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## Changing Places, Changing Taxes: Exploiting Tax Discontinuities

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## Changing Places, Changing Taxes: Exploiting Tax Discontinuities

Julie Roin\*

*President Trump's decision to move his official state of residence from high-tax New York to no (income)-tax Florida has brought public attention to an issue that has long troubled scholars, designers and administrators of income tax systems: how the interaction of tax rules deferring the taxation of income and tax rules based on residency allows taxpayers to reduce and even avoid taxation of their deferred income. These discontinuities in tax treatment may lead to excessive migration, as well as reductions in state income tax revenues. This article explains what states would have to do to eliminate these avoidance opportunities. However, it also points out that many of these policy changes would create other tax discontinuities. Ultimately, it leaves open the question of whether making any of these changes would lead to fewer financial and behavioral distortions.*

## Introduction

Interjurisdictional mobility is a critical component of the salutary process of interjurisdictional competition, through which governments compete for residents.<sup>1</sup> It is the mechanism which allows individuals (and businesses) to choose the jurisdiction that best comports with their desired mix of tax burdens and governmental services.<sup>2</sup> Such competition helps police against governmental incompetence and corruption, while also catering to the heterogeneity of individual desires regarding the scope and content of governmental services.<sup>3</sup> Since individuals'

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\* Seymour Logan Professor of Law, University of Chicago Law School. Thanks are due Saul Levmore, Walter Hellerstein, Charles Wolf, and participants in the Cegla Center's Conference on Legal Discontinuity and the University of Chicago Law School's Works in Progress Workshop for their comments on a previous draft of this article.

<sup>1</sup> See Charles Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 420 (1956) ("The act of moving or failing to move is crucial. Moving or failing to move replaces the usual market test of willingness to buy a good and reveals the consumer-voter's demand for public goods.").

<sup>2</sup> See *id.* at 419 ("the consumer-voter may be viewed as picking that community which best satisfies his preference pattern for public goods"). It is not of course the only mechanism people have for expressing their desires; residents can also utilize their political "voice" in an effort to mold the choices made by their political representatives. See A.O. HIRSCHMAN, *EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES* 16 (1970) ("Voice is political action par excellence.").

<sup>3</sup> Few dispute that in the real world, such competition is far from perfect in achieving these desirable ends. For starters, the Tiebout model begins with a number of unrealistic assumptions, ranging from full knowledge by all taxpayers to costless mobility and incomes stemming from capital investment rather than labor. See Vicki Been, *"Exit" as a Constraint on Land Use Exactions: Rethinking the Unconstitutional Conditions Doctrine*, 91 COLUM. L. REV. 473, 514-15 (1991). And many have decried the effects of tax competition on the overall levels of tax collections, and thus government spending. See Reuven Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1576 (2000) ("globalization and tax competition lead to fiscal crises for countries that wish to continue to provide social insurance"); Richard A. Musgrave, 11 J. ECON. PERSP. 65, 69-70 (1997) (tax competition may lead to a "'race to the bottom'" and [p]ublic services, as seen by the nation as a whole, may be left at a deficient level"); but see John Brooks II, *Fiscal Federalism as Risk-Sharing: The Insurance*

choice of jurisdictions is supposed to turn, at least in part, on the particulars of a given jurisdiction's package of tax burdens and governmental services, it seems logical that anyone physically leaving a jurisdiction to establish residency elsewhere should be relieved from further responsibility for paying the taxes levied by the original jurisdiction on the basis of residence,<sup>4</sup> while losing access to services paid for by such taxes.<sup>5</sup> The new nonresidents, like all other nonresidents, should remain taxable in the original state only with respect to income generated from sources within, and property located within, that state.

There is a well-known problem with the income tax, however. Because the tax is collected on a yearly basis, rules have been established to allocate income to particular tax years. Many current tax rules allow taxpayers to defer taxation by allocating income to years later than the year in which the income had been economically accrued. Although such tax deferrals impose a financial cost on the adopting jurisdictions,<sup>6</sup> jurisdictions often decide that the administrative and (in some cases) behavioral incentives of delay are worth the limited revenue loss. But the stakes change when taxpayers who have taken advantage of these favorable timing rules move to lower tax or no-income-tax jurisdictions before the end of the deferral period. In such situations,

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*Role of Redistributive Taxation*, 68 TAX L. REV. 89, 116 (2014) (“State competition for high-value taxpayers is not the only possible behavior. Coordination and even collusion are possible.”).

<sup>4</sup> There are two widely accepted bases for asserting taxing jurisdiction: source of income and residence of the taxpayer. See FERDINAND P. SCHOETTLE, STATE AND LOCAL TAXATION: THE LAW AND POLICY OF MULTI-JURISDICTIONAL TAXATION 14 (2003) (“Taxing of income can be based on a relationship with the taxpayer, such as being the state of domicile or of resident. Alternatively, the right to tax can be based upon a relationship with the income, such as being the source of the income.”); MICHAEL J. MCINTYRE, THE INTERNATIONAL INCOME TAX RULES OF THE UNITED STATES 1-3 to 1-4 (1992) (discussing “competing claims for tax revenue based on residence and source”); AM. LAW INST., FEDERAL INCOME TAX PROJECT: INTERNATIONAL ASPECTS OF UNITED STATES INCOME TAXATION 6 (1987) (“Jurisdiction to tax the income of a person or an entity may be based on ... domicile or residence....Jurisdiction to tax may also be based on the source of the income subject to tax....”). Taxpayers moving away from a jurisdiction, like all nonresidents, remain taxable on income sourced within the jurisdiction. See Edward A. Zelinsky, *Apportioning State Personal Income Taxes to Eliminate the Double Taxation of Dual Residents: Thoughts Provoked by the Proposed Minnesota Snowbird Tax*, 15 FLA. TAX REV. 533, 539 (2014) (“As a practical matter, the jurisdiction in which income is earned typically has the first and most enforceable claim to tax.”).

<sup>5</sup> In fact, nonresidents continue to enjoy the right to receive some governmental benefits, pursuant to local practice, local law, and the Commerce and Privileges and Immunity Clauses of the federal Constitution. The exact contours of those rights remains a matter of some dispute. See Martin H. Redish & Brandon Johnson, *The Underused and Overused Privileges and Immunities Clause*, 99 B.U.L REV. 1535, 1539–41 (2019) (arguing that “to make up for its own artificially created limitations on the protective power of the Privileges and Immunities Clause, the Court developed an entirely atextual doctrine known as the Dormant Commerce Clause” which together “restrict state legislative authority in ways far more invasive than a principled construction of the Privileges and Immunities Clause would have allowed”); Roderick M. Hills, Jr., *Poverty, Residency, and Federalism: States’ Duty of Impartiality Toward Newcomers*, 1999 SUP. CT. REV. 277, 286 (1999) (“Article IV’s Privileges and Immunities Clause specifies that discrimination against nonresidents is presumptively forbidden. But the Court allows such discrimination in contexts where no ‘fundamental right’ is at stake.”).

<sup>6</sup> Allowing taxpayers to defer the payment of tax is the economic equivalent of granting such taxpayers an interest-free loan with a principal amount equal to the amount of tax deferred. See Daniel I. Halperin & Alvin C. Warren, Jr., *Understanding Income Tax Deferral*, 67 TAX L. REV. 317, 321 (2014) (“A second relationship that is often used to elucidate deferral is that the tax benefit...is equivalent to an interest-free loan from the government.”).

taxpayers may avoid, rather than merely defer, the underlying tax obligations. And even if they eventually do pay tax on this accrued income, they often end up paying the tax to jurisdictions other than that in which they lived when the income was earned. As a result, the first jurisdiction's tax revenue declines—or the jurisdiction is forced to increase its tax rate on the income that remains subject to its taxing jurisdiction or to otherwise reconfigure its taxing structure.<sup>7</sup> All of these responses reduce that jurisdiction's attractiveness to new entrants, while increasing the economic incentive for all residents, and especially those residents who have taken advantage of such deferral privileges, to move to lower-tax jurisdictions. They inefficiently distort decisions about mobility.

In the international arena, tax authorities have long regarded taxpayer attempts to minimize taxes payable on already accrued but untaxed income through strategic residency changes as an abuse.<sup>8</sup> Countries have fought back by altering tax rules to make such tax minimization techniques less attractive or less available. The United States, like many countries,<sup>9</sup> imposes an “exit tax” on expatriating taxpayers, treating them as having sold all of their property on the day prior to their expatriation, and forcing them to pay an immediate tax on all their accrued gains.<sup>10</sup> However, at least in the United States, there are constitutional impediments to imposing such taxes inside the country, at the state level.<sup>11</sup> Absent the exit tax option, state tax authorities have

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<sup>7</sup> For example, a jurisdiction might increase sales tax rates to make up for lost income tax revenues.

<sup>8</sup> At the Conference, some questioned whether it should be considered an abuse. After all, they argued, the new jurisdiction would provide the new resident with (presumably costly) benefits, and might need the tax revenues to pay for them. And in fact this argument held some appeal for Congress in 1996 when it enacted Pub. L. No. 104-95, discussed *infra* text at notes 77-80, forbidding states from taxing the pension income of nonresidents. See Walter Hellerstein & James Charles Smith, *State Taxation of Nonresidents' Pension Income*, 56 TAX NOTES 221, 224 (1992) (describing this argument as “unpersuasive”). However, Congress has not accepted this argument when a U.S. taxpayer moves to another country; indeed, it amended the Internal Revenue Code in 2008 to impose an exit tax on the accrued but as yet untaxed income of expatriating taxpayers. See I.R.C. § 877A(a)(1) (2019) (treating covered taxpayers as selling all of their property on the day prior to their expatriation). There is no principled reason to believe that a new state is more entitled to the tax due on pre-existing gain than a new nation would be.

<sup>9</sup> See, e.g., Council Directive (EU) 2016/1164—of 12 July 2016—laying down rules against tax avoidance practices that directly affect the functioning of the internal market, ¶ 10 (laying out parameters of permissible exit taxes), <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016L1164&from=DE>; Government of Canada, Leaving Canada (emigrants), <https://canada.ca/en/revenue-agency/services/tax/international-non-residents/individuals-leaving-entering-canada-non-residents.leaving-canada-emigrants.html> (“When you leave Canada, you are considered to have sold certain types of property (even if you have not sold them) at their fair market value (FMV) and to have immediately reacquired them for the same amount. This is called a deemed disposition and you may have to report a capital gain (also known as a departure tax).”); Sebastian Duenas, *Tax Avoidance Rules Increase the Compliance Burden in EU Member Countries*, TAX FOUND., Mar. 28, 2019, <http://taxfoundation.org/eu-tax-avoidance-rules-increase-tax-compliance-burden/> (17 out of 28 EU members have exit taxes which tax “the excess of the market value of the transferred assets over their tax value”).

<sup>10</sup> See I.R.C. § 877A(a)(1) (2019) (“All property of a covered expatriate shall be treated as sold on the day before the expatriation date for its fair market value.”). The corresponding rule for corporate taxpayers is found at I.R.C. § 367(a) (2019) (foreign corporations not “considered to be a corporation” for purposes of a variety of nonrecognition rules).

<sup>11</sup> At least there are in the absence of an explicit congressional authorization for such taxation. See *infra* text and notes 18-30.

dealt with this sort of tax avoidance by intensifying “residence audits” to ensure that individuals claiming to have moved to another state have actually done so.<sup>12</sup>

This Article looks at whether states could do more. It examines the alternatives to exit taxes for two particular types of deferred income: gains generated from the sale of investment property, such as stocks and bonds, and retirement income. To some extent, it reevaluates and updates two articles written thirty years ago by Professors James Charles Smith and Walter Hellerstein. The first article dealt with state taxation of income that was realized but unrecognized under federal tax law,<sup>13</sup> whereas this Article looks at the slightly different issues raised by taxpayers exiting with unrealized<sup>14</sup> income. The second looked at the issues surrounding the state taxation of

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<sup>12</sup> See Sandy Weinberg, *Voices: Moving from a high-tax state? Be prepared for a residency audit*, ACCOUNTINGTODAY, Nov. 20, 2019, <http://accountingtoday.com/opinion/moving-from-a-high-tax-state-be-prepared-for-a-residency-audit> (New York, Connecticut, New Jersey, Rhode Island and California and “other high tax states” audit taxpayers purporting to leave the jurisdiction; New York alone “[i]nitiating over 3,000 residency audits on high net worth and high income individuals each year” during the last five years); Darla Mercado, *Five reasons why your high-tax state won’t let you move out*, CNBC.COM, June 14, 2019, <https://www.cnbc.com/2019/06/14/five-reasons-why-your-high-tax-state-wont-let-you-move-out.html> (“If you’re thinking of moving from your high-tax locale, chances are your state’s income tax auditor won’t let you leave without a fight.”); Anupam Singhai, *Voices: 4 red flags that can trigger a residency audit*, ACCOUNTINGTODAY, June 4, 2019, <https://www.accountingtoday.com/opinion/4-red-flags-that-can-trigger-a-residency-audit> (“As states seek to fill revenue gaps and recover tax revenue losses, the risk of state residency and non-residency audits continues to grow.”); *Dual state residency can result in dual taxation*, BAKERTILLY, <https://www.bakertilly.com/insights/dual-state-residency-can-result-in-dual-taxation/> (“Increasingly, states are challenging former residents who attempt to change their domicile to another state. Residency audits are on the rise, particularly in states where larger numbers of residents are more likely to spend winters elsewhere.”); *Moved to a New State: Be Prepared for a Residency Audit*, KRUGGEL LAWTON CPAS, Dec. 11, 2018, <https://www.klcpas.com/moved-to-a-new-state-be-prepared-for-a-residency-audit/> (“In the last 10 years, states have had to fight harder for revenue. They began picking up on a trend of taxpayers changing the location of their residence while still maintaining significant ties to their former home state.... This resulted in an increase in residency audits.”); *The Growing Specter of State “Exit Taxes” as Residents Abandon High-Tax States*, EZLANDLORDFORMS, Oct. 8, 2013, <https://articles.ezlandlordforms.com/landlord-and-real-estate-news/the-growing-specter-of-state-exit-taxes-as-residents-abandon-high-tax-states/> (“So what do high-tax states do, to try and prevent their residents from moving their legal residence to low- or no-tax states? In a word, they audit them.”).

<sup>13</sup> James Charles Smith & Walter Hellerstein, *State Taxation of Federally Deferred Income: The Interstate Dimension*, 44 TAX L. REV. 349 (1989). In particular, the article examined the problems posed by the nonrecognition of gain from the sale of a personal residence under the now-repealed I.R.C. § 1034, or from exchanges by like-kind property located in different states. See *id.* at 350.

<sup>14</sup> The “realization requirement” is instantiated most obviously in section 61(a)(3) of the Internal Revenue Code, which limits gross income for tax purposes to “gains derived from dealings in property.” Mere increases in the value of property—though undubitably beneficial to owners of such property—are excluded from the tax base. Some tax scholars have characterized the realization doctrine as “the original sin of the federal income tax” because of the problems and distortions it creates. See JOSEPH BANKMAN, DANIEL N. SHAVIRO, KIRK J. STARK & EDWARD D. KLEINBARD, FEDERAL INCOME TAXATION 230 (18<sup>th</sup> ed. 2019) (“Many tax scholars believe that the realization doctrine is the original sin of the federal income tax.”). States incorporate the realization rule along with most other base-defining tax rules for purposes of operating their own income tax systems. See Tax Pol’y Ctr., Urb. Inst. & Brookings Inst., *The State of State (and Local) Tax Policy*, BRIEFING BOOK, <https://www.taxpolicycenter.org/briefing-book/how-do-state-and-local-individual-income-taxes-work> (“The

retirement income.<sup>15</sup> Much has happened in the intervening thirty years, including the enactment of federal legislation limiting state taxation of nonresidents' retirement benefits.<sup>16</sup> More change is on the horizon. The possible enactment of some form of wealth taxation, for example, may ameliorate some of the valuation problems underlying the existence of the realization requirement, while the possible removal of the realization requirement for investment property held by high-income taxpayers may undercut some of the administrative arguments against state relaxations of the realization requirement.<sup>17</sup> Changes in tax—and asset—administration may also make certain options that seemed unattainable in 1989 seem possible in the present day.

Part I of this Article explores the constitutional impediments to the imposition of exit taxes. Part II describes the tax avoidance opportunities made available by the realization requirement's treatment of investment gains, and the options, other than exit taxes, available to states seeking to reduce those opportunities. Part III looks at the separate tax avoidance possibilities made available through qualified pension arrangements, and the options states have for dealing with that problem. Part IV concludes.

## I. Exit Taxes, the Constitution, and Tax Neutrality

Although different commentators have cited different constitutional grounds for arguing that state exit taxes are constitutionally impermissible,<sup>18</sup> there seems to be no dispute that such taxes are constitutionally problematic. Much of the doctrinal confusion can be traced to one of the original Supreme Court cases striking down such a tax. In *Crandall v. Nevada*,<sup>19</sup> the Court struck down a Nevada tax imposed on travelers leaving the state by railroad or state coach. Although several of the Justices would have struck down the tax as a violation of the Commerce Clause,<sup>20</sup> the majority expressed uncertainty over whether the tax at issue “institute[ed] any regulation of commerce of a national character,” and instead held the tax unconstitutional because it “may totally prevent or seriously burden all transportation of passengers from one part of the country

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individual income tax base in most states is similar to the federal tax base. Most states start with federal adjusted gross income....”).

<sup>15</sup> Hellerstein & Smith, *supra* note 8.

<sup>16</sup> See *infra* text and notes 77-80.

<sup>17</sup> One of the leading Democratic Party candidates for president, Elizabeth Warren, has proposed enacting both a wealth tax and eliminating the realization requirement for high-income taxpayers. See Erica York & Garrett Watson, *Reviewing Elizabeth Warren's Tax Proposals to Fund Medicare for All*, TAX FOUND., Nov. 1, 2019, <https://taxfoundation.org/elizabeth-warren-medicare-for-all-tax-proposals/> (explaining tax proposals); Elizabeth Warren, *Ending the Stranglehold of Health Costs on American Families*, MEDIUM ELECTION 2020, Nov. 1, 2019, <https://medium.com/@teamwarren/ending-the-stranglehold-of-health-care-costs-on-american-families-bf8286b13086> (describing tax proposals).

<sup>18</sup> See William Thomas Worster, *The Constitutionality of the Taxation Consequences for Renouncing U.S. Citizenship*, 9 FLA. TAX REV. 921, 950 (2010) (arguing that the right to travel extends to expatriation, so that I.R.C. § 877A violates that right); Smith & Hellerstein, *supra* note 13, at 369 (exit tax would violate the Privileges and Immunities clause); *id.* at 396 (expressing “doubt” that an in-state investment limitation on nonrecognition against nonresidents would be countenanced under the Commerce Clause)

<sup>19</sup> 73 U.S. 35 (1868).

<sup>20</sup> See *id.* at 49 (Justice Clifford and Chief Justice Chase).

to another”— a claim that sounds more in the nature of the “right to travel”<sup>21</sup> than the Commerce Clause.

The common factual predicate underlying all of these constitutional claims is that exit taxes in general, and an exit tax on unrealized income in particular, impose a tax cost on departing taxpayers that exceeds the tax burdens imposed on taxpayers who remain residents of the taxing state. Individuals who stay in their original jurisdiction can continue to benefit from tax rules allowing them to defer the taxation of economically accrued income.<sup>22</sup> Such deferral is a clear economic benefit, equivalent to allowing the taxpayer to enjoy an interest-free loan financed by the government.<sup>23</sup> Moreover, such deferral often morphs into a permanent tax exemption. Much property gain can escape income taxation due to the rule allowing for the step-up in basis at death.<sup>24</sup> The basis of inherited property is its fair market value on the date the previous owner died. Gain accrued during the lifetime of the decedent thus permanently escapes income taxation when such a basis step-up rule applies.<sup>25</sup> Although state tax rates are lower than federal tax rates, few states have special rates for capital gains,<sup>26</sup> and many states maintain progressive rate structures,<sup>27</sup> so both deferral and exemption can provide taxpayers with substantial economic benefits. The imposition of an exit tax on departing residents would bring this tax deferral to a premature end (relative to remaining residents), while causing the forfeiture of any possibility of obtaining a tax exemption through basis step-up for gains accrued during the taxpayers’ period of residency. This would constitute a substantial economic disincentive to moving across state lines,

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<sup>21</sup> The “right to travel” is a non-textually based constitutional right, which at least sometimes is conceptualized as a component of the protections provided by the Privileges and Immunities clause. *See Saenz v. Roe*, 526 U.S. 489, 500-02 (1999) (explaining constitutional derivation and reach of the “right to travel” doctrine).

<sup>22</sup> States follow the federal rule, including in income only “gains derived from dealings in property.” I.R.C. §61(a)(3) (2019). Increases in the value of property are ignored until the year in which such “dealings” take place.

<sup>23</sup> *See supra* note 6.

<sup>24</sup> *See* I.R.C. § 1014 (2019) (providing step-up). States seem to follow this federal rule. *See* Elizabeth McNichol, *State Taxes on Capital Gains*, CTR. ON BUDGET AND POL’Y PRIORITIES, Dec. 11, 2018,

<https://www.cbpp.org/research/state-budget-and-tax/issue-brief-state-taxes-on-capital-gains> (“Under current state and federal law, people who inherit assets...pay no taxes on any appreciation of those assets that occurred before they inherited them.”).

<sup>25</sup> Such gains do become part of the tax base used when calculating a decedent’s state and federal estate tax liability (if any).

<sup>26</sup> *See* Elizabeth McNichol, *supra* note 24 (nine states tax long-term capital gains less than ordinary income).

<sup>27</sup> Katherine Loughhead, *State Individual Income Tax Rates and Brackets for 2019*, TAX FOUND., March 20, 2019, <https://taxfoundation.org/state-individual-income-tax-rates-brackets-2019/> (“32 states levy graduated-rate income taxes”).

at least arguably interfering with interstate commerce,<sup>28</sup> burdening an individual's right to travel,<sup>29</sup> and violating the Privileges and Immunities Clause.<sup>30</sup>

For purposes of this Article (and this conference), however, the point is not so much that an exit tax levied by the states would be unconstitutional, but that if it were constitutional, it would merely substitute one discontinuity in tax treatment for another. Instead of encouraging taxpayers to move to low-tax states, an exit tax would discourage moves to both high-tax and low-tax states. All relocations would be accompanied by a tax penalty if a taxpayer owned appreciated property.<sup>31</sup> From a policy standpoint, although some states may be made financially better off by levying an exit tax, states as a whole will undoubtedly collect more tax because their combined tax bases will include more income,<sup>32</sup> and some taxes will be accelerated.<sup>33</sup> If the goal is to reduce tax-induced distortions in behavior, it is unclear whether the enactment of exit taxes will achieve that goal. It may well lead to an inefficiently low number of taxpayer relocations rather than merely correct for an inefficiently high number of such relocations.

The question is whether and what alternatives exist to make the tax system more neutral with respect to taxpayer moves. Not only would such alternatives be less likely to face constitutional challenges, but ideally they could reduce the distortionary behavioral effects of the current tax rules. Those alternatives are the subject of the next sections of this Article.

## II. Eliminating or Reducing the Reach of the Realization Doctrine

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<sup>28</sup> Given that 68 percent of the national economy consists of consumer spending, *see* Kimberly Amadeo, *Consumer Spending Trends and Current Statistics*, THE BALANCE, Nov. 1, 2019, <https://www.thebalance.com/consumer-spending-trends-and-current-statistics-3305916> ("Consumer spending made up 68% of the U.S. economy."), the tax could certainly be regarded as a protectionist attempt by a state to keep such spending within its borders.

<sup>29</sup> The Supreme Court established in *Saenz v. Roe*, *supra* note 21, that the right to travel included the right to establish residency in another state. *Id.* at 502. The obstacle to the movement in that case was the receiving state, but there is no reason to think that the outcome would or should be different if the barrier to establishing a new residency was enacted by the state of origin.

<sup>30</sup> *See* Ruth Mason, *Flunking the ECJ's Tax Discrimination Test*, 46 COLUM. J. TRANSNAT'L L. 72, 82 n. 38 (2007) ("The Privileges and Immunities Clause also provides a basis for invalidating discriminatory taxation by the U.S. states against individual taxpayers."); Smith & Hellerstein, *supra* note 13, at 366 n. 71 (exit tax a tax on nonresidency).

<sup>31</sup> Taxpayers would still move to low-tax states if the reduction in taxes on future-earned income offsets the additional tax burden imposed by an exit tax. They would be further discouraged from such moves, of course, if their new state levied a second tax on the pre-move accrued but unrealized gain. Such a second tax would be avoided if the new state lacks an income tax or takes the first state's tax into account (by granting an exemption or a tax credit) for purposes of calculating its tax. However, as discussed in greater detail *infra* text at note 50, inconsistencies in the two states' rules for taxing such income could lead to duplicative state income taxation, further disincentivizing interstate moves.

<sup>32</sup> Some income that would have been omitted from the tax base due to the step-up in basis due to death will now be included in the income tax base.

<sup>33</sup> Governments are on the losing side of taxpayers' deferral gains. Their effective rate of taxation declines when taxpayers are able to defer paying taxes without the imposition of an offsetting interest charge. Anything that reduces deferral opportunities for taxpayers benefits state treasuries—unless, of course, those tax increases are accompanied by behavioral distortions which have the opposite effect.

As the discussion in Part I makes clear, tax discontinuities are created by the disconnect between the economic accrual of income and its taxation. Because of the realization rule, gains may be taxed well after they accrue in economic terms and, in the interim period, taxpayers may have changed locations or other relevant tax characteristics. One possible solution is to eliminate the disconnect by eliminating the realization requirement—in short, to move towards what is called “mark-to-market” taxation. But less systemic changes can also reduce the impact of the realization requirement. Both alternatives warrant further discussion.

#### A. Instituting Mark to Market Taxation

Imagine a taxpayer, Jane, a resident of the state of Illinois, who buys 100 shares of X Corporation’s stock in 2019 at a price of \$10 per share. Luckily for her, the stock zooms in price to \$30 per share by the end of that year. Under current law, no portion of that \$2,000 gain appears in her gross income for federal or state tax purposes in 2019 unless she sells her shares of stock in that year. This is because tax law awaits a “realization” event. Now suppose Jane moves to Florida, a state which has no income tax, on January 1, 2020, and promptly sells her X Corporation stock for \$3,000. She will have to pay federal tax on that gain—but no state income tax because the sale took place while she was a resident of Florida, a state with no income tax. The state of Illinois would have no basis for taxing that income, even though the gain accrued economically while Jane was a resident of Illinois, because it would not be viewed to have either a “source” or residence basis for asserting taxing jurisdiction. Under section 61(a)(3) of the (U.S. Tax) Code, gains are not includable in gross income unless and until there has been a “dealing” in property, and at the time Jane engaged in a dealing, she was a resident of Florida, not Illinois. Illinois would also lack a claim to tax this income based on source, because under the doctrine of *mobilia sequuntur personam*, the source of investment income generated from intangible property such as stocks and bonds is “attributed to and taxed by the state of residence of the owner of such stocks and bonds”<sup>34</sup> at the time such “dealings” occur. The discontinuity in tax treatment is obvious—as is the fact that it is entirely a function of the decision to defer taxation of gains until the occurrence of a “dealings” in property. If Jane had to include the \$2,000 of gain in her income for tax purposes in the year the stock went up in value, in 2019—as it would if the tax regime incorporated “mark-to-market” principles<sup>35</sup>--she would still have been a resident of

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<sup>34</sup>Zelinsky, *supra* note 4, at 538. It is unclear whether this allocation of taxing authority is being made on “source” grounds (the actual economic “source” of the gain often being indeterminate because the underlying business is active in many different jurisdictions) or is a pure expression of residence-based taxing jurisdiction because of the absence of “source.” The distinction is important if some other jurisdiction asserts source tax jurisdiction over such income. Under applicable tax norms, a state asserting only residence jurisdiction would have to grant some form of tax relief to offset the taxes paid to the “source” state. *See id.* at 542 (“The domestic (and international) norm is for the jurisdiction of residence to extend to its resident an income tax credit for income taxes the resident pays to the jurisdiction of source.”).

<sup>35</sup> Under a “mark-to-market” tax regime, taxpayers establish the fair market value on the last day of a taxable period and pay tax on the difference (positive or negative) between that value and the value calculated at the end of the last taxable period, whether or not they engaged in an actual dealings or disposition of such property. *See* BANKMAN ET AL, *supra* note 14, at 241 (describing “mark to market” taxation). Rules would have to be established to deal with

Illinois, and therefore the gain would have been taxable in that state. She might still have moved to Florida in 2020, and enjoyed the absence of a state income tax on income earned or accrued subsequent to her move, but the tax due on that \$2,000 of 2019 gain would not change as a result of her relocation.

If a state mandated that all taxpayers had to mark their assets to market value each year—rather than limiting this treatment to departing residents as an exit tax does—such departures would not create any tax discontinuities with respect to formerly accrued income. A change in residence would affect only the amount of taxes paid with respect to future income, as would be appropriate. There could be no constitutional objections, because the change in residence would not itself trigger any additional taxation. Illinois would collect its tax, but it would collect it in the normal course and without ever referring to, or having the tax liability in any way based on, changes in a taxpayer's residency status. All taxpayers would be treated exactly the same, whether or not they moved across state boundaries.<sup>36</sup>

The desirability (or not) of moving the federal government's tax system away from realization and towards a mark-to-market approach has been widely debated for almost as long as the income tax has been in existence.<sup>37</sup> Its virtues—in terms of eliding valuation and liquidity problems—are as obvious as its evils. Neither of these virtues seems particularly relevant to investments in publicly traded stock. Public trading establishes visible, and generally reliable, values for the instruments being traded, and few investors own a high enough percentage of a publicly traded company to generate worries about the costs of (perhaps) forcing them to sell shares to raise the cash necessary to pay the tax liability generated under a mark-to-market regime. I would not be the first to suggest<sup>38</sup> moving to a mark-to-market system for publicly traded stock, while retaining a realization based system for other, more difficult to value, assets.<sup>39</sup> Yet agreement on even such a partial move to mark-to-market taxation at the federal level is far from universal. Concerns have been expressed about the discontinuities created by a mixed system. The expressed fear is that the inequality in tax treatment between publicly traded

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situations in which a taxpayer moved in mid-year. Presumably, the state would declare that for state tax purposes, the day before the taxpayer moved would constitute the last day of the taxable period.

<sup>36</sup> However, they might be subject to duplicative taxation if they moved to another state which operated a realization-based tax system. See *infra* text at note 50.

<sup>37</sup> See, e.g., Karen C. Burke & Grayson M. P. McCouch, *The Moving Target of Tax Reform*, 93 N.C.L. REV. 649, 669 (2015) (“One approach that deserves further consideration is an accrual-based tax on unrealized appreciation in publicly traded stock...”); Samuel D. Brunson, *Taxing Investors on a Mark-to-Market Basis*, 43 LOY. L.A. L. REV. 507, 511 (2010) (“As a best-case solution, this Article proposes expanding the mark-to-market election to investors...”); Deborah H. Schenk, *An Efficiency Approach to Reforming a Realization-Based Tax*, 57 TAX L. REV. 503, 527 n. 85 (2004) (listing articles debating mark-to-market taxation); David A. Weisbach, *A Partial Mark-to-Market Tax System*, 53 TAX L. REV. 95, 96 n. 6 (1999) (listing articles debating mark-to-market taxation).

<sup>38</sup> I am not sure, however, that I am suggesting it.

<sup>39</sup> See, e.g. David Elkins, *The Myth of Realization: Mark-to-Market Taxation of Publicly-Traded Securities*, 10 FLA. TAX REV. 375, 406 (2010) (“Mark-to-market taxation [of publicly traded stock] , on the other hand, is both equitable and efficient”); Brunson, *supra* note 37, at 511 (“As a best-case solution, this Article proposes expanding the mark-to-market election to investors”); Schenk, *supra* note 37, at 528 (“almost everyone assumes that marking publicly traded securities to market is a good idea because there would be no valuation and liquidity issues.”).

stock and other investment assets would encourage taxpayers to shun the first and invest more in the second.<sup>40</sup> It is unclear how seriously to take such objections; the inability to easily value alternative investments may well keep most investors (and certainly most unsophisticated investors) away from them. If there is some movement at the margin, it is likely to be fairly limited. Moreover, some of the valuation issues surrounding non-publicly traded assets may be confronted and surmounted if current Democratic proposals for a wealth tax come to fruition.<sup>41</sup> If these politicians are able to come up with a workable mechanism for determining asset values for a wealth tax, it might be possible to include a broader range of investment assets in a mark-to-market system for income tax purposes,<sup>42</sup> reducing the opportunities for (and the distortions created by) strategic behavior.

States contemplating a move towards mark-to-market taxation would face a set of additional hurdles. These hurdles stem from the fact that the federal government does not have the same fiscal concern that states do about revenue losses due to expatriating taxpayers. It has, after all,

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<sup>40</sup> See Schenk, *supra* note 37, at 529 (arguing that marking publicly traded securities to market would be useless unless derivatives were also marked to market, which would “increase valuation costs”); Weisbach, *supra* note 37, at 97 (“It is not clear that a mixed system... would be an improvement over current law. . . . Wherever the line is drawn, similar transactions on either side of the line will be taxed differently, causing taxpayers to distort their behavior and requiring the complexity and anti-avoidance rules of current law. The problem of the second-best may mean that a partial move toward the ideal may not be an improvement.”).

<sup>41</sup> See Elizabeth Warren, *Ultra-Millionaire Tax*, PLANS (2019), <https://elizabethwarren.com/plans/ultra-millionaire-tax> (describing wealth tax proposal); Warren, *supra* note 17 (describing wealth tax component of Medicare-for-all tax). Although in theory, states would not have to wait for the federal government to adopt a wealth tax or move to mark-to-market taxation, and could independently decide to use such valuation mechanisms to impose a state mark-to-market regime, in actuality, few if any states maintain tax bureaucracies large or sophisticated enough to effectively operate such valuation schemes. Most state tax authorities are relatively small operations and rely on the federal government’s tax bureaucracy for the performance of many auditing and valuation functions. It is unclear whether it would be financially worthwhile for states develop such capabilities. See Ruth A. Mason, *Delegating Up: State Conformity with the Federal Tax Base*, 62 DUKE L.J. 1267, 1321 (2013) (“Notice also that a state’s ease of deviation [from the federal tax base] varies with its resources. California may have the resources to administer a deviation that North Dakota could not.”).

<sup>42</sup> Liquidity problems, however, would remain. These liquidity problems could be ameliorated through a taxing scheme which delays tax collection until the year the underlying asset is sold, while including an interest charge to compensate for the delay. The federal government maintains such a regime as an option for the taxation of passive foreign investment companies. See I.R.C. §§ 1291–1298 (2019). However, U.S. persons owning interests in passive foreign investment companies generally have to file U.S. tax returns on a yearly basis in any event, and report gains from their realization events on those returns. Even so, taxpayers and “IRS agents in the field... routinely overlook” the additional taxes due under the [PFIC] regime. See Kimberly S. Blanchard, *PFICs*, TAXES—THE TAX MAGAZINE 47, 47 (2012). Once individuals leave a state, they need not file returns in their former state unless and until they earn income from sources within that state. In the (often extended) time between the year in which they leave a jurisdiction and the year in which they sell their assets, many will forget about (or simply choose to ignore) their obligation to make this delayed tax payment to their former state. It would likely require a substantial increase in state tax authorities’ budgets to track such individuals and to try to collect the appropriate tax amounts. Although states have the ability to enforce tax judgements against out-of-state individuals, see Walter Hellerstein, *Reflections on the Cross-Border Tax Challenges Of the Digital Economy*, 96 TAX NOTES INT’L 671, 680-81 (describing process for enforcing state tax judgments against out-of-state taxpayers), the state tax authorities first have to know that an enforcement action is warranted.

enacted an exit tax to solve its version of that problem. Thus it is likely that a state seeking to adopt mark-to-market taxation would find itself operating outside of the federal administrative umbrella. As a result, it would not be able to rely on federal income calculations—nor would taxpayers be able to rely on the information returns calculated by third parties to aid them in making their federal income calculations in order to determine the amount of tax owed to the state.<sup>43</sup> Not only might dramatic differences develop between a taxpayer's state and federal income calculation, but also, over time differences would develop over the federal and state tax bases of affected assets.<sup>44</sup>

If every state with an income tax adopted the same mark-to-market regime, some of these administrative problems could be ameliorated. If there were enough demand by taxpayers, the financial institutions that serve as intermediaries for so many publicly traded stock and security transactions could keep track of, and annually distribute to taxpayers, separate information returns covering their state tax liabilities.<sup>45</sup> These intermediaries have, after all, all the information necessary to make these calculations. In most cases, they have records of the taxpayers' original basis in shares, and they track the changes in market value for each investor. It should not be terribly complicated for them to report the annual change in market value, and then to add that number to each client's basis.<sup>46</sup>

But would every state maintaining an income tax adopt such a regime? Although all states, like the federal government, lose tax revenues to the normal operation of the realization doctrine, those losses have not yet been sufficient to bring about serious consideration of adopting a mark-to-market system. States that believe they are losing large amounts of tax revenue to low tax states—revenue that is not being recouped through their ability to tax previously accrued, but untaxed, gains of new entrants—might well decide these additional revenue losses warrant moving to a mark-to-market system. But inasmuch as some states are winners because of the inclination of taxpayers to move to low tax states, it is plain that not every state would adopt mark-to-market regimes. Some states have to be net “winners” under the current legal regime for other states to be net “losers” and it is hard to believe that the (perceived)<sup>47</sup> net winners would be

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<sup>43</sup> See Mason, *supra* note 41, at 1329 (moving to a partial mark-to-market system would entail changing “significant aspects of its tax base as compared to the federal tax base...[and] as the calculation of taxable income at the state level diverges from its calculation at the federal level, the state is able to rely less and less upon federal resources, including federal tax legislative drafting expertise, federal tax information collection, federal enforcement, and so on”).

<sup>44</sup> Taxpayers would be entitled to add any gains taxed to them, and not withdrawn from the property, to their basis in the property for state tax purposes, at least in the state using the mark-to-market tax system. Whether other states, operating under realization-based regimes, would accept these basis adjustments for purposes of calculating taxes owed in their jurisdiction is another matter entirely. See *infra* text at note 50 (discussing the interaction of conflicting state rules). Since the federal tax on those gains would be deferred, so too would be any basis adjustments for federal tax purposes.

<sup>45</sup> Some additional complexity would be introduced by the need to deal with intra-year moves. See *supra* note 35.

<sup>46</sup> Whether taxpayers will understand that they have different tax bases for federal and state income tax purposes is another matter entirely.

<sup>47</sup> In fact, it is unclear how significant these revenue losses actually are. Although there are certainly well-publicized examples of extremely wealthy individuals moving to low-tax states, see *The Country Home of Capital*, THE

willing to sacrifice the administrative and competitive advantages of the current realization based system unless the federal government adopted such a system. The most likely outcome in the absence of a federal mandate<sup>48</sup> would be a “mixed” system, with some states moving to a mark-to-market system while others continued to follow the federal realization standard for including gains in the income tax base.

The evolution to a mixed system as just described, comes with another discontinuity, as it creates another opportunity for clever taxpayers to avoid or minimize taxes by strategically moving from one jurisdiction to another. If a taxpayer accrued gains while living in a realization state, and is now motivated to move to a state operating under a mark-to-market regime, the mark-to-market state should not have any right to tax the gain that accrued in the first state. Under its own tax rules, that income arose and was realized in, and should have been taxed by, another state in an earlier year; the current state is effectively a stranger to any income accrued while the taxpayer resided in another state. Applying a different set of tax rules to new residents, in the form of a

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ECONOMIST, Jan. 11, 2020 (attributing Connecticut’s loss of 20,000 residents, including 2,050 earning more than \$200,000 per year, to increases in state taxes); Chris Edwards, *Tax Reform and Interstate Migration*, 84 CATO INST. TAX AND BUDGET BULL., Sept. 6, 2018, <https://www.cato.org/publications/tax-budget-bulletin/tax-reform-interstate-migration> (listing “[v]ery wealthy entrepreneurs...gravitating to Florida, which has no income tax or estate tax”), and numerous websites tout the tax advantages of moving to low-tax states, *see, e.g.*, Rocky Mengle, & David Muhlbaum, *The 10 Most Tax-Friendly States in the U.S.*, KIPLINGER ON-LINE, Oct. 1, 2019, <https://www.kiplinger.com/slideshow/taxes/T054-S001-10-most-tax-friendly-states-in-the-u-s-2019/index.html> (advising people to “consider the impact of state and local taxes on your bottom line” when considering a move); Emily Brandon, *13 States Without Pension or Social Security Taxes*, U.S. NEWS & WORLD REP., Apr. 1, 2019, <https://money.usnews.com/money/retirement boomers/slideshows/13-states-without-pension-or-social-security-taxes> (“Retirees can help their savings last longer by moving to a place with lower taxes.”); Sandra Block & David Muhlbaum, *10 Most Tax-Friendly States for Retirees*, 2018, KIPLINGER ON-LINE, Nov. 29, 2018, <https://www.kiplinger.com/slideshow/retirement/T037-S001-10-most-tax-friendly-states-for-retirees-2018/index.html> (“These 10 states impose the lowest taxes on retirees.”); *What Are the Best States to Retire for Taxes?*, SMARTASSET, <https://smartasset.com/retirement/retirement-taxes> (“Click on a state to see a full overview and calculate your taxes.”), there is actually relatively little evidence that the level of state taxes systematically influences interstate moves. *See* Michael Mazerov, *State Taxes Have a Negligible Impact on Americans’ Interstate Moves*, CTR. ON BUDGET & POL’Y PRIORITIES 1, May 21, 2014, <http://www.cbpp.org/sites/default/files/atoms/files/5-8-14sfp.pdf> (“Differences in tax levels among states have little to no effect on whether and where people move, contrary to claims by some conservative economists and elected officials.”); Karen Smith Conway & Jonathan C. Rork, *No Country for Old Men (Or Women)—Do State Tax Policies Drive Away the Elderly?*, 65 NAT’L TAX J. 313, 315 (2012) (“Our results are overwhelming in their failure to reveal any consistent effect of state tax policies on elderly migration across state lines.”). This may be particularly true of retirees, since many states partially or fully exempt retirement income from their income tax bases. *See Deciding Where to Retire: Finding a Tax-Friendly State to Call Home: 2018 Whole Ball of Wax*, WOLTERS KLUWER, Jan. 2018, <https://taxna.wolterskluwer.com/whole-ball-of-tax-2018/state-retirement-taxes> (charts listing state tax policies). Of course, competition (or the fear of competition) with other states may be one reason so many states provide preferential tax treatment for retirees, Such fears would be eased if the majority of the taxing rights were allocated to the state in which such income was earned rather than allocated to the taxpayer’s current state of residence.

<sup>48</sup> Assuming some states moved to a mark-to-market system. Actually, the most likely result is probably the universal continuation of the present realization based system, unless the federal government moves to limit or eliminate the realization requirement for federal income tax purposes. *See supra* note 17 (describing Elizabeth Warren’s tax proposals).

mark-to-market scheme for its long-time residents and a realization rule for new residents, would surely be deemed to violate the Privileges and Immunities Clause, and possibly the Due Process Clause as well.<sup>49</sup> The same conclusion holds if the only grounds for imposing a tax on such gains was residency; the state in which the taxpayer formerly resided would also not have any claim to tax this income, because the income was not realized (under its rules) while the taxpayer was a resident there.

Not only might some taxpayers avoid paying any state tax on their gains, others might find themselves subject to double state taxation. A taxpayer moving from a mark-to-market state to a realization state might find that its new state refuses to take the prior state's tax into account when calculating the tax due at the time of an actual realization event. Under the new state's rules, no realization event occurred in the previous state, and thus the asset's basis should remain its federally calculated basis up until the time of the actual realization event; thus, the entire difference in value accruing between the time of its initial purchase or acquisition and its actual sale would constitute gain taxable at source in the second state. The fact that discrepancies between states' rules for determining the source of income leads to duplicative taxation may "appear unfair to the individual taxpayer who is compelled to pay tax on the same income to two states" but it is not necessarily illegal.<sup>50</sup>

In sum, moving in the direction of mark-to-market taxation<sup>51</sup> would not provide a solution to the discontinuity problem. Like an exit tax, it would simply exchange one distortion for another, and it is unclear whether the distortions created by this new discontinuity would be smaller than those created under current law. It is possible, however, that less systemic changes could reduce the impact of the realization requirement. It is to those possibilities that we now turn.

## B. Expanding Source Taxation

Source taxation takes precedence over residence taxation. This means that if income has an economic source, and the source jurisdiction exercises its taxing rights, the residence jurisdiction must provide some sort of accommodation, typically in the form of a tax credit against its own taxes for those paid to the source jurisdiction. Alternatively, it may offer an exclusion from its

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<sup>49</sup> See Smith & Hellerstein, *supra* note 13, at 371–72 (describing California and Oregon cases holding that the state in which a taxpayer resided when a nonrecognition period came to an end could not tax gains that were realized in—but because of a nonrecognition rule not taxed by—another state).

<sup>50</sup> WALTER HELLERSTEIN, KIRK J. STARK, JOHN A. SWAIN & JOAN M. YOUNGMAN, *STATE AND LOCAL TAXATION CASES AND MATERIALS* 434 (11<sup>th</sup> ed. 2019). The Supreme Court's acceptance of duplicative taxation due to conflicting source rules in the corporate income tax context stretches at least as far back as its decision in *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978), which upheld Iowa's use of a single-factor formula for allocating income against claims that it would lead to duplicative taxation because of other states' use of three-factor allocation formulas. Later cases extended this policy of non-interference to other situations. See *infra* note 63.

<sup>51</sup> To be clear, the complete elimination of the realization requirement—universal adoption of mark-to-market taxation of all property gains for all taxpayers, enacted at the federal level and imposed on all states, would completely eliminate this distortion. But not even Elizabeth Warren's tax proposals would go this far. See *supra* note 17 (describing proposals).

tax base for previously taxed income.<sup>52</sup> Often, there is little room left for a residence jurisdiction to impose tax on income that is sourced and taxed elsewhere. But it is hard to assign a source to some income because it is attributable to activities undertaken in multiple jurisdictions.<sup>53</sup> That sourcing dilemma is the underpinning of the “long-recognized doctrine of ‘*mobilis sequuntur personam*’ ... under which income derived from intangible assets like stocks and bonds is sited to, and thus taxed by, the state (or states) of residence of the owner of such assets.”<sup>54</sup> If this income were to be taxed at its source, residence tax—wherever imposed--would become much less important. It is plain, then, that one possibility for reducing the distortions created by changes in residence is to increase source taxation on income that is currently subject to tax only under the *mobilis sequuntur personam* doctrine.

In theory, it would be possible to assign a source to income generated from intangible assets, like stocks and bonds. The underlying business entities, after all, have to allocate their income among the many source jurisdictions for tax purposes; distributions such as dividends, interest, and gains generated from the sale of those interests could be allocated on the same basis as the underlying income.<sup>55</sup> If, for example, ten percent of the income of Caterpillar, Inc. is allocated to the state of Indiana for tax purposes, then ten percent of all dividend and interest distributions, and ten percent of the gains generated from the sale of those financial instruments, could also be treated as Indiana source income. The corporation could withhold from any distributions it made, and pay over to state treasuries the amounts of tax due, on amounts sourced under these rules. An additional complication is that many such instruments are owned by tax exempt entities or pension plans. Integrating ownership information into the withholding rules would present another layer of difficulty. It is unlikely to be an insuperable barrier; after all, the process for informing payors’ of withholding relief provided under tax treaties seems to work reasonably well. However, the number of taxpayers involved in any state scheme of this sort would likely be vastly greater, increasing administrative difficulties and costs.

As a practical matter, it is unrealistic to expect individual owners of investment assets to file returns in each state to which taxes have been paid on their behalf. Indeed, it may even be too much to expect them to list each of these payments on the returns they file with their own residence states. However, if most shares are held by intermediaries such as mutual funds, those

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<sup>52</sup> See Zelinsky, *supra* note 4, at 542 (“The domestic (and international) norm is for the jurisdiction of residence to extend to its resident an income tax credit for income taxes the resident pays to the jurisdiction of source.”).

<sup>53</sup> See *id.* at 540-41 (discussing why “investment intangibles like stocks and bonds” are “difficult-to-source”).

<sup>54</sup> *Id.* at 541.

<sup>55</sup> There is a timing issue here, of course. Distributions, particularly dividend distributions, may not be made out of current year income, so strictly speaking, the “sources” of such a distribution would depend on the sources of the income out of which distributions were made. And the source of the current year’s income typically is not known or knowable until the time at which the tax returns for the corporation are filed, which would make it impossible for such entities to know how much to withhold and pay over for distributions made during the taxable year. In the interests of simplicity, perhaps the previous year’s sourcing allocations should be used. Even this would be complex because it would require recalculating or reprogramming the withholding formula on a yearly basis. It is worth noting that for federal tax purposes, interest and dividends are generally sourced to the country in which the underlying entities are incorporated. See I.R.C. §§ 861(a)(1) (2019) (interest) & 861(a)(2) (2019) (dividends).

intermediaries could keep track of, and report to their customers, the total amounts withheld, and residence states could, as the federal government does for persons earning small amounts of foreign investment income and paying small amounts of foreign tax, allow such source taxes to be credited as an undifferentiated whole against the residence tax due on this investment income. Although this might result in some taxes paid to high-tax states to effectively offset residence tax that would have been payable to the residence state, the administrative costs of perfection would likely be too high to countenance. This complicated system sounds clever, but it is probably too costly to implement and monitor.

Whether residence states would be happy with such an approach (even if it is simplified) is uncertain. It would likely depend on how much additional tax revenue they would collect by expanding their source tax jurisdiction compared to the amount they would lose by virtue of (essentially) giving up their residence tax jurisdiction. Some jurisdictions would likely profit from such a change while others would see their revenues decrease.

Perhaps most important, the scheme outlined here would not help with the taxation of gains generated from the sale of financial instruments, since the issuing corporations are not involved in these transactions and would rarely be in a position to withhold funds to pay over to state authorities. It is unclear how, or even whether, exchanges would be able to bring about a complex withholding regime. To the extent the sales were effected through sophisticated intermediaries, these intermediaries might be able to play the role of the withholding agent. Then again, particularly if the withholding formula is complex, it might be asking entirely too much of the intermediaries.<sup>56</sup>

If expanding source taxation generally seems unattractive, a more limited approach—taking a limited number of transactions outside the reach of the *mobilia sequuntur personam* paradigm—might be an acceptable alternative. Under current law, any gain generated from the sale of the tangible assets of a business is attributed to their physical location.<sup>57</sup> However, if instead of selling the assets of a business, its owners sell stock, the gain from the sale is taxed at the residence of the taxpayer, which may be different from the location of the business, because the stock is deemed to be an intangible, subject to tax under the *mobilia sequuntur personam* doctrine. While the distinction between the tax treatment of the sale of stock of a multinational company and its assets may make sense, it makes much less sense to treat gains generated from the sale of the stock of a largely or entirely local business differently from the sale of its

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<sup>56</sup> This might be another reason to opt for a simpler sourcing rule such as the one the federal government uses. However, since a very significant percentage of U.S. corporations are incorporated in Delaware, a low-tax jurisdiction, following in the federal government's footsteps may not advance the ball very far.

<sup>57</sup> Goodwill, which is often a substantial component of the value of a business, is considered an intangible asset, and many states do not tax nonresidents on gains from the sale of such assets. *See, e.g.*, WIS. DEPT. OF REVENUE, PUB. 122, TAX INFORMATION FOR PART-YEAR RESIDENTS AND NONRESIDENTS OF WISCONSIN FOR 2018 19 (2019), [http://revenue.wi.gov/DOR\\_Publications/pb122.pdf](http://revenue.wi.gov/DOR_Publications/pb122.pdf) (“Your share of the gain or loss from the sale of each partnership’s goodwill is not taxable income...for Wisconsin purposes. Since the goodwill is intangible property, your share of the gain or loss from its sale is not taxable by Wisconsin.”). Of course, this rule could also be changed for goodwill associated with the operation of an in-state business.

underlying assets.<sup>58</sup> States could enact legislation to treat gains from the sale of stock and partnership interests in local businesses—those deriving more than fifty percent of their income from local sources, or having more than fifty percent of their assets physically located in the state<sup>59</sup>—as sourced at least partially within the state, and subject to tax.<sup>60</sup> Such a tax could be enforced through a withholding obligation placed on sellers.<sup>61</sup> A few states have done just that.<sup>62</sup> While this would not entirely eliminate the incentive to move to low tax jurisdictions, it would

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<sup>58</sup> It is worth noting that in the 2017 Tax Cut and Jobs Act, Congress enacted a new section of the tax code, I.R.C. § 864(c)(8), to ensure that a foreign partner's capital gain or loss would be treated as "effectively connected with a U.S. trade or business" and thus subject to tax in the U.S. to the same extent that a sale of the underlying assets by the partnership would have generated effectively connected income. KPMG Tax, *Initial impressions of proposed regulations under section 864(c)(8)*, KPMG, Dec. 21, 2018, <https://tax.kpmg.us/taxnewsflash/taxnewsflash-tax-reform/tnf-kpmg-report-initial-impressions-of-proposed-regulations-under-section-864c8.html>. The tax obligation is enforced through a withholding tax obligation placed on transferees. *See id.* ("section 1446(f)...requires that the transferee of a partnership interest withhold 10% of the amount realized on a sale or exchange of the interest...."). The provision was added to reverse the outcome of a case, *Grecian Magnesite Mining v. Comm'r*, 149 T.C. 63 (2017), *aff'd* 926 F.3d 819 (D.C. Cir. 2019), holding that a foreign partner was not subject to U.S. tax on a sale of a U.S. partnership interest. *See* JOINT COMM. ON TAX'N, JCS-1-18, 115<sup>TH</sup> CONG., GENERAL EXPLANATION OF PUBLIC LAW 115-97 220 (2018) ("The provision overturns the result in *Grecian Magnesite* by treating gain or loss from the sale or exchange of a partnership interest as effectively connected with a U.S. trade or business to the extent that the transferor would have had effectively connected gain or loss had the partnership sold all of its assets...."). Structuring the disposition of businesses to avoid taxation at source is a worldwide, and oft-challenged, practice. When the British "telecom giant" Vodafone disposed of its (very profitable) investment in its Indian subsidiary through an offshore sale of stock in an intermediary corporation to avoid incurring an Indian source tax obligation, India enacted retrospective legislation seeking to tax the transaction. The validity of the retrospective aspects of that law went to an international arbitration panel. *See Vodafone tax dispute: Arbitration panel to begin hearing in February 2019*, LIVEMINT, May 20, 2018, <https://www.livemint.com/Companies/zG26zTioMTHVQwJgk7AfBP/Vodafone-tax-dispute-Arbitration-panel-to-begin-hearing-in.html> (explaining dispute).

<sup>59</sup> There is nothing magical about the 50 percent cut-off.

<sup>60</sup> New York currently treats a pro-rated portion of the gains from the sale of interests in S-corporations as New York source income when 50 percent or more of the S-corporation's assets consist of New York real estate. *See* New York Tax Law § 631(a); Jeff Glickman, *New York Rules That a Nonresident's Sale of S-Corporation Stock Constituted New York Source Income*, APRIO, Sept. 2016, <https://www.aprio.com/new-york-rules-nonresidents-sale-s-corporation-stock-constituted-new-york-source-income/> (explaining statute). And the U.S. government treats gains generated from the sale of certain U.S. corporations by foreigners as U.S. source gain when a high percentage of their underlying assets consists of U.S. real estate. *See* I.R.C. § 897(c)(2)(2019) (defining "United States real property holding corporation").

<sup>61</sup> States have devised legally acceptable withholding tax regimes to ensure that nonresident sellers of in-state real estate pay the applicable source tax. *See* Kyle J. Sweeney, *The Nonresident Real Estate Withholding: An Exit Tax In Disguise?*, 26 GEO. MASON L. REV. 549, 584-85 (2018) (surveying and evaluating state real estate withholding regimes). Buyers of interests in businesses consisting largely of assets or income derived in one state presumably are sufficiently aware of the local connection to warrant imposing such a withholding obligation on them. It is unclear how successful states are at collecting taxes imposed on nonresidents in the absence of withholding.

<sup>62</sup> Indeed, some states have done exactly that, and the taxes have been held to meet constitutional standards. *See* Hellerstein & Smith, *supra* note 8, at 226 n.33 (citing *International Harvester Co. v. Wisconsin Department of Revenue*, 322 U.S. 435 (1944) and *Anderson v. Lambert*, 494 So.2d 370 (Miss. 1986)). But more could take advantage of this taxing opportunity. Of course, as discussed earlier *supra* text at note 50, this only helps if the new state accepts the source rules promulgated by the first state and reduces its own tax claim accordingly. If it does not, such an expansion may simply lead to the different discontinuity of duplicative state taxation.

generate a publicly acceptable outcome with regard to instances of flagrant tax avoidance. This acceptability might, however, come to an end if sellers learned that they ought to merge their local businesses with others that do business in other jurisdictions to dilute the local character of the business prior to a sale, and avoid the source tax regime. Tax law is, of course, a messy and ever-changing business.

Expanding taxation at source is just one mechanism for reducing the tax significance of tax residence, and thus the benefits (or burdens) of changes in tax residence. Another approach involves reducing the significance of tax residence itself by expanding the concept of part-year residence. At present, taxpayers are part-year residents of states (and countries) only in the year in which they cease being a resident of one jurisdiction and establish residency in a new jurisdiction. People are supposed to be residents of only one state at a time. And the consequences of being considered a resident of more than one state at a time—a situation that can exist because of differences in state laws regarding the definition of “residency”<sup>63</sup>— can be dire. Both states may tax the same income, with no offset for taxes paid to the other.<sup>64</sup> There is a

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<sup>63</sup>The Supreme Court has been resistant, at least up until now, of wading into disputes involving inconsistent definitions of “source” or “residence,” preferring to avoid choosing between two different, but otherwise acceptable, state statutes. *See, e.g.*, *Moorman Mfg. Co. v. Bair*, *supra* note 50, at 278 (upholding Iowa’s single factor apportionment formula despite the “risk of duplication” created by its use when other states use three factor apportionment); *State Tax Comm’n v. Aldrich*, 316 U.S. 174, 181 (1942) (“no constitutional rule of immunity from taxation of intangibles by more than one State”); *Texas v. Florida*, 306 U.S. 398, 410 (1939) (same); *Zelinsky*, *supra* note 4, at 546 (“Residence-based double taxation has been accepted as constitutional”).

<sup>64</sup> For an example of a taxpayer caught in this situation, *see* *Edelman v. N.Y. State Dept. of Tax’n & Fin.*, 80 N.Y.S.3d 241 (2018), *app. dismissed* 122 N.E.3d 557 (N.Y. 2019), *cert.denied* 140 S.Ct. 134 (2019). The petitioners were taxed on the gains generated through the sale of their business by both Connecticut and New York; neither state provided an offset for taxes paid to the other because each claimed the petitioners were “residents” of the state. Connecticut asserted residency based on the taxpayers’ “domicile” and New York asserted residency because petitioners maintained a place of abode in the state and were present in the state for more than 183 days during the year. The petitioners resided in Connecticut, but worked in New York, and had an apartment there. The petitioners argued that New York’s definition of tax residency, which includes both taxpayers domiciled in the state and those maintaining an abode in the state and present in the state for more than 183 days during the year, violated the Commerce Clause because the definition failed to meet the “internal consistency test” required under *Comptroller of Treasury of Maryland v. Wynne*, 575 U.S. 542 (2015). *See* *Edelman v. N.Y. State Dept. of Tax’n & Fin.*, Petition for Writ of Certiorari, p. 2, [https://www.supremecourt.gov/DocketPDF/18/18-1570/103827/20190624120144526\\_Edelman\\_cert\\_petition.pdf](https://www.supremecourt.gov/DocketPDF/18/18-1570/103827/20190624120144526_Edelman_cert_petition.pdf). Specifically, the plaintiffs contended that if every state followed New York’s definition of residency for tax purposes, many dual residents would be created and subjected to duplicative taxation. Rather than being created by a mismatch between state laws, as in *Moorman*, *supra* note 50, the plaintiffs argued that the duplicative taxation followed from the overly aggressive reach of the New York definition of residency. *See id.* at 13 (“if every State were to adopt New York’s tax scheme, a taxpayer who earned income while traveling frequently across state lines would face a higher tax burden on intangible income than a taxpayer whose activities were largely confined to a single State”); *see also* Michael S. Knoll & Ruth Mason, *Dual Residents: A Sur-Reply to Zelinsky*, 85 STATE TAX NOTES 269, 270 (2018) (arguing that “New York’s residence rules are internally inconsistent”). This defect could only be cured, the plaintiff’s in *Edelman* contended, by New York providing a credit for taxes paid to the state of domicile. In the *Wynne* case, the legal issue was the extent of the credit a residence state, which taxed on the basis of residence and source, had to offer for taxes paid to a source state; it did not, strictly speaking, involve a dispute over credits that one residence state had to offer for taxes paid to another residence state. The New York Supreme Court held, following an earlier New York decision,

solution that is capable of solving both the dual resident and, to some extent, the change in residence problem. As described below, states could agree to treat taxpayers who spend significant amounts of time in more than one state as part-year residents of each of the states, and then apportion their personal income tax liabilities in accordance with the time spent in each state. This possibility is now described and evaluated in the next section.

### C. Dual Residency and Income Apportionment

Changes in residency matter so much because tax residency is regarded as an all-or-nothing, or discontinuous, proposition. Individuals are either residents of a state or not. In reality, many individuals spend considerable amounts of time in two or more jurisdictions. For example, many retirees are seasonal movers, with retained homes in their original states of residence. Some of these individuals find themselves in the unfortunate position of being considered residents of more than one state for tax purposes; others pay close attention to state definitions of residency and manage to become residents only of the low-tax state. Unsurprisingly, states that find themselves on the losing end of these residency changes, and especially those that provide significant benefits to seasonal residents, have explored the possibility of “snowbird taxes.” In 2013, Governor Mark Drayton of Minnesota proposed legislation which would have treated individuals spending two months or more and with a permanent abode in Minnesota as a “part-year” resident of Minnesota, subject to a proportional individual income tax.<sup>65</sup> The legislation was not enacted, but it caught the eye of a noted tax scholar, Edward Zelinsky, who then advocated the adoption of such “apportioned residence-based income taxation”<sup>66</sup> by any and all possible means.<sup>67</sup> Although the focus of his work was on reducing the burdens imposed on double-taxed, multi-state residents, the same approach could be used to expand the taxing jurisdiction of states that would not, under current conceptions of residence, qualify as residence states. The proportional approach would allow states to tax some of the investment income and gains of former residents, and reduce the tax incentive for (inefficiently) moving to another jurisdiction before selling appreciated assets.

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*Matter of Tamagni v. Tax Appeals Trib. of State of N.Y.*, 695 N.E.2d 1125 (N.Y. 1998), *cert. denied* 525 U.S. 931 (1998), that the Commerce Clause was inapplicable to “‘intangible investment income, which ‘has no identifiable situs,’ ‘cannot be traced to any jurisdiction outside New York,’ and is ‘subject to taxation by New York as the State of residence.’” This decision was upheld by the New York Court of Appeals, in a decision stating simply that “no substantial constitutional question is directly involved.” *Edelman v. N.Y. State Dept. of Taxation & Fin.*, 122 N.E.3d 577 (N.Y. 2019). The Supreme Court declined to grant certiorari in *Edelman*, effectively refusing to extend the “internally consistent” test under the Dormant Commerce Clause to state definitions of residency.

<sup>65</sup> See H.B. 677, 88<sup>th</sup> Leg., Reg. Sess. §2 (Minn. 2013) (creating category of “part-year resident”); *id.* at § 13 (describing income taxable to part-year residents).

<sup>66</sup> See Zelinsky, *supra* note 4, at 572.

<sup>67</sup> See *id.* at 572-73 (“The best way to achieve apportioned residence-based income taxation is by federal legislation under Congress’s Commerce Clause power. If Congress won’t adopt such legislation, the U.S. Supreme Court should require such taxation via its Commerce Clause and Due Process doctrines. If neither Congress nor the Court will act....the states on their own can agree that a state without source jurisdiction over part or all of a dual resident’s income should only tax its pro rata share of the income which the state taxes on the basis of residence.”).

Allowing residence taxation based on part-year residence is no panacea. For one thing, an individual may reduce (or even eliminate) the amount of time spent in the state of original residence to stay below the established cut-off for becoming a part-year resident. The resulting loss of in-state economic activity might outweigh the tax gains gleaned from taxes imposed on other taxpayers. Moreover, a part-year, proportional regime will not allow the original residence state to tax all the gain accrued with respect to investment assets while a taxpayer was a full-time resident; part of the tax on that gain still will be diverted to the state to which the taxpayer has (partially) moved by the time the asset was sold. On the other hand, the original state of residence could have an offsetting benefit from its ability to tax some of the ongoing income generated from those investment assets (including newly accrued gain) following the relocation. Overall, a state might collect more tax than if it had been allowed to levy an exit tax on the accrued gains, and then lost all taxing jurisdiction. The gain or loss to the state depends on the underlying facts.

In any event, the operation of a proportional, perhaps continuous, tax regime is not easy either for taxpayers or governments. The initial burden will fall on the taxpayers, who will find themselves responsible for filing multiple state tax returns.<sup>68</sup> They will need to keep track of their days of presence in each of the states in which they were “part year” residents.<sup>69</sup> Even developing a common definition of “days of presence” may not be easy. There are, after all, many days on which a mobile taxpayer is in in both states. Then there is the question of how to treat commuters who are “domiciled” in one state and work in another. The problem is compounded where a married couple do not work in the same state or do not always travel together. Another question is how to account for days spent in neither residence state.<sup>70</sup> States will need to agree on all of these issues in order to avoid double and under-taxation. Again, every non-uniformity will, like the exit tax, substitute one set of distortions for another. Discontinuities are hard to eliminate.

In short, there is much to be said for a part-year residence regime, but it comes with significant problems. This relatively continuous approach comes with its own discontinuities. The multi-state approach is probably most interesting when it comes to investment income, as just described, and when it comes to retirement income, the subject to which we now turn. As we will see, mechanisms directly focused on the taxation of retirement income may operate independently or alongside a part-year residence regime.

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<sup>68</sup> Highly paid athletes, artists, consultants and attorneys already face this burden, because their income is often sourced to many jurisdictions.

<sup>69</sup> This task may be made easier by the ubiquity of smartphones and related devices which routinely track users’ locations. However, taxpayers will be quite averse to being forced to hand their devices over to state tax officials as part of an audit process. The potential for political blow-back may make this an unwise auditing technique.

<sup>70</sup> This problem would be analogous to the “throw-back” versus “throw-out” problem encountered when taxpayers allocate multistate income using the formulary method. See Jared Walczak, *Throwback and Throwout Rules: A Primer*, TAX FOUND., July 2, 2019, <https://taxfoundation.org/throwback-rules-throwout-rules-2019/> (describing use of rules to tax “nowhere income”); Katherine Loughead, *Does Your State Have a Throwback or Throwout Rule*, TAX FOUND., Dec. 5, 2018, <https://taxfoundation.org/throwback-rule-throwout-rule/> (mapping out distribution of such rules).

### III. Taxing Retirement Income

While many individuals directly own assets that give rise to income taxed under the *mobilia sequuntur personam* doctrine, many more are beneficiaries of qualified retirement arrangements owning such assets.<sup>71</sup> As a general rule, the income derived from such arrangements, if taxed at the state level,<sup>72</sup> is taxed by the state in which the taxpayer is residing when he or she receives the retirement distribution. States that do not tax distributions from retirement plans lose nothing when retirees relocate prior to receiving distributions under these arrangements.<sup>73</sup> But the states that do tax such distributions are understandably aggrieved when a taxpayer first excludes portions of state-taxable wage income from the tax base as contributions to a qualified retirement arrangement, and then relocates to another jurisdiction before the accumulated funds are distributed. When a retiree moves, both the diverted wage income and associated investment income disappear from the tax base of the state in which the wages were earned.

The federal government does not tolerate such revenue losses, at least when high-income taxpayers are involved. U.S. accrued retirement benefits are included in the expatriation tax regime contained in section 877A of the Internal Revenue Code. Section 877A provides expatriates covered by such arrangements with a choice. Covered expatriates<sup>74</sup> may notify the administrators of their plans of their status as covered expatriates, authorize those administrators to withhold and pay over to the U.S. Treasury 30 percent of any payments made under the plan, and waive any treaty right to a lower withholding rate.<sup>75</sup> If an individual fails to make the required notification and waiver within the time prescribed under the regulations, the individual is immediately taxed on the amount of the “accrued benefit” as a distribution under the plan “received by such individual on the day before the expatriation date.”<sup>76</sup> The federal government

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<sup>71</sup> As of June 20, 2019, U.S. individuals had accumulated approximately \$29.8 trillion in retirement assets. See *Investment Company Institute, Frequently Asked Questions About 401(k) Plan Research*, ICIGLOBAL, 2019, [https://www.ici.org/policy/retirement/plan/401k/faqs\\_401k](https://www.ici.org/policy/retirement/plan/401k/faqs_401k). This figure includes “employer-sponsored retirement plans (both defined benefit (DB) and defined contribution (DC) plans with private- and public-sector employers), individual retirement accounts (IRAs), and annuities.”

<sup>72</sup> Many states exempt some or all income derived from such arrangements from their income tax bases. See Rocky Mengle, *12 States That Won't Tax Your Retirement Income*, KIPLINGER, Feb. 12, 2019, <https://www.kiplinger.com/slideshow/retirement/T047-S001-12-states-that-won-t-tax-your-retirement-income/index.html> (“Twelve states...completely exempt the most common types of retirement income—401(k)s, IRAs and pensions—from taxation”); *Deciding Where to Retire: Finding a Tax-friendly State to Call Home, 2018 Whole Ball of Wax*, *supra* note 47 (chart of state tax provisions).

<sup>73</sup> This assumes, of course, that their decision to refrain from taxing retirement distributions does not stem from the fear that if they tried to impose such a tax, retirees would seek out a lower-tax jurisdiction.

<sup>74</sup> See I.R.C. §§ 877A(g) & 877(a)(2) (2019) (defining “covered expatriate”).

<sup>75</sup> See I.R.C. § 877A(d)(1) & (3) (2019) (establishing withholding tax regime for distributions from “eligible deferred compensation items”).

<sup>76</sup> See I.R.C. § 877A(d)(2)(A) (2019) (rules for taxation of deferred compensation item which is not an “eligible deferred compensation item”). The sole relief provided affected taxpayers is that such deemed distributions are exempt from the early distribution taxes which may have been levied on an actual distribution from such plans. I.R.C. § 877A(d)(2)(B). See Phil Hodgen, *Income Taxation of a Covered Expatriate's 401(k) Plan*, HODGENLAW

views retirement income as properly sourced to, and taxable by, the country in which the underlying income was earned.

But the federal government has not taken the same approach when the question is which state ought to have jurisdiction to tax retirement income. In 1996, after six states enacted laws which would have imposed state income tax on retirement distributions paid to nonresidents out of pension arrangements funded by contributions deducted for tax purposes from in-state wages,<sup>77</sup> Congress enacted a law explicitly limiting states' authority to tax the pension income of nonresidents.<sup>78</sup> This law provides that that "[n]o State may impose an income tax on any retirement income of an individual who is not a resident or domiciliary of such State (as determined under the laws of such State.)"<sup>79</sup> The statute's expansive definition of "retirement income" includes amounts distributed from qualified pension trusts, simplified employee pension arrangements, IRA's, 403(b) annuities and annuity contracts, governmental plans, and "any plan, program, or arrangement...if such income...is part of a series of substantially equal periodic payments...made for...the life or life expectancy of the recipient (or the joint lives or joint life expectancies of the recipient and the designated beneficiary of the recipient), or...a period of not less than 10 years."<sup>80</sup>

Given that the imposition of a source-based tax upon distributions is foreclosed by this legislation, the question is whether such a tax can be accelerated. Specifically, the question is whether such a tax can be imposed and collected when funds are put into such arrangements.<sup>81</sup> It

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PC, Jan. 12, 2015, <https://hodgen.com/income-taxation-of-a-covered-expatriates-401k-plan/> ("The paperwork you should **not** screw up is Form W-8CE. You should give this to the 401(k) plan administrator within 30 days of renouncing your U.S. citizenship or abandoning your green card visa.").

<sup>77</sup> See SCHOETTLE, *supra* note 4, at 568 (California, Colorado, Kansas, Louisiana, New York and Oregon "sought to tax the deferred income of former residents"). It is worth noting that the state in which a taxpayer performed the services giving rise to the pension benefits may not, strictly speaking, be the sole source of subsequent pension distributions. Such distributions are funded in part by employee or employer contributions to such arrangements, traceable to deferred or re-directed wages. However, some benefits are paid out of the investment earnings generated from such set-aside amounts. And that portion of benefits, like all investment income, would in the first instance be sourced to the state in which the beneficiary was resident in the year it was earned under the *mobilia sequuntur personam* doctrine discussed in the previous section of this Article. The beneficiary of such an arrangements would likely have been a resident of the state in which he or she earned wages prior to retirement, but the post-retirement investment income could have a different source. And depending on the number of post-retirement years involved, such post-retirement investment income could represent a substantial portion of the actual distribution amounts. See Hellerstein & Smith, *supra* note 8, at 226 ("Because states generally lack the constitutional power to tax the portion of a former resident's pension income that reflects accumulations after the taxpayer's change of residence, states must limit their taxation of nonresident pension income to the deferred employment income and the income accumulated prior to the retiree's change of residence.").

<sup>78</sup> Act of Jan. 10, 1996, Pub. L. No. 104-95, §114, 109 Stat. 979 (1996) (codified as 4 U.S.C. § 114)).

<sup>79</sup> *Id.* at § 114(a).

<sup>80</sup> *Id.* § 114(b).

<sup>81</sup> This possibility appeared to have been discussed at the time the legislation was passed. See Pillsbury Tax Page, *Federal Statute Enacted Prohibiting State Income Taxation of Certain Pension Income of Nonresidents*, STATE & LOCAL TAX BULL., Feb. 1996, <http://pmstax.com/state/bull9602.shtml> (explaining AARP opposition to legislation due to "concern[] that the affected states could respond by limiting deferred compensation deductions to make up for

is worth noting that federal law specifically allows some pension arrangements to be financed on a post-tax basis. These Roth arrangements,<sup>82</sup> as they are called, allow taxpayers to fund retirement accounts out of post-tax money, while excluding distributions from later taxation.<sup>83</sup> In theory, the tax advantage of Roth plans is identical to that of a more traditional pension arrangement,<sup>84</sup> so that a state adopting such a tax regime could not be accused of undermining the federal tax preference for qualified retirement plans.<sup>85</sup> Taxation at this earlier point in time can be justified (in most situations) on both source and residence grounds.

Effecting such a tax would be complicated by the fact that there are two types of qualified pension arrangements: defined benefit plans and defined contribution plans. In a defined benefit plan, covered employees are promised a retirement benefit calculated according to a pre-established formula, often based on some combination of salary and years of employment.<sup>86</sup> Employers maintaining such plans are required to contribute amounts to a dedicated pension

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the lost revenue.”). Another alternative would be for states to impose an exit tax on the untaxed value of accumulated pension benefits at the time a taxpayer moved to another state. Although such a tax might not fall afoul of 4 U.S.C. § 114 because it would not be levied on a pension “distribution,” presumably it would raise the same constitutional issues discussed earlier, *see* text at notes 18-30 (discussing Dormant Commerce Clause and Privileges and Immunities issues), in the context of an exit tax imposed on unrealized gains.

<sup>82</sup> William Roth, a former Senator from Delaware, sponsored the bills authorizing such arrangements in the IRA and 401(k) contexts. *See* Wikipedia, Roth IRA, [https://en.wikipedia.org/wiki/Roth\\_IRA](https://en.wikipedia.org/wiki/Roth_IRA) (detailing history of Roth IRAs); Wikipedia, Roth 401(k), [https://en.wikipedia.org/wiki/Roth\\_401\(k\)](https://en.wikipedia.org/wiki/Roth_401(k)) (Roth 401(k) and 403(b) options added by the Economic Growth and Tax Relief Reconciliation Act of 2001).

<sup>83</sup> *See* I.R.C. § 408A (2019) (statutory authority for Roth IRAs); I.R.C. § 402A (2019) (statutory authority for Roth 401(k) and 403(b) contributions).

<sup>84</sup> *See* Julie Roin, *Planning Past Pensions*, 46 LOY. U. CHI. L. J. 747, 782 (2015) (“If one assumes constant tax rates and normal rates of return, this [Roth] tax treatment is indistinguishable from that accorded other qualified pension plans for which a deduction for contributions is allowed up-front and distributions are fully taxable”); Daniel I. Halperin, *Special Tax Treatment for Employer-Based Retirement Programs: Is It “Still” Viable as a Means of Increasing Retirement Income? Should It Continue?*, 49 TAX L. REV. 1, 13 (1993) (“the real benefit of a [non-Roth] qualified plan is the tax exemption of the investment income earned by the trust which holds the trust assets”). In practice, Roth type arrangements may actually benefit taxpayers more than the more traditional qualified plan combining an exclusion for contributions followed by full taxation of eventual distributions. *See* PETER J. WIEDENBECK, *ERISA: PRINCIPLES OF EMPLOYEE BENEFIT LAW* 299 (2010) (explaining why immediate deduction and yield exemption often lead to different results); Adam Bergman, *Mitt Romney’s Retirement Account Makes Case For Roth IRAs*, FORBES, Aug. 3, 2018, <https://www.forbes.com/sites/forbesfinancecouncil/2018/08/03/mitt-romneys-retirement-account-makes-case-for-roth-iras/-385493bf215a> (explaining how Romneys’ out-sized return on his regular IRA would have been magnified if he had used a Roth IRA instead); Edward J. McCaffery, *A New Understanding of Tax*, 103 MICH. L. REV. 807, 827 (2005) (reasons to prefer a tax on distributions rather than contributions).

<sup>85</sup> Actually, nothing that a state did short of imposing heavier taxes on retirement arrangements would undercut the federal tax preference. There does not appear to be any law requiring states to magnify the federal tax preference by providing state tax relief for such arrangements. Both the Supreme Court, in *DeBuono v. NYS-ILA Medical and Clinical Services Fund*, 520 U.S. 806 (1997), and more recently the Sixth Circuit in *Self-Insurance Institute of America, Inc. v. Snyder*, 827 F.3d 549 (6<sup>th</sup> Cir. 2016), *cert. denied* 137 S. Ct. 660 (Jan. 9, 2017), found that ERISA’s federal preemption provision did not preclude states from imposing taxes on hospitals or insurers providing health benefits under employer-sponsored, ERISA-regulated health plans, differentiating revenue-raising measures from proscribed hospital regulation.

<sup>86</sup> *See* WIEDENBECK, *supra* note 84, at 8-9 (describing different benefit formulas).

trust in accordance with actuarial estimates of the amount needed to defray their pension obligations to all covered employees.<sup>87</sup> The benefits, however, are supposed to be paid regardless of whether the employer has set aside enough funds in the trust to do so.<sup>88</sup> Neither the employer contributions nor the assets in the trust are allocated to, or owned by, particular beneficiaries.<sup>89</sup> In contrast, in the case of defined contribution arrangements, individual accounts are established for each intended beneficiary.<sup>90</sup> Employers and employees make contributions to accounts in accordance with the terms of the applicable plan; each beneficiary's retirement benefit consists of the balance contained in his or her account at the time of retirement.<sup>91</sup> As explained below, any regime attempting to tax contributions would entail the development of different rules for the two plan types.

#### A. Defined Contribution Plans

It would be relatively simple for a state to tax contributions to a defined contribution plan on a current basis. It would merely have to eliminate the current exclusion of the contributions from income. The amount of such contributions is known, and could easily be incorporated in current information returns. There would be a mismatch between the gross amount of income reported for federal and state tax purposes, but there is already (often) a difference between the amount of income reported for federal and state tax purposes.

To be sure, there is some complexity. Issues arise if, for example, a taxpayer works in several states. If one state taxes the wages of nonresidents under a source tax rationale, its claim to tax the associated amount of retirement income should be both expected and honored; the state claiming only residence taxing jurisdiction should then either exclude the contributions taxed by the other state from its own tax base or grant a tax credit for the other state's taxes against its own tax obligation.

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<sup>87</sup> *Id.* at 9 (describing need for actuarial estimates).

<sup>88</sup> *Id.* at 7 (“a defined benefit plan is an employer’s commitment to make specified future payments; the employer is contractually obligated to make those payments even if the assets set aside to finance them prove to be inadequate”).

<sup>89</sup> See WIEDENBECK, *supra* note 84, at 7 (distinguishing defined contribution plans from defined benefit plans).

<sup>90</sup> Indeed, the beneficiaries of most such accounts are allowed to direct the investment of the assets contained therein. See *id.* at 136–37 (“by 2005, about 95 percent of participants had some say over the investment of their accounts”). Not all regard this extension of participant control as a welcome development. See Susan J. Stabile, *Freedom to Choose Unwisely: Congress’ Misguided Decision to Leave 401(k) Plan Participants to their Own Devices*, 11 CORNELL J.L. & PUB. POL’Y 361, 363 (2002) (“The statutory scheme overestimates the ability of participants to protect themselves.”); Colleen E. Medill, *The Individual Responsibility Model of Retirement Plans Today: Conforming ERISA Policy to Reality*, 49 EMORY L. J. 1, 15 (2000) (“Studies also have concluded that a significant portion of the public lacks fundamental knowledge of the financial concepts necessary for decision-making under the individual responsibility model”).

<sup>91</sup> See WIEDENBECK, *supra* note 84, at 7 (“benefits based solely on the amount contributed to the participant’s account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant’s account”).

The more difficult problems involve the decisions that must be made about the taxation of actual distributions. These problems come in two varieties. The first is the transition problem. The second is an ongoing issue that will arise from the likely disparity in state taxing regimes.

The transition issue comes first. A state that begins including retirement plan contributions in income is unlikely to include all past years' contributions in the income of an account's owner in the year it adopts the new rule.<sup>92</sup> For one thing, a taxpayer may not have the records necessary to determine the amount of past contributions to the account. Under current law, there has been no need to track how much of a retirement account's assets is attributable to contributions as opposed to the returns from investing those contributions, since both amounts are taxable in full at ordinary income rates when distributed. Moreover, the amounts involved could be quite large, and the individual involved may lack the liquid assets necessary to defray the large tax liability that would result from such an inclusion. As a result, a taxpayer might have to withdraw funds from retirement accounts in order to pay the tax due to the state—and withdrawals from qualified retirement accounts trigger a contemporaneous federal tax obligation,<sup>93</sup> possibly up to and including a ten percent penalty tax.<sup>94</sup> For that reason, states adopting such a regime will probably want to reserve the right to tax distributions attributable to pre-change contributions, and the associated investment returns. That will require states to come up with some mechanism for allocating actual distributions between the pre-change taxable distributions and the post-change exempt distributions.

As a practical matter, the easiest mechanism for dealing with the transition issue would be to require taxpayers to create a separate retirement account to hold the contributions made on a post-tax basis along with the investment returns derived from those contributions. Distributions from accounts paid out of pre-tax contributions could continue to be taxed (or not) as they were made. Distributions from the post-tax account, and only the post-tax account, would be received tax-free. Although states would be able to tax the distributions from the pre-change accumulations of their residents, they would still be unable to tax distributions made to former residents. This means that a considerable amount of tax discontinuity would exist for many years, although its significance would gradually diminish.

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<sup>92</sup> There would be no constitutional objection to doing this, as long as the rule applied to all account holders and not just those leaving the state.

<sup>93</sup> I.R.C. §402(a) (2019) (“distributions from an employee’s trust...exempt from tax under section 501(a) shall be taxable to the distributee, in the taxable year of the distributee in which distributed....”). Alternatively, a state might assess a tax based on the pre-effective-date balance in the account, but allow taxpayers to delay payment of the tax by agreeing to the imposition of an interest charge. Such a tax might not be deemed to run afoul of Pub. L. No. 104-95, as the levy would not (technically) be imposed on retirement distributions. However, states may find enforcement of these deferred tax obligations difficult for the reasons laid out *supra* note 42: they may lose track of taxpayers once they leave the state, and there is no guarantee that those taxpayers will be in a position to pay the sums owed at a later date. Placing a withholding responsibility on retirement plan fiduciaries (the easiest way to effect compliance) would bring the whole scheme uncomfortably close to the tax scheme explicitly forbidden by Pub. L. No. 104-95.

<sup>94</sup> I.R.C. § 72(t) (2019) (imposing 10% additional tax on most distributions made to participants who had not attained the age of 59 ½ at the time of the distribution).

The mechanics would be easy if every state adopted the same new regime in one given year. If they do not—if this new pattern of taxation is not imposed by federal law—a plethora of new discontinuities are created. Some taxpayers could be double taxed on their retirement contributions, if they moved from a state which taxed retirement contributions but not distributions, to another, which allowed for tax-free contributions and taxed distributions. Contributions would then be taxed both by the state in which someone lived in the year contributions were made, and again by another state in the year such a distribution took place. We might hope that the distribution state would allow a credit or exclusion for the taxes paid to the first state on the contributions, on grounds that the income was sourced in that state, but it is unlikely to do so because under state law (not to mention the federal statute) such income seems to be deemed sourced within the distribution state’s borders.<sup>95</sup> This sourcing rule would probably pass muster under the “internal consistency test” described earlier.<sup>96</sup> If all states taxed retirement distributions, such distributions would be taxed by only one state.

While taxpayers moving from a tax-at-contribution state to a tax-at-distribution state would be subject to duplicative taxation, those moving from a tax-at-distribution state to a tax-at-contribution state could completely escape state taxation. It would depend on whether states maintaining tax-at-contribution rules taxed all distributions received by their residents from accounts funded by tax-deductible contributions; the question would be whether accounts earned by new residents would be treated the way “transitional” accounts are treated. As a legal matter, states should be able to tax distributions made out of any accounts accrued prior to the date of the adoption of their new taxing regimes, whether those accounts are owned by existing or new residents. This treatment would not require any discrimination between old and new residents, thereby eliminating possible objections to such taxation under the rubric of the Privileges and Immunities Clause. Further, although the income inherent in such accounts accrued as an economic matter before the new residents entered the state, any claim against this taxation due to the lack of nexus between the new state and retirement benefits earned while the owner was resident in another state under the Due Process Clause could not be sustained without imperiling the validity of 4 U.S.C. § 114—or of interpreting it to mean that no state could tax any portion of the retirement benefits received by a person who moved to a state other than the state in which his or her retirement benefits had been earned.<sup>97</sup> But what about benefits earned out-of-state after enactment of the tax-at-contribution rule by the new state? Could those be subject to tax in the new state? The grounds for doing so would be questionable. Not only would the new state be treating new residents differently from old residents, but if retirement income is sufficiently “realized” (deemed earned and received) to be subject to tax at the time contributions are made

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<sup>95</sup> See WALTER HELLERSTEIN, ET AL., *supra* note 50, at 434 (“In general, it is the credit-granting state that determines the sourcing rules that are employed to determine whether the state that is purporting to tax on a source basis is taxing income that has a its source in that country for tax credit purposes. As the cases below reveal, this can result in double taxation. . .”).

<sup>96</sup> See *supra* note 64.

<sup>97</sup> See WALTER HELLERSTEIN, ET AL., *supra* note 50, at 413-14 (defending right of states to tax pension benefits earned before, but distributed after, taxpayer became a resident).

to the account, that income should have been deemed earned and received for the new state's tax purposes while the taxpayer was a resident of another state, and thus outside the taxing jurisdiction of that new state. The new state would not have a sufficient relationship to that income to warrant its taxation as a constitutional matter.<sup>98</sup>

Once again the mechanism required to remedy one set of tax discontinuities caused by a taxpayer's change in residence gives rise to another set of discontinuities. To make matters worse, defined contribution plans present more tractable problems than do defined benefit problems, as described in the next section.

### B. Defined Benefit Plans

Beneficiaries of defined benefit plans do not have individual retirement accounts, nor do they own any particular assets of the pension trust(s) established to fund their benefits.<sup>99</sup> In addition, it is impossible to determine with any certainty the amount contributed to such trusts on a yearly basis on a particular beneficiary's behalf, as contributions are computed with reference to the characteristics of the entire participant base and expectations about future investment earnings, employment patterns, and mortality rates.<sup>100</sup> Thus, treating pension contributions as income to potential beneficiaries in the year contributions are made seems implausible as an administrative matter. That does not mean that contributions cannot be taxed by states when made. It does mean that the tax has to be imposed on, and collected by, employers. States may require employers to add back any deductions they claimed for federal tax purposes for contributions to defined benefit plans, just as they require individual taxpayers to add back amounts from state and local bond interest exempted from their federally defined income when calculating their state income taxes.

If an employer has employees working in multiple jurisdictions, the amount of pension contributions added back to any particular jurisdiction must be limited to the amount of the contributions related to in-state employees.<sup>101</sup> Although a perfectly accurate allocation is impossible for the reasons already mentioned, a formulaic allocation should be close enough to be acceptable. Several plausible bases for such an allocation formula exist, including the number of in-state employees covered by the plan relative to the total number of plan participants, the in-state payroll of plan participants relative to the total payroll of plan participants, the in-state

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<sup>98</sup> See Smith & Hellerstein, *supra* note 13, at 371-72 (explaining why a new state of residence lacks jurisdiction to tax gain from the sale of a primary residence located in another state that was realized but not recognized while the taxpayer was a resident of that other state).

<sup>99</sup> See Eric D. Chason, *Lemon Socialism and The Federal Guaranty of Private Pension Obligations* (March 2006) 16, at SSRN:<https://ssrn.com/abstract=887405> ("Employees have few claims against plan assets, except to enforce benefit payments fiduciary obligations. They have no enforceable claim to any surplus funding before a plan terminates. . .").

<sup>100</sup> See WIEDENBECK, *supra* note 84, at 9 (listing factors that must be estimated to actuarially determine contribution).

<sup>101</sup> See Hellerstein & Smith, *supra* note 8, at 227 (explaining allocation problem facing states seeking to impose a source tax on the retirement income of individuals who worked in several states).

covered payroll<sup>102</sup> of plan participants relative to the total covered payroll of plan participants, or simply the percentage of income apportioned to the state for tax purposes relative to the employer's total income. These are imperfect solutions, and allowing choice would obviously increase the imperfection. Still, a state could mandate one approach, and fairly think it had improved things compared to the current system.

On the other hand, there is the annoying fact that employers and their employees may be subject to tax at different rates. These rate differentials may lead to significant shortfalls (or excesses) in the amount of tax collected from employers, relative to taxes imposed on employees. After the Tax Cut and Jobs Act of 2017, most corporations pay federal tax at rates lower than individuals;<sup>103</sup> the relationship between state corporate and individual income tax rates is more mixed.<sup>104</sup> The income of non-corporate employers is included in the income of the company's owner, who may pay tax at higher marginal rates than many covered employees. The most extreme example of the differential concerns government employees. Inasmuch as governments pay no taxes, their loss of deductions costs them nothing and correspondingly raises no revenue for the tax authorities. At present, almost half of the individuals covered by traditional defined benefit pension plans are employees of state and local governments,<sup>105</sup> and many of them retire to low-tax states.<sup>106</sup>

The disparate tax rate problem could be ameliorated if instead of eliminating the deduction for pension contributions, the state levied an excise tax on employers equal to a stated percentage of pension contributions allocated to the state. The federal government included such a device in the Tax Cut and Jobs Act of 2017 to tax non-profit employers on the cost of providing certain income-excludable fringe benefits.<sup>107</sup> Of course, this option will not help the finances of a state

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<sup>102</sup>The Internal Revenue Code caps the amount of compensation that can be taken into account under a qualified plan. See I.R.C. §401(a)(17) (2019). The annual compensation limit in 2019 was \$280,000. I.R.S. Notice 2018-83, 2018-47 I.R.B. 274.

<sup>103</sup> The top marginal rate of tax on individuals in 2019 is 37 percent, *see* Rev. Proc. 2018-57, §3.01, 2018-49 I.R.B. 827, while the corporate tax rate is 21 percent. I.R.C. § 11 (2019).

<sup>104</sup> *See* Janelle Cammenga, *State Corporate Income Tax Rates and Brackets for 2019*, TAX FOUND., Feb. 27, 2019, <https://taxfoundation.org/state-corporate-rates-brackets-2019/> (listing state corporate income tax rates).

<sup>105</sup> Approximately 15,340,000 private sector employees (13 percent of 118 million workers) and 14,630,000 governmental employees (77 percent of 19 million workers) are covered by traditional pension plans. *See How many American workers participate in workplace retirement plans?*, PENSION RTS. CTR., July 15, 2019, <http://www.pensionrights.org/publications/statistic/how-many-american-workers-participate-workplace-retirement-plans> (information drawn from Bureau of Labor Statistics' National Compensation Survey for 2018).

<sup>106</sup> About 18 percent of Illinois public sector retirees have moved out of state. Jake Griffin, *About 18 percent of public employee retirees move out of state*, CAPITALFAX.COM, June 24, 2019, <https://capitolfax.com/2019/06/24/about-18-percent-of-public-employee-retirees-move-out-of-state/> ("Florida leads all migration destinations, followed by Arizona....), which is higher than some states, *see id.* (16% of Iowa's, 15% of California's) and lower than others, *see A Snapshot of NYSLRS Retirees*, N.Y. RETIREMENT NEWS, Oct. 30, 2019, <https://www.nyretirementnews.com/> (21 percent of retirees live out of state). Interestingly, Illinois currently exempts all retirement income from its income tax base, while New York exempts government funded pensions from its income tax base.

<sup>107</sup> *See* I.R.C. § 512(a)(7) (2019) (including cost of providing qualified transportation fringe benefits as "unrelated business taxable income" of nonprofit employers). However, Congress retroactively repealed this provision on

government unless the economic burden of this tax can be transferred to state employees. Otherwise, a state will simply find itself paying a tax to itself, generating a circular flow of money slightly diminished by enforcement costs.

The structure of defined benefit plans also makes it more difficult, and certainly more expensive, to design a workable transition rule. It is not enough to tell employers to set up a new, separate pension trust to cover future earned benefits, and to treat any benefits paid out of it as exempt from tax, while benefits paid out of the first trust would be taxable upon receipt. How would an employer know whose benefits ought to be payable out of the assets of each trust? Surely it would not be acceptable to spend down the assets of the first trust, so that the entirety of early retirees' benefits are taxable (even if some of the contributions made on their behalf had been taxed), while later retirees' benefits are wholly excludable from income (even though some might have been financed out of nondeductible contributions). Yet to create equity among employees, the employer would have to calculate the amount of pension benefits that each employee would be entitled to, had he or she terminated employment on the date the law changed. Then that amount of each benefit distribution would be includable in the beneficiary's income for tax purposes, with the rest of any eventual distribution excludable. This sort of calculation can be done, as it is when employers terminate defined pension plans,<sup>108</sup> but it is expensive.

In sum, the above-described techniques for taxing contributions to defined benefit plans, in lieu of taxing distributions from such plans, create the same potential for duplicative or non-existent taxation as explored in detail in connection with the taxation of contributions to defined benefit plans. The type of plan neither ameliorates nor exaggerates the problems caused by inconsistencies in state taxing rules. And as an administrative matter, it would be considerably more difficult to treat the participants in such plans in a fair and equitable manner.

#### IV. Conclusion

There is little doubt that a significant number of high-wealth, high-income taxpayers move across state, if not national, lines to lower their individual income tax burdens. President Trump's recent decision to change his legal residency from New York, a high tax state, to Florida, a state with no state income tax,<sup>109</sup> is merely the latest and perhaps most news-worthy example of such behavior. In Trump's case, there may be no efficiency loss, but the retroactive escape from taxes previously deferred is surely objectionable.

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December 20, 2019. *See* Taxpayer Certainty and Disaster Tax Relief Act of 2019, P.L. 116-94, Div. Q, Title III, §302, 133 Stat. 2534(2019) (enacted as part of the Further Consolidated Appropriations Act, 2020); *Repeal of Unrelated Business Income Tax on Qualified Transportation Fringe Benefits*, NAT'L L. REV., Dec. 26, 2019, <http://natlawreview.com/article/repeal-unrelated-business-income-tax-qualified-transportation-fringe-benefits>.

<sup>108</sup> *See* WIEDENBECK, *supra* note 84, at 278 (describing "notice of plan benefits" that must be distributed to employees prior to termination of a defined benefit pension plan)

<sup>109</sup> *See* Maggie Haberman, *Trump Makes Florida Resort His New Home*, N.Y. TIMES, Nov. 1, 2019, at A-1 & A-18 ("a person close to the president said the reasons were primarily for tax purposes").

However, tax rules that eliminate this tax discontinuity cannot be devised in a world in which valuation issues make universal mark-to-market taxation impossible, and states can maintain different tax bases and rates. Any change less comprehensive than universal mark-to-market taxation merely creates different inefficiencies and distortions. In the absence of empirical data,<sup>110</sup> it is a matter of opinion as to whether familiar or unfamiliar distortions are preferable. Nor is the alternative option for eliminating these discontinuities, forcing the states to “harmonize” their tax rates and tax bases, any less problematic. Forcing harmonization would undercut states’ ability to cater to the desires of heterogeneous populations, with different preferences regarding the scope and cost of government services, creating other inefficiencies. Sensible policies and tax reforms can and ought to take inefficiencies and discontinuities into account, and aim for the least objectionable combination of them, rather than struggle to achieve their complete elimination. No doubt that “least objectionable combination” will differ over time as economic and social conditions change, but that is what legislatures are for.

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<sup>110</sup> The empirical work to date suggests that the effect of the current discontinuities are relatively minor. *See supra* note 47 (empirical studies of effect of tax rate differentials on interstate mobility). A different design might lead to a different result. In addition, studies thus far have not looked at whether states have reconfigured their tax structures to minimize the costs of interstate mobility. The current studies’ failure to answer the empirical questions raised in this article does not mean that those questions cannot be answered. Future studies may have more success in isolating the magnitude of the behavioral incentives provided by current legal rules, as well as the effects of various proposals discussed in this article.