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MEMORANDUM

To: Rep. Kornheiser, Chair, Committee on Ways and Means
From: Abby Shepard
Date: January 20, 2023
Subject: Conformity to federal tax statutes

Overview

Statutes often incorporate or reference other law from the same jurisdiction or from a different authority like the federal government. For example, the Internal Revenue Code (I.R.C.) in title 26 of the U.S. Code.

The question is which version of the law to use (what was in effect on what date).

- (1) refer to version of statute in effect at time of enactment, or at a particular point in time, i.e., a "snapshot" of the law, frozen in time despite later amendments.
    - This is called "static" or "fixed-date" incorporation.
- (2) refer to the most current version of the statute.
    - This is called "dynamic" or "rolling" incorporation because the incorporated law changes when the source law is amended.

Advantages & Disadvantages

- Static conformity
    - Statute will not keep up with amendments to federal statute without additional attention and approval by the Vermont Legislature. Requires an annual accounting for federal changes, otherwise conformity will remain frozen in time to a prior year's version of federal law.
    - However, this allows for more oversight by Legislature to decide which federal changes will flow through to Vermont.
- Rolling conformity
    - Automatic incorporation of federal changes without requiring review and decision-making by the Vermont Legislature.
    - Potential for constitutional challenge in Vermont.

Vermont currently uses static incorporation, pinpointing the laws of the U.S. in effect the end of the year (December 31st). 32 V.S.A. § 5824. In practice, the year is usually updated annually, which effectively results in a rolling conformity.

Constitutionality of Dynamic Incorporation

In conforming to federal law through static incorporation, the Legislature is presumed to know the contents of the federal law and to decide that the exact provisions contained in that law are appropriate for state law. However, in dynamic incorporation, amendments to the incorporated statute (e.g., the I.R.C.)) are automatically applied or "flow through" to the Vermont. This arguably means that a state has delegated the power to amend the state income tax code to the federal government. If Congress amends the I.R.C., then the state income tax code is also changed without any intervening act or approval by the state legislature. Essentially, Congress is given the power to write state law.

Some state high courts have held that dynamic incorporation of federal law violates state constitutions because it is an impermissible delegation of legislative power (MI). Other states have found no constitutional problem (TN, MA, Neb.). To settle the question, several states have constitutional provisions expressly forbidding or authorizing dynamic incorporation generally or in the tax context. (HI, Ill.).

Vermont's Constitution does not specifically address incorporation of federal law.

- "The Supreme Legislative power shall be exercised by a Senate and a House of Representatives." Vt. Const. Ch. II, § 2.
- Interpreting this provision in the context of delegation to municipalities or the executive branch, the Vermont Supreme Court has said that "the functions of the Legislature which are purely and strictly legislative cannot be delegated but must be exercised by it alone."[1]
- Vermont courts have not addressed the application of this provision to incorporation of federal law, and it is not clear how they would rule.
- To be clear, this is not the current state of Vermont's conformity; Vermont conforms through static incorporation,

Federal Tax Reform and the Annual Link Up

This becomes a particularly salient issue whenever there is significant federal tax reform that will impact State tax law. This happened in 2018, following the TCJA, and in 2020, after the passage of retroactive tax provisions in the Families First Act, CARES Act, and the Consolidated Appropriations Act.

The choices for the Legislature are to link up to some, all, or none of the changes that occurred in 2022. To pull in all of the federal changes, the year needs to be changed. To pull in no changes, the statute would remain linked to the IRC in effect at the end of 2021. To pull in some of the changes, the Legislature would need to link up to the IRC and make individual amendments to the relevant sections of law.

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[1] *Stowe Citizens for Responsible Gov't v. State*, 730 A.2d 573, 575-76 (Vt. 1999) (emphasis original) (quoting *Village of Waterbury v. Melendy*, 199 A. 236, 239 (Vt. 1938)); see also *Heisse v. State of Vt.*, 519 F. Supp. 36, 48 (D. Vt. 1980) ("[T]here is a distinction between a delegation of power to make law and the conferring of authority for the execution of the law. The former is impermissible. The latter can be done if certain guidelines apply.").

Example Language to Conform to Federal Tax Statutes in 2022

Sec. [_]. 32 V.S.A. § 5824 is amended to read:

§ 5824. ADOPTION OF FEDERAL INCOME TAX LAWS

The statutes of the United States relating to the federal income tax, as in effect on December 31, ~~2021~~ 2022, but without regard to federal income tax rates under 26 U.S.C. § 1, are hereby adopted for the purpose of computing the tax liability under this chapter and shall continue in effect as adopted until amended, repealed, or replaced by act of the General Assembly.

Sec. [_]. 32 V.S.A. § 7402(8) is amended to read:

(8) "Laws of the United States" means the U.S. Internal Revenue Code of 1986, as amended through December 31, ~~2021~~ 2022. As used in this chapter, "Internal Revenue Code" has the same meaning as "laws of the United States" as defined in this subdivision. The date through which amendments to the U.S. Internal Revenue Code of 1986 are adopted under this subdivision shall continue in effect until amended, repealed, or replaced by act of the General Assembly.

Sec. [_]. EFFECTIVE DATE

Notwithstanding 1 V.S.A. § 214, Secs. [_]–[_] (annual link to federal statutes) shall take effect retroactively on January 1, 2023 and shall apply to taxable years beginning on and after January 1, 2022.