Act).

186. *See* Thimmesch, *supra* note 184 (discussing this baseline issue).

exclude forgiven loans from their income *and* allowing them to deduct the expenses funded with those loans was and continues to be costly for states. It is difficult to calculate that cost precisely but it is easily in the tens of billions of dollars. According to the Small Business Administration (SBA), as of May 24, 2021, nearly $280 billion of PPP loans had been forgiven from a total 2020 loan volume of over $520 billion.[187] The total PPP grant amount is now nearly $800 billion after expansions to the program in 2021.[188] If we just look at the $280 billion, though, and apply a state tax rate of 5%,[189] we see a state tax loss of $14 billion as compared to the tax revenues that would have been collected had the PPP recipients not received the double benefit. If all $800 billion are forgiven, that would translate into $40 billion of aggregate state tax losses from piggybacking on the double tax benefit.

The actual state tax losses from PPP conformity depend on a number of variables that cannot be teased out in this piece, but suffice it to say that without the CAA, state revenues would have been billions of dollars higher than they were after the enactment of the CAA. The decision to provide that tax relief may have made sense at a federal level, but hardly seemed to make sense at the state level. The firms who received PPP funds were already receiving direct financial assistance from the federal government and a double federal tax benefit to boot. The provision of a double *state* tax benefit on top of those federal assistance payments only added to the funds being supplied to this same group of privileged taxpayers. And since states could not borrow to provide those funds, those payments were either funded by other taxpayers in the state who were not fortunate enough to receive PPP funding or funded through spending cuts, which effectively shifted the cost of incorporation to other groups in the state. It is again hard to imagine a state legislature, in 2020, enacting an appropriations bill to provide further support to the exact same businesses that had already been chosen by Congress to receive aid. Incorporation of the PPP double tax benefit thus raises the same concerns as discussed in connection with the CARES Act, but magnified by the financial magnitude of that program.

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187. *PPP Data*, U.S. SMALL BUS. ADMIN., https://www.sba.gov/funding-programs/loans/covid-19-relief-options/paycheck-protection-program/ppp-data [https://perma.cc/LRD3-DBHX] (last visited Feb. 27, 2022).

188. *Id.*

189. State corporate and individual income tax rates generally max out between 5 and 10%. *Tax Rates/Surveys – Tax Rates*, FED'N OF TAX ADM'RS, https://www.taxadmin.org/current-tax-rates [https://perma.cc/2R6V-5Q6Q] (last visited Feb. 27, 2022) .

D. Conclusion

The prior sections introduced the state experience with three recent federal bills that modified the Tax Code. The discussion showed how incorporation resulted in mismatches between state and federal law, resulted in the replication of tax policies that made little to no sense at the state level, and impacted state revenues by hundreds of millions or billions of dollars. These issues might seem isolated or fixable with a more attentive Congress. Or some might suggest that states have little reason to complain because their residents have representation in Congress and obtain protection from these types of changes in the future. That argument would certainly be in line with the idea of representation as a remedy in the context of Professor Dorf's analysis of dynamic incorporation. At this point, though, it should be quite obvious that what makes good tax policy at the federal level may not make good tax policy at the state level. And states could conceivably obtain relief from Congress as it enacts those provisions. For instance, Congress could implement social policy choices through tax credits, rather than deductions. Unfortunately, neither history nor the trajectory of the federal legislative practice suggests that states can rely on Congress to be a good partner in these ways in the years to come.

As one final point in this section, it is also worth noting that states are not even getting the full benefit of conformity with regard to the enforcement of their tax laws. Generally, one of the accepted benefits of mirroring state and federal tax law is that states are able to piggyback on federal enforcement efforts.[190] A taxpayer who is audited by the IRS will have to report any adjustments to the states in which they file returns as well.[191] Unfortunately, Congress has significantly cut funding for federal enforcement efforts in recent years. As noted by the Congressional Budget Office (CBO), "Between 2010 and 2018, the agency's appropriations decreased by 20[%], measured in real dollars."[192] Enforcement efforts are also generally skewed toward wage earners rather than at high-income capital owners given the ease of computer matching and the audit rate for tax benefits like the EITC.[193] The result is that federal enforcement efforts could result in regressive results at the state level.

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190. *See supra* Part II.B.

191. HELLERSTEIN ET AL., *supra* note 45, at ¶ 7.02(4)(b).

192. CONG. BUDGET OFF., TRENDS IN THE INTERNAL REVENUE SERVICE'S FUNDING AND ENFORCEMENT 10 (2020).

193. Dorothy Brown, *The IRS Is Targeting the Poorest Americans*, ATLANTIC (July 27, 2021) https://www.theatlantic.com/ideas/archive/2021/07/how-race-plays-tax-policing/619570/ [https://perma.cc/E3WG-QHWR]; Chye-Ching Huang, *Depletion of IRS Enforcement Is Undermining the Tax Code*, CTR. ON BUDGET & POL'Y PRIORITIES (Feb. 11, 2020), https://www.cbpp.org/research/federal-tax/depletion-of-irs-enforcement-is-undermining-the-tax-code [https://perma.cc/7D62-PQDQ].

And with many states imposing flat personal income tax rates in any event, reliance on federal enforcement activities could be particularly problematic with regard to the overall distribution of the tax burden at the state level.

States might take some solace in the Biden administration's proposal to increase federal enforcement dollars and to focus on enforcement against higher-income taxpayers,[194] but those efforts have been stymied to a degree by backlash to a June 2021 ProPublica story using stolen IRS data.[195] Many conservative commentators and politicians have used that event as further reason to oppose adequate IRS funding, and it is unclear whether and how the Biden administration's goals will be realized. Increased IRS funding was stripped out of the bipartisan infrastructure bill after the ProPublica story, so the administration will have to pursue that funding separately.[196]

It is also the case that upcoming elections could change a lot. It is not unreasonable to expect that Republicans will again control one or both houses of Congress and/or the Presidency in the near term. Republicans under the Trump administration and before seemed keen to undercut the IRS through budget cuts, and it is reasonable to expect that they will do so again if they have the political power to do so. States expecting to freeride off of federal enforcement efforts will either need to change course or be prepared to accept the revenue and distributional consequences of that reduced audit activity.

III. TAX INCORPORATION AND THE SPECTRUM OF REVOCABILITY

The material above tells a story of a challenged basis for dynamic incorporation—although the Tax Code might provide a good starting point for state tax policy, states should not expect that federal tax changes will either translate into parallel state tax policy or into policy that makes sense at the state level. The ultimate safeguard for states, then, is that state legislatures can protect themselves from every federal tax change by simply decoupling.

194. Jim Tankersley & Alan Rappeport, *Biden Seeks $80 Billion To Beef Up I.R.S. Audits of High-Earners*, N.Y. TIMES (July 7, 2021), https://www.nytimes.com/2021/04/27/business/economy/biden-american-families-plan.html [https://perma.cc/MF9E-B2CQ].

195. Jesse Eisinger, Jeff Ernsthausen & Paul Keil, *The Secret IRS Files: Trove of Never-Before-Seen Records Reveal How the Wealthiest Avoid Income Tax*, PROPUBLICA (June 8, 2021), https://www.propublica.org/article/the-secret-irs-files-trove-of-never-before-seen-records-reveal-how-the-wealthiest-avoid-income-tax [https://perma.cc/JYJ4-HN2D].

196. *Senator: Bipartisan Infrastructure Bill Loses IRS Provision*, ASSOCIATED PRESS (July 18, 2021), https://apnews.com/article/joe-biden-business-government-and-politics-bills-4da016e1ab4d2331a0310391ecbc4d73 [https://perma.cc/SC8J-ZJMZ]; Nicolas Vega, *The White House Says Closing the 'Tax Gap' Will Help Pay for the $1 Trillion Infrastructure Bill—Here's What That Means*, CNBC (Aug. 10, 2021), https://www.cnbc.com/2021/08/10/what-is-the-tax-gap-infrastructure-plan.html [https://perma.cc/B9EW-GZV3].

This is a key aspect of Dorf's theoretical account of incorporation and the very practical safeguard that exists for states that piggyback on the Tax Code. From a law and economics standpoint, the adoption of apparently suboptimal federal tax policy changes by states could actually be the result of measured analysis and a determination that the efficiency benefits of incorporation make more sense than incurring the costs to achieve "better" state tax policy.

In this context, though, it is useful to recall Dorf's spectrum of revocability. It is not the case that every revocable position is equally revocable. Some provisions of law become entrenched in ways that make decoupling very difficult for states and that therefore undermine our faith that conformity reflects an optimal position.[197] To Dorf, entrenchment didn't seem to be a concern for tax incorporation, where he noted that federal tax choices could be undone with a "simple legislative act."[198] But experience tells us that legislation gets entrenched for many reasons,[199] inertia being among them,[200] and with the benefit of exposure to academic research on defaults[201] and years of state tax legislative practice, it is also the case that these generalized concerns actually seem to be of special force in the state-tax context.

A. The Time Cost of Legislation

In a world with perfect information and no transaction costs, we would expect that a state's default position of conformity to federal tax changes would not impact the ultimate content of state law. State legislatures could decouple from, or affirmatively elect into, any provisions that they deemed ill-suited or well-suited for their jurisdiction, and incorporation would not

197. Dorf, *supra* note 17, at 120 (noting that "as the degree of entrenchment . . . increases, so too does the difficulty of reconciling the provision (or its interpretation) with democratic principles").

198. *Id.* at 113–14.

199. *See, e.g.*, *id.* at 122–23 (explaining that "all legislation is entrenched in some sense" because it takes effort to repeal absent an automatic sunset); Eric A. Posner & Adrian Vermule, *Legislative Entrenchment: A Reappraisal*, 111 YALE L.J. 1665, 1686–88, 1696–97 (2002) (recognizing that all legislation becomes "entrenched" to the extent that it creates a new default rule that "shifts the burden of inertia"); Rebecca M. Kysar, *Lasting Legislation*, 159 U. PA L. REV. 1007, 1060 (noting that ordinary legislation gets entrenched because the legislative effort to change course is a "costly endeavor"); Mirit Eyal-Cohen, *Unintended Legislative Inertia*, 55 GA. L. REV. 1193, 1203–08 (2021) (discussing the existence and causes of legislative inertia).

200. Dorf, *supra* note 17, at 122–23 (noting that "as a practical matter, the burden of overcoming legislative inertia even in a single house of the legislature makes the repeal of legislation substantially more difficult that its nonenactment in the first place"); *see generally* Paul Jones, *Session Ends Without CARES Act Decoupling*, 99 TAX NOTES ST. 283, 284 (Jan. 18, 2021) (on file with author).

201. *See, e.g.*, Cass R. Sunstein, *Deciding by Default*, 162 U. PA. L. REV. 1 (2013) (discussing the role of defaults).

change state law or subvert democratic self-rule in any way. Of course, we do not live in that world, nor would any knowledgeable observer suggest that we do. The practice of decoupling is costly for many reasons. Transaction costs are very high in this area of law, which means that defaults may matter a great deal.[202]

To start, legislators are generalists, and some may have tax knowledge, but not likely to a significant degree. Fifteen states also impose term limits on state legislators,[203] which means that they are unable to fully utilize the gained experience that comes with repeated exposure to these types of matters. The time that state legislators must put into understanding these issues, and the impacts of those changes on their states, is a very real cost of dynamic incorporation, especially where a state was perfectly happy with its tax laws as they existed.

Perhaps the more problematic cost is the opportunity cost of decoupling.[204] Only seven states and the District of Columbia have legislative bodies that meet for the entire year.[205] Many states have sessions that last only from January to March.[206] The result is that time is one of the most precious resources for state legislatures, and any time spent considering tax changes is time that is not spent considering other matters, which is problematic because state legislatures are certainly not lacking for work these days. From normal budgeting matters to education funding, Medicaid expansion, infrastructure projects, the legalization of gambling and recreational or medicinal marijuana, police reform, election security, privacy, and climate change, state legislatures have a lot on their plates. Adding tax changes made by Congress to the mix can be an awful lot.[207]

These costs apply to all state legislation, of course, and so this critique is applicable to state incorporation in general. But state tax may be different in

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202. Defaults matter even when transaction costs may seem to be nonexistent. Herbert Hovenkamp, *Fractured Markets and Legal Institutions*, 100 IOWA L. REV. 617, 652 (2015) ("Even when transaction costs are very low, default rules might serve to address behavioral issues, including inertia and limitations on perspective.").

203. *The Term-Limited States*, NAT'L CONF. OF STATE LEGISLATURES, (Nov. 12, 2020) http://www.ncsl.org/research/about-state-legislatures/chart-of-term-limits-states.aspx [https://perma.cc/3BKF-ZTFT].

204. *See* Ronald Dworkin, *Political Judges and the Rule of Law*, *in* ARGUING ABOUT LAW 193, 200 (Aileen Kavanagh & John Oberdiek eds., 2009) ("Legislative time is a scarce resource, to be allocated with some sense of political priorities . . . .").

205. Those states are Massachusetts, Michigan, New Jersey, New York, Ohio, Pennsylvania, and Wisconsin. *2019 Legislative Session Calendar*, NAT'L CONF. OF STATE LEGISLATURES (Oct. 3, 2019), http://www.ncsl.org/Portals/1/Documents/NCSL/2019_session_calendar.pdf [https://perma.cc/MMS3-6FKW].

206. *Id.*

207. *See* Monahan, *supra* note 16, at 93 (noting that conformity requires states to respond to congressional action "under tremendous time pressure.").

ways that make dynamic incorporation more problematic for states and their residents in the tax context. Chiefly, the incorporation of the Tax Code represents the incorporation of a multitude of provisions, regulations, and administrative rulings that are handed down regularly and often at inopportune times. Incorporation in the tax context is unlike the incorporation of a definition of a term with fewer collateral consequences. Take, for example, the practice of many states to piggyback on the federal definition of a "controlled substance" for purposes of state law.[208] A change to the federal definition might change whether a particular drug is regulated or prohibited, but the effect should not swing state revenues wildly or impact the services that a state can provide to its residents.[209] The change is also fairly straightforward in effect. Tax changes are often very different.

This can again be evidenced by looking at scope and timing of the TCJA.[210] Not only were that bill's tax changes multiple, partially offsetting, and sometimes technically complicated, all were made on December 22, 2017,[211] obviously a time when very few legislatures would have been in session. Some of the changes in the TCJA were even immediately effective or retroactive, so states had absolutely no opportunity to review those provisions before the changes impacted state tax collections.[212] The same was obviously true of the tax changes in the CARES Act and in the CAA as well.

The retroactive nature of tax changes during a year, and the inclusion of provisions retroactive to prior tax years, makes state tax conformity decisions highly consequential in ways that dynamically incorporating prospective changes to banking, environmental, or drug standards might not. This is not to say that tax is the only area that presents these challenges, but it is to say

208. *See, e.g.*, 720 ILL. COMP. STAT. 648/10 (2013) (incorporating a wide variety of definitions for purposes of the state's Methamphetamine Precursor Control Act); N.M. STAT. ANN. § 30-31-2(E) (2021) (incorporating the federal definition of a "controlled substance"); WASH. REV. CODE § 69.50.101(g) (2020) (incorporating the federal definition of a "controlled substance").

209. I remain cognizant that I may overstate the complexity and impact of tax and understate the complexity and impact of other areas of law. If that is the case, it is not fatal to the argument, of course, but states should think about their legislative practices with this in mind.

210. *See supra* Part II.A.

211. *2017 Legislative Session Calendar*, NAT'L CONF. OF STATE LEGISLATURES (Dec. 6, 2017), https://www.ncsl.org/documents/ncsl/2017sessioncalendar.pdf [https://perma.cc/6RF6-42SZ].

212. *2017 Tax Reform: President Signs Tax Cuts and Jobs Act, Fixing Effective Date of Various Provisions*, THOMSON REUTERS TAX & ACCT. (Dec. 27, 2017), https://tax.thomsonreuters.com/news/2017-tax-reform-president-signs-tax-cuts-and-jobs-act-fixing-effective-date-of-various-provisions/ [https://perma.cc/ZN47-VKZ3]; Peter J. Reilly, *Retroactive Depreciation Changes Encourage Closing Deals Before Year End*, FORBES (Dec. 21, 2017), https://www.forbes.com/sites/peterjreilly/2017/12/21/retroactive-depreciation-changes-encourage-closing-deals-before-year-end/?sh=7c6c61086db6 [https://perma.cc/FX7S-UVQH].

that legislative costs that impede otherwise efficient decoupling are particularly problematic in the tax sphere. The direct link between tax laws and state budgets is critically important.

Unfortunately, it is also the case that states' limited legislative session lengths and their full calendars means that it is highly probable that Congress will pass tax changes at a time when states are unable to respond, especially given the federal legislative practices discussed above. States will have to either live with the results or change their laws retroactively, possibly many months after the federal law change.

The end result of these pressures is that the default position taken by a state would seem to matter a great deal. Dynamic incorporation puts states in a position where it will be more difficult to decouple from federal tax changes, no matter how ill-suited those changes are for a state's own residents. Static incorporation, in contrast, does not put states in quite the opposite position, but it does seem to allow for easier deviations from federal law. Static states are essentially forced to spend some time dealing with federal tax changes by virtue of having to pass legislation to at least update their conformity dates, which might overcome some inertia against decoupling. Nevertheless, static states can still easily update those dates, and simple path dependency might similarly lead states to conform more often than they otherwise would in a "pure" world. In all, though, flipping the default position from that which exists under dynamic conformity puts states back in the driver's seat on their own laws, while still allowing them to leverage the benefits of incorporation if they wish.

B. Framing Effects and the Psychology of Decoupling

It is difficult to discuss the topic of decoupling without recognizing that potential behavioral biases could impede otherwise "optimal" state deviation for reasons other than simple time cost. We know from academic research, and likely from our own lived experiences that defaults matter. Change requires action, and change is often framed in ways that seem suboptimal as compared to the status quo, regardless of the actual utility of those positions. Whether understood through behavioral psychology[213] or through more

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213. Research into behavioral psychology tells us that there are a range of cognitive biases that produce real world results that differ from those that might occur if humans were purely rational beings. Loss aversion and status quo bias in particular, are related and demonstrate that the framing of decisions can be of incredible significance. Daniel Kahneman, Jack L. Knetsch & Richard H. Thaler, *Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias*, 5 J. ECON. PERSPS. 193, 194 (1991); *see also* Gamage, *supra* note 3, at 794–801 (broadly discussing the issue of baselines and framing in tax policy).

general experience, it is particularly the case that it is more difficult to take action that can be framed as resulting in a "loss."[214] And in an environment that generally seems anti-tax, it can be difficult for states to take wholly rational behavior that can be framed or labelled as a "tax increase" despite that behavior merely maintaining the status quo. These effects can make it very difficult for states to deviate from federal tax cuts even when they would never have proposed those cuts of their own accord.

In this vein, consider again the tax cuts implemented in the CARES Act. Those cuts were enacted by Congress to provide federal tax relief and without state input. From a clean slate, the state adoption of those same tax changes would be framed as tax cuts. Incorporation can change that framing though because once a federal tax cut has been incorporated into state law, a choice to decouple from that cut looks like a tax increase. In the context of the CARES Act, decoupling bills were framed in precisely that way by opponents.[215] At the same time, though, some commenters noted that states would need to decouple from the few CARES Act revenue raising provisions to prevent state tax increases.[216] In that context, the baseline was not the status quo of conformity, but the prior state law. States can't win.

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214. Loss aversion refers to the tendency of individuals to feel more pain from giving up an object than the utility that they get from acquiring it (Marie Kondo's nightmare). As Kahneman, Knetsch, and Thaler put it, "changes that make things worse (losses) loom larger than improvements or gains." Kahneman et al., *supra* note 213, at 199. This effect helps, but does not fully, explain what researchers have identified as a "status quo bias" where people tend to prefer the status quo to a change from that baseline. *See generally* William Samuelson & Richard Zeckhauser, *Status Quo Bias in Decision Making*, 1 J. RISK & UNCERTAINTY 7 (1988). Related is the endowment effect, which refers to the tendency of individuals to value assets more when they have them than before. A person who would only pay $100 for a vase, for example, will tend to require more than $100 from a potential buyer. Kahneman et al., *supra* note 213, at 194 (noting "that people often demand much more to give up an object than they would be willing to pay to acquire it").

215. *See, e.g.*, Jaliya Nagahawatte, *States Are Sticking with Most CARES Act Tax Provisions*, PLATTE INST. (June 22, 2020), https://platteinstitute.org/states-are-sticking-with-most-cares-act-tax-provisions/ [https://perma.cc/9SQT-WZ9H] ("If the Legislature does move forward with the decision to decouple, though, Nebraskans and Nebraska businesses could be seeing additional taxes on the horizon."); *see also* Jones, *supra* note 200 (reporting a comment by the Illinois House GOP caucus to the effect that decoupling "'would have saddled Illinois businesses with a $1 billion tax hike'"); Adam Schuster, *Pritzker Wants $500M Tax Hike on Illinois Small Businesses*, ILL. POL'Y (Jan. 13, 2021), https://www.illinoispolicy.org/pritzker-wants-500m-tax-hike-on-illinois-small-businesses/ [https://perma.cc/9VR8-E7A8] ("In reality, the legislative change he is proposing would increase the tax liability for small businesses when many can least afford it and impede economic recovery from the COVID-19 crisis.").

216. *See, e.g.*, Steven N.J. Wlodychak, *INSIGHT: The CARES Act May Have Just Increased Your State Taxes. Wait. What? – Part 1*, BLOOMBERG TAX (June 30, 2020), https://news.bloombergtax.com/daily-tax-report-state/insight-the-cares-act-may-have-just-increased-your-state-taxes-wait-what-part-1 [https://perma.cc/63HK-EX7Z].

The rhetoric involved in state legislative debates demonstrated the use, and potentially the power, of framing. Consider, in this vein, a comment from the Illinois House of Representatives GOP caucus in response to a bill that would have decoupled from federal tax cuts provided in the federal CARES Act. That group latched onto the changed baseline of dynamic conformity and framed the state's decoupling bill as a "bill that would have saddled Illinois businesses with a $1 billion tax hike."[217] The reality, of course, is that the tax cuts were thrust on Illinois without any vote in Illinois and at a time when the legislature was not even in session due to the pandemic. In other states, opponents of decoupling bills even referenced as support for conformity the fact that taxpayers had already filed refund claims based on the retroactive changes.[218] To decouple would be to require taxpayers to pay that money back, something framed as a tax increase. The changed baseline was important, and the changed baseline was largely attributable to dynamic incorporation.

C. *The Substance of Form*

The discussion above suggests that the default of incorporation may be particularly sticky in the state-tax context. Decoupling requires states to dedicate precious time to tax matters and to potentially overcome some recognized biases in favor of defaults. This suggests that Dorf's "simple legislative act" might not be so simple and that the form of incorporation might matter more than currently accepted or appreciated in the literature.

To explore this side of incorporation further, this section of the Article brings the academic literature on defaults and choice architecture to the tax incorporation discussion by adopting and then testing a fairly intuitive frame—that the adoption of either static or dynamic conformity is the setting of a default position from which deviation can be difficult. Within this frame, static conformity sets a default of nonconformity. A state must take affirmative action to either update its conformity date to incorporate federal tax changes or pass legislation targeted at such a change. In contrast, dynamic conformity sets a default of conformity, and a state that does not want to adopt a federal tax change must take affirmative action to decouple. With this framing set, we would expect that, all else being equal, static conformity

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217. Jones, *supra* note 200, at 284.

218. *See, e.g.*, Jennifer Young & Robert O'Neill, *Oregon Governor's Budget Would Increase Taxes on Overburdened Businesses*, 99 TAX NOTES ST. 319, 321 (Jan. 25, 2021) (on file with author) (noting that Oregon had already paid some refund claims before the legislature was considering decoupling legislation). The author also personally testified in hearings in two different states where this claim was made by opponents of decoupling bills. *Id.*

states would tend to deviate from federal tax changes more often than dynamic conformity states.

As a first step toward testing the efficacy of this frame, I evaluated every state's response to six different changes in law—captured in four different tax provisions discussed above—over the last several years. The data indeed show a sharp distinction between how static and dynamic states have responded to certain federal tax changes. Overall, we see that static states decoupled from the selected federal changes to a much greater degree than did dynamic states. The analysis offered is far from empirical, but this snapshot is entirely consistent with the account offered above and provides the first systemic look at state incorporation practice along these dimensions. All else being equal, we should not expect state reactions to federal law to deviate to such a degree along these lines. So, while we obviously cannot rule out other causes for this difference in response, these results certainly suggest that states and researchers should pay more attention to the effects of the method of incorporation chosen by states.

1. Full Expensing

As discussed above, one of the big policy changes in the TCJA was the adoption of full expensing for most business purchases of tangible personal property. Prior to the TCJA, the Tax Code had allowed for generous first-year depreciation, and accelerated expensing was often used as a tool of economic stimulus.[219] That bonus depreciation allowance was extended several times until the TCJA obviously took the idea to its fullest extent, at least in the short term. Under the terms of the TCJA's modifications to Section 168(k), taxpayers are allowed to take a 100% depreciation allowance for "qualified property" placed in service before January 1, 2023, but the full expensing ratchets down over time.[220] So, what did states do? A full table showing how states responded is included in Appendix A as Table 168(k), but a summary follows and provides a very useful insight into the differences between static and dynamic incorporation.[221]

219. *See supra* text accompanying note 161 (discussing several bills that used this tool of economic stimulus).

220. I.R.C. § 168(k).

221. Because this section of the Article is focused on the difference in how static and dynamic conformity states responded, states that either do not impose an income tax, or that impose such a tax but do not specifically incorporate adjusted gross income or taxable income are excluded.

Summary 168(k) - TCJA

	Conform[222]	**Decouple**[223]
Dynamic	16	10
Static	2	17

What we see is that, of the twenty-six jurisdictions that dynamically incorporate the Tax Code for one or both of their corporate and personal income taxes, sixteen (62%) fully conform with the full-expensing allowance of Section 168(k).[224] That means, of course, that only 38% of dynamic states acted to decouple from federal bonus depreciation. The results are much different when looking at states with static conformity provisions. Of the nineteen jurisdictions with static conformity for either or both of their personal and corporate income taxes, only two (11%)—Arizona and West Virginia—fully conform with 100% bonus depreciation. That of course means that 89% of those states have decoupled from 168(k). That is an eight-fold increase in decoupling correlated with the utilization of static incorporation rather than dynamic incorporation.

2. Net Interest Limitation

We can compare the state response to the TCJA's full expensing provision with the state response to a partially related revenue raiser. As noted above, Section 163(j) of the Tax Code was added to implement a restriction on the amount of interest that certain taxpayers could deduct.[225] Congress then made

222. The number of dynamic states that conform includes Michigan, which conforms for purposes of its personal income tax but not its corporate income tax. The number of static states that conform includes Arizona, which conforms for purposes of its personal income tax but not its corporate income tax.

223. The number of dynamic states that decouple includes Michigan, which decoupled for purposes of its corporate income tax. The number of static states that decouple includes Arizona, which also decoupled for purposes of its corporate income tax. *See* sources cited *infra* note 236.

224. *See infra* app. A, tbl. 168(k). One of the states considered to be dynamically incorporating the Tax Code is Iowa, which presents some difficulty of categorization. That state was also a static conformity state at the time of the TCJA's enactment and has only recently moved to incorporating on a dynamic basis. Iowa also has historically conformed to federal bonus depreciation; however, Senate File 619 was enacted on June 16, 2021, which provides for full conformity to 168(k) retroactively beginning January 1, 2021. Iowa S. File 619, § 54, 89th Gen. Assemb, Reg. Sess. 1, 24 (2021), https://www.legis.iowa.gov/docs/publications/LGE/89/SF619.pdf [https://perma.cc/K2KZ-4C56]. For purposes of the numbers provided, Iowa is considered a dynamic state that does conform.

225. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 13301, 131 Stat. 2054, 2117 (codified as amended in scattered sections of I.R.C.).

that restriction less severe in the CARES Act for a period of years. A complete table of state responses to those changes in federal law is included in Appendix A as Table 163(j). Summaries are provided below for reference. The first table shows how states responded to the TCJA's 163(j) limit and the second table shows how states responded to the CARES Act's relaxation of that limit.

Summary 163(j) - TCJA

	Conform	**Decouple**
Dynamic	23	3
Static	12	6

Summary 163(j) - CARES

	Conform	**Decouple**
Dynamic	20	6
Static	6	12

With the caveat, again, that you cannot take too much from this snapshot of one particular provision, the data do reveal a trend consistent with what we see with bonus depreciation. Namely, states with static conformity deviated from the Tax Code more often than did dynamic conformity states. When looking at the TCJA's implementation of Section 163(j), only three of the twenty-six dynamic jurisdictions (12%) decoupled from that change. Of static jurisdictions, 6 of 18 (33%) decoupled. These numbers are notable for two reasons. First, a majority of both static and dynamic states did choose to fully incorporate the TCJA's provision, which suggests that incorporation did provide states with the benefits discussed above. Second, however, we see that static incorporation was correlated with a nearly three times increase in the likelihood of decoupling.

The CARES Act's changes show a similar story. And we can break out those numbers in a few different ways. First, if we focus just on dynamic states, we see that six of twenty-six (23%) decoupled, whereas only three of twenty-six (12%) decoupled from 163(j) after the TCJA. That doubling of decoupling states could be a function of many factors but might suggest that dynamic states did broadly recognize that the tax cut was inadvisable.

The numbers were more drastic among static states. Among those states, we see that 12 of 18 (67%) states decoupled from the CARES Act's changes as compared to only six static states (33%) that had decoupled from the TCJA's original position. Again, static incorporation correlated with higher rates of deviation.

3. Excess Business Loss Limitation

The excess business loss rules present a situation much like the Section 163(j) limitations. States were faced with an expanded loss limitation rule in the TCJA and then a retroactive carve back of that rule in the CARES Act. States responded largely like they did with the previous sections discussed above. A summary of states' responses is included in Appendix A as Table Excess Business Loss. Summaries are again provided for reference, again with a table that summarizes how states responded to the implementation of the excess business loss limitation in the TCJA and then how they responded to the CARES Act's relaxations.

Summary EBL - TCJA

	Conform	**Decouple**
Dynamic	21	0
Static	16	1

Summary EBL - CARES

	Conform	**Decouple**
Dynamic	19	2
Static	5	12

We can again evaluate this data in a few ways. First, it is worth noting that every state but one adopted the TCJA's excess business loss rule. The only state to decouple did so without action because the state—Massachusetts—has a static conformity date of January 1, 2005.[226] When we move forward to the CARES Act's relaxation of those rules, we see results much more consistent with what we saw with the provision discussed previously. Of the twenty-one states that incorporate the personal income tax on a dynamic

226. MASS. GEN. L. ch. 62, § 1(c) (2019).

basis, only two (10%) decoupled. We see a dramatic shift, though, when we look at static states. Of the seventeen states that incorporate the Tax Code on a static basis, twelve (71%) chose to not adopt the EBL relaxation provision in the CARES Act.

4. Paycheck Protection Program

States' decisions with respect to the PPP were more uniform than some other provisions. To briefly review, the PPP tax provisions were two-fold. The CARES Act provided an exclusion from gross income for forgiven PPP loans and the CAA provided a deduction for expenses funded with those same funds.[227] For a variety of reasons, what states did with these provisions was to overwhelmingly conform, despite the costs of doing so.

States with dynamic incorporation immediately incorporated the PPP exclusion in the CARES Act and the deductibility provision in the CAA of 2020, and, of those states, only Utah affirmatively acted to decouple. The state did not act to decouple from the CAA of 2020 though. What happened was that Utah passed a bill—S.B. 6005—on August 31, 2020 that provided that Utah PPP recipients could exclude forgiven PPP loans to the extent that deductions were not allowed for the funded expenses.[228] At the time, that provision served to conform to the CARES Act given the IRS policy statement, but it ultimately resulted in decoupling after the Consolidated Appropriations Act, 2021, was passed because the PPP-funded expenses became deductible. Utah did not update its law to conform again. In essence, Utah's August bill put it in the position of a static conformity state, in that it would have had to act to conform to federal law after the CAA of 2020. It did not do so. Utah is the only dynamic conformity state to have not fully conformed with the federal PPP tax provisions.

Unlike the provisions discussed above, static conformity states overwhelmingly conformed to federal tax law on the PPP, but two did decouple and others debated it for quite some time. California limited the availability of PPP deductions to many taxpayers and outright denied deductions for any taxpayer classified as an "ineligible entity."[229] Virginia,

227. *See supra* Part II.C.

228. S.B. 6005, 2020 6th Spec. Sess. (Utah 2020).

229. A.B. 80, 2021 Sess. § 1 (Cal. 2021). Under the California law, an "ineligible entity" is a taxpayer that is either a publicly traded company or a company that does not experience a 25% reduction in gross receipts in an applicable quarter of 2020 as compared to the same quarter in 2019.

another static conformity state, also limited PPP deductions, but limited them to $100,000 for all taxpayers.[230]

Among the static conformity states to adopt the PPP tax provisions, many did wait and debate conformity for some time and made their decisions in light of budget pictures that looked much better than expected. Conformity was not a given though. Hawaii enacted its conformity bill in early July 2021.[231] Minnesota did the same.[232] New Hampshire did not pass its PPP conformity bill until June of 2021.[233] Vermont acted in June.[234] In all, then, we see again that static conformity still leads to widespread conformity, but that it does allow for deviation and for more debate about these provisions.

D. Summary

It is no secret that inertia can impede otherwise rational legislative action.[235] The sources of this inertia are certainly present in the state tax realm, where there are many factors that prevent state legislatures from acting to decouple from federal tax changes. States need to better appreciate this dynamic given the importance of state tax changes to their ability to fund their operations. The analysis of this Article shows that states' methods of incorporation could heavily influence the ultimate content of their laws. The survey evidence that is reported and analyzed above provides states and researchers with new, unique data to support that conclusion and suggests that something as simple as a requirement that states update their incorporation dates can be enough to help states overcome the impediments to beneficial decoupling legislation. With those lessons in mind, the final section of this Article again draws from the experiences and practices of the states to suggest a variety of approaches that states can take to better protect their own interests while still leveraging the benefits that accrue to them when they piggyback on the Tax Code.

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230. VA. CODE ANN. § 58.1-322.03(17) (2022).

231. H.B. 1041, Act 89, 31st Leg. (Haw. 2021).

232. H.F. 9, 92nd Leg., 1st. Spec. Sess. (Minn. 2021).

233. N.H. DEP'T OF REVENUE ADMIN., TIR 2021–003, NEW HAMPSHIRE TAXATION OF FORGIVEN PAYCHECK PROTECTION PROGRAM LOANS (2021).

234. Evan Fallor, *Vermont Exemptions, Federal Conformity Bill Signed into Law*, 2021 TAX NOTES ST. 112–14 (June 11, 2021) (on file with author).

235. *See* sources cited *supra* note 199.

IV. INCORPORATING LESSONS FROM THE STATES

The analysis above points out many of the downsides of dynamic incorporation for the states, but none of that analysis is meant to ignore the very real benefits that accrue to states and to their taxpayers from that practice. To the contrary, incorporation brings many benefits. States can improve their tax systems, though, by adopting practices that reduce incorporation's costs. The most obvious recommendation for states given the entirety of this Article is that that they conform on a static basis rather than on a dynamic basis. Static incorporation allows states to consider the effects of federal tax changes before those changes have already been worked into the states' baselines. That position of stability would help states to more meaningfully analyze federal tax changes for their fit before those changes are incorporated into state law. The materials below will not belabor that point. Instead, section A proposes some intermediate steps that states can take if they are not willing to adopt static incorporation. Section B then proposes steps that all states can take to make better tax choices for themselves and their taxpayers. Section C moves beyond tax and invites states to think more deeply about their balanced budget requirements and the use of debt, and Section D concludes by addressing some concerns that states and taxpayers might have about these proposals.

A. Intermediate Steps

It is much too optimistic to think that all dynamic incorporation states will adopt static incorporation—although there are obviously many reasons that they should do so. Nevertheless, there are a number of options that states can consider to improve their incorporation practices even if they continue to dynamically incorporate. The most obvious design choice for states is the incorporation of federal adjusted gross income rather than taxable income because the former reflects fewer federal judgments about economic and social, rather than tax, policy. Professor Ruth Mason advocated for this approach nearly a decade ago and Professor Amy Monahan's recent review of state responses to the TCJA suggests the same.[236]

There are other sensible changes that do not require states to reinvent the wheel. Two entirely sensible design choices are to adopt "lagged conformity" which means that federal tax changes do not affect state law in the taxable year in which they are enacted. Another is for states to automatically decouple

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236. Mason, *supra* note 5, at 1334–36; Monahan, *supra* note 16, at 61 (noting that the Article's sample suggests that "conformity—or at least tight conformity that incorporates nearly all of the federal individual income tax—may work against state tax policy goals").

from changes that exceed a certain revenue impact. Maryland currently uses a provision that implements a mix of these approaches.

1. The Maryland Model

Maryland is sometimes recognized as conforming to the Tax Code on a dynamic basis, but that is not quite accurate. Maryland's incorporation statute is not a pure dynamic-incorporation provision, but instead provides as follows:

> Except as provided in subsection (c) of this section and unless expressly provided otherwise by law, an amendment of the Internal Revenue Code that affects the determination of federal adjusted gross income or federal taxable income, does not affect the determination of Maryland taxable income under this title for:
>
> (1) any taxable year that begins in the calendar year in which the amendment is enacted; or
>
> (2) any taxable year that precedes the calendar year in which the amendment is enacted.[237]

This provision implements what has been termed "lagged conformity."[238] Under the terms of the statute, federal tax changes do not become effective immediately for Maryland tax purposes, but they do automatically become effective the next taxable year. That provision, then, is not as protective as static conformity would be, but it does at least buy the state and taxpayers some time to consider changes before they are implemented and allows the state to gather information, discuss the changes, and debate what approach makes sense.

The downside of this approach is that taxpayers will bear the burden of complying with state law that differs from federal law for at least one year. The Maryland statute mitigates that cost to a degree by providing for the automatic incorporation of federal changes that have little anticipated effect on state revenues. This is accomplished through the reference to subsection (c) in the statutory excerpt above. Subsection (c) provides that the general rule of lagged conformity "does not apply to an amendment of the Internal Revenue Code if the Comptroller determines that the impact of the amendment on State income tax revenue for the fiscal year that begins during

237. MD. CODE ANN., TAX–GEN. § 10-108(a) (West 2022).
238. Mason, *supra* note 5, at 1334 (suggesting a "lagged conformity" approach).

the calendar year in which the amendment is enacted will be less than $5,000,000."[239]

This effect of this provision is that federal tax changes will automatically become part of Maryland tax law unless they impact state revenues in the current year by at least $5,000,000. The impetus is on the state comptroller, though, to establish that the revenue impact will not meet or exceed that amount. To that end, the Maryland statute requires the Comptroller to provide a report to state officials within 60 days of any amendment to the Tax Code that outlines those changes and the impact of those changes, including the revenue and distributional effects.[240]

Maryland also only recently changed this provision to protect the state against retroactive tax changes.[241] Prior to the state's 2021 legislative session, the provision excerpted above only required lagged conformity for tax changes that impacted "the fiscal year that begins during the calendar year in which the amendment is enacted."[242] The provision did not require lagged conformity for tax changes that impacted *prior* years, which is generally not an issue because Congress generally does not enact retroactive tax changes. As discussed above, however, Congress did provide retroactive relief in the CARES Act, with the effect that Maryland had lagged conformity for 2020, but automatic conformity for prior years impacted by the federal changes. Amid that experience, the Maryland legislature very wisely amended that provision, and the state's lagged conformity provision now applies to changes that affect current or prior table years and thus serves many of the objectives listed in this Article. This approach should serve as a model for other states.

States could also consider a modified version of this approach that automatically decouples from tax changes with a set revenue impact in perpetuity, instead of merely delaying their effective date like under the Maryland model. The Maryland model buys the state time, but that approach ultimately retains a default of conformity.

2. The New York Model

If states are unable or unwilling to change to static or lagged conformity more generally, they could still consider the approach taken by New York in 2020. New York is another dynamic state, but during the early days of the COVID-19 pandemic the New York legislature protected that state's tax base by affirmatively adopting static conformity for a limited duration.

239. TAX–GEN. § 10-108(c).
240. *Id.* § 10-108(b).
241. SB 578, 2021 Reg. Sess. (Md. 2021).
242. TAX–GEN. § 10-108(c).

Specifically, the New York legislature added the following provision to its general rule of dynamic incorporation: "Provided however, for taxable years beginning before January first, two thousand twenty-two, any amendments made to the internal revenue code of nineteen hundred eighty-six after March first, two thousand twenty shall not apply to this article."[243]

That simple change effectively shifted the state to a static-incorporation position for a period of years and resulted in the state effectively decoupling from the CARES Act changes. That provision allowed the state to take better control of its tax base during that public health and fiscal crisis. Notably, however, the New York state legislature's adoption of this provision did not mean that it rejected all of the CARES Act's changes. New York did affirmatively adopt some of the tax provisions enacted by Congress in response to the pandemic, including the tax treatment of PPP loans and forgiveness.[244]

3. Colorado Model

Sometimes legislative changes will be impossible to timely implement given other challenges being faced by states. This was proven true in 2020 as state legislatures were unable to convene for their normal periods due to the challenges of the pandemic. Instead of adopting a legislative change to its dynamic conformity position, like New York, Colorado took a different approach. Colorado's revenue department implemented an emergency regulation in 2020 clarifying that the state's dynamic conformity provision applied only to prospective changes. Colorado Regulation 39-22-103(5.3) now provides that:

> "Internal revenue code" does not, for any taxable year, incorporate federal statutory changes that are enacted after the last day of that taxable year. As a result, federal statutory changes enacted after the end of a taxable year do not impact a taxpayer's Colorado tax liability for that taxable year. Changes to federal statutes are incorporated into the term "internal revenue code" only to the extent they are in effect in the taxable year in which they were enacted and future taxable years.[245]

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243. N.Y. TAX LAW § 607(a) (McKinney 2020).

244. *New York State Tax Implications of Recent Federal COVID Relief*, N.Y. STATE DEP'T TAX'N & FIN. (Dec. 15, 2021), https://www.tax.ny.gov/pit/cares-act-faq.htm [https://perma.cc/9X23-DPGG].

245. COLO. CODE REGS. § 39-22-103(5.3) (2022) (adopted as an emergency regulation effective June 2, 2020 and made permanent effective Sept. 30, 2020).

This regulatory approach is not preferable to a legislative approach generally, but it does provide another model for states to consider in the future if needed. To the extent that state statutes and administrative law allow for this type of change, it can be of great help to a state undergoing financial difficulty.

B. Best Practices for All States

Regardless of which incorporation type states adopt, it is the case that states will need to evaluate federal tax changes for their suitability at the state level. Just as states should not accept every federal change, they certainly should not reject them all. The costs of having a state tax system that deviates too far from the Tax Code are large, for the reasons discussed above.[246] The Article has proceeded not from a normative commitment to decoupling or to conformity but from a commitment to strengthening the state tax base, the preservation of democratic self-rule, and the utilization of processes that lead to state laws that better reflect the will and interests of the people.

In the end, states will not be able to critically evaluate every single federal tax change, nor would it be optimal for them to do so. In light of those constraints, I propose five practices that states should consider adopting as a way of better leveraging the benefits of incorporation without that practice costing them too much. These proposals would ideally be implemented along with the utilization of static incorporation but would also be second best approaches for states that continue to use dynamic incorporation as well.

1. Understand the Dollar Cost of Conformity

One highly beneficial state practice would be for states to ensure that they have good estimates from their revenue estimators before determining whether to adopt or decouple from federal tax changes. States could very rationally adopt federal tax changes that represent "bad tax policy" if the result is not a large loss of revenue. The costs on the state of dedicating legislative time to the issue and/or the costs imposed on taxpayers by deviating from federal tax reporting might overwhelm the potential revenue savings to the state. Obviously, though, if the revenue estimate were more meaningful, a different approach would be taken.

State practice regarding revenue estimates for federal tax changes appears to vary widely. Some states statutorily require timely estimates. Maryland, for example, requires that the state Comptroller provide a report to the state

246. *See supra* Part I.B.

governor and legislature within 60 days of any amendment to the Tax Code detailing the changes and their revenue and distributional impacts.[247] Nebraska added virtually the same requirement into its laws in 2017.[248] Nebraska did make one change from the Maryland model. Under the new Nebraska law, the state Tax Commissions is not required to provide a report if the impact of the federal change is determined to be less than five million dollars in the year of enactment.[249] The Maryland law also has a five million dollar threshold, but that relates to the state's conformity default, not the requirement of a report of the change.[250] California takes another approach and requires the state Franchise Tax Board to provide a report to the legislature by January 10th each year reporting all changes to the Tax Code enacted in the last year and an estimate of the revenue effect to the state of conformity to those changes, "to the extent possible."[251] The statute also allows for delayed reporting for changes that occur late in the calendar year.[252] Other states do not appear to require any reporting.

The downside to mandatory requirements is that they can put immense pressure on state revenue estimators. Revenue estimation is no easy task given the wide range of variables at play. States cannot expect these calculations to be done overnight or to be particularly precise. Nevertheless, states can and do look to revenue estimates for general budgeting purposes, and they can leverage federal estimates as well. There is also growing evidence that states are willing to rely on work of this type for purposes of cutting taxes more generally, something with even greater impact than single-year conformity decisions.[253] It is also the case that states can likely better coordinate their efforts through national-level organizations, as discussed in the next section.

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247. MD. CODE ANN., TAX–GEN. § 10-108(b) (West 2022).

248. S. LB 217, 105th Leg., 1st Reg. Sess. at § 15 (Neb. 2017) (enacted as NEB. REV. STAT. § 77-27,222).

249. NEB. REV. STAT. § 77-27,222(2) (2022).

250. TAX–GEN. § 10-108(c); *see infra* Part IV.A (discussing this provision in further detail).

251. CAL. REV. & TAX. CODE § 19522(a)(1)(A) (2022).

252. *Id*. § 19522(B).

253. One practice of growing popularity among some states is the use of revenue estimates to automatically trigger income tax cuts. Michael Mazerov & Marlana Wallace, *Revenue "Triggers" for State Tax Cuts Provide Illusion of Fiscal Responsibility*, CTR. ON BUDGET & POL'Y PRIORITIES, https://www.cbpp.org/research/state-budget-and-tax/revenue-triggers-for-state-tax-cuts-provide-illusion-of-fiscal [https://perma.cc/85KJ-EAMW] (Feb. 6, 2017). This particular use of revenue estimates is not advisable to this author given the long-term effects of revenue cuts and the lack of consideration for state revenue needs, but states' acceptance or consideration of that use of estimates shows that some at the state level do have confidence in the accuracy of those estimates for choices with much more consequence than a particular conformity decision.

2. Coordination Mechanisms

Most of the concerns raised about state decoupling involve cost. It is costly for states to identify the problematic provisions, work through decoupling language, and negotiate their passage. Decoupling is also costly for taxpayers who then face increased tax-preparation costs. These costs cannot be eliminated under any plan short of complete federal and state harmonization, but state coordination can limit them all to a degree.

States do work together on tax matters in a variety of ways. The Multistate Tax Commission (MTC), for example, is "an intergovernmental state tax agency working on behalf of states and taxpayers to facilitate the equitable and efficient administration of state tax laws that apply to multistate and multinational enterprises."[254] The MTC was formed under the Multistate Tax Compact, which was drafted in 1966 largely to produce uniformity in the taxation of multistate transactions.[255] The MTC operates with a number of committees, including a uniformity committee that could theoretically help states with conformity choices and practices.[256]

States could also coordinate through the National Conference of State Legislatures (NCSL) or the Federation of Tax Administrators (FTA). The NCSL is a national organization that represents state legislatures with a mission "to advance the effectiveness, independence and integrity of legislatures and to foster interstate cooperation and facilitate the exchange of information among legislatures."[257] One of the NCSL's standing committees is the Budgets and Revenue Committee, the purposes of which are to "examine[] federal and state policies with fiscal implications, including: funding for services and programs; budget processes; tax and revenue systems; legislative oversight; unfunded mandates; and state-local fiscal relations, and to promote the exchange of ideas and information."[258] That committee provides a wide range of valuable research about state fiscal

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254. *The Commission*, MULTISTATE TAX COMM'N, https://www.mtc.gov/The-Commission [https://perma.cc/HF3Q-R2UX].

255. *MTC History*, MULTISTATE TAX COMM'N, https://www.mtc.gov/The-Commission/MTC-History [https://perma.cc/9XEL-LMWU].

256. *Programs & Committees*, MULTISTATE TAX COMM'N, https://www.mtc.gov/The-Commission/Committees [https://perma.cc/T5GR-7VTD]; *see also* Multistate Tax Compact, art. VI, § 3, MULTISTATE TAX COMM'N, https://www.mtc.gov/The-Commission/Multistate-Tax-Compact#Article_VI [https://perma.cc/Q8JW-XCPR] (giving the MTC wide authority to promote uniform and simpler state tax laws).

257. *About Us*, NAT'L CONF. OF STATE LEGISLATURES, https://www.ncsl.org/aboutus.aspx [https://perma.cc/9YKT-K87U].

258. *Budgets and Revenue Standing Committee*, NAT'L CONF. OF STATE LEGISLATURES, https://www.ncsl.org/ncsl-in-dc/standing-committees/budgets-and-revenue.aspx [https://perma.cc/XQ4N-MCNQ].

issues, including many throughout the pandemic.[259] It is conceivable that more work on information sharing in this area would be possible through this group as well.

Finally, the Federation of Tax Administrators is an organization that serves the subnational tax-collection agencies in the U.S.[260] The FTA "serves as a source of information and expertise for state administrators and others on the workings of state tax agencies and systems as well as issues generally affecting tax policy and administration."[261] The group "works with state tax agencies and the Internal Revenue Service to foster cooperative tax administration projects among states and with IRS."[262] Consideration could be given to whether and how coordination and discussion through this group would assist the states.

The reasons for states to coordinate through these groups are multiple. Most obviously, it makes little sense for each state to separately work to identify and evaluate each federal tax change from scratch. The financial impact of tax changes on states will be different, but the qualitative effects should be very similar. Coordination can also result in model legislation that eases lawmaking and reduces variations in states' laws. Finally, states can also use coordinated activity during their legislative sessions to temper concerns about being an outlier state or about imposing too high of a cost on taxpayers. The costs on multistate taxpayers of only one state deviating from federal law might be relatively high given the need to make the required adjustments, but the marginal cost of each additional state deviating could be quite low. And if a number of the states require the same adjustment, then no state should back away from that change based on cost concerns for taxpayers. Taxpayers will bear the costs of determining any adjustment regardless.

One big challenge with this proposal is that states do not act at the same time and acting to decouple requires many steps in the legislative process. Getting a legislator to introduce legislation is a first step, and there is no way to know what other states will eventually do at the time a state needs to act. The best response that I can offer to this valid critique is that (1) static and lagged incorporation provisions give states a much better chance to consider these issues than dynamic incorporation provisions, and (2) coordination

259. *Fiscal Policy Databases*, NAT'L CONF. OF STATE LEGISLATURES, https://www.ncsl.org/research/fiscal-policy/fiscal-policy-databases.aspx [https://perma.cc/7DS7-JPCG].

260. *What Is FTA*, FED'N OF TAX ADM'RS, https://www.taxadmin.org/about-fta [https://perma.cc/KVL5-EPGM].

261. *Id.*

262. *Id.*

gives states better information than acting in isolation. States should not operate in a world where they have to ask academics, or even reporters,[263] what other states are doing or considering. States can, and should, better coordinate on these issues.

3. Presumptively Problematic Provisions

Another helpful step for states to take in their conformity practices would be to better recognize the harm that certain types of federal tax changes impose on states and to create a presumption, either formally or as a matter of principle, against their adoption. Those presumptively problematic provisions should include, to start: (1) retroactive changes, (2) tax deferral provisions, and (3) investment-based economic incentives. Retroactive tax law changes impact states a great deal given states' balanced budget requirements and general budgeting practices. Retroactive changes can work well as economic stimulus at the federal level because they provide immediate assistance to taxpayers, but states are largely unable to borrow the funds that are necessary to fund those refunds and spending state resources in that way can be incredibly harmful. The danger of retroactive tax relief became clear during the pandemic, when dynamic states were caught in the position of having to come up with state refunds at a time when their revenues were incredibly challenged and uncertain. And this says nothing of whether states should trust that federal tax policy is crafted in ways that best direct stimulus motivated tax relief.

Tax deferral provisions should also be recognized as presumptively problematic for states. Deferral provisions allow taxpayers to defer the reporting of income from the year in which it is earned into a future year. That can create tax losses when a state loses taxing power over the person who deferred the income, which can occur due to constitutional or administrative constraints. States that allow taxpayers to defer the reporting of income into future periods may as well be offering a tax exemption. Taxpayer mobility at high income levels will lead to significant revenue loss because deferral rules are generally skewed toward upper-income taxpayers who have larger amounts of capital income and wage income that can be saved rather than consumed immediately.

States should also consider a default of non-conformity with any federal tax provision that provides tax benefits that are based on re-investment criteria. In this vein, consider the federal opportunity zone investment

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263. The Author has experience with multiple situations where reporters are the parties informing state legislators about what other states are doing across the country.

program, which not only provides tax deferral but also a reduction in taxable gains based on certain investment criteria.[264] States have no way of ensuring that taxpayers who take advantage of that program will invest in their state, so piggybacking on that tax benefit can amount to subsidizing out-of-state-investment. The state experience with Section 1031 shows that states will find it considerably difficult to incorporate those federal programs into their own tax laws while limiting their benefits to those who invest in the state offering the benefit.[265] The practical and constitutional impediments to limiting tax benefits in that way are sufficiently high that states would likely be better off just denying the benefits at all.

Beyond those provisions, states should take guidance from federal tax-expenditure analysis. For those unfamiliar with the idea of tax expenditures, the basic concept is built on the recognition that government spending programs can be implemented through either direct expenditures or through the Tax Code.[266] Assume, for example, that Congress wanted to promote the meat industry by giving citizens up to $500 to spend on beef. Congress could directly appropriate money to write those checks, or Congress could implement a tax credit that served the same function. Direct spending is generally more salient and can be subject to different rules than tax provisions, with the result that the choice between a direct expenditure and a "tax" expenditure can be of significance and hide the real cost of congressional spending.[267]

In response to these concerns, the Department of the Treasury and the Congressional Joint Committee on Taxation publish annual lists of tax expenditures and estimates of the revenue losses associated with those provisions.[268] These estimates suffer from many difficulties—most notably how one determines a "neutral" tax base from which a tax expenditure marks

264. *Opportunity Zones*, INTERNAL REVENUE SERV., https://www.irs.gov/newsroom/opportunity-zones [https://perma.cc/M555-BHY9] (June 21, 2021).

265. *See* HELLERSTEIN, *supra* note 45, ¶ 20.06[5], at 20-151 (noting Oregon's difficulty incorporating Section 1031 and limiting benefits to those who invest in their state).

266. David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L.J. 955, 972–73 (2004); *see also id.* at 972 n.42 (for a brief introduction to the vast literature on this topic); Ruth Mason, *Federalism and the Taxing Power*, 99 CALIF. L. REV. 975, 984–88 (2011) (discussing tax expenditures in the context of fiscal federalism).

267. *See* Weisbach & Nussim, *supra* note 266, at 975 (noting the difference in treatment of tax programs and direct spending programs under existing federal budget rules).

268. *Tax Expenditures*, U.S. DEP'T OF THE TREASURY, https://home.treasury.gov/policy-issues/tax-policy/tax-expenditures [https://perma.cc/S6GJ-LRWB]; JOINT COMM. ON TAX'N, https://www.jct.gov/publications/?category_name=Tax+Expenditures [https://perma.cc/BN6Y-RQLM].

a deviation[269]—but they do provide useful guidance for states about which federal tax provisions are seeking some end other than "pure" tax policy. States will not be able to, or desire to, deviate from each expenditure, but they can use these federal estimates to help guide their analyses.[270]

Finally, both with tax expenditures and other provisions, states should remain mindful that decoupling is easier with any federal tax item for which there is a corresponding item of incorporation reporting or required reporting on the federal tax return. Ruth Mason noted this feature of conformity nearly a decade ago in *Delegating Up*, and the lesson is even more important for states that want to adopt more proactive, protective conformity practices.[271] Decoupling from a new federal deduction will be easier, for example, than decoupling from an exclusion from gross income because the latter might never be reported federally. States should keep this in mind as they think proactively about proposed federal policy changes that could be framed as exclusions, deductions, or credits.

4. Conform and Decouple Better

Once states get to a point of choosing to decouple from a federal tax change or to specifically adopt a federal tax provision, they should better consider how to do so in ways that will withstand future federal changes. Two prime examples of disparate state practice in this regard were provided above: (1) the ways in which states adopted the federal personal exemptions and (2) the ways in which states decoupled from federal bonus depreciation. On the first, we saw that states adopted state personal exemptions through different kinds of references to federal law.[272] Rather than piggybacking on the federal definition of a "dependent," some states piggybacked on the federal allowance of an exemption or on the number of exemptions claimed on the taxpayer's federal return.[273] Those different approaches led to very different results when the federal government set the exemption amount to zero but

269. Stanley S. Surrey, *Federal Income Tax Reform: The Varied Approaches Necessary To Replace Tax Expenditures with Direct Governmental Assistance*, 84 HARV. L. REV. 352, 354–55 (1970) (noting issues with "borderline questions" as to an unadulterated tax base); Weisbach & Nussim, *supra* note 266, at 973–77 (discussing the debates surrounding the normatively pure income tax base for purposes of these analyses).

270. For example, states may very reasonably determine that the dollar cost of decoupling is not worth the effort, that the signaling effect is not ideal, or that decoupling would not reflect local preferences. *See* Mason, *supra* note 5, at 1324 n.247 (discussing the signaling effect of deviations from tax expenditures specifically).

271. *Id.* at 1315.

272. *See supra* Part II.A.

273. *See supra* Part II.A.

retained the exemptions in the law. States should use that experience to evaluate where and how they incorporate the Tax Code to ensure that their policy is set as they wish. States need to be very clear about what policy they want to adopt and ensure that their statutory language stands up to future federal changes.

This lesson was also made clear in the context of state decoupling. Recall, for example, the discussion above about state responses to the federal government's use of bonus depreciation as a method of stimulus in recent decades.[274] Many states decoupled from those allowances, but the ways that they accomplished that end differed greatly. Some states decoupled from bonus depreciation by explicitly adopting static incorporation for that provision.[275] Other states decoupled from the particular acts of Congress that implemented bonus depreciation. Among those states, some referenced the implementing federal legislative acts by name. Wisconsin took a unique approach and instead referenced the individual sections of the public laws in which bonus depreciation changes were made.[276] Other states got to that point more simply by requiring an addition to gross income for all federal depreciation and then allowing a subtraction for a state allowed amount.[277] It is not the place of this piece to say which method states should use, but what should be clear is that the method chosen by a state impacts both how a state is impacted by future federal changes and the difficulty of compliance for taxpayers. Not all decoupling is equal. The overarching lesson, then, is that states should carefully think through how they decouple when they choose to do so.

5. Communicate Better

The final suggestion of this section is that states should endeavor to communicate their conformity choices very clearly and carefully. State decoupling always comes with the risk of imposing cost on taxpayers. That is unavoidable, but states can make things much easier by clearly communicating whether and when their legislatures have decoupled. This Article's author admittedly began this piece with an underappreciation of the difficulties of determining states' responses to federal law. News reports seem to provide good guidance, and multistate tax research platforms offer a variety of charts and publications that provide 50-state summaries. Unfortunately, those news reports and summaries often prove to be incorrect.

274. *See supra* note 114.
275. *See supra* Part II.A.
276. *See supra* Part II.A.
277. *See supra* Part II.A.

Taxpayers and their advisers need to be able to get clear information either from primary sources—which is where statutes like those in Wisconsin are deeply problematic—or from states' own websites. Some states do a good job with these,[278] while others do not. As a final recommendation, then, this Article suggests that states dedicate time and funding to better communications, including webpages dedicated specifically to conformity issues. These suggestions require resources to implement, but perhaps they can pay for themselves if they facilitate better decoupling from inadvisable federal tax provisions.

C. Debt Is Not a Dirty Word

The suggestions above all focus on how to improve state incorporation practice. As introduced at the outset, though, the budgetary issues that states face also relate to their utilization and interpretation of balanced budget requirements. Those provisions were implemented in the nineteenth century in response to debt crises of the states[279] and take a variety of forms.[280] The source of these limitations is clear. The allure of debt is powerful, and many people worry that states will incur too much debt to satisfy the desires of current constituents at the expense of future residents.[281] Nevertheless, debt is a perfectly rational way for states to manage short-term downturns in their economies.

It is much too bold to think that states will significantly weaken or eliminate their balanced budget requirements at this time. States should, however, think more strategically about how to work within existing constraints and about how to push on general conceptions of how their requirements operate. To that end, Professors David Gamage and Darien Shanske have explained how states likely have much wider latitude to borrow than is currently understood or exercised.[282] States obviously have to be more

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278. *See, e.g.*, *Conformity to Federal Internal Revenue Code (IRC)*, IDAHO STATE TAX COMM'N, https://tax.idaho.gov/i-1006.cfm [https://perma.cc/CA4X-WU75].

279. Gamage, *supra* note 3, at 762; R. Daniel Kelemen, *Law, Fiscal Federalism, and Austerity*, 22 IND. J. GLOB. LEGAL STUD. 379, 383–84 (2015).

280. NAT'L CONF. OF STATE LEGISLATORS, *supra* note 3, at 2–6; Yilin Hou & Daniel L. Smith, *A Framework for Understanding State Balanced Budget Requirement Systems: Reexamining Distinctive Features and an Operational Definition*, 26 PUB. BUDGETING & FIN. 22, 24–25 (2006); David Lubecky, Comment, *The Proposed Federal Balanced Budget Amendment: The Lesson from State Experience*, 55 U. CIN. L. REV. 563, 568–71 (1986).

281. Gamage, *supra* note 3, at 761–62; Theodore P. Seto, *Drafting a Federal Balanced Budget Amendment That Does What It Is Supposed To Do (and No More),* 106 YALE L.J. 1449, 1460–62 (1997).

282. *See generally* Darien Shanske & David Gamage, *The Case for State Borrowing as a Response to the Current Crisis*, 97 TAX NOTES ST. 1337 (2020).

conservative with debt than does the federal government given their smaller economies and inability to print money, but they can likely do more to protect themselves from downturns.[283]

As with all of the suggestions in this piece, the time for states to think about these options is now. Even though the financial doom feared early in the pandemic seems to have been averted, the conditions discussed throughout this piece will almost surely result in more fiscal shocks to the states in the coming years. Thinking about these tools for handling the next downturn now will put states in a better place to handle those emergencies when they occur, especially if the federal government fails to act sufficiently to protect the states.

D. Addressing Concerns

As with any proposal, there are costs to each of the suggestions contained above. Current conformity practice exists for a reason, and it is possible that suggesting these modifications is simply tilting at windmills. This section hopes to dispel some anticipated concerns.

The first obvious objection to the proposals above is their cost. The story of dynamic incorporation is largely one of legislative efficiencies, and asking states to spend time and resources thinking even *more* about tax might be too much. What I propose, though, is that the costs of updating a conformity date are a worthwhile investment. Running a government is not easy, and neither is funding one. It is easy to lose sight of what state funds mean when thinking in the abstract and in the aggregate. A few million dollars or hundred million dollars can seem like a small sum to quibble over in those frames. But at the same time, those dollar figures as appropriations can seem very meaningful. It is also the case that greater state coordination on incorporation issues can limit the costs of these debates and decisions. States need not act alone in assessing federal tax changes and their fit at the state level.

Finally, it should be noted that ignoring these issues to avoid the costs of legislative attention is necessarily an abdication of the legislature's responsibility to govern in the interests of their residents. A desire to avoid these costs also runs squarely into Dorf's concerns about incorporation and the subversion of democratic principles. If state legislatures view dynamic incorporation as a practice that can free them from having to think about state taxation, we should be concerned about this practice more generally.

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283. *Id.* at 1140–41 (explaining how states can use cash flow or special fund exceptions to help smooth spending).

It is also worth recognizing that none of the proposals above impact states in a particular revenue direction; the proposals are not about raising revenue. Dynamic incorporation subjects states to fiscal volatility in both ways. The TCJA generally increased state revenues and the CARES Act reduced them.[284] In addition, Democrats have recently proposed a wide range of tax changes that would increase taxes now that their party is in control of Congress and the Presidency. Those changes, including mark-to-market taxation, would impact states to a great degree as well, and states would be wise to build in time and processes to evaluate those possible changes before they immediately take effect.

V. CONCLUSION

State governments are responsible for laying the groundwork for individual health, safety, and success in our American federal system. States do so in part by enacting taxes that provide large, but volatile, sources of revenue to fund their endeavors. This Article has provided reasons and methods for states to take better control of their tax bases through better incorporation practices. States should not shy away from piggybacking on the federal Tax Code for purposes of raising revenue, but they can do so in ways that better protect them from revenue and policy volatility that undermines their abilities to serve their residents. Tax, incorporated, can better serve states and their residents in our modern fiscal state.

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284. *See supra* Part II.A–B.

APPENDIX A

Table 168(k)

Taxing Jurisdiction	Conformity Type	Decouple from Corporate Bonus?	Decouple from Individual Bonus?
Alabama	Dynamic	No	No
Alaska	Dynamic	No	N/A
Arizona	Static	Yes[285]	No[286]
California[287]	Static	Yes	Yes
Colorado	Dynamic	No	No
Connecticut[288]	Dynamic	Yes	Yes
Delaware	Dynamic	No	No
Florida[289]	Static	Yes	N/A
Georgia[290]	Static	Yes	Yes
Hawaii[291]	Static	Yes	Yes
Idaho[292]	Static	Yes	Yes

285. ARIZ. REV. STAT. ANN. § 43-1121(4) (2022) (requiring an addback for all depreciation taken federally); *Id.* § 43-1122(20) (allowing a subtraction for depreciation as if bonus depreciation had not been elected).

286. Arizona first fully conformed to federal bonus depreciation in 2017. ARIZ. DEP'T OF REVENUE, ARIZONA INDIVIDUAL INCOME TAX PROCEDURE ITP 16-2, at 11 https://azdor.gov/sites/default/files/PROCEDURES_INDIV_2016_itp16-2.pdf (Sept. 21, 2020) [https://perma.cc/6CSR-BEHZ].

287. "California has never conformed to bonus depreciation." SPIDELL PUBL'G, INC., CALIFORNIA NONCONFORMITY TO THE TCJA 2 (2018), https://www.caltax.com/spidellweb/public/marketing/pages/Nonconformity-TCJA.pdf?utm_source=Real%20Magnet&utm_medium=email&utm_campaign=129037768 [https://perma.cc/693H-GPHC].

288. Connecticut has historically not conformed to 168(k), instead statically conforming to the I.R.C. of 1986 for purposes of depreciation deductions. *Connecticut Enacts New Pass-Through Entity Tax and Other Tax Law Changes*, DELOITTE (June 7, 2018), https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-connecticut-enacts-new-pass-through-entity-tax-and-other-tax-law-changes.pdf [https://perma.cc/C5B3-X4VU]; *see also* CONN. GEN. STAT. § 12-217(b)(1) (2022).

289. FLA. STAT. § 220.13(1)(e)(1) (2022).

290. GA. CODE ANN. § 48-1-2(14) (2021).

291. HAW. REV. STAT. § 235-2.4(m) (2022).

292. Idaho first coupled to 168(k) as included in the Economic Stimulus Act of 2008 but decoupled in 2010 and has never recoupled. *See Conformity to Federal Internal Revenue Code (IRC)*, *supra* note 278.

Taxing Jurisdiction	Conformity Type	Decouple from Corporate Bonus?	Decouple from Individual Bonus?
Illinois[293]	Dynamic	Yes	Yes
Indiana[294]	Static	Yes	Yes
Iowa[295]	Dynamic	No	No
Kansas	Dynamic	No	No
Kentucky[296]	Static	Yes	Yes
Louisiana	Dynamic	No	No
Maine[297]	Static	Yes	Yes
Maryland[298]	Dynamic	Yes	Yes
Massachusetts[299]	Dynamic	Yes	Yes
Michigan	Dynamic	Yes[300]	No[301]
Minnesota[302]	Static	Yes	Yes

293. Illinois decoupled from the 100% bonus depreciation of 168(k) beginning in FY 2021 with the enactment of S.B. 2017 on June 17, 2021—previously, it was only decoupled from bonus depreciation less than 100%. S.B. 2017, 102d Gen. Assemb., Reg. Sess. (Ill. 2021), https://www.ilga.gov/legislation/102/SB/PDF/10200SB2017lv.pdf [https://perma.cc/U3A2-FMB9].

294. IND. CODE § 6-3-1-3.5 (2022).

295. Historically, Iowa has not coupled to federal bonus depreciation; however, S.F. 619 was enacted on June 16, 2021, which provides for full conformity to 168(k) retroactively beginning Jan. 1, 2021. S. File 619, 89th Gen. Assemb., Reg. Sess. (Iowa 2021), at 24, https://www.legis.iowa.gov/docs/publications/LGE/89/SF619.pdf [https://perma.cc/93AW-U6DC].

296. KY. REV. STAT. ANN. § 141.0101(16)(a) (West 2022).

297. ME. REV. STAT. ANN. tit. 36, §§ 5200-A.1.BB, CC, 2.Z (2022).

298. MD. CODE ANN., TAX–GEN. §§ 10-210.1(b), 10-310 (West 2022).

299. MASS. GEN. LAWS. ch. 63, § 30(4)(iv) (2022). Massachusetts decoupled from 168(k) with the passage of An Act Providing Equitable Tax Deductions for the Depreciation of Certain Assets, 2002 Mass. Acts, ch. 96, §§ 4–6, on Apr. 17, 2002. *See also* MASS. DEP'T OF REVENUE, TIR 02-11: EFFECT OF FEDERAL "BONUS" DEPRECIATION ALLOWANCE (2002) https://www.mass.gov/technical-information-release/tir-02-11-effect-of-federal-bonus-depreciation-allowance-as-revised; MASS. DEP'T OF REVENUE, TIR 03-25: DEPRECIABLE BUSINESS ASSETS; MODIFICATIONS FOR DECOUPLING FROM FEDERAL BONUS DEPRECIATION (2004) https://www.mass.gov/technical-information-release/tir-03-25-depreciable-business-assets-modifications-for-decoupling-from-federal-bonus-depreciation.

300. MICH. COMP. LAWS § 206.607(1) (2022).

301. Michigan only decoupled from 168(k) for their business income tax. S.B. 1038, 94th Leg., Reg. Sess. of 2008 (Mich. 2009) (effective Jan. 1, 2008), http://www.legislature.mi.gov/documents/2007-2008/publicact/pdf/2008-PA-0433.pdf; *see also* SENATE FISCAL AGENCY, BILL ANALYSIS: S.B. 1038 & 1052: SUMMARY AS ENACTED (2009).

302. MINN. STAT. § 290.0133 (2021) (allowing only 20% of the federal amount of bonus depreciation).

Taxing Jurisdiction	Conformity Type	Decouple from Corporate Bonus?	Decouple from Individual Bonus?
Missouri	Dynamic	No	No
Montana	Dynamic	No	No
Nebraska	Dynamic	No	No
New Hampshire[303]	Static	Yes	N/A
New Mexico	Dynamic	No	No
New York[304]	Dynamic	Yes	Yes
North Carolina[305]	Static	Yes	Yes
North Dakota	Dynamic	No	No
Ohio	Static	N/A	Yes[306]
Oklahoma[307]	Dynamic	No	No
Oregon	Dynamic	No	No
Pennsylvania[308]	Dynamic	Yes	N/A
Rhode Island[309]	Dynamic	Yes	Yes
South Carolina[310]	Static	Yes	Yes
Tennessee	Dynamic	Yes[311]	N/A
Utah	Dynamic	No	No
Vermont[312]	Static	Yes	Yes
Virginia[313]	Static	Yes	Yes

303. N.H. REV. STAT. ANN. § 77-A:3-b(I) (2022).

304. N.Y. TAX LAW § 208(9)(iv)(b)(17) (McKinney 2022); N.Y. TAX LAW § 607(a) (McKinney 2022).

305. North Carolina allows for a 15% first-year deduction while the other 85% is deferred over the preceding five years. N.C. GEN. STAT. §§ 105-130.5B(a) (corporate), 105-153.6(a) (individual).

306. Ohio requires bonus depreciation be deferred over six years. OHIO REV. CODE ANN. § 5747.01(A)(17), (18) (West 2022).

307. Oklahoma has not decoupled from bonus depreciation provided in the TCJA, but it did decouple from prior bonus depreciation allowances. OKLA. STAT. ANN. tit. 68, § 2358.6(A), (B) (West 2022).

308. 72 PA. STAT. AND CONS. STAT. ANN. § 7401(3)(1)(q), (r), (s) (West 2022).

309. 44 R.I. GEN. LAWS ANN. § 44-61-1.1(a) (West 2022).

310. S.C. CODE. ANN. § 12-6-50(4) (2022).

311. TENN. CODE. ANN. § 67-4-2006(b)(1) (West 2022).

312. VT. STAT. ANN. tit. 32, § 5811(18) (2022).

313. VA. CODE ANN. § 58.1-301(B) (2022).

Taxing Jurisdiction	**Conformity Type**	**Decouple from Corporate Bonus?**	**Decouple from Individual Bonus?**
West Virginia	Static	No	No
Wisconsin[314]	Static	Yes	Yes
District of Columbia[315]	Dynamic	Yes	Yes

314. WIS. STAT. § 71.98(3) (2022).
315. D.C. CODE § 47-1803.03(a)(7) (2021).

Table 163(j)[316]

Taxing Jurisdiction	**Conformity Type**	**Conform to 163(j)?**	**Conform to CARES changes?**
Alabama	Dynamic	Yes	Yes
Alaska	Dynamic	Yes	Yes
Arizona	Static	Yes	Yes
California[317]	Static	No	No
Colorado[318]	Dynamic	Yes	Prospective Only
Connecticut[319]	Dynamic	No	No
Delaware	Dynamic	Yes	Yes
Florida[320]	Static	Yes	No
Georgia	Static	No[321]	No[322]
Hawaii	Static	Yes	Yes
Idaho	Static	Yes	Yes
Illinois	Dynamic	Yes	Yes

316. Due to the nature of this provision, this table tracks only practice within the state corporate income tax and again includes only states that impose such a tax and incorporate the Tax Code.

317. California has a static conformity date of January 1, 2015 and has not specifically incorporated either of the changes to Section 163. CAL. REV. & TAX. CODE § 17024.5(a)(1) (Deering 2022).

318. *Colorado Enacts Legislation Restoring Certain CARES Act Benefits*, ERNST & YOUNG TAX NEWS UPDATE, (Feb. 1, 2021), https://taxnews.ey.com/news/2021-0233-colorado-enacts-legislation-restoring-certain-cares-act-benefits?uAlertID=37PWF8MfiwikWD2BUhLo%2Fw%3D%3D [https://perma.cc/U3W4-D33L].

319. CONN. GEN. STAT. § 12-217(a)(6) (2022). The statute provides that the deduction for business interest is determined "as provided under the Internal Revenue Code, except that in making such determination, the provisions of Section 163(j) shall not apply." *Id.* As a result, no further action was required to decouple from the CARES act changes to 163(j).

320. H.B. 7059, § 3, 2021 Leg., Reg Sess. (Fla. 2021) (amending FLA. STAT. § 220.13(1)(e) (2021)).

321. GA. CODE ANN. § 48-1-2(14) (2021), *as amended by* H.B. 419, 155th Gen. Assemb., Reg. Sess. (Ga. 2019), *effective* for taxable years beginning on or after Jan. 1, 2018.

322. The state's prior decoupling legislation operated such that the state did not need to decouple from the CARES Act changes specifically. *See* GA. CODE ANN. § 48-1-2(14) (2022) (listing the state's decoupling from Section 163(j) in the TCJA).

Indiana[323]	Static	No	No
Iowa	Dynamic	No[324]	No[325]
Kansas[326]	Dynamic	No	No
Kentucky[327]	Static	Yes	No
Louisiana	Dynamic	Yes	Yes
Maine[328]	Static	Yes	No
Maryland[329]	Dynamic	Yes	Yes
Massachusetts	Dynamic	Yes	Yes
Michigan	Dynamic	Yes	Yes
Minnesota[330]	Static	Yes	No
Missouri[331]	Dynamic	No	No
Montana	Dynamic	Yes	Yes
Nebraska	Dynamic	Yes	Yes
New Hampshire[332]	Static	Yes	No
New Mexico	Dynamic	Yes	Yes

323. IND. CODE § 6-3-1-3.5(a)(24) (2022).

324. Iowa updated its conformity date after the TCJA but did decouple from this provision for 2018. IOWA CODE § 422.3(5) (2022), *as amended by* S. File 2417, 87th Gen. Assemb., Reg. Sess. (Iowa 2018), *effective* for taxable years beginning on or after Jan. 1, 2019; IOWA CODE § 422.32(h) (2022).

325. H. File 2641, Div. VIII, Sec. 77, 88th Gen. Assemb., 2020 Sess. (Iowa 2020) (amending Iowa Code section 422.7 to add a provision decoupling from Tax Code section 163(j)).

326. The Kansas legislature decoupled from both the TCJA and CARES Act changes after the passage of the CARES Act. The legislature accomplished this via override of the Governor's veto. S.B. 50, 2021 Leg., Reg. Sess. (Kan. 2021).

327. Kentucky has not updated its static conformity incorporation date, so it has not adopted the CARES Act changes. *See* KY. REV. STAT. ANN. § 141.010(21)(b) (West 2022) (conforming to the Tax Code as of December 31, 2018).

328. H. Paper 155, 130th Leg., 1st Reg. Sess. (Me. 2021) enacting FY 2021 Supplemental General Fund Budget, Part e (amending ME. REV. STAT. ANN. tit. 36, § 5122(1)(NN) (2022) to deny the CARES Act expansions).

329. Maryland did not conform to this change in 2020 due to its lagged conformity provision but it has not broadly decoupled. *See supra* Part IV(A)(1).

330. Minnesota did not update its conformity date to incorporate the changes made by the CARES Act and did not adopt the CARES Act changes to Section 163(j).

331. Missouri decoupled from Section 163(j) prior to the enactment of the CARES Act. *See* MO. REV. STAT. § 143.121(2)(6) (2021) *as amended* by S.B. 87, 100th Gen. Assemb., 1st Reg. Sess. (Mo. 2019).

332. New Hampshire has updated its conformity date to December 21, 2018, so it incorporates the TCJA's 163(j) limitations but not the CARES Act's expansions. N.H. REV. STAT. ANN. § 77-A:1(XX)(o) (2022).

New York[333]	Dynamic	Yes	No
North Carolina[334]	Static	Yes	No
North Dakota	Dynamic	Yes	Yes
Oklahoma	Dynamic	Yes	Yes
Oregon	Dynamic	Yes	Yes
Pennsylvania	Dynamic	Yes	Yes
Rhode Island	Dynamic	Yes	Yes
South Carolina	Static	No[335]	No[336]
Tennessee[337]	Dynamic	Yes	No
Utah	Dynamic	Yes	Yes
Vermont	Static	Yes	Yes
Virginia	Static	No[338]	No[339]
West Virginia	Static	Yes	Yes
Wisconsin	Static	No[340]	No[341]
D.C.	Dynamic	Yes	Yes

333. S.B. 7508B pt. WWW, §§ 1, 4, 2020 Leg., Reg. Sess. (N.Y. 2020).

334. N.C. GEN. STAT. § 105-130.5(a)(31) (2022).

335. H.B. 5341 § 3, 122d Gen. Assemb., 2d Reg. Sess. (S.C. 2018).

336. The South Carolina bill that decoupled from the TCJA's 163(j) limitation modified state law to decouple from that section by reference, so no modification was required to decouple from the CARES Act's modification. S.C. CODE ANN. § 12-6-50(5B) (2022) *as amended* by H.B. 5341 § 3, 122d Gen. Assemb., 2d Reg. Sess. (S.C. 2018).

337. For taxable years beginning on or after Jan. 1, 2020, Tennessee conforms to I.R.C. § 163(j) as was in effect on Dec. 20, 2017. TENN. CODE ANN. § 67-4-2006(a)(10) (2022), *as added by* S.B. 2119, 110th Gen. Assemb., 2d Reg. Sess. (Tenn. 2018).

338. Virginia allows a deduction equal to only 20% of the federal business interest deduction disallowed under I.R.C. § 163(j). VA. CODE ANN. § 58.1-301(B)(3) (2022), *as amended by* H.B. 2529, 2019 Sess., Reg. Sess. (Va. 2019), *effective* Feb. 15, 2019 and applicable to tax years beginning on or after Jan. 1, 2018; VA. CODE ANN. § 58.1-402(B)(9) (2022); VA. CODE ANN. § 58.1-402(G) (2022), *as added by* H.B. 2529, 2019 Sess., Reg. Sess. (Va. 2019) *effective* for tax years beginning on and after Jan. 1, 2018.

339. VA. CODE ANN. § 58.1-301(B)(9) (2022) *as amended by* H.B. 1935, 2021 Sess., 1st Spec. Sess. (Va. 2021).

340. WIS. STAT. § 71.22(4)(L) (2021), *as amended by* Assemb. B. 259, 103d Legis. Sess., 2017–18 Reg. Sess. (Wis. 2018) *effective* April 3, 2018; WIS. ADMIN. CODE TAX § 3.01(3)(c) (2021).

341. WIS. STAT. § 71.22(4)(m)(2) (2021) (listing section 2306 of P.L. 116-136—the CARES Act's modifications to the 163(j) limitations—as a provision to which the state does not conform); *see also* WIS. STAT. § 71.01(6)(m)(2) (2021) (providing the same rule for purposes of the Wisconsin personal income tax).

Table Excess Business Loss

Taxing Jurisdiction	**Conformity Type**	**Conform to TCJA**	**Conform to CARES changes?**
Alabama	Dynamic	Yes	Yes
Arizona	Static	Yes	Yes
California	Static	Yes[342]	No[343]
Colorado[344]	Dynamic	Yes	No
Connecticut	Dynamic	Yes	Yes
Delaware	Dynamic	Yes	Yes
Georgia[345]	Static	Yes	No
Hawaii[346]	Static	Yes	No
Idaho	Static	Yes	Yes
Illinois	Dynamic	Yes	Yes
Indiana[347]	Static	Yes	No
Iowa	Dynamic	Yes	Prospective[348]
Kansas	Dynamic	Yes	Yes
Kentucky[349]	Static	Yes	No
Louisiana	Dynamic	Yes	Yes
Maine	Static	Yes	No[350]
Maryland	Dynamic	Yes	Yes

342. CAL. REV. & TAX. CODE § 17560.5 (West 2022).

343. *What's New for Filing 2020 Tax Returns*, CAL. FRANCHISE TAX BD., [https://perma.cc/YZ2Z-2B89] (last updated Sept. 23, 2021).

344. *Colorado Decouples from Some CARES Act Provisions*, GRANT THORNTON (Sept. 22, 2020), [https://perma.cc/F5HD-YTTE].

345. GA. CODE ANN. § 48-1-2(14) (2022).

346. H.B. 1041, 31st Legis., Reg. Sess. (Haw. 2021).

347. IND. CODE §§ 6-3-1-3.5(a)(29), (f)(14) (2022).

348. *Iowa Nonconformity: Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020*, IOWA DEP'T OF REVENUE. [https://perma.cc/X4P5-Z9UT] (last updated Jul. 16, 2021) (explaining that the state conforms to the CARES Act's changes for 2020 but not for 2018 and 2019).

349. *COVID-19 Tax Relief: Frequently Asked Questions*, KY. DEP'T OF REVENUE, [https://perma.cc/GV58-K6B3].

350. H. Paper 155, 130th Legis., 1st Reg. Sess. (Me. 2021) enacting FY 2021 Supplemental General Fund Budget, Part d (amending ME. STAT. tit. 36 § 5122(1)(MM) to deny the CARES Act expansions to the excess business loss rules).

Massachusetts[351]	Static	No	No
Michigan	Dynamic	Yes	Yes
Minnesota[352]	Static	Yes	No
Missouri	Dynamic	Yes	Yes
Montana	Dynamic	Yes	Yes
Nebraska	Dynamic	Yes	Yes
New Mexico	Dynamic	Yes	Yes
New York[353]	Dynamic	Yes	No
North Carolina[354]	Static	Yes	No
North Dakota	Dynamic	Yes	Yes
Ohio	Static	Yes	Yes
Oklahoma	Dynamic	Yes	Yes
Oregon	Dynamic	Yes	Yes
Rhode Island	Dynamic	Yes	Yes
South Carolina[355]	Static	Yes	No
Utah	Dynamic	Yes	Yes
Vermont	Static	Yes	Yes
Virginia[356]	Static	Yes	No
West Virginia	Static	Yes	Yes
Wisconsin[357]	Static	Yes	No
D.C.	Dynamic	Yes	Yes

351. Massachusetts conforms as of January 1, 2005, so it adopted neither the TCJA's limitation nor the CARES Act's relaxation. MASS. GEN. LAWS ch. 62 § 1(c) (2022).

352. Minnesota passed legislation conforming to certain provisions of the CARES Act, but not the changes to these rules.

353. Because New York changed its personal income tax to a position of static conformity, it did not adopt the CARES Act's changes. *See supra* Part IV.A.2 (discussing this change).

354. H.B. 1080 § 1.(e), 2019–2020 Sess., Reg. Sess. (N.C. 2020).

355. H. 4017 § 2(A)(4), 2021–2022 Sess., 124th Gen. Assemb. (S.C. 2021).

356. VA. CODE ANN. § 58.1-301(B)(8) *as amended by* H.B. 1935, 2021 Sess., Spec. Sess. 1 (Va. 2021).

357. Assemb. B. 2, 2021–22 Reg. Sess., 105th Legis. Sess. § 21 (Wis. 2021) (adding a new section that decouples from section 2304 of P.L. 116-136, which contains the relaxation of the excess business loss rule of the TCJA).