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**Hearing Statement of Senator Max Baucus (D-Mont.)**  
**Regarding Tax Reform and State and Local Tax and Fiscal Policy**  
*As prepared for delivery*

In Federalist Paper Number 41, James Madison wrote that one of the powers conferred on the Federal government is the “maintenance of harmony and proper intercourse among the states.”

When Madison and our founders crafted the Constitution, they debated the proper division of power between the federal and state governments. Today we examine this question when it comes to the tax code.

Most state governments are in tough financial shape. In 2010, 48 states had budget shortfalls. All states except one are required by state law to balance their budgets. That has forced states to make tough decisions, such as raising taxes or cutting spending. Since the financial crisis, 46 states have cut services and 30 states have raised taxes.

To help states and local governments balance their budgets, the federal government provides direct support through programs like Medicaid. Thirty-six percent of all state revenues come from federal grant programs.

The federal government has also long played an indirect role boosting state and local governments through the tax code. Since the first income tax law, Congress has exempted interest on state and local bonds. This exemption helps cover part of the borrowing cost of projects by state and local governments.

The same is true for the state and local taxes. Since 1913, Congress has allowed some or all state and local income, general sales, excise and real and personal property taxes to be deducted from income for federal income tax purposes. These tax exemptions and deductions total more than twice what the Federal government provides to states in highway funding. Combined, they cost more than \$105 billion per year.

During hard economic times, this federal support helps cushion the blow on state and local finances. It also ensures that state and local governments play a role deciding how some federal dollars are spent. For example, making the interest on bonds tax-exempt reduces the interest rate state and local governments pay to finance roads, schools, hospitals and other construction projects.

Just this February, voters in Manhattan, Montana approved new bonds so the community can afford to repair the Manhattan Elementary School's roof. Likewise, the deduction for state and local taxes reduces the burden that a state or local government places on its own residents in raising revenue.

As we reform the tax code to encourage growth and make our country more competitive, we need to ask whether the current exemptions and deductions make sense. State and local taxes could potentially be allowed as above-the-line deductions, allowing all taxpayers to benefit.

We could also consider providing a uniform subsidy for bond holders. Tax-exempt bonds subsidize interest paid on such bonds by exempting the interest from tax. Currently, the value of this subsidy varies based on taxpayers' marginal income tax rates. For every dollar we spend on infrastructure through a tax exempt bond, twenty cents goes to tax breaks for higher-income taxpayers. A uniform subsidy would mean each taxpayer receives the same subsidy regardless of tax bracket.

The Build America Bonds program achieved success using this approach. In Montana, the Barrett Hospital in Dillon was outdated and in need of constant repair. Dillon issued \$30 million of insured Build America Bonds at a 3.67 percent interest rate. This reduced the borrowing cost to Dillon residents by a full percentage point, saving them more than \$800,000. The project created 33 full-time jobs. Dillon now has a new, state-of-the-art, critical-access hospital.

Beyond these provisions in current law, we should also ask what else we can be doing to efficiently help state and local governments maintain sustainable budgets.

We need to make sure our federal, state and local tax systems are working together. As part of tax reform, we should ask how we can help states collect taxes owed and how we can encourage standard rules to protect taxpayers from multiple taxes and needless complexity.

We've worked together with the states to simplify rules in the past. Originally driven by the states, the International Fuel Tax Agreement provides a uniform system for the administration and reporting of fuel taxes paid by commercial trucks and buses operating in multiple states. States agreed to simplified administration burdens in exchange for the ability to enforce fuel use taxes. More recently, Congress enacted the Mobile Telecommunications Sourcing Act to establish uniform rules on which states can tax mobile calls. We should consider how we can learn from these examples to simplify the code.

So as we work to reform the tax code, let us remember the lessons from Madison and our founders. Let us bear in mind the relationship between our federal tax code and state and local tax systems. Let us improve the tax code to create growth and make the U.S. more competitive. And let us do this in a way that improves federal, state and local budgets.

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