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By

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The State Tax Dilemma. States, often hamstrung by state constitutional balanced budget requirements preventing deficit spending, must reduce services (or increase taxes) if revenue is insufficient to fund them.[2] To maintain revenue and services, states have sought, sometimes aggressively, additional sources of tax revenue. As earnings of athletes and entertainers increased, for example, states began to assert claims to tax a portion of their earnings from playing or performing occasionally, but not regularly, in the state.[3] Similarly, use tax payment lines began to appear on state income tax returns.[4] In response to the increasing volume of sales by remote vendors to state residents, taxing authorities sought to require out-of-state vendors to collect use taxes on goods shipped into the state.[5] This strategy was bolstered significantly by the recent Supreme Court decision in *South Dakota v. Wayfair*.[6] Unlike Amazon laws imposing use tax collection obligations on out-of-state vendors that have a physical presence in the taxing state, *Wayfair* enables states to require out-of-state vendors without a physical presence in the taxing state to collect use tax on the taxing state's behalf.[7] Some states have been slow to implement legislation to utilize the authority that *Wayfair* provides, but it is likely that all states with a sales and complementary use tax ultimately will enact the necessary legislation to assure collection of use tax revenue.[8]

During the ongoing pandemic, commuter destination states like Massachusetts (Boston) and New York (New York City), threatened with loss of income tax revenue because neighboring state residents stopped physically working in the commuter destination state, assert continuing taxing

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[2] For example, MO. CONST. art. III, § 37; MO. CONST. art. IV, § 24. See, generally, Jared Walczak, State Strategies for Closing FY 2020 with a Balanced Budget, Tax Foundation (4/2/20), available at https://taxfoundation.org/fy-2020-state-budgets-fy-2021-state-budgets/; GAO, Briefing Report to the Chairman, Committee on the Budget, House of Representatives Balanced Budget Requirements State Experiences and Implications for the Federal Government (1993), available at https://www.gao.gov/products/AFMD-93-58BR.

[3] See, for example, N.Y. tax Law § 631 (McKinney 2019); Mo. Rev. Stat. §143.183 (2018); Jerome R. Hellerstein & Walter Hellerstein, State Taxation P 20.05(4)(d), at 18 (3d ed. 2003).

[4] For example, line 91 of California Form 505. Inclusion of use tax lines has enjoyed limited success in the absence of third-party collection of use taxes or reporting of sales into the state to resident purchasers.

[5] INSTITUTE FOR LOCAL SELF-RELIANCE, https://ilsr.org/rule/internet-sales-tax-fairness/ (last visited Jan. 23, 2021) ("In 2008, New York pioneered a policy strategy that effectively skirted the constraints of Quill and forced Amazon, Overstock, and other web-only retailers to collect the state's sales tax.").

[6] S. Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2080 (2018).

[7] Wayfair overruled previous Supreme Court precedent in *Quill* which required a physical presence but invited Congress to change the physical presence requirement. Congress failed to act and the Supreme Court then reserved itself. For additional discussion, Henry Ordower, *Avoiding Federal and State Constitutional Limitations in Taxation*, 168 TAX NOTES FED. 1447, 1447 (2020).

[8] Hannah Meehan, Comment*, Leveling the Playing Field for Remote Sellers: Missouri's Response in a Post-Wayfair World*, 65 St. Louis U. L.J. (forthcoming Mar. 2021).

jurisdiction over the wages resident employers pay the employees working remotely from their states of residence. New Hampshire has sued under the original jurisdiction of the Supreme Court to resolve the interstate dispute.[9] The assertion of continuing taxing jurisdiction risks saddling employees who stopped commuting, possibly only temporarily, with income tax obligations in both the state of residence and the state of their previous commute. Residence states, like New Jersey and Connecticut, ceded primary taxing jurisdiction to the commuting destination state through a credit against their state income tax for tax payable to the state in which the employee was working.[10] These states may deny the tax credit because, absent physical presence of the employee in destination state, that state arguably no longer has jurisdiction to collect the income tax. This quest for enhanced state income tax revenue may mark the beginning of increased competition among states for individual incomes taxes.

Historically, states with income taxes[11] tied most of their income tax computations to federal income tax computations although each state makes adjustments that distinguish the computation of state taxable income from the federal taxable income. The decision to follow federal computations was sensible and simple. That decision facilitated state reporting and enabled states to rely primarily on federal auditing and limited the amount of infrastructure each state needed to enforce tax compliance. Decoupling from the federal income tax is not a new concept at all but most decoupling was relatively low cost to the states. An example is the capital gain preference. Except for a short period following recodification of the Internal Revenue Code in 1986, net capital gains of individuals and trusts have enjoyed a rate preference under the federal income tax[12] but not under most state income taxes. In recent years that separation required no distinct computational mechanism as it was simply the imposition of a rate to net income. Earlier, when the preference at federal level was a deduction, the state had to adjust federal adjusted gross income to tax capital gain fully. States have decoupled from federal income tax computations in other ways as well, recently from the qualified business income deduction enacted in 2017.[13] Colorado, Idaho and North Dakota follow the federal income tax deduction for qualified business income; other states using federal adjusted gross income as their computational point of departure do not follow federal.

Consistent reliance on federal tax computations does not prevent multiple state tax impositions but does avoid some complexities from differing computations. For businesses that must apportion their revenue among states in which they operate, inconsistent state apportionment

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[9] New Hampshire v Massachusetts, Sup. Ct. Dkt 22O154 (10/23/20), https://www.supremecourt.gov/search.aspx?filename=/docket/docketfiles/html/public/22o154.html (challenging under the Supreme Court's original jurisdiction, the extra-territorial reach of the Massachusetts' income tax into New Hampshire on New Hampshire commuting employees' wages when they are working remotely without entering Massachusetts. New Hampshire's does not tax income from services. New Jersey does tax wage income and joined other states in filing an amicus brief supporting New Hampshire's claim).

[10] See N.J. STAT. ANN. § 54A:4-1 (West 2020).

[11] Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming have no income tax. New Hampshire and Tennessee do not tax income from the performance of services, including wages.

[12] I.R.C. § 1(h). Before 1987, the rate preference was indirect through a 50 or 60% net capital gain deduction or partial exclusion. Net capital gain under I.R.C. § 1222(11) is the excess of net long term capital gain over net short term capital loss.

[13] I.R.C. § 199A, added by the Tax Cuts and Jobs Act (TCJA) in 2017 (most states begin their state income tax computation from federal adjusted gross income and the qualified business income deduction is not an adjustment to federal gross income, so it is not part of that computation).

formulas yield confusion and duplicative taxation.[14] As states decouple from federal income tax rules and assert broader taxing jurisdiction than before, complexity and discontinuities may grow and result in multiple tax impositions.

This commentary reflects on the structure of state income taxes and credits for taxes paid by residents to other states and the confusion non-uniform decoupling generates across state borders. Separation from federal rules may help to staunch the loss of state revenue from federal tax amendments[15] and enhance state tax revenue, especially revenue that the state otherwise might never capture but to which it may have a claim.

This short article focuses on proposed legislation in New York state ("NY") that would tax the unrealized gain and other deferred income of NY's billionaires[16] and the complexities that legislation's enactment is likely to generate. The article will consider responses from other jurisdictions to ameliorate the discontinuity that the NY legislation will cause as states seek to enhance their income tax revenue and capture a larger share of the income tax base without running afoul of constitutional limitations on states' taxing power, especially equal protection[17] and the right to travel.[18]

Unrealized appreciation and other deferred income. Among features of the federal income tax most favorable to wealthy taxpayers is the realization requirement. Gain and loss are not realized until the taxpayer chooses to sell property.[19] Inclusion of gain and loss in gross income, referred to as recognition, generally follows realization unless another tax provision defers the recognition.[20] With very limited exceptions,[21] if a taxpayer does not choose to sell property, the taxpayer's economic gain remains free from the income tax. In a variety of ways, a taxpayer may dispose of property without recognizing the economic gain embedded in the property. The taxpayer may give the property to others,[22] even claiming a charitable contribution deduction

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[14] R. Bruce Johnson, *The Multistate Tax Commission - Its History and Its Future*, 6 THE ST. AND LOC. TAX LAW. 45, 50-51 (2001); Andrea Muse, *States Trending Toward Single Sales Factor, Panelist Says*, TAX NOTES (Jan. 27, 2021), https://www.taxnotes.com/tax-notes-today-state/apportionment/states-trending-toward-single-sales-factor-panelist-says/.

[15] When the federal rules for depreciation deductions accelerate depreciation recovery, for example, the intended reduction of the federal income tax is accompanied by reductions in state income taxes.

[16] The "billionaire mark to market tax and the worker bailout fund tax" (the "MtM Tax"), S08277, 2019-2020 General Assembly, https://www.nysenate.gov/legislation/bills/2019/S8277 (visited 1/18/21).

[17] Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 564 (1997) (property tax exemption discriminating against out of state residents is impermissible under Equal Protection).

[18] *Kent v. Dulles*, 357 U.S. 116 (1958) (recognizing fundamental right to travel). Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 564 (1997) (property tax exemption discriminating against out of state residents is impermissible under Equal Protection).

[19] I.R.C. § 1001(a) (gain is realized from the sale or other disposition of property if the amount realized under I.R.C. § 1001(b) on sale exceeds the taxpayer's adjusted basis in the property under I.R.C. § 1011).

[20] I.R.C. § 1001(c). Installment sales (I.R.C. § 453) defer inclusion in income of realized and recognized gain and are not an exception to recognition governed by I.R.C. § 1001.

[21] Exceptions include mark to market inclusion for commodities and other financial positions (I.R.C. § 1256), mark to market inclusion for dealer securities (I.R.C. § 475), and the expatriation tax (I.R.C. § 877A).

[22] I.R.C. § 1001(c) (requiring a sale or exchange for recognition) and I.R.C. § 102 (no inclusion of value of gift in recipient's income); I.R.C. § 1015 (donee takes donor's basis if the donor is living thereby preserving the donor's economic gain for inclusion if the donee sells the property).

equal to the value of the property while giving it away,[23] and exchange the property for different property.[24] The taxpayer also may monetize the appreciation in value by borrowing against the security of the property without disposing of it.[25] If the appreciated property passes from the taxpayer to another at death, the embedded economic gain permanently escapes income taxation because the decedent's estate receives a new basis in the property, equal to its fair market value on the decedent's date of death, against which to measure gain or loss.[26]

Combining the realization requirement and the new basis at death elements of the federal income tax enables affluent taxpayers who hold much of their wealth in appreciated property to escape both federal and state income tax on their economic gains. States have no federal constitutional or federal statutory obligation to follow federal taxation rules or principles, but it is customary for them to do so. Even if realization were a U.S. constitutional requirement under the 16th Amendment definition of income, as it originally may have been interpreted to be,[27] states have been free to adopt their own income definitions and reject both the realization requirement and the new basis at death rule. Nevertheless, states have uniformly, and understandably, followed federal taxation on these matters. Perhaps the stress on state treasuries from the pandemic[28] marks the moment for states to capture additional revenue by decoupling further than they do from federal tax rules.

While the realization requirement affords all property owners the opportunity to enjoy increase in property value without current taxation, the loss of potential tax revenue from failure to tax economic appreciation is troubling. Commentators[29] and politicians[30] have argued that both the

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[23] I.R.C. § 170 (charitable contribution deduction).

[24] I.R.C. § 1031 (nonrecognition of realized gain if the taxpayer exchanges real property for like-kind property); I.R.C. § 1034 (nonrecognition of realized gain if the taxpayer reinvests the proceeds from an involuntary disposition of property in property related in service or use); I.R.C. § 351 (nonrecognition of gain on exchange of property for corporate stock); I.R.C. § 721 (likewise for a partnership or limited liability company interest).

[25] Borrowing money does not yield includable income because the taxpayer has an obligation to repay the borrowed funds even if the taxpayer is not personally obligated to repay because the borrowing is without recourse. Crane v. Commissioner, 331 US. 1, 1 (1947).

[26] I.R.C. §1014(a) (property received from a decedent's estate has an adjusted basis equal to the fair market value of the property at the decedent's date of death without regard to the decedent's adjusted basis in the property while alive). The new basis at death rule does not apply to property that would yield income with respect to a decedent under I.R.C. § 691 including retirement accounts, other than Roth IRAs, and installment sale contracts. I.R.C. § 1014(c). The new basis at death rule was changed twice to a rule requiring recipients of property from a decedent to continue the decedent's pre-death basis. The first change in 1976 enacting I.R.C. § 1023 (repealed 1977) while the second change applied only to decedent's dying in 2010, a year in which there was no estate tax. Repeal of this rule may become part of President Biden's proposals to increase taxes on wealthy taxpayers. Paul Sullivan, *WEALTH MATTERS*: *The Estate Tax May Change Under Biden, Affecting Far More People*, THE NEW YORK TIMES (1/15/21), https://www.nytimes.com/2021/01/15/your-money/estate-tax-biden.html (visited 1/18/21).

[27] Eisner v. Macomber 252 U.S. 189, 211-12 (1920).

[28] Covid-19 coronavirus began to spread in early 2020. A DICTIONARY OF EPIDEMIOLOGY 179 (Miquel Porta et al. eds., 5th ed. 2008); WHO Director-General's opening remarks at the media briefing on COVID-19, https://www.who.int/director-general/speeches/detail/who-director-general-s-opening-remarks-at-the-media-briefing-on-covid-19---11-march-2020 (last visited 1/25/2021).

[29] This commentator, for example, Henry Ordower, Capital, an Elusive Tax Object and Impediment to Sustainable Taxation, 23 FLA. TAX REV. 625, 625 (2020) and Abandoning Realization and the Transition Tax: Toward a Comprehensive Tax Base, 67 BUFFALO L. REV. 1371, 1371 (2019).

[30] See U.S. SENATE COMMITTEE ON FIN., WYDEN UNVEILS PROPOSAL TO FIX BROKEN TAX CODE, EQUALIZE TREATMENT OF WAGES AND WEALTH, PROTECT SOCIAL SECURITY (2019).

realization requirement and the new basis at death rule[31] have become obsolete. Without providing relief for some taxpayers, changing the rule may prove politically problematic where it might compel homeowners to sell or encumber their homes to raise the funds needed to pay the tax on appreciation in value.[32] Where great wealth is involved, however, eliminating this opportunity to avoid taxation of gain is appealing and a potential source of much needed tax revenue.

The NY Mark to Market Tax. Against this background and consistent with calls to increase taxes on the wealthy, the proposed legislation in NY would tax billionaires currently on much of their deferred income and the unrealized appreciation in their assets. If enacted,[33] the MtM Tax requires resident billionaires to realize and recognize gain for NY income tax purposes as if they sold all their assets, including pension savings plans, at their fair market values on July 1, 2020. Special valuation rules seek to eliminate any value-discounting the taxpayer has undertaken. For purposes of determining whether a taxpayer is a billionaire, the net fair market value of assets owned by them is enhanced under rules akin to constructive ownership rules[34] by the assets of related persons, including spouse, minor children, certain private foundations to which the billionaire has contributed, and assets the billionaire transferred to third parties by gift within the previous five years. Billionaire residents in NY for less than a five-year period as of July 1, 2020 may increase the adjusted bases of their assets for purposes of the MtM Tax to fair market value on the date they became a resident. That basis increase, as opposed to the basis increase following inclusion of mark to market gain in income, must not apply to basis for purposes of an actual sale. If it did, it would offer less than five year residents of NY a planning opportunity to escape state tax on much of their unrealized gain. Taxpayers subject to the MtM Tax may spread the additional tax liability over ten years but must pay a 7.5 percent per annum charge on the deferred amounts. After 2020, the MtM Tax becomes an annual mark to market inclusion requirement for resident billionaires.

Enactment of the MtM Tax and its effective date, if enacted, are uncertain.[35] The currently pending legislation would apply to billionaires who were resident in the state of NY on July 1, 2020, a date now past. As the legislation was not introduced until May 1, 2020, a non-domiciled billionaire with a permanent abode in the state had only a short window during which to avoid the 183-day residence definition[36] and avoid imposition of the tax. Had NY offered more time between the proposed effective date and the introduction of the legislation, NY resident billionaires might have established residence in another state to avoid the tax and the tax would

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[31] Harry L. Gutman, Taxing Gains at Death, 170 TAX NOTES FEDERAL 269 (JAN. 11, 2021).
[32] This concern has been raised repeatedly with respect to *ad valorem* real property taxes and contributed to successful voter tax limitation initiatives, including Proposition 13 in California.
[33] Whether NY's proposal is a serious contender for passage is doubtful. See, for example,
Luis Ferré-Sadurní and Jesse McKinley, *Cuomo Offers Doomsday Proposal to Attack a Possible $15 Billion Deficit*, NEW YORK TIMES (Jan.19, 2021), https://www.nytimes.com/2021/01/19/nyregion/budget-cuomo-ny.html?searchResultPosition=1.
[34] I.R.C. § 318.
[35] Anna Gronewold, *Cuomo warns of tax hikes, dire cuts if feds can't find $15B,* POLITICO (Jan. 1, 2021, 7:24 PM), https://www.politico.com/states/new-york/albany/story/2021/01/19/cuomo-warns-of-tax-hikes-dire-cuts-if-feds-cant-find-15b-1358381.
[36] N.Y. tax Law § 605(b)(1) (B) (McKinney 2018). (Section 605(b)(1)(A) includes another test for taxpayers domiciled in NY without a permanent abode.).

not produce revenue as planned. Even if the proposal fails, it may be a harbinger of future mark to market tax legislation in states needing to increase tax revenue.

Exit and Continuation Taxes. Rather than taxing billionaires immediately on all economic gain, a state might tax gain accrued during residence when the taxpayer ceases to be a state resident. NY could have used such a tax to backstop a longer interim between introduction and effective date. While the U.S. and other countries, including Canada, impose a tax on expatriating individuals that requires them to include deferred income and mark their assets to market and include gain as if they sold their assets on the date of expatriation,[37] a state seeking similarly to tax those who cease to be residents might run afoul of the constitutional right to travel. Such a tax advances the legitimate state interest of protecting its tax base by preventing appreciation and deferred compensation that accrued during a taxpayer's resident period from permanently escaping the state's income tax. Insofar as the state could have taxed the income when earned or accrued, but permitted the tax benefit of deferral, the state has a rational basis for taxing the income when it is about to lose taxing jurisdiction over the taxpayer.[38] Moreover, the federal prohibition on the alternate scheme of a continuation tax on retirement fund distributions, discussed in the next paragraph, limits the ability of the state to capture that tax revenue in another manner. Nevertheless, immediate and burdensome taxation of deferred income and unrealized appreciation is likely to chill taxpayers from changing their state of residence and perhaps excessively burden their fundamental right to travel.[39]

Paralleling an expatriation tax is a continuation tax.[40] A continuation tax does not impose any immediate burden when the taxpayer changes their state of residence. Instead, the taxpayer's previous residence state taxes the portion of deferred income and includable gain that accrued while the taxpayer was resident when the taxable event, receipt of payment or sale of property, occurs. Several state courts have held such a tax to be constitutional and permissible but federal legislation now prohibits states from asserting continued taxing jurisdiction over certain retirement income of previous residents.[41] Given the federal prohibition and uncertainty concerning the constitutionality of an exit tax, decoupling from the federal computation of income, including abandonment of the realization requirement and other federal income deferral rules becomes an attractive structural change to bolster state tax collection and protect the state tax base from future revenue loss accompanying changes of residence.[42]

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[37] I.R.C. § 877A.
[38] Nordlinger v. Hahn, 505 U.S. 1, 1 (1992) (applying a rational basis standard of review to the California property tax assessment scheme of Proposition 13 despite its likely increased tax burden on taxpayers moving to California).
[39] *Id.* at 10-11 (Right to travel was not before the Court in *Nordlinger* and the Court did not address this issue on the merits. It is an argument that could be brought in the future.). In the EU, a French expatriation tax was held to violate the Treaty of Rome because it burdens free movement. Case C-9/02, Hughes de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie, 2004 E.C.R. I-2452.
[40] Compare I.R.C. § 877 (taxing an expatriate on income following expatriation).
[41] 4 U.S.C. § 114 (2017); Jerome R. Hellerstein & Walter Hellerstein, State Taxation P 20.07, at 9 (3d ed. 2003) (In 1996, Congress enacted legislation prohibiting a state from imposing "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).").
[42] NY currently has many taxpayers who retire to low state income tax jurisdictions such as Florida and Texas collecting their deferred pension compensation from NY employment free from NY state tax. Alexandre Tanzi and Wei Lu, *Even Before Covid 2,600 People a Week Were Leaving New York City*, BLOOMBERG (Dec. 5th, 2020), https://www.bloomberg.com/news/articles/2020-12-05/even-before-covid-2-600-people-a-week-were-leaving-new-york-city; Jack Kelly, *New Yorkers Are Leaving The City In Droves: Here's Why They're Moving And Where*

The MtM Tax and other states. With its effective date of July 1, 2020, the proposed MtM Tax stands to generate significant revenue quickly for the state of NY from resident billionaires who missed the opportunity to change their residence to a state not considering a similar tax.[43] Operation of the MtM Tax raises issues with respect to harmonization of tax rules among states and poses a serious risk of double or multiple impositions of income tax on the same income and gain. There is also a question as to whether the tax might be a wealth tax imposed *ad valorem* on property. If it is and burdens intangible personal property, the NY state constitution prohibits the tax.[44] Further questions arise whether the tax unreasonably discriminates against a class of taxpayers, but the class of billionaires hardly seems worthy of constitutionally enhanced scrutiny and protection.

Tax basis discontinuity under the MtM Tax. A few examples suffice to illustrate the complex range of basis and double tax issues enactment of the MtM Tax will generate.

Example 1. Taxpayer ("T"), a billionaire resident in NY for more than five years, owns appreciated real property in New Jersey ("NJ"). The MtM Tax includes the unrealized appreciation in the property in the taxpayer's NY income tax. Two years later, the taxpayer sells the property. NJ follows federal computations and taxes the gain based on the taxpayer's adjusted basis, not as increased following imposition of the MtM Tax but following federal adjusted basis. Since the gain would not be taxable in NY, insofar as T has an increased basis in NY, the gain would not generate a tax credit in NY for the New Jersey tax. New Jersey would not credit the earlier MtM Tax since the tax credit structure always has the general taxing jurisdiction ceding tax to the non-resident jurisdiction not vice versa as is the case here.

Example 2. T as in example 1, following imposition of the MtM Tax, moves to NJ. After establishing NJ residence, T sells some corporate shares that were subject to the MtM Tax in NY. T is taxable in New Jersey on the gain following federal adjusted basis. T no longer is taxable in NY, so there is no tax in NY against which to credit the New Jersey tax and New Jersey would not need to credit the earlier MtM Tax and NY would not refund the earlier MtM Tax when T is correctly taxed in New Jersey. Since the MtM Tax increases the basis in T's assets as it imposes the tax, T can avoid the NJ imposition by selling all T's assets before changing residence. That choice would make little sense to T because T would become subject to federal income tax as well – hardly a reasonable trade-off for avoiding a possible future New Jersey income tax of some portion of T's assets.

Many other examples will suggest themselves readily that result in the same income taxed under the now differing state rules by two states without a resident tax credit available because the

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They're Going, FORBES (Sep. 5th, 2019), https://www.forbes.com/sites/jackkelly/2019/09/05/new-yorkers-are-leaving-the-city-in-droves-heres-why-theyre-moving-and-where-theyre-going/.

[43] Revenue estimates for the MtM Act are $23.3 billion in additional revenue for the State of NY for 2020, and another $1.2 billion in each subsequent year.

[44] NY State Const. Art. 16, § 3 provides in part: "[i]ntangible personal property shall not be taxed ad valorem nor shall any excise tax be levied solely because of the ownership or possession thereof, except that the income therefrom may be taken into consideration in computing any excise tax measured by income generally." This section also would seem to prohibit New York from taxing the amount included under I.R.C. § 965 because the section further states: "[u]ndistributed profits shall not be taxed."

years of tax imposition differ. T in the examples could avoid the result in example 2 by not changing residence.

The example 1 double tax is more difficult to avoid other than selling all non-NY real property in the same year as the MtM Tax takes effect but that is no longer possible if NY adheres to its 2020 effective date to prevent billionaires from changing residence to avoid the tax. NJ might consider taxing the gain on the NJ property when NY taxes it under the MtM Tax to force NY to offer a tax credit for the NJ tax and cede the tax revenue to NJ. Such a tax in NJ violates precedents under which states may not tax out-of-state taxpayers less favorably than resident taxpayers.[45] NJ might generalize the tax and apply it to NJ residents as well but that change would be without substance since there would be no occasion on which the MtM Tax would be imposed on a non-NY resident, but it may be imposed where there is a difference in determining the taxpayer's state of residence.

NY may alter the MtM Tax to provide a refund of the MtM Tax when the income is properly taxed in another jurisdiction. The current proposal does not do so although it does provide a credit for a similar tax imposed by another jurisdiction before imposition of the MtM Tax. NY also might offer a generalized future credit against NY tax liability for such duplicative taxes without limiting the credit to matching income source with creditable out-of-state tax, as most resident credits currently do. But if the taxpayer does not own NY property and never resides in NY again, such a credit would be of little value.

The reaction of other states to enactment of the MtM Tax would be to follow NY and impose a like tax on their residents–certainly a difficult political challenge. The NY proposal, however, is not compelling for other states. When it would become effective, NY residents who previously were residents of another state get a credit against the NY tax for an MtM-like tax paid in another state. As identified above, no state ever has imposed such a tax, so the credit means nothing. The MtM Tax also permits new residents of NY–under the proposal meaning fewer than five years–to increase the basis of their assets to fair market value on the date they become NY residents, so they are taxable under the MtM Tax only on value increases accruing since they became NY residents. The new residents would retain their historical bases for purposes of the regular income tax lest they escape the NY income tax when they sell assets while NY residents. The basis complexity is manifest insofar as imposition of the MtM Tax results in an increase in NY basis both for regular income tax and MtM Tax inclusion purposes so as not to tax the same income in NY twice.

The proposal is unclear on status changes. If a resident of another state who is not a billionaire has substantially appreciated assets when they move to NY and does not become a billionaire until they have been a NY resident for six years, the MtM Tax is imposed in the sixth year. The MtM Tax proposal is unclear as to whether the taxpayer's basis for purposes of the MtM Tax became fair market value when the taxpayer became a NY resident regardless of billionaire class status at that time. If that becomes the rule, anyone moving to NY who aspires to becoming a billionaire would have to determine the value of all their assets when they become a NY resident and maintain that record to protect against the MtM Tax. But for purposes of the NY resident

[45] Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 564 (1997) (property tax exemption discriminating against out of state residents is impermissible).

income tax on realized gain and collection of deferred compensation, the basis remains the smaller historical basis.

To avoid many of these problems for their residents who might move to NY sometime in the future, other states would enact a tax like the MtM Tax but at a lower threshold determined by the relative likelihood that someone will become a billionaire more than five years after moving to NY. NJ might set that level at a mere $500 million for example and Connecticut at $400 million of assets thereby setting off a race to the bottom by other states whose residents might someday move to NJ or Connecticut. Ultimately, the outcome would become current taxation of appreciation in value and the elimination of deferred compensation for state tax purposes, that is, virtual complete decoupling from the federal income tax ideally under uniform rules.[46] Perhaps such decoupling will encourage Congress to eliminate many of the deferrals currently available and to include in taxpayers' incomes the annual change in value of all taxpayers' assets under a mark to market system. Such a system would eliminate the need for a new basis at death since unrealized appreciation would be taxed annually under a Haig-Simons comprehensive tax base.[47]

[46] Uniformity has been elusive on sales tax matters and revenue apportionment despite the efforts of the Multistate Tax Commission.
[47] HENRY SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 49 (1938).