



STATE CORPORATE TAX DISCLOSURE

The Next Step in Corporate Tax Reform

By

Michael Mazerov

The **Center on Budget and Policy Priorities**, located in Washington, D.C., is a non-profit research and policy institute that conducts research and analysis of government policies and the programs and public policy issues that affect low- and middle-income households. The Center is supported by foundations, individual contributions, and publications sales.

| | | |
|--|---|---|
| | David de Ferranti, Chair The World Bank | |
| Henry Aaron Brookings Institution | Beatrix A. Hamburg, M.D. Cornell Medical College | Robert D. Reischauer Urban Institute |
| Kenneth Apfel University of Texas at Austin | Frank Mankiewicz Hill and Knowlton | Audrey Rowe AR Consulting |
| Barbara B. Blum National Center for Children in Poverty Columbia University | Richard P. Nathan Nelson A. Rockefeller Institute of Government | Susan Sechler German Marshall Fund |
| Marian Wright Edelman Children's Defense Fund | Marion Pines Johns Hopkins University | Juan Sepulveda, Jr. The Common Enterprise San Antonio |
| James O. Gibson Center for the Study of Social Policy | Sol Price The Price Company (Retired) | William Julius Wilson Harvard University |

John R. Kramer
Founding Chair
1937 - 2006

Robert Greenstein
Executive Director

Iris J. Lav
Deputy Director

February 2007

Center on Budget & Policy Priorities
820 First Street, N.E., Suite 510
Washington, DC 20002
(202) 408-1080

E-mail: center@cbpp.org
Web: www.cbpp.org

ACKNOWLEDGEMENTS

The author wishes to thank Center on Budget and Policy Priorities Deputy Director Iris J. Lav for her thoughtful review and careful editing of several drafts of this report and Senior Writer John Springer for his assistance in drafting the Executive Summary. State Fiscal Project intern Brian Filipowich provided helpful research assistance. Thanks are also due Tina Marshall, who prepared the document for publication, and Josh Kaufman, who prepared it for posting on the Center's Web site.

The author also appreciates receiving helpful comments on early drafts of the paper and its model corporate tax disclosure legislation from Phineas Baxandall of the National Association of State PIRGs and from Dwight Holmes, Kay Coles, Michael Kahn, and Robert Glenn of the National Education Association. Discussions with Frank Mauro of New York's Fiscal Policy Institute and Chuck Sheketoff of the Oregon Center for Public Policy were valuable in shaping the analysis in this report and the model bill.

State corporate income tax disclosure was extensively debated in the early 1990s, when Massachusetts voters enacted and the legislature subsequently amended a disclosure law. To contribute to the Massachusetts debate, Professor Richard D. Pomp of the University of Connecticut School of Law wrote a major 1993 report on corporate tax disclosure. The Pomp report remains the definitive analysis of the case for company-specific disclosure and response to disclosure critics. The report also recounts the long, largely unknown history of public disclosure of federal tax return information and the limited state experience with disclosure through the end of 1993. Professor Pomp's report has recently been made available on the World Wide Web by the Fiscal Policy Institute, which commissioned his study. (See: www.fiscalpolicy.org/CorporateTaxPolicy&TheRightToKnow.pdf). In light of its comprehensiveness and continuing relevance, this report relies heavily upon and only partially summarizes Professor Pomp's work. The author owes him a special debt of gratitude.

We wish to thank the Annie E. Casey Foundation, the Ford Foundation, the John S. and James L. Knight Foundation, the Charles Stewart Mott Foundation, the Open Society Institute, Brodie Price Fund of the Jewish Community Foundation, The Nathan Cummings Foundation, and the Stoneman Family Foundation for their support of our state fiscal work.

The author is solely responsible for the content of this report.

TABLE OF CONTENTS

EXECUTIVE SUMMARY

| | | |
|------|--|----|
| I. | The Fading State Corporate Income Tax — And the Debate about What Is Causing It | 5 |
| II. | The Case for Company-specific Corporate Tax Disclosure | 11 |
| III. | Responding to Arguments against Company-specific Disclosure | 19 |
| IV. | Proposed Alternatives to Company-specific Disclosure Are Inadequate | 31 |
| V. | Explanation of the Model State Corporate Tax Disclosure Act | 37 |
| VI. | Conclusion..... | 45 |
| | Appendix A: The Model State Corporate Tax Disclosure Act..... | 47 |
| | Appendix B: Key Differences between the Separate Entity, Consolidated, and Combined Reporting Methods of Levying State Corporate Income Taxes..... | 55 |

Figures and Tables

| | |
|---|---|
| TABLE 1: State Corporate Income Taxes as a Share of Total State Taxes, Selected Years, 1979-2005 | 6 |
| FIGURE 1: Average Effective State Corporate Income Tax Rates, 1981-2005 | 7 |
| FIGURE 2: Corporate Profits and Corporate Income Tax Receipts, 1993-2005 | 9 |

Executive Summary

Data from numerous sources suggest that something is seriously wrong with the state corporate income tax. The share of tax revenue supplied by this tax in the 45 states that levy it fell from more than 10 percent in the late 1970s, to less than 9 percent in the late 1980s, to less than 7 percent today. The effective rate at which states tax corporate profits fell from 6.9 percent in the 1981-85 period, to 5.4 percent in 1991-95, to 4.8 percent in 2001-05. Also, many state-specific studies have found that most corporations filing income tax returns paid the minimum corporate tax — often \$0 — even in years in which the economy was growing strongly.

A vigorous debate is occurring about the meaning of these data. The business community generally argues that firms are simply taking advantage of provisions of corporate income tax laws that state policymakers quite deliberately enacted, such as tax incentives for businesses that make major investments in the state. And they argue that such incentives are an effective and wise use of state funds.

Policymakers and advocates concerned about the decline of the state corporate income tax disagree. They say that businesses downplay the scope of the aggressive tax-sheltering strategies they employ. And they argue that a large body of research suggests that corporate tax incentives are not very cost-effective at stimulating economic development.

This debate is unlikely to be resolved satisfactorily unless much more information about state corporate tax payments enters the public domain. States can take a major step toward this goal by mandating public disclosure of the amount of corporate income tax that specific corporations pay to specific states.

Such a change would:

- **Help show policymakers and the public whether the corporate income tax is structured in a way that ensures all corporations doing business in the state are paying their fair share of tax.** Because of the large number of variables that affect a corporation's tax liability, it is quite difficult for non-experts to understand the impact of states' tax policy choices. Concrete examples of how these policies actually affect the tax liability of identifiable corporations could be invaluable in enabling policymakers and citizens to understand the

effectiveness and fairness of a state's corporate tax policies.

- **Shed light on the effectiveness of tax policies designed to promote economic development.** A number of states have enacted corporate tax incentives and/or tax cuts with the aim of creating jobs or encouraging investment in the state. Without the information provided by company-specific tax disclosure, it is difficult — sometimes impossible — to analyze the effectiveness of such policies.
- **Stimulate any needed reform of the state's corporate income tax system.** Despite the significant erosion of state corporate income taxes in recent decades, very few states have enacted meaningful reforms to address this problem — except in the area of an egregious tax shelter sometimes called the “Toys R Us” scheme. Efforts against this tax shelter have been successful in a number of states, primarily because the public has learned (through court cases) the names of specific well-known corporations that have exploited this shelter. Similarly, corporate tax disclosure could galvanize tax reform efforts by stimulating public and policymaker interest in these issues.

In short, corporate tax disclosure would help illuminate the real-world outcomes of a state's corporate tax laws and policies and facilitate reforms if needed.

Some corporate representatives and independent experts oppose company-specific disclosure. Some have argued that it would force companies to release proprietary information that would provide an advantage to competitors that do not do business in the state. However, a 1993 corporate tax disclosure study commission in Massachusetts rejected this claim; a large majority of the corporate financial experts it interviewed concluded that the information disclosed would be of little benefit to competitors. One reason is that by the time such information would be released, it would often be too old to be of much use to competitors.

Critics have also warned that any state that mandated corporate tax disclosure would be branded as “anti-business.” But such disclosure would help put all businesses in the state on a level playing-field by encouraging reforms that eliminate special advantages for corporations able to exploit tax loopholes. Such changes would improve a state's business climate, not worsen it.

In addition, it is sometimes claimed that tax disclosure is counterproductive to informed debate on state corporate tax policy because tax return information is too complex for the public to understand. This claim ignores the fact that other types of information that are equally complex — such as corporate financial information filed with the federal Securities and Exchange Commission — are regularly made public. For democracy to work, the public must be able to hold policymakers accountable for their decisions, and this cannot happen without the free flow of information.

Some have also argued that because corporate tax disclosure forms would include information from state corporate income tax returns, corporations would falsify information in their returns — and thus in their disclosure forms — in order to keep the information secret from competitors. However, corporations face substantial penalties for noncompliance with state tax laws. Moreover, the head of the Internal Revenue Service recently stated that “making corporate tax returns or a portion thereof public would likely *improve* [corporations' tax] compliance.” (Emphasis added.)

Finally, opponents of state corporate tax disclosure sometimes assert that it is not an appropriate

way to accomplish what they regard as its primary aim: ensuring that existing corporate tax laws are fully enforced. In reality, however, the aim of disclosure is not to evaluate the tax compliance of individual corporations (that is the job of state tax administrators), but rather to help policymakers and the public evaluate whether existing laws implement good corporate tax policy.

The “Model State Corporate Income Tax Disclosure Act”

This report presents for consideration by state policymakers a “Model State Corporate Income Tax Disclosure Act.” The Act, which could be enacted by a state legislature or (in states that permit this) through a ballot measure, would mandate company-specific corporate tax disclosure by all publicly traded corporations and their subsidiaries doing business in the state. Its provisions seek to balance the public’s need for information related to critical tax policy issues against the need to minimize the burden of complying with the disclosure requirement and the possibility of placing some corporations at a disadvantage vis-à-vis their competitors.

Under the Model Act, corporations would have to file a form with the state’s secretary of state annually that would identify the corporation and provide selected information from its income tax return. Such information would include the firm’s bottom-line tax payment and some of the major line-items that factor into this payment (such as the corporation’s “state taxable income” and its overall “apportionment factor,” which determines the share of the corporation’s nationwide profit that the state will tax).

The Model Act also includes a few special provisions to illuminate the impact of particular features of state corporate tax codes. Corporations would be required, for example, to disclose payments of royalties and interest to entities that appear to be subsidiaries set up as tax shelters. In addition, any corporation making sales in the state but not required to file an income tax return would have to file a disclosure form. (One of the most frequent shortcomings of states’ corporate tax structures is their failure to require corporations making profitable sales to their residents to pay any tax at all.)

These disclosure forms would be available to the public upon request, and the information contained in them would be accessible through a searchable Internet database. Public release would occur, however, with a time lag. Release of disclosure forms and the database would be delayed 24 months beyond the tax year in question. This safeguard would minimize the possibility that information that could be valuable to competitors would be disclosed.

Company-specific tax disclosure may well be the precondition to meaningful progress in restoring the state corporate income tax to a significant role in financing state services. A robust corporate income tax is needed to help states address the large structural budget gaps many of them face as a result of factors such as rising health care costs and an aging population. Also, the corporate income tax is one of the few revenue sources available to states that can offset the regressivity of such other major revenue sources as sales taxes, property taxes, and gasoline taxes.

Policymakers and interested citizens in numerous states will, it is hoped, use the information in this report to start a vigorous debate about the role that disclosure could play in revitalizing state corporate taxation.

I. The Fading State Corporate Income Tax — And the Debate about What Is Causing It

During the past several years, there has been a growing awareness and concern among state policymakers and fiscal analysts that the state corporate income tax is in a state of declining health. The concern is well justified:

- U.S. Census Bureau data indicate that the corporate income tax supplied 10.2 percent of total state tax revenue in the 44 states levying such a tax in 1979 but only 6.5 percent of total state tax revenue in 2005. (See Table 1.)
- Notwithstanding strong growth in state corporate tax receipts in 2005 (an acceleration that seems likely to be temporary), the share of total state tax revenue provided by this tax was lower in 2005 than in 2000 in more than half the states. (Table 1.)
- According to the Congressional Research Service, the *effective rate* at which corporations pay state corporate profits taxes fell from a 1986 peak of 8.5 percent of profits to a trough of 4.2 percent in 2004, with a modest rebound to 5.5 percent in 2005.¹ (Figure 1.)

The waning vitality of the state corporate income tax reflected in these federal government statistics is echoed in many of the nearly 30 studies of corporate income tax base erosion that have been conducted since 2002 by state government agencies and private state fiscal analysis organizations:

- A 2003 report by the Florida Committee on Finance and Taxation found that “If CIT revenue had grown at the same rate as Florida personal income since FY1979-80, it would have reached \$1,957 million in FY2002-03, instead of the actual \$952 million.”²
- A study by the Oklahoma Tax Commission found that only 35 percent of corporations filing 2000 state corporate income tax returns reported positive taxable income — despite the fact that 2000 was the year in which the U.S. economy reached its peak *before* slipping into the 2001 recession.³

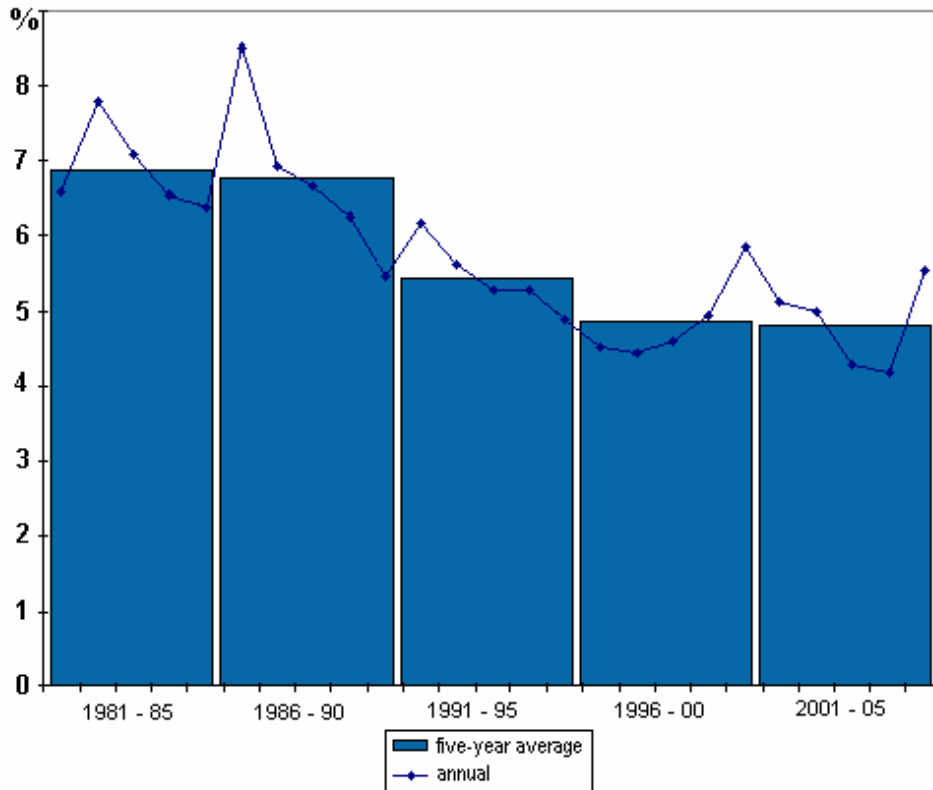
**TABLE 1: STATE CORPORATE INCOME TAXES AS A SHARE
OF TOTAL STATE TAXES**
(States with Corporate Income Taxes, Census Data, By Fiscal Year)

| State | 1979 | 1989 | 2000 | 2004 | 2005 |
|----------------|-------------|-------------|-------------|-------------|-------------|
| United States | 10.2% | 8.8% | 6.3% | 5.6% | 6.5% |
| Alabama | 5.8% | 5.9% | 3.8% | 4.2% | 5.1% |
| Alaska | 31.5% | 32.6% | 30.8% | 26.4% | 31.7% |
| Arizona | 5.9% | 4.9% | 6.5% | 5.5% | 6.4% |
| Arkansas | 8.4% | 5.1% | 4.9% | 3.3% | 4.2% |
| California | 14.5% | 12.3% | 7.9% | 8.1% | 8.8% |
| Colorado | 7.8% | 5.9% | 4.7% | 3.4% | 4.1% |
| Connecticut | 13.5% | 16.6% | 4.2% | 3.7% | 5.0% |
| Delaware | 10.2% | 13.7% | 11.3% | 9.2% | 9.1% |
| Florida | 7.3% | 5.8% | 4.8% | 4.4% | 5.3% |
| Georgia | 9.2% | 8.3% | 5.3% | 3.4% | 4.5% |
| Hawaii | 4.6% | 4.0% | 2.3% | 1.5% | 2.8% |
| Idaho | 8.4% | 6.9% | 5.3% | 3.9% | 4.8% |
| Illinois | 7.7% | 9.1% | 9.9% | 8.1% | 8.3% |
| Indiana | 4.8% | 4.8% | 9.2% | 5.4% | 6.4% |
| Iowa | 8.3% | 6.4% | 4.1% | 1.7% | 3.2% |
| Kansas | 11.9% | 7.9% | 5.6% | 3.2% | 4.4% |
| Kentucky | 7.9% | 7.6% | 4.0% | 4.5% | 5.3% |
| Louisiana | 9.7% | 8.7% | 3.4% | 2.9% | 4.1% |
| Maine | 7.4% | 6.1% | 5.6% | 3.9% | 4.4% |
| Maryland | 5.5% | 5.3% | 4.2% | 3.6% | 6.0% |
| Massachusetts | 13.4% | 13.0% | 8.1% | 7.8% | 7.4% |
| Minnesota | 11.4% | 7.6% | 6.0% | 4.3% | 5.9% |
| Mississippi | 4.9% | 6.3% | 4.8% | 4.8% | 5.2% |
| Missouri | 6.5% | 5.2% | 3.1% | 2.5% | 2.3% |
| Montana | 9.0% | 7.7% | 7.1% | 4.2% | 5.2% |
| Nebraska | 6.7% | 5.6% | 4.7% | 4.6% | 5.2% |
| New Hampshire | 24.2% | 24.8% | 18.4% | 20.3% | 23.6% |
| New Jersey | 11.5% | 12.5% | 7.4% | 9.0% | 9.7% |
| New Mexico | 4.8% | 4.0% | 4.3% | 3.5% | 5.4% |
| New York | 10.5% | 7.6% | 6.6% | 4.5% | 5.5% |
| North Carolina | 8.7% | 10.7% | 6.5% | 5.0% | 6.8% |
| North Dakota | 8.9% | 6.4% | 6.7% | 4.1% | 5.4% |
| Ohio | 10.9% | 6.8% | 3.2% | 4.7% | 5.5% |
| Oklahoma | 6.2% | 3.4% | 3.3% | 2.1% | 2.5% |
| Oregon | 12.0% | 6.1% | 6.8% | 5.2% | 5.6% |
| Pennsylvania | 12.6% | 9.2% | 7.6% | 6.6% | 6.2% |
| Rhode Island | 10.4% | 6.7% | 3.7% | 2.9% | 4.3% |
| South Carolina | 9.2% | 5.9% | 3.6% | 2.9% | 3.4% |
| Tennessee | 10.1% | 9.1% | 7.9% | 7.3% | 8.1% |
| Utah | 4.7% | 5.7% | 4.4% | 3.5% | 4.0% |
| Vermont | 8.9% | 6.0% | 3.0% | 3.5% | 3.1% |
| Virginia | 7.7% | 5.2% | 4.5% | 3.0% | 3.8% |
| West Virginia | 2.2% | 10.8% | 6.5% | 4.8% | 10.8% |
| Wisconsin | 10.0% | 7.0% | 4.6% | 5.4% | 5.8% |

Source: U.S. Census Bureau, Government Finances data series.

FIGURE 1

Average Effective State Corporate Income Tax Rates, 1981-2005



Source: Steven Maguire, *Average Effective Corporate Tax Rates: 1959 to 2005*, Congressional Research Service, Updated September 6, 2006.

- The Oregon Center for Public Policy reported that 69 percent of Oregon corporations paid the state’s \$10 minimum corporate tax in 2002; this was even true for 51 percent of Oregon-taxable corporations that had Oregon sales over \$25 million.⁴
- The Iowa Fiscal Partnership similarly found that over half of corporations with at least \$1 million of sales in the state pay no corporate income tax, year-in and year-out.⁵

The Unresolved Debate about the Causes of Corporate Tax Erosion

There is not a great deal of dispute about the reality of state corporate tax decline documented in the data and studies just cited. There is, however, a vigorous debate about the causes.

The business community generally argues that most of the declining contribution of the corporate income tax to state revenues is the result of businesses taking advantage of provisions of corporate income tax laws that state policymakers quite deliberately enacted to make it easier for corporations to comply with the law and/or to encourage them to create jobs and invest within their borders. Business representatives contend, for example, that:

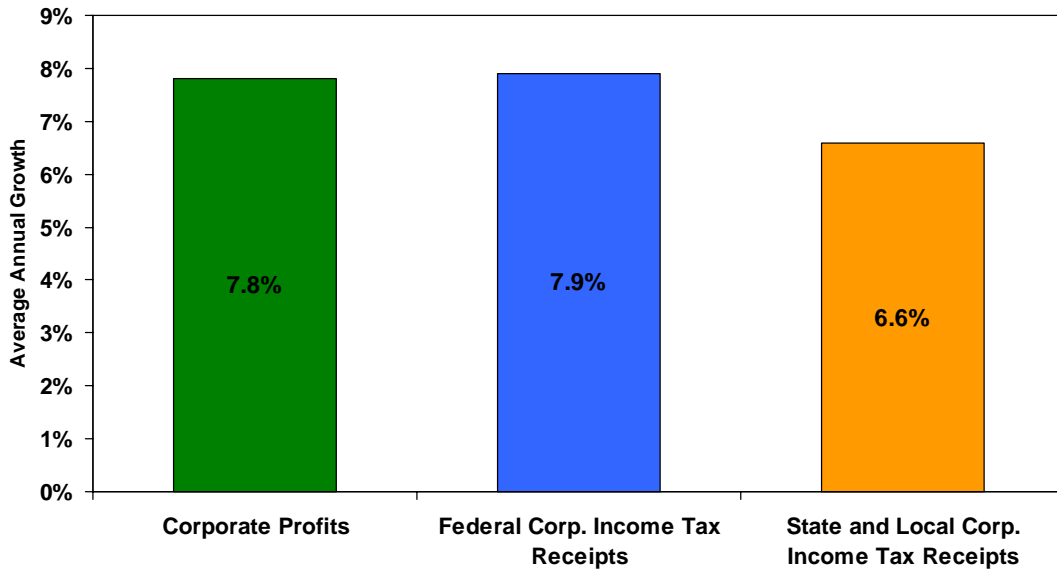
- Many of the corporations that pay zero taxes in years in which the economy appears to be growing strongly are merely taking advantage of duly-enacted provisions of state law that allow corporations to “carry-forward” economic losses suffered during the most-recent recession — that is, to use the losses to offset current profits;
- A considerable portion of the relative decline in state corporate income taxes is attributable to the growing use of business legal structures — such as “limited liability companies” (LLCs) and “Subchapter S corporations — that are completely exempt from such taxes; again, they note that state policymakers have consciously chosen to conform their state tax laws to provisions of federal law that provide this tax-exempt status;⁶
- Even highly-profitable corporations can have very low income tax liability if they make major investments that are eligible for investment or job-creation tax credits — and that such incentives are an effective and wise use of state funds; and
- To the extent that some corporate tax base erosion may be attributable to corporations implementing various types of tax shelters and other aggressive “tax-planning” techniques, only a minority of corporations are engaged in such activities.

These explanations, while credible, do not necessarily explain the drop in state corporate income tax collections. For example:

- Losses carried forward from earlier years probably are not a large explanatory factor. The disparity between the share of corporations showing positive taxable income at the federal level and that figure at the state level suggests that some factors specific to state corporate taxation are at work generating the large number of corporations paying minimal state corporate income taxes. In 2000, fully 56 percent of all U.S. corporations reported positive federal taxable income, while — as noted — only 35 percent of Oklahoma corporations reported positive taxable income in that year. A number of other states had similar proportions reporting positive income.
- Growth in the number of S-corporations and LLCs adversely affects federal and state corporate income tax collections alike. Yet federal corporate income tax revenues have grown significantly faster than state corporate income tax revenues for more than a decade.⁷ (See Figure 2.) This suggests that factors specific to state corporate income taxes, not just growth in the number of S-corps and LLCs, are a major contributor to declining state corporate income tax receipts.
- The claims regarding high use of tax credits, the effectiveness of tax credits, and the minimal use of tax shelters are impossible to evaluate without the type of additional information that currently is not available on the public record. There is limited evidence from some states that tax credits are not an effective economic development tool, and there is a strong suspicion that use of tax shelter gimmicks such as the well-known “Delaware Holding Company” is far more than minimal.⁸ But it is impossible to know for sure.

FIGURE 2

Corporate Profits and Corporate Income Tax Receipts 1993 - 2005



Source: Bureau of Economic Analysis, U.S. Department of Commerce

In short, both sides of this debate can muster some logic, anecdotes, and empirical evidence to support their claims. It is becoming increasingly clear, however, that these controversies are unlikely to be resolved satisfactorily unless much more information about state corporate tax payments than is currently available to policymakers and citizens enters the public domain.

II. The Case for Company-specific Corporate Tax Disclosure

A significant number of states regularly publish aggregate statistics on corporate tax payments extracted from corporate tax returns filed with their tax agencies. As indicated in the previous chapter, however, these data have more often fueled than helped resolve the debate over what is happening to the state corporate income tax. It may well be time, therefore, to revive serious discussion of a change in state tax policy that was widely discussed in the early 1990s but has languished since then: *mandating public disclosure of the amount of corporate income tax that specific corporations pay to specific states.*

Proponents of such “company-specific corporate tax disclosure” generally do not envision a requirement that *all* corporations make public their *entire* state corporate income tax returns. Rather, the concept is that *some class* of corporations would be required to file a separate “form” — paper or electronic — that would report both their “bottom line” corporate income tax liability to a specific state in a particular tax year and sufficient supplementary tax-return information to elucidate the major factors leading to the final tax payment. In addition, the corporation would be required to include limited information — such as the level of its employment in the state and the primary industry in which it operates — that could be used to analyze such relevant state tax policy issues as the cost-effectiveness of economic development tax incentives. The forms themselves would be available to the public upon request, and the information contained in them also would be accessible through a searchable Internet database. This is the approach to corporate tax disclosure embodied in the model legislation presented in Appendix A of this report and described in Chapter V below.

Helping Non-experts Understand the Overall Impact of Corporate Tax Policy Choices

State corporate income taxes are complicated. The tax liability of a particular corporation in a particular state is determined by a host of economic and legal factors specific to the corporation itself, a large number of discrete state policy choices, and complex interactions among them. Relevant variables affecting tax liability include:

- The legal structure of the corporation, in particular, whether it is a single legal entity or is composed of a parent corporation and one or more majority-owned subsidiary corporations.

- The nature of the corporation’s business, which will often affect its eligibility for certain state tax benefits (such as an investment tax credit limited to manufacturers).
- The taxing state’s choice about whether and how extensively to conform with the federal definition of taxable corporate profits in defining taxable profits for state tax purposes (for example, whether to allow federal deductions for “loss carrybacks” and “domestic production”).⁹
- The specific “apportionment formula” that is used to determine the share of the corporation’s nationwide or worldwide profit that the state will actually seek to tax.
- Whether or not the corporation is subject to a corporate income tax in states other than the taxing state (which may affect its right to use an apportionment formula in calculating its taxable income or the specific formula that is used).
- Whether the state treats the parent and each individual subsidiary corporation as a separate “taxpayer” that calculates its tax liability independently or requires some form of consolidation or combination of related corporations as part of the calculation of their tax liabilities.
- State-specific tax credits for which the corporation may be eligible based on in-state investment, job creation, or other behavior the state is seeking to incentivize, the order in which the credits must be claimed if more than one may be claimed, and whether unused credits may be carried over into future years.
- The expertise and other resources available to the corporation to help it minimize its corporate tax liability to the taxing state, as well as the extent to which the culture of the corporation is one that encourages aggressiveness in exploiting the many gray areas of state corporate tax law.

As these cursory descriptions and necessarily incomplete list of relevant factors may suggest, it can be quite difficult for non-experts to understand the overall impact of the corporate income tax policy choices that states make. Even long-tenured members of state legislative revenue committees often do not have the luxury of focusing extensively on this one particular tax and learning all of its nuances, let alone average citizens who wish to hold their elected officials accountable for their tax policy decisions and members of the media who wish to help them do so. Given the complexity of state corporate taxes, concrete examples of how they work in practice to establish the tax liability of identifiable corporations could be invaluable in enabling policymakers and citizens alike to understand the effectiveness and fairness of a state’s current corporate tax policies.

To illustrate the value of real-world examples in understanding state corporate taxes, consider the potential interaction between the formulas that “apportion” the nationwide profit of a corporation to the states in which it is doing business for purposes of taxation, the laws that determine whether a corporation is taxable in those states, and a fallback rule that some states have in place when the formulas and the laws are out of synch. Approximately a dozen states apportion corporate profits to the state solely in proportion to the share of a corporation’s nationwide sales made to customers within the state. Federal law provides, however, that selling goods in a state is not sufficient to empower the state to impose an income tax on a corporation, but having a plant, store, or office in a state *is* sufficient for taxability or “nexus.” Accordingly, a manufacturer that is located in a state with

such a “sales-only” formula but that makes all its sales in other states where it has no facilities will not have any of its profit taxed anywhere; it is not taxable in any of the states where its customers are located and the only state that has the legal authority to tax it — its home state — deems all of its profits to be earned elsewhere. A number of states, however, have a fallback law in place — the so-called throwback rule — that deems the entire nationwide profit of the corporation in this example to be taxable in its home state.

As the preceding complicated explanation suggests, a person would have to know a lot about how state corporate income taxes work to understand a hypothetical explanation of why it is important to enact a throwback rule. Moreover, it would be all too easy for businesses to assert that there are no corporations that fit the hypothetical example and thus there is no need for such a rule. An educated citizen or even a policymaker would not know which argument is correct. It would be far easier to understand the throwback rule issue, and the argument could be settled, if there were examples of actual in-state manufacturers who had extremely low or zero corporate tax liability because of the lack of such a rule. A well-structured corporate tax disclosure law would provide sufficient information for policymakers and educated — but non-expert — members of the public and the media to be able to grasp the interaction of apportionment, nexus, and throwback provisions of state tax law with respect to specific corporations.

Facilitating Analyses that Cannot Be Done Easily — or at All — Without Company-specific Information

Company-specific tax disclosure facilitates types of analyses of the real-world operation and effectiveness of state corporate income taxes that cannot be done easily — or at all — without such information. As noted above, for example, studies in numerous states have found that a very large number of corporate income tax returns filed report zero taxable income, and the proportion of such zero-income returns in many states is often larger than what is found for U.S. corporations as a whole as revealed in publicly-available data from the Internal Revenue Service. If the identity of (state) zero-income corporations were known, it would be possible to examine their or their corporate parents’ financial reports filed with the Securities and Exchange Commission. If it turned out that a significant number of zero-income returns were filed by subsidiaries of corporations that reported substantial economic profits to their stockholders and paid a significant amount of federal income taxes in a given year, that might suggest a need to evaluate the state corporate tax structure to determine whether it provided profitable subsidiaries excessive opportunities to make themselves look unprofitable on paper by artificially shifting their income into other states.

Company-specific disclosure could also be especially valuable in evaluating the effectiveness of provisions of state corporate income tax law that are intended to stimulate in-state job-creation, investment, and other desired behavior. Researchers have conducted statistical analyses of the relationship between the availability of economic development-oriented tax credits and other tax incentives and state employment and investment growth, but the studies present a wide range of differing conclusions. Company-specific disclosure could open up new approaches to evaluating this issue. For example, corporations throughout the country have recently lobbied successfully for a change in state corporate tax policy, the switch to the so-called “single sales factor apportionment formula” discussed above. Business representatives assert that this formula provides strong incentives to maintain existing jobs in a state that adopts it and to create new jobs in such a state as

well. Researchers would like to know whether these claims have been borne out over time. If data were publicly available showing which corporations paid how much less income tax as a result of the adoption of the formula and what their employment levels in the state were over time, researchers could evaluate whether the companies that benefited most from the formula had a better record in retaining or creating jobs than those companies that benefited little or not at all. With such research available to them, policymakers could make better-informed decisions about whether to enact the single sales factor formula in their states or consider repealing it where it is already in effect.

There is especially strong justification for company-specific disclosure of tax incentives. If state revenues are deliberately being forgone to provide incentives for corporations to create jobs, conduct R&D activities, or invest in the state, then the public arguably has a right to know specifically which corporations are benefiting from such provisions and what the state is gaining in return. These incentives are not mandatory features of state tax law; if corporations don't wish to have this information publicly disclosed, then they can forgo claiming them.

Policymakers in a growing number of states seem to share this perspective. According to Good Jobs First, some 12 states now mandate disclosure of economic development incentives claimed by specific companies.¹⁰ Seven of these twelve states — Connecticut, Illinois, Maine, Minnesota, North Carolina, North Dakota, and West Virginia — mandate company-specific disclosure of *state corporate income tax* incentives received by companies, including the exact value of the incentive(s) received.

What If Multiple States Were to Mandate Company-specific Disclosure?

If *multiple* states were to mandate company-specific corporate tax disclosure, enormous opportunities to better understand the effects of individual states' corporate tax policies would be opened up:

- **Company-specific disclosure would facilitate an evaluation of the effectiveness of tax policy choices that differed among the states.** For example, states differ in their approaches to nullifying abusive tax shelters. The well-known “Delaware Holding Company” (DHC) shelter is based on one subsidiary of a corporation licensing the right to use corporate trademarks to a sister corporation in exchange for receiving royalty payments. Because these payments usually are tax-deductible expenses for the corporation paying them, they have the effect of siphoning corporate profits out of the states in which they are actually earned and into a few tax-haven states (like Delaware) that do not tax income from trademark royalties. Now, assume that a particular corporation had established a DHC. If the corporation paid the same effective corporate income tax rate in State X and State Y, one of which had enacted a statute aimed at nullifying the DHC shelter by disallowing the royalty deduction and one of which hadn't, this would be an indication that this approach to addressing the problem was not effective. Similarly, if a particular retail store chain experienced higher effective corporate income tax rates in states mandating “combined reporting” than in states that did not, this would provide evidence in support of the claim that combined reporting prevents corporations from using “transfer pricing” to artificially shift their profits into subsidiaries in low-tax-rate states. In both instances, further investigation of these issues could then be undertaken.¹¹

- **Company-specific disclosure would facilitate interstate comparisons of effective corporate income tax rates.** State policymakers are intensely focused on comparing their state’s business tax structures with those of other states due to concerns about economic “competitiveness.” Because of the numerous factors that influence how much income tax a particular corporation pays to a particular state, comparing effective corporate tax rates across states is far from a straightforward process. Being able to compare across states the actual, effective income tax rates paid by a large number of identifiable corporations could provide a much clearer picture of real-world differences in state corporate taxation than the typical analyses that attempt to get at this through the use of aggregate data that are poorly suited for it (such as calculating state corporate tax collections as a share of gross state product) or the use of “simulation” models that do not necessarily correspond to any specific corporation’s actual tax liability.
- **Cross-state comparisons for the same corporation(s) could also be extremely useful in evaluating the effectiveness of state economic development tax incentives.** For example, policymakers in a state that enacted a single sales factor corporate income tax formula as a job-creation incentive would be very interested in seeing whether specific corporations that benefited from the formula had a greater share of their employees in their state or in non-single sales factor states five years after the policy had been implemented. If a number of both categories of states had company-specific disclosure in effect, such an analysis could be readily performed.

Giving Impetus to Corporate Tax Reform Efforts

The data and studies cited in Chapter I documenting the declining yield of state corporate income taxes during the past five years or so received reasonably widespread attention in the media and statehouses alike. Nonetheless — and despite the fact that this period saw major revenue shortfalls in most states — only a small minority of states enacted significant corporate income tax reforms into law. A 2002 Center on Budget and Policy Priorities report, for example, identified a number of steps states could take to improve the revenue-generating capacity and fairness of their corporate taxes. Yet relatively little action was taken to address the three major state corporate tax loopholes identified in that report:

- Only one state enacted a simple change in tax law that ensures that corporate profits do not escape taxation entirely due to a mismatch between the rules that assign corporate profits to specific states for taxation and the rules that determine if a corporation is subject to a state’s corporate income tax at all. (This “throwback rule” was discussed above.)
- Only two states enacted a recommended change that ensures that states are able to tax their fair share of profits arising from irregular corporate transactions.
- Only two states enacted “combined reporting,” a more comprehensive reform that nullifies a variety of state corporate income tax avoidance strategies.

(See “Closing Three Common Corporate Income Tax Loopholes Could Raise Additional Revenue for Many States,” available at www.cbpp.org/4-9-02sfp.pdf, for a more detailed discussion of these policy options.)

A State Example

There is one exception to the lackluster record of the states in implementing corporate income tax reforms in recent years, and it is quite telling. Since 2002, nine states plus the District of Columbia have enacted targeted legislation aimed at shutting down the Delaware Holding Company (DHC) tax shelter discussed above.

What is unique about DHCs is that it has been possible to identify a significant number of corporations that have used them. After scouring court records from cases in which states had challenged the use of this device, reporter Glenn Simpson published a front-page *Wall Street Journal* story in August 2002 that named over 50 corporations that used DHCs to reduce their taxes.¹² In several states, DHCs actually came to be referred to as the “Toys R Us” or “Geoffrey Giraffe” shelter, named for the first corporation to have its use of the strategy challenged in a high-profile court case. In some states it even proved possible to estimate how much tax liability a particular corporation avoided. Widespread press coverage of this relatively easy-to-explain tax-avoidance scheme generated public anger that many retailers patronized by consumers on a daily or weekly basis were avoiding paying their fair share of state taxes. Legislators in numerous states felt compelled to enact bills aimed at shutting the shelter down.

The contrast between the substantial success that corporate tax reformers have had in passing legislation aimed at nullifying Delaware Holding Companies and the relative lack of action on other potential loophole-closing measures suggests that company-specific corporate tax disclosure could give an important impetus to needed reform in corporate tax structures. Publishing aggregated statistics demonstrating that state corporate tax payments are declining and that a large proportion of corporations pay zero corporate income tax to particular states has largely failed to generate serious consideration of the need for change. Sketching hypothetical scenarios of how corporations can “game” particular states’ tax laws to avoid paying taxes has been even less effective. In contrast, when legislators, the media, and the general public have been shown a concrete example of how particular provisions of state tax law have enabled specific corporations to avoid their financial responsibilities, improvements in corporate tax laws often have been enacted.

A Federal Example

Earlier experience at the federal government level reinforces this conclusion about the potential value of having information about specific corporations’ tax payments in making the case for corporate tax reform. Studies in the early 1980s by Citizens for Tax Justice showed that some of the largest and most profitable corporations in the United States paid less federal income tax than the workers that swept their factory floors. The CTJ analyses, which also “named names,” were widely credited with helping to spur the corporate income tax changes embodied in the Tax Reform Act of 1986.¹³ The CTJ reports not only documented surprisingly-low tax payments by some highly profitable corporations, but they also showed that the federal corporate tax policy of that era resulted in vastly disparate tax burdens among corporations — even those competing in the same

industry. As a result, many businesses that were paying significant corporate taxes actively supported the Act and the “level playing field” it offered.

CTJ’s studies relied on the mandatory public disclosure in annual reports filed by publicly-traded corporations with the Securities and Exchange Commission of their federal corporate income tax payments. This type of analysis cannot be replicated at the state level, however. SEC rules only require the disclosure of an aggregate state corporate income tax payment for the states collectively, and tax confidentiality rules in all states but one — Wisconsin — prohibit public disclosure of the actual corporate income tax payment to the state by a specific corporation. Even in Wisconsin, the only information that may be made public is a corporation’s “bottom-line” tax payment. This limitation enables any corporation with a suspiciously-low liability to claim — with little fear of refutation — that its low tax bill results from legitimate use of such provisions as losses carried forward from previous years or economic development incentives duly enacted by state legislators.¹⁴ That is why, to be truly useful, company-specific corporate tax disclosure must also require the divulging of sufficient information to obtain a reasonably-clear picture of the factors contributing to a corporation’s bottom-line tax liability.

In the real world of politics and policymaking, concrete examples of problems are needed to sustain public interest in solving them. As Professor Richard Pomp observed in his definitive 1993 report on state corporate tax disclosure:

It is a basic truth that in order to spark interest in an issue it must be made real and human. A cold statistic is just that — cold. Eyes glaze and interest wanes. Policymakers and other concerned citizens cannot have a dialogue with a statistic. The impact that CTJ [Citizens for Tax Justice] had on federal tax reform provides a dramatic example of the effectiveness of using ‘warm bodies’ rather than impersonal data. After all, there was no shortage of statistics before CTJ’s work, but the arid raw data alone were not enough to galvanize the public into supporting sweeping reform.¹⁵

As evidenced by the grassroots and legislative activism that occurred in numerous states in the past several years over the Delaware Holding Company issue, company-specific disclosure seems likely to stimulate greater interest in state corporate tax policy on the part of policymakers and citizens alike.

Encouraging Open Government

Finally, company-specific disclosure could promote more democratic and accountable tax policymaking and broader public confidence in the tax system. If policymakers and corporations alike know that a specific corporation’s bottom-line tax liability is going to be subject to public disclosure, narrow exemptions and other types of “sweetheart” deals are less likely to be sought and enacted. In Professor Pomp’s words: “Openness and accountability make it less likely that tax laws will be made behind closed doors, where special interests are more likely to prevail over the public’s interest.”

Pomp cites a number of federal laws that mandate company-specific public disclosure of corporate activities, such as their use of toxic substances, the amount of pollution they release, and their records in hiring women and minorities. He observes:

As these various pieces of legislation exemplify, our society has a clear bias in favor of making as much information available [as possible], not only so that we may make informed decisions, but also so that we may have confidence in our institutions. We should esteem disclosure for the same reason we should esteem ‘sunlight’ — because it illuminates. ‘Sunlight’ in regard to state corporate income tax data will help to restore confidence in both the business community and the tax system. If disclosure shows that large businesses are indeed paying their fair share, it will help to convince the public that the current tax system is working. If, on the other hand, disclosure helps to identify shortcomings in the current system, it will provide the basis for necessary reforms which will help restore public confidence in the corporate sector and the tax system.¹⁶

Summary

Mandating public disclosure of a particular corporation’s income tax payment to a specific state, together with sufficient supplementary tax-return information to elucidate the major factors leading to the liability, has three principal goals:

- Helping policymakers, tax analysts, and interested citizens to understand and evaluate whether the corporate income tax is structured in such a way that all corporations doing business in the state pay their fair share of the tax and tax liabilities are distributed among corporations as policymakers intend;
- Helping these individuals to analyze whether specific corporate tax incentives and/or tax cuts enacted to achieve a variety of economic development-related objectives (for example, in-state job creation, investment, and R&D) are in fact achieving those objectives; and
- Making any problems that may exist visible and concrete to policymakers, the media, and the general public, increasing the likelihood that appropriate changes in tax policy will be enacted.

In short, the primary goal of corporate tax disclosure is to help provide an accurate picture of the real-world outcomes of a state’s existing corporate tax laws and policies and to facilitate reforms if changes appear to be warranted.

III. Responding to Arguments against Company-specific Disclosure

Considerable discussion took place in the early 1990s of the pros and cons of various possible approaches to expanding public disclosure of information included in state corporate tax returns. Most of that discussion arose in the context of the approval by Massachusetts voters of a 1992 ballot measure mandating company-specific disclosure. That law was quickly amended by the legislature to substantially scale back the scope of the information that had to be divulged. Then, a year later, adopting a far-from-unanimous recommendation of a study commission that had explored the disclosure issue, the legislature substituted a system of so-called “anonymous” or “coded” disclosure.¹⁷ Under that system, still in place today, corporations file statements that disclose limited information from their tax returns, but the corporation’s identity is stripped from the form before it is released to a person who requests it. (The shortcomings of anonymous disclosure will be discussed in Chapter IV.)

The 1992-94 Massachusetts debate brought to the fore most of the arguments against company-specific disclosure that are still heard today. Professor Richard Pomp’s comprehensive 1993 report provides a vigorous response to these arguments. The following summarizes the arguments typically made against disclosure and the counter-arguments.

Company-specific Disclosure Would Not Violate Corporate Taxpayers’ Right to Privacy.

Some companies claim that disclosure violates their rights as taxpayers to privacy, but the privacy argument against corporate tax disclosure is weak. Corporations issuing stock that is traded on public stock exchanges long ago ceded any “rights” they had to keep their financial affairs private. The Securities and Exchange Commission (SEC) mandates detailed public disclosure of all aspects of their current finances, including the profits they earn, what they pay their top executives, the federal corporate income taxes they pay, the aggregate amount of state corporate income taxes they pay, and a detailed narrative concerning their business goals and the markets they serve. In comparison to the amount of financial information they are already compelled to disclose, the addition of state-by-state data on tax payments (and related tax parameters) would be relatively insignificant.

Moreover, corporations are creatures of government; that is, the ability to operate a business in corporate form is a privilege granted by states. Society apparently agrees that the need for investors in publicly-traded corporations to have sufficient information with which to make wise investment decisions trumps the corporation's "right" to privacy. Surely the need of the public and state policymakers to understand the way their states' corporate tax policies are or are not working and whether corporate tax expenditures are fulfilling their objectives are of at least equal importance.

Privacy issues may be raised more legitimately with respect to the disclosure of state corporate tax information for privately-held corporations, particularly small ones owned by a family or a few individuals. In such a case, disclosure of corporate income tax information could be tantamount to revealing a substantial portion of a family's or an individual's personal income. On the other hand, some of the very largest corporations in the United States are not publicly traded, including such giants as Cargill, Koch Industries, Publix Supermarkets, Cox Broadcasting, and Toys R Us.¹⁸ Exempting such large corporations from disclosure requirements solely on the grounds that they are privately held would eliminate a significant share of the corporate sector and state economic activity from disclosure requirements.

Nonetheless, erring on the side of privacy claims, the model legislation presented later in this report takes the restrictive approach of requiring state corporate tax disclosure only of publicly-traded corporations and their subsidiaries. At this time, there is no evidence to suggest that there are systematic differences between privately-held and publicly traded corporations in the way that state corporate tax policies affect their liabilities. Since the goal of tax disclosure is to elucidate the impact of state corporate tax policies, not to single-out the taxpaying behavior of particular corporations, and since there are thousands of publicly-traded corporations, sufficient information with which to evaluate state corporate tax policies can be gleaned from publicly-traded corporations without subjecting privately-held corporations to disclosure requirements.

Disclosure Unlikely to Lead to the Harmful Release of Proprietary Information about a State's Corporations

The argument against company-specific state corporate tax disclosure made most vociferously by its opponents is that it will compel corporations that are taxable in a state to reveal significant information about their finances that could be valuable to their competitors, particularly competitors that are not taxable in the state and therefore not subject to the disclosure requirement. Allegedly, this is harmful not only to the disclosing corporation (for example, enabling its non-disclosing competitors to get an accurate picture of its profit margin and steal its customers by undercutting its prices), but to the state requiring the disclosure as well. For example, it is claimed that a state mandating disclosure will lose jobs if its major employers lose market share to out-of-state competitors that are able to undercut prices. It is argued even more strongly that corporations will simply choose not to locate or expand in a state requiring tax disclosure in order to avoid even the slightest possibility that they will be required to disclose valuable proprietary information to competitors.

Several counterarguments can be made to these claims:

- **No supporting evidence from longstanding SEC financial disclosure.** Massive amounts of financial information already must be disclosed by publicly-traded corporations under SEC rules, information that is far more detailed than what has been contemplated under proposed state tax disclosure laws. Publicly-traded corporations compete with both privately-held U.S. corporations not subject to *any* financial disclosure requirements and foreign corporations that may be subject to much less stringent financial disclosure rules. Yet opponents of state corporate tax disclosure have not presented any evidence that publicly-traded U.S. corporations have suffered any loss of business to their competitors not subject to SEC rules. If no evidence of competitive disadvantage can be gleaned from the long experience with the very detailed SEC disclosure, it seems quite implausible that the small amount of state-tax-related information that would have to be disclosed under the laws being contemplated would lead to any meaningful disadvantage.
- **The 1993 Massachusetts study examined and substantially refuted this claim.** A 1993 Massachusetts study commission that examined all facets of the disclosure issue interviewed twelve expert industry analysts to assess the claim that tax disclosure would reveal valuable proprietary information. As summarized by Pomp: “Of the twelve, eight stated that Massachusetts law [with company-specific disclosure] would reveal little information of value to competitors for the following reasons: 1) comparable information is available from other reports, such as annual financial reports and reports compiled by consulting firms and underwriters; 2) the information would not be disaggregated enough to be of much value, even if reported on a subsidiary-by-subsidary basis; 3) tax accounting principles differ so much from financial accounting principles (especially in the case of banks) that tax information provides very little insight into the financial condition and operational characteristics of a company; [and] 4) the information would be disclosed with a long lag. . .”¹⁹
- **Tax information will be — or can be rendered — too old to provide any meaningful benefit to competitors.** The last issue mentioned in the previous paragraph — timing — particularly undercuts the argument that tax disclosure is likely to benefit non-disclosing competitors. A corporation with a fiscal year ending on December 31 typically will not file its tax return for that year until nine months later. Realistically, a complete database for all corporations subject to a disclosure requirement in a state could not be produced for at least another six months after that. Thus, information on corporate operations gleaned from a tax return for, say, calendar year 2006 would not be publicly available at the earliest until the middle or end of calendar year 2008. As Pomp observes: “For information to be valuable, a business needs to know yesterday what a competitor is going to do tomorrow. . . . For a businessperson to learn two years after the fact that a competitor paid \$X in state taxes or claimed \$Y in state credits pales by comparison with what can be learned by reading the trade press, schmoozing at trade show and conventions, searching computer databases, or hanging out at the local bars that dot large plants — all traditional ways of obtaining current information about competitors.”²⁰ To further reduce the potential utility of tax-related information to out-of-state competitors not subject to the disclosure requirement, the model disclosure bill presented below provides that there shall be no disclosure of a corporation’s tax return information for a particular tax year for at least two calendar years following the end of the tax year. Thus, if a corporation had a January 1 to December 31, 2006 tax year, the information from its state corporate tax disclosure form for that year could not be released until January 1, 2009.

- **Most of the disclosed information will be of almost no strategic benefit to competitors.** Even leaving aside the matter of timeliness, it is quite difficult to see how the vast majority of the pieces of information that corporations would be compelled to divulge under typical state tax disclosure proposals could benefit their competitors in any meaningful way. For example, even if it were possible for a competitor to calculate how much R&D spending a corporation had done in a particular year by “reverse engineering” the size of an R&D credit claimed on a state return, of what real practical benefit is knowing the amount without knowing what the money was spent on? It seems unlikely that one corporation would feel compelled to step up its R&D spending merely because it learned that one of its competitors was spending more on R&D than it thought. Likewise, it is hard to imagine that a corporation subject to disclosure in a particular state would be harmed by its competitor knowing the total amount of taxable profit reported on its income tax return, given the vast number of variables that determine the corporate “bottom line.”
- **The limited tax return information that could even hypothetically be useful to competitors will usually be too aggregated to be of strategic benefit.** There are only a couple of pieces of tax-related information that would have to be divulged under typical tax disclosure laws (including the model presented later in this report) that could reasonably be characterized as potentially valuable to competitors. One such item is the “gross profit margin” that a manufacturer, retailer, or wholesaler of physical goods earns on its sales, calculated as gross receipts from aggregate sales of all the items it sells minus the cost of producing or buying the items sold. In theory, knowing the true gross profit margin earned by a corporation in a particular state might help a competitor know how far it could go in seeking to undercut the corporation’s prices in order to steal business away. In reality, it is unlikely that this information will be very useful. Even small corporations or individual subsidiaries of a larger corporate group usually sell a range of products with quite different profit margins resulting from competitive conditions in specific markets for specific items — or narrow categories of items. Even if Corporation B knew the overall profit margin its competitor, Corporation A, earned on its total sales in a particular state, Corporation B could not have much confidence about what the profit margin was on any particular item.²¹
- **Gross sales data are not likely to be strategically useful to competitors, either.** The other piece of information that would have to be reported under a well-designed state corporate tax disclosure law that hypothetically could be useful to competitors not subject to the same mandate is the amount or share of a corporation’s sales occurring in the state. Knowing the amount of a corporation’s sales in a particular state might conceivably encourage a competitor to begin marketing its wares in that state when it had not previously thought it worth its while to do so. Here again, however, the real-world implications of such disclosure are likely to be trivial. First, as discussed above, even in the absence of a specific requirement in the disclosure law that the data be “aged,” the sales data are likely to be 1-2 years old; relying on them would be strategically risky. Second, for many companies, such as manufacturers, the vast majority of the market is likely to be outside of the state that is mandating disclosure, and therefore knowing the amount of sales occurring in the disclosure state is not very useful. (For example, if Kentucky mandated corporate tax disclosure, Michigan-based General Motors doesn’t gain much by knowing that X% of Kentucky-based Toyota’s sales occur in Kentucky when the two companies are competing to sell cars mostly outside Kentucky.) Finally, even if the state mandating disclosure is the relevant economic market — for example, in the case of an out-of-state retailer contemplating entering the state for the first time — it seems likely that market

research firms could provide the potential new entrant with fairly good (and more timely) estimates of the market potential in the state with or without the additional information that would be provided by competitors disclosing their in-state sales. Indeed, very detailed state-by-state, industry-by-industry statistics on business sales are regularly published by the U.S. Census Bureau; it is unclear that knowing the particular sales of a particular competitor provides that much additional strategic value.

In sum, there are numerous reasons to doubt that mandating state corporate tax disclosure will compel corporations to divulge information that can provide a significant competitive advantage to other corporations not subject to the disclosure requirement. Although this claim was often made during the Massachusetts debate of the early 1990s, according to Professor Pomp: “When pressed, those who argue that disclosure will reveal proprietary information have never been able to provide a detailed illustration.” Until opponents can provide concrete scenarios of how harm could occur, these claims should be viewed with a great deal of skepticism.

Tax Disclosure Will Not Create an Anti-Business ‘Business Climate’

Some businesses representatives argue that the enactment of company-specific corporate tax disclosure would create a negative image of the state adopting this policy. Professor Pomp concisely sums up this line of attack on disclosure:

Opponents of disclosure argue that it would reflect or exacerbate an anti-business climate in the state. Disclosing corporate taxes would antagonize the business community and fuel the hostility of its enemies. Opponents argue that it would detract from the aura of goodwill that creates a positive “business climate,” and would provide one more weight in the balance of factors that may ultimately influence a corporation to relocate its business to a friendlier state.²²

Deciding whether or not to implement tax disclosure based on these kinds of arguments would be tantamount to giving veto power over the decision to a segment of business interests that make these claims, because “business climate” is a completely subjective concept. Many states have decided to impose taxes on businesses to which they are not subject in other states, to require businesses to pay a state-specific minimum wage higher than the federal minimum wage, and to require businesses to finance unemployment compensation benefits more generous than those paid in other states. Businesses routinely object to such choices as “bad for the business climate” and adversely affecting their willingness to invest in a state adopting such policies. Nonetheless, many states have decided that the benefits of such policies outweigh the risks that businesses will carry out threats to avoid states that implement them.

Such threats have especially low credibility with respect to tax disclosure. First, as discussed above, there is little risk that the major alleged harm to in-state businesses in a state mandating tax disclosure — the revelation to competitors of valuable proprietary information — will occur. Second, tax disclosure merely entails the preparation and submission of an additional paper or electronic “form,” most of the contents of which will be taken from calculations routinely made in the course of preparing the corporation’s state tax return. The marginal costs to businesses of tax disclosure will be minimal. Given the vast differences that exist among states in the objective costs

of doing business — divergent wage rates, property acquisition costs, and energy and transportation costs, to name a few — it is difficult to believe that rational business executives would allow the presence of a tax disclosure requirement in a state to “trump” otherwise favorable considerations related to the cost of doing business and allow that one variable to drive business location decisions.²³ Of course, the greater the number of states that mandate corporate tax disclosure, the lesser the ability of businesses to carry out explicit or implicit threats to avoid doing business in such states.

As to the charge that corporate tax disclosure itself will somehow “poison” the business climate and enhance conflict between the business community and other stakeholders, Pomp points out:

[N]ot all businesses might resist such a [disclosure] proposal, and some might actually welcome it, if only to dispel the negative image that corporations are somehow tax freeloaders. Corporations that pay little or no income tax may be few in number but, in the public’s mind, might be seen as representative of business in general. Disclosure of tax information could help to correct the perception that corporations are all under-taxed, and thereby enhance, rather than prejudice, attitudes toward business.²⁴

One consequence of flawed corporate tax policies is that some businesses can end up paying more than their competitors and therefore be at an economic disadvantage. The studies of federal corporate tax liabilities published by Citizens for Tax Justice in the mid-1980s highlighted for some corporations just such disadvantages, and many of them actively supported the 1986 Tax Reform Act for that reason. Pomp observes: “Should disclosure lead to a more level playing field [with respect to business tax payments], as it did at the federal level in 1986, businesses in general will benefit. A state that rewards corporations for their business decisions rather than their tax decisions ought to be viewed as advancing the business climate,” not harming it.²⁵

Finally, as economist Robert Tannenwald pointed out in a 1993 report for the Massachusetts disclosure study commission, responsible behavior on the part of users of tax disclosure information could go a long way toward ensuring that it is used to enlighten public discussion of tax issues rather than demagogically:

[A]dherence to certain procedures would help reduce the probability of bitter, harmful conflict. . . [P]ublic interest groups should be encouraged to contact those companies that they are investigating before they go public with their analysis. Investigators should attempt to begin a dialogue with companies before discussing their findings and interpretations of tax information with the media. Ideally, the dialogue would spill over into the public arena. Perhaps investigators and companies could present their viewpoints on specific tax disclosure information to the media jointly. . . [A] spirit of dialogue and cooperation needs to continue if [Massachusetts’] competitiveness is to be sustained.²⁶

Responsible, non-inflammatory use of tax information reported by businesses can be encouraged by two administrative features of state corporate tax disclosure. (Both of these are incorporated in the model disclosure law presented below.) First, state corporate tax disclosure laws should provide for the publication of a complete database of all information disclosed by all corporations subject to the law. Such a requirement will make it difficult for any person or organization to get away with “cherry-picking” data from particular corporations that are not representative of the corporate tax base of the state or otherwise using the information to present a distorted picture of corporate tax

payments. Any such attempt could be counteracted with research based on a representative sample of corporations filing disclosure reports. Second, any corporation subject to the disclosure requirement should have the right to include in its record any supplementary information it wishes to provide to further elaborate on its tax position. The availability of such information or the information itself should be provided automatically when a particular corporation's tax information is accessed.

The business community may have legitimate concerns that unscrupulous analysts could use disclosed tax information to present a distorted picture of corporate tax payments and that this could create an anti-business atmosphere in a state. The best antidote for this problem is to ensure that the information needed to undermine any such effort is widely available as well.

Tax Return Information Can Be Presented in a Form that Enhances Public Understanding

A 2006 policy statement on "Confidentiality of Taxpayer Information" issued by the Council on State Taxation claimed that disclosure is not a useful public policy tool because the meaning of the disclosed information would be subject to misunderstanding by unsophisticated observers.²⁷ (COST is a trade association that represents major multistate corporations on state corporate tax legal and policy issues.) According to COST:

From an empirical perspective, having legislators or the public examine specific tax returns is not useful in formulating policy. When such disclosures have been made in the past, they have generally been counterproductive due to the lack of public understanding of the complexities of corporate income taxes, especially as they apply to multistate business entities.

This is a fundamentally anti-democratic argument. No one questions either the right or the need of the public to have access to all kinds of information about both corporate and government operations that is at least as complex as state corporate tax return information. For example, the information contained in a typical SEC "10-K" annual financial report for a corporation is certainly as complex as the information that would be included in most of the state corporate tax disclosure proposals that have ever been advocated. State budgets and financial reports are also complex documents, and members of the general public have full access to them as well. Of course, it is quite possible that non-experts and experts alike will misunderstand these data, but no one objects to their public release on this basis. Opponents of corporate tax disclosure need to explain what is uniquely "counterproductive" about the release of this particular category of information.

It may well be true that an average member of the public will not be able on her own to grasp the meaning and significance of the information that will be included in tax disclosure reports. But with the aid of academic researchers, interest groups, and members of the news media that do have sufficient expertise to analyze, summarize, and interpret such information, members of the public can understand it well enough to hold their elected officials accountable for the corporate tax policies they adopt. Of course, the business community has every right to present its interpretation of those data and to seek to correct the public record when it believes that others are distorting it.²⁸

An effective democracy depends on the free flow of information relevant to critical issues of public policy and open debate about the interpretation of that information. State corporate taxes supply more than \$30 billion in revenue to states annually, and their structure and distribution are important issues that citizens and policymakers alike must consider periodically. Far from being counterproductive, corporate tax disclosure — for reasons discussed at length above — will make a valuable contribution to the evaluation of state corporate tax policy.

Tax Disclosure Will Not Discourage Corporations from Filing Accurate Tax Returns

The 2006 COST policy statement approvingly cites a 2000 congressional study that asserts that voluntary tax compliance is based on confidentiality and concludes that tax disclosure will undermine compliance. Although as typically envisioned state corporate tax disclosure involves filing a separate form containing only a subset of the information contained on the tax return and not the return itself, the actual numbers will be the same for the line-items that the tax return and the disclosure form have in common. Hence, COST is raising a concern that taxpayers will react to the disclosure requirement by filing less than fully accurate tax returns.

The argument that tax disclosure might negatively affect tax compliance has some plausibility with respect to disclosure of individual income tax return information. For example, people might be tempted to not report all their income if their next-door neighbors had access to that figure.

In the corporate tax context, however, the argument seems dubious. Corporations face substantial penalties for inaccurate compliance with state tax laws. It seems unlikely that many corporate managers would risk such penalties when, as previously discussed, the majority of the categories of information that would be disclosed under typical proposals are little different from what they are already required to disclose under SEC rules and would not be strategically valuable to non-disclosing competitors.

Professor Pomp's analysis casts additional doubt on this claim. He makes two key points:

- “The ‘full and frank disclosure’ rationale presumes that secrecy helps assure honesty and that publicity discourages it. If this presumption is correct, the SEC reporting requirements must have led to less honest tax returns — a position that apparently has never been argued in the literature — and one that seems far fetched on its face. If corporations were not induced to file false federal returns by SEC disclosure, why should it be assumed they will do so in response to state disclosure?”
- “Public disclosure might actually discourage corporations from minimizing their tax liabilities through tax avoidance techniques. For public relations purposes, corporations required to disclose tax information might be leery of paying only nominal amounts of tax.”²⁹

It is worth noting, finally, that perhaps no public official has more of a stake in the question of whether enhanced corporate tax disclosure will improve or worsen corporate tax compliance than does the head of the Internal Revenue Service. Yet the current Commissioner of the IRS, Mark Everson, recently called for serious debate concerning public disclosure of federal corporate tax return information:

A third subject pertaining to corporations is transparency. As long as financial accounting standards differ from the tax rules, there will be a continuing tension between increasing book earnings in order to drive up share value, and lowering taxable earnings to minimize tax payments and maximize cash flow. If we are not willing to operate the two systems by the same set of rules, it makes sense to discuss whether corporate tax returns should be public. Just over the weekend, there was press coverage about one of America's largest businesses, one which, according to the accounts, has reorganized overseas and increased its exposure to liability simply in order to limit public disclosure of its activities. There are important public policy arguments to be made in favor of maintaining the privacy of corporate returns. *Nevertheless, making corporate tax returns or a portion thereof public, would likely improve compliance. I believe this idea merits debate.*³⁰

Disclosure Does Not Have to Jeopardize the States' Access to Critical Federal Tax Information Supplied by the IRS

All or nearly all state revenue departments have exchange of information agreements with the federal Internal Revenue Service. Under these agreements, the IRS supplies the federal tax returns and other federal tax-related data of individuals earning income and corporations doing business within their borders. This information is critical to state individual and corporate income tax enforcement and saves the states considerable financial and human resources. For example, it obviates the need of the states in many cases to audit the reported "taxable income" amount reported on the state tax form. If the state's definition of taxable income substantially conforms to the federal definition, then the state can rely on the IRS's auditing of that particular line-item.

Section 6103 of the Internal Revenue Code provides, however, that the IRS may not disclose federal tax return information

to any officer or employee of any State which requires a taxpayer to attach to, or include in, *any State tax return* a copy of any portion of *his* Federal return or information reflected on such *Federal return*, unless such State adopts provisions of law which protect the confidentiality of the copy of the return (or portion thereof) attached to, or the Federal return information reflected on, such State tax return. [Emphasis added.]

It has long been argued — most vigorously by Professor Robert Strauss of Carnegie-Mellon University — that this language means that any state that mandates company-specific corporate tax disclosure likely would no longer be eligible to receive federal taxpayer information from the IRS.³¹ In particular, because most states' calculations of taxable income begin by requiring the corporation to copy its federal taxable income onto its state income tax return, and because this line-item would presumably also appear on the state corporate tax disclosure form, it is presumed that the Section 6103 prohibition on information sharing would be triggered.

There are good reasons to question this conclusion, however. First, it is not clear that this provision of Section 6103 applies or was intended to apply to corporations; the reference to "*his* Federal return" suggests that it may only apply to individuals. Second, the prohibition applies to the inclusion of Federal tax return information in a *state tax return*, which is then disclosed publicly. It is

not clear that a corporate tax disclosure form, particularly if it is filed with a state agency other than the revenue department (such as the Secretary of State), would be considered a “state tax return” covered by this language. Third, during the 1992-94 debate in Massachusetts regarding its disclosure law:

the Massachusetts Special Commission on Tax Policy actually received an informal opinion by the IRS . . . which stated that as long as the Secretary of State’s Office obtained the disclosed data from reports filed with it by corporations. . . there would be no violation of section 6103(p)(8)(A). The informal view of the IRS is that it has entered into an information-sharing agreement with the Massachusetts Department of Revenue, which has no role in the preparation of the taxpayer-specific reports that are disclosed. Under the Massachusetts disclosure law, the Department of Revenue would be honoring the agreement so that no violation would exist. The Massachusetts commissioner of revenue independently reached the same conclusion as that of the IRS.³²

Until such time as a state enacts a law mandating non-anonymous corporate tax disclosure, it is impossible to know how the IRS would formally rule on this issue. The uncertainty should not be a barrier to state adoption of disclosure, however. Even were the IRS to rule that a state corporate tax disclosure law triggered the information-sharing prohibition in Section 6103, there would be ways to modify the disclosed data to come into compliance. For example, the state could simply change the disclosure law to ensure that no line-item on the disclosure form corresponds exactly to a line-item appearing on the federal return.

Corporate Tax Disclosure Will Help in Formulating and Evaluating Tax Policy

The argument that corporate tax disclosure does not reveal information that can actually be helpful in evaluating state tax policy was made most systematically by Boston Federal Reserve Bank economist Robert Tannenwald in a 1993 report he wrote for the Massachusetts commission that studied the pros and cons of various disclosure options.³³ Tannenwald’s criticism seems highly specific to the Massachusetts situation of that time and not applicable to a well-conceived disclosure statute.

As previously discussed, in November 1992 Massachusetts voters approved a ballot initiative mandating company-specific disclosure. Question 2 was sponsored by the Tax Equity Alliance for Massachusetts (TEAM). Earlier that year, however, in a spirit of compromise with the business community, TEAM had agreed that even if voters approved the measure, it would support the legislature’s amending of the bill to provide for less extensive, “slimmed down disclosure.” In January 1993, the legislature enacted the slimmed-down disclosure bill, which relieved corporations of an obligation to report a number of line-items on their disclosure forms. The subsequent Tannenwald report for the business tax study commission argued that the removal of those line-items would impair the ability of users of the information to pinpoint the sources of low tax payments by disclosing corporations.

Notwithstanding the irony of TEAM’s falling victim to its willingness to compromise, some of Tannenwald’s observations concerning flaws in the “slimmed-down” disclosure bill were probably valid. For example, the removal of the requirement that corporations report the tax-return line-item

that detailed the share of their nationwide profit assigned for tax purposes to Massachusetts did indeed significantly reduce the utility of some of the other information reported on the form.

The model corporate tax disclosure bill described in Chapter V and set forth in the Appendix would effectively require the reporting of all the line-items contained in the original Massachusetts Question 2 for publicly-traded corporations. It has been carefully drafted to ensure that any federal tax information that is to be disclosed matches the individual corporation or corporate group that files a return for state tax purposes. It further requires disclosure of information relevant to a number of key tax policy problems, such as the impact of non-standard apportionment formulas and the use of tax-avoidance devices like “Delaware Holding Companies.” Whatever the flaws identified by Tannenwald in the 1992-93 Massachusetts legislation, it is likely that the model disclosure bill offered below would provide substantial information that would illuminate the key strengths and weaknesses in the corporate income tax law of any state that adopts it.

Tax Disclosure Is Not Aimed at Ensuring Corporate Tax Compliance

Business opponents of state corporate tax disclosure sometimes try to forestall its consideration by first suggesting that its primary aim is to ensure that existing corporate tax laws are fully enforced and then arguing that disclosure is not an appropriate mechanism for achieving that goal. The 2006 COST policy statement on state tax disclosure represents a good example of this line of argument. COST states:

The proposition that confidential tax returns should be made available for public inspection so that the public can determine whether a business is paying its “fair share” is fundamentally wrong. The determination of one’s “fair share” is inherently subjective. A taxpayer’s tax liability is determined by law, not by subjective criteria. The public’s right to set appropriate levels of taxation for different groups is through the lawmaking power of its elected representatives. Those laws, once made, must be fairly interpreted and enforced.

Because tax laws are inherently complex, every state has a dedicated agency of specialists to ensure that tax laws are fairly interpreted and enforced. If lawmakers are concerned that those laws are not being correctly administered, the appropriate response is proper oversight of the tax agency and not disclosure of confidential taxpayer information.

This argument represents a distraction from the real issue. The goal of tax disclosure is not to evaluate the tax compliance behavior of individual corporations or single them out for criticism. It is likely that the vast majority of corporations — even those paying little or no tax in a particular state in a particular year — are doing so in full compliance with the law. Rather, the aim of tax disclosure is to help policymakers and the public evaluate whether existing tax laws implement good corporate tax policy — or at least the tax policy and tax incentives that policymakers intended to put in place.

IV. Proposed Alternatives to Company-specific Disclosure Are Inadequate

Business representatives have sometimes suggested alternative approaches to providing policymakers and interested citizens with additional information regarding corporate tax payments, as a way of forestalling adoption of company-specific state tax disclosure. First, it has been suggested that states should simply compile and publish in aggregated form additional information extracted from state corporate income tax returns. Second, when confronted in 1992 with the enactment of company-specific disclosure in Massachusetts, some members of the state's business community supported a system of "anonymous" or "coded disclosure," in which corporations file somewhat detailed disclosure forms but information on the identity of the corporation is removed before the form is released. Third, corporations have tended not to vigorously oppose company-specific corporate tax disclosure that has been limited to specific tax credits for economic development and job creation; this might be offered as an alternative to full-blown disclosure.

This chapter discusses why these alternatives are inferior to company-specific disclosure and inadequate if the goal is to give policymakers and the public a complete picture of the overall impact of a state's corporate tax policy. It again quotes extensively from the 1993 Pomp report, which discussed these issues in depth.

The Limits of Aggregate Tax Return Data

In its 2006 policy statement on corporate tax confidentiality and disclosure, the Council on State Taxation suggests that "If . . . the legislative branch is concerned that certain classes of taxpayers are inappropriately taxed, it can and should ask the executive branch for aggregate information on that class of taxpayers."

In addition to state legislators, individual citizens, non-governmental research and advocacy groups, and members of the news media may have a legitimate interest in corporate tax policy. Moreover, episodic release of corporate tax return-based information for "certain classes of taxpayers" at the *ad hoc* request of legislators may not permit ongoing monitoring of the impact of corporate tax policies on *all* taxable corporations nor yield the consistent data time-series that is often essential to teasing-out the significance of such statistics. Even assuming that COST would

acknowledge these points and have no objection to the regular and systematic public release of data extracted from state corporate income tax returns filed in a state, the fact remains that such data are severely limited in their potential to bring to light any problems that may exist in state corporate tax structures.

A number of states — including California, Massachusetts, New York, Oregon, Pennsylvania, and Utah — already publish fairly-detailed reports compiling aggregated data regarding corporate tax filings along the lines of the annual “Corporate Statistics of Income” report published by the Internal Revenue Service. These reports sometimes generate intriguing questions, but without being able to link the data to specific corporations few conclusions about the appropriateness of corporate tax policy can be drawn. For example, the most recent report from the California Franchise Tax Board reveals that California’s apportionment formula assigned eight percent and six percent of the average multistate corporation’s nationwide profit from ongoing business operations to the state in 2002 and 2003, respectively. However, these same corporations elected to assign a considerably smaller share of their nationwide “non-business” income from irregular transactions to the state — just 2 percent in 2002 and less than half a percent in 2003. Non-business income is usually assigned to the state in which a corporation is headquartered, and, like many coastal states, California is the headquarters state for a large number of corporations. One might expect, therefore, that, if anything, the share of nationwide non-business income assigned to California would be larger than its share of income from ongoing operations. A previous Center report identified significant problems with the typical definition of “non-business income” — also in effect in 2002 and 2003 in California — that may give corporations excessive discretion to assign such income to states in which it is likely to be taxed at lower rates.³⁴ California is a relatively high corporate tax rate state. Without knowing exactly which corporations that filed corporate income tax returns had non-business income, where they were headquartered, and what the source of their non-business income was, however, it is not possible to resolve the question of whether there was a problem with California’s non-business income definition in effect in those two years.

Professor Pomp’s 1993 report on corporate tax disclosure suggests that there are at least six ways that aggregated corporate tax return data are inherently inferior to company-specific data with respect to resolving corporate tax policy controversies:

- **Aggregated corporate tax return information buries valuable, policy-relevant data in statistical averages.** Pomp observes that “statistical aggregates [of information drawn from corporate tax returns] can simply hide much of value in evaluating a state tax system. If, for example, a few of the largest, most profitable corporations in a state pay no (or only a minimum) income tax, such information is highly relevant from a policy perspective but might be lost if buried in an aggregate.” For example, “a 1982 study of the New York investment and employment tax credits indicated that two corporations received nearly forty percent of all of the credits allowed — \$56.8 million. Yet, on an aggregate basis, the average credit claimed was \$16,423 and half of the claimants received credits of less than \$1,172.” Publishing only the aggregated data would have provided a distorted picture of the distributional impact of New York’s credits.³⁵
- **In publishing aggregated corporate tax return data, states are often compelled to bury valuable information in statistical averages for broad classes of corporations to preserve tax return confidentiality for large corporations.** Closely related to the previous point, Pomp notes: “Situations commonly exist in which knowing certain limited information about

an unnamed corporation, such as its size and the nature of its primary business activities, allows an informed judgment to be made about its identity. . . . Obviously, the need to present data in a manner that protects the identity of a taxpayer reduces the value of the information that can be made public. Moreover, those situations in which the data need to be sanitized are probably those situations in which the public interest is greatest because they involve major taxpayers.”³⁶

- **Publishing aggregated corporate tax return information involves choices that may not correspond to the need of researchers to examine particular policy options.** Publishing only statistical aggregates of information drawn from corporate tax returns “inevitably limits its use by researchers. Statistical information can be presented in various ways. For example, income taxes paid by a corporation can be compared with its receipts, property, number of employees, amount of assets, type of business, and so forth. The value of the data is obviously constrained by the way it is presented. What might be a valuable presentation for some policymakers and researchers would be irrelevant for others.”³⁷ To provide a simple illustration of this point, consider that any presentation of statistical data is likely to aggregate data within particular classes of corporations grouped by assets, sales, or net income. What if the classes chosen for publication are not those that are relevant for policy purposes? What if an advocacy group, for example, wished to determine how many corporations would be affected by a proposed law that would add an additional corporate income tax bracket for corporations with profits greater than \$50,000,000, but the data published by the state aggregated the corporate tax payments for all corporations with profits greater than \$10,000,000? In this case, there would be no way to use aggregated state data to evaluate the impact of the proposal. And if the Governor opposed the proposal, she could direct the revenue department not to perform a private “run” of the data for the advocacy group.
- **Failure to release company-specific corporate tax return information blocks the use of other types of publicly-available information about a specific corporate taxpayer that could be relevant for policy analysis.** Publishing statistical aggregates of information drawn from corporate income tax returns, and even releasing information for a specific return without identifying the company (as is done in Massachusetts) forecloses the ability of “researchers [to] correlate the tax information with any other publicly available data which they wish to utilize.”³⁸ The clearest example of this limitation arises in the context of interpreting the significance of the very large share of corporations that report no taxable income in many states even in years of relatively healthy state economic growth. Being able to identify such corporations would permit researchers to examine their or their corporate parents’ annual financial reports filed with the Securities and Exchange Commission. If the profitability of the corporations reported for state income tax purposes largely correlated with the profitability reported to stockholders, this would assuage concerns about potential serious flaws in the state income tax or excessively generous state tax incentives that the aggregate data might otherwise suggest.
- **Company-specific information is needed to evaluate company-specific claims about the impact of corporate tax policy.** In lobbying for or against proposed changes in corporate tax policy, specific corporations frequently make claims about the incentives such changes will create for them to modify their own investment/job-creation behavior, the impact on their own tax payments, and the fairness of their own tax burdens as compared with those of their competitors. Particularly if offered by major employers in a state, such anecdotes can have significant influence on the outcome of corporate tax policy debates. Pomp notes that in the absence of company-specific disclosure, these are completely one-sided arguments that

advocates of the proposed changes cannot refute: “[I]t is virtually impossible based only on statistical aggregates to evaluate the claims of various corporations for tax relief or to verify other tax-related information that corporations might provide in their lobbying efforts.”³⁹ Pomp also notes that the type of anonymous, company-specific disclosure practiced in Massachusetts suffers from the same shortcoming: “Corporations would still be able to take public positions [about their own tax situations] that would be inconsistent with the facts” but effectively irrefutable.⁴⁰

- **Company-specific information is needed to build the type of economic model that is most useful for corporate tax policy analysis.** Effective analysis of the distributional and revenue impacts of proposed changes in corporate tax policy necessitates the use of so-called “microsimulation models.” These seek to replicate the overall corporate tax base of a state by taking a representative sample of actual corporate income tax returns filed in a state (or at least substantial information drawn from such returns). Because the bulk of corporate income tax payments tend to be made by a relatively small number of large corporations, there is no way to build an accurate microsimulation model without releasing information that likely can be identified as being that of a specific firm. Thus, if a state does not authorize generalized corporate tax disclosure, this effectively means that the state revenue department (which of course has access to confidential tax returns) will have a monopoly on the only tool that permits detailed analysis of corporate tax policy options. Pomp observes: “This significantly limits the ability of other interested organizations to participate in debates over corporate tax policy in the most informed manner possible.”⁴¹

“Why Not Disclose Firm-specific Data Anonymously?”

As noted in the preceding section, the type of company-specific but anonymous corporate tax disclosure in effect in Massachusetts suffers from most of the shortcomings of aggregated state corporate tax return data. Professor Pomp identifies two additional problems unique to this form of corporate tax disclosure:

- **Anonymous disclosure enables corporations to file inaccurate disclosure forms with little fear of being found out.** “With anonymous disclosure, this problem [of verifying the accuracy of the information submitted] is compounded because the information submitted by a firm does not have to stand the test of public scrutiny by those who would have a basis for evaluating its accuracy in terms of general orders of magnitude. This might include securities analysts, other researchers, and tax reform groups.”⁴² Professor Pomp might well have added that this same anonymity could encourage corporations to not file the required disclosure statements at all — particularly where penalties are low or non-existent (as in Massachusetts).
- **“[A]nonymous disclosure will inevitably lead to public speculation about which corporations are involved,” and such speculation can lead to an inaccurate or incomplete picture of the distributional and economic impact of corporate tax policy.**⁴³ New Jersey again provides an illustration of this pitfall of anonymous disclosure. In 2002, Governor James McGreevey was seeking to convince the public and the legislature of the need for major reform of the state’s corporate income tax policies. His administration released some information concerning the aggregate corporate income tax liabilities of what it characterized as

10 of the 50 largest employers in New Jersey. In the course of this debate, an advocacy group supporting the McGreevey proposals released a list of what purported to be the 50 largest employers in the state published by a state trade association. Business representatives complained that these corporations were all being tarred as tax evaders when, in fact, it was entirely possible that none of them were among the 10 corporations that the administration was discussing. Yet in any state in which anonymous, company-specific disclosure is enacted, this same scenario could be played out. A research group could access the “anonymous” tax disclosure statements of the corporations with the 50 highest sales totals or payrolls in the state and find some other credible list of the 50 largest employers. The only way to eliminate the possibility that taxpaying corporations are misidentified as engaged in aggressive tax-avoidance strategies is for company-specific disclosure to be non-anonymous.

Company-specific Disclosure of Corporate Tax *Incentives* Is Not Sufficient

As discussed in Chapter II, while only Wisconsin permits public disclosure of a specific corporation’s “bottom line” tax payment to the state, some seven states now mandate company-specific disclosure of various kinds of economic development-oriented tax breaks claimed by corporations. The latter type of disclosure has not been as controversial as the broad form of disclosure discussed in this report, perhaps because it arguably is a reasonable quid pro quo for specific tax benefits that corporations may elect to forgo if they wish to preserve complete tax confidentiality. For this reason, tax-incentive disclosure might be offered as an alternative to broad disclosure.

Despite its undeniable value and importance, it would be a mistake to conclude that company-specific disclosure of corporate tax incentives claimed is an adequate substitute for broader disclosure — or even a reasonable political compromise:

- **Although they are unquestionably a significant factor, tax credits and exemptions deliberately enacted as economic development incentives are only one contributor to the recent decline in the effective rate at which states tax corporate profits.** According to a study by University of Iowa economist Peter Fisher of effective corporate tax rates on manufacturing companies in 20 states, tax incentives offset only about one-third of corporate tax liability in 1998.⁴⁴ States have been particularly active in subsidizing manufacturing; incentives probably have an even smaller impact on tax liability in most other sectors of the economy. Tax incentive disclosure does not help elucidate other important factors that have contributed to state corporate tax base erosion, such as state conformity to federal tax changes that reduce state definitions of taxable income and more aggressive exploitation by corporations of weaknesses and loopholes in state corporate tax structures.
- **As currently practiced in most states, company-specific tax incentive disclosure does not encompass several key changes in tax policies that have been enacted in the name of economic development.** For example, incentive disclosure does not identify the beneficiaries of across-the-board cuts in tax rates, adoption of single sales factor apportionment formulas, conformity to federal “bonus depreciation” rules, and state adoption of tax preferences for capital gains income. All of these changes in tax policy have been justified on economic development grounds. Thus, even if the primary goal of corporate tax disclosure

were to determine whether tax changes aimed at improving a state's "economic competitiveness" were succeeding, achieving this goal requires broad disclosure of information from state corporate income tax returns — not just information about specific credits and exemptions.

- **Incentive disclosure does not allow an evaluation of the impact on a corporation's tax liability of a state's overall tax incentive "package."** Even if they strongly support all of the specific economic development incentives that have been enacted in their states, policymakers are likely to be interested in the impact of these incentives on the ultimate tax liability of corporations. It is not at all clear, for example, that policymakers would want corporations to be able to completely eliminate their tax liability by claiming incentives — evidenced by the fact that a number of states have a variety of "alternative minimum taxes" in effect that supersede otherwise legitimate tax incentive claims. Yet as presently practiced, incentive disclosure only lists the value of incentives claimed on returns (and in some cases available for carryover into future years) but not the impact on "bottom-line" liability. Accordingly, broad corporate tax disclosure is needed to evaluate the fairness and appropriateness of a state's total "package" of available incentives.

V. Explanation of the Model State Corporate Income Tax Disclosure Act

The Model State Corporate Income Tax Disclosure Act set forth in Appendix A would, if adopted by a state, mandate company-specific, state corporate income tax disclosure. The statute could be enacted through the action of a legislature or via a voter-approved ballot measure in states that provide for legislation via citizen initiative. Disclosure of limited tax-related information would occur through the filing by a corporation of a new, electronic “form.” Data from these forms would be available to the public in both hard copy and via a searchable Internet database. As discussed above, disclosure forms would be filed with and published by the office of the Secretary of State rather than the state tax or revenue department to decrease the risk that disclosure could void the latter agency’s information-exchange agreement with the Internal Revenue Service.

The Model Act has been drafted with the aim of remedying some of the major deficiencies of previous state bills and ballot measures that would have mandated corporate tax disclosure. These have included such serious problems as failure to ensure that corporations that were subsidiaries of publicly-traded corporations but were not themselves publicly-traded would be subject to the disclosure requirement and failure to take into account whether or not the state required commonly-owned corporations to calculate their taxes on the basis of consolidated or combined reporting. (See Appendix B.)

The Model Act should be viewed as a work in progress, and the author would welcome suggestions for improving it.

Which Corporations Would Be Subject to a Corporate Tax Disclosure Requirement?

In combination, the definitions in Section 1 (lines 1-14) and the filing mandate in Section 2 (lines 15-21) establish which corporations would be required to disclose their state corporate income tax information. Key features of the Model Act in this regard include the following:

- **Tax disclosure would be required of all publicly-traded, federally-taxable corporations (“C” corporations in Internal Revenue Code terminology) doing business in the state — as well as their subsidiaries.** This would include corporations that have stock traded on

foreign stock exchanges. Because partnerships and limited liability companies (LLCs) generally are neither publicly traded nor subject to the federal corporate income tax (their profits are instead “passed through” to the tax returns of their owners), the disclosure requirement would not apply to such entities. However, publicly-traded, federally-taxable corporations doing business in a state through ownership of an interest in a partnership or LLC *would* be subject to the disclosure requirement despite the fact that the partnership/LLC itself would not be.

- **Tax disclosure would be required of all publicly-traded corporations “doing business in a state,” whether or not they are required to file an income tax return.** “Doing business in the state” is defined to include making sales of goods or services in the state and “engaging in regular and systematic solicitation of sales” in the state. Accordingly, corporations making sales to customers in the state but not filing a return would be required to disclose the fact that they are — or consider themselves to be — not subject to the state’s corporate income tax. Rather than file the full disclosure report required of corporations that file an income tax return, such non-taxable corporations could elect to file a limited report identifying themselves, explaining why they are — or consider themselves to be — not subject to the corporate income tax, and disclosing into which of five stated dollar ranges their annual sales to customers in the state fall. (The parameters of this alternative disclosure statement are set forth in Section 4 of the Model Act, lines 156-171.) The aim of requiring such disclosure by corporations not filing an income tax return is twofold. First, it would help the public and policymakers to identify possible flaws in that portion of the state’s corporate income tax statute that defines which corporations are subject to the tax. Second, it would identify which corporations are making substantial sales into the state without being subject to the state’s corporate income tax due to a federal statutory limitation on the imposition of this tax on out-of-state corporations — Public Law 86-272. This information could be used to evaluate the revenue impact on the state of P.L. 86-272 and might engender debate about whether the state’s policymakers and congressional representatives should seek modification or repeal of this law.

What Information Would Have to Be Disclosed?

All corporations subject to disclosure would, first, have to provide basic identifying information. This includes their name, address of their principal executive office, name and address of their ultimate parent corporation (if they are a subsidiary of some other corporation), a standard federal code that pinpoints their principal industry, and a unique corporate identifying number that would facilitate the tracking of the corporation’s tax payments and related parameters from year to year.

The Model Act lists the tax-related information that would have to be disclosed in two different places. Lines 37-94 are applicable (and would be enacted into law) in states in which each corporation that files an income tax return does so solely on the basis of its own finances — so-called “separate-entity states.” Lines 37-94 would apply as well in states in which the corporation’s finances are merged with other, commonly-owned corporations and a single “consolidated tax return” is filed for the entire consolidated group of companies that are subject to taxation in the state. Lines 96-155 are applicable (and would be enacted into law) in states that require corporations to calculate their tax liability on the basis of “combined reporting.” Under combined reporting (and in contrast to “consolidated reporting,” where the entire consolidated group doing business in the state is “the taxpayer”), each individual member of a multi-corporate group — referred to as a

“unitary group” — usually is considered to be a separate “taxpayer.” The tax liability of each individual corporate member of the multi-corporate group is determined by, first, calculating the combined income of the group (as is also done under consolidated reporting) and, second, using a legally-specified formula to assign (“apportion”) that combined income to the state for taxation in proportion to activities carried on in the state by the *individual* corporate member.⁴⁵ Appendix B provides additional information to clarify the differences between the separate entity, consolidated, and combined reporting methods of state corporate income taxation.

Tax Return Information

Regardless of whether a particular corporation is filing its own tax return on the basis of its own books, is included in a consolidated tax return with its parent and sister corporations, or calculates its liability on the basis of “combined reporting,” the tax-related information it is required to file under the Model Act is the same. The first set of information comes directly from the tax return and related schedules (or at least is internally-generated and used in calculating line-items on the tax return). This information includes:

- Total gross receipts or gross income of the corporation/consolidated group/unitary group. [A “unitary group” is the group of related corporations whose income is merged under “combined reporting.”]
- Total “cost-of-goods-sold” of the corporation/consolidated group/unitary group, that is, the cost of making or buying the physical goods sold or resold by the business.
- Taxable income (including negative income, or losses) of the corporation/consolidated group/unitary group.
- The shares of the corporation’s total, nationwide/worldwide sales, property, and payroll that are located in the state, which often are averaged to determine the share of its nationwide/worldwide income taxable by the state, and the overall “apportionment factors” reported on the return under the state’s current law.
- The amount of the corporation’s nationwide/worldwide income that is actually taxable by the state after the apportionment percentage has been applied.
- Any operating losses of the corporation from previous or later years that have been deducted in calculating the corporation’s final taxable income, under so-called loss “carry-forward” and “carryback” provisions.
- Any so-called “non-business” income that is ineligible for apportionment by formula and that must instead be assigned directly [“allocated”] to a particular state for taxation, including the amount assigned to other states.⁴⁶
- Taxable income after adding income apportioned to the state and any “non-business” income allocated to the state and then deducting any operating losses from previous or later years.
- Tax before credits.

- All tax credits claimed, individually enumerated, or, alternatively, all tax credits claimed that exceed some chosen threshold (such as reducing pre-credit tax liability of all corporations taxable in the state collectively by more than five percent).
- Final tax owed (including any alternative minimum tax), the amount of tax paid, and the amount of tax paid under protest.

Other Tax-related Information

The Model Act also requires the disclosure of a second set of information not drawn from or used in the preparation of the tax return. Some of these items are intended to assist in the interpretation of the tax return data, and others are intended to identify or assess the impact on corporate tax payments of a number of key corporate tax policy choices made by states. These items and the rationale for their mandatory disclosure are as follows:

- **A description of the source of any “non-business” income reported on the return and identification of the state to which it was assigned for taxation.** This information is sought to uncover problems in the state statutory treatment of non-business income. Flawed definitions often allow corporations to classify as “non-business” income certain non-recurring income items that states believe should be “thrown into the pot” of income that is apportioned by formula among all the states in which the corporation is doing business. If income that could be apportioned by formula is reported as “non-business,” all but one of the states in which the corporation is doing business are denied their fair share of tax on such income. Moreover, there is some risk that a corporation will not report a particular income item as non-business income consistently in all of the states in which it is doing business, leading some or all of it to escape state taxation completely. Disclosure of the source and the destination of any non-business income reported on the return will facilitate analysis of this issue.⁴⁷
- **If a corporation is included in a consolidated tax return or calculates its tax liability on the basis of combined reporting, a listing of all sister and/or parent corporations included in the return or the combined report.** This information can be used in combination with other publicly-available information to evaluate whether the corporation may have improperly included — or, more likely, excluded — certain sister corporations from the consolidated/combined group in an effort to reduce its tax liability. (For example, a corporation subject to combined reporting in a given state may be able to reduce its tax liability by excluding from the unitary combined group a particularly-profitable sister corporation.) The requirement to list all corporations included in a consolidated/unitary group will help policymakers and interested analysts evaluate whether statutory language mandating consolidated or combined reporting is adequate or needs to be clarified.
- **In a state that requires combined reporting, an identification or “flagging” of any differences between the way it has defined the unitary group for that state’s tax purposes and the way it has defined the unitary group in other combined reporting states.** The objective is to uncover any attempts to improperly minimize taxes by taking advantage of the inherently subjective nature of determining which corporations do and do not belong in a particular corporation’s unitary group (see Appendix B). The requirement to flag

inconsistent compositions of unitary groups in combined reporting states will help policymakers and interested analysts evaluate whether statutory language defining a unitary group is adequate or needs to be clarified. It will also enable policymakers to evaluate whether there is a need for greater information-sharing among the states to ensure that corporations do not improperly take inconsistent tax filing positions in different states with the same or substantially similar “unitary business” definitions.

- **In the case of a U.S. publicly-traded corporation or an affiliate of such a corporation, profits before tax reported on the corporate annual report filed with the Securities and Exchange Commission.** This information would facilitate a comparison of the profits of a corporation reported on its state tax return and the profits of the corporate group of which it is a member (as reported in the latter’s annual report). If, for example, a subsidiary of a retail store chain that owned stores in only one particular state reported a profit margin of two percent while the chain reported a four percent profit margin on a nationwide basis, this might suggest that the corporation was using one or more common techniques to artificially and improperly shift income out of the state. If many corporations exhibited this type of discrepancy, it might suggest that a change in tax policy would be warranted.
- **The corporation’s total employment in the state for the disclosure year and the previous three years.** States frequently tweak their tax policies to encourage greater corporate job-creation within their borders. The changes including offering a wide variety of new economic development-oriented tax credits, cutting tax rates, altering the apportionment formula, and granting more generous depreciation deductions. The efficacy of these measures cannot be judged unless the public, the media, and policymakers have access to the employment track-record of the corporations that benefit from them.
- **Total deductions for management fees, rent, and fees for the use of trademarks and other intangible property paid to related corporations.** An extremely common technique corporations use to reduce their income taxes is to have a related corporation located in a no-tax or low-tax state or foreign country charge the in-state corporation for management services or the use of real estate or intangible property.⁴⁸ Since these expenses are deductible for state corporate tax purposes, they reduce the taxable income of the corporation paying them and shift the income to the tax-haven corporation receiving the payment. Requiring corporations to disclose the amount of such payments to affiliates and the name and location of the affiliate receiving them can facilitate an analysis of how widespread the use of such strategies may be. It would also facilitate the estimation of the revenue lost from the implementation of such schemes, which in turn could lead to informed public debate about the pros and cons of implementing policy changes that nullify them (such as combined reporting).
- **In states in which the “throwback rule” has not been adopted, an estimate of what the corporation’s sales apportionment factor would have been had the state enacted the rule.** The Uniform Division of Income for Tax Purposes Act (UDITPA) is a model law promulgated in 1957 that sets forth a standardized formula for dividing (“apportioning”) corporate profits among the states. Most states have adopted UDITPA in whole or in substantial part. However, approximately half the states levying corporate income taxes have not enacted a key UDITPA provision known as the “throwback rule.” This rule is aimed at ensuring that the profits of multistate corporations do not escape taxation because of a mismatch between UDITPA’s apportionment formula and the laws — including Public Law

86-272 — that govern when a state can tax an out-of-state corporation.⁴⁹ The throwback rule deems a sale delivered into a state in which the selling corporation is not taxable to have been delivered to a customer located in the state in which the shipment of the sold item originated. In other words, it increases the corporation’s “sales apportionment factor” in that state. The Model Act mandates the calculation and disclosure of what the corporation’s sales factor would have been in the state had the throwback rule been in effect. Such a requirement would enable policymakers and policy analysts to estimate how much tax particular corporations are avoiding due to the absence of the rule and could stimulate informed public debate about the pros and cons of adopting it.

- **In states in which corporate profits are apportioned by a formula that does not take into account in-state property and employment, an estimate of what the corporation’s property and payroll apportionment factors would have been had the state formula included them.** The model apportionment formula set forth in UDITPA assigns the nationwide profits of a multistate corporation to a particular state for taxation in proportion to the shares of the corporation’s nationwide sales, property, and payroll located in the state. These three “apportionment factors” are averaged together, often with double-counting (or “weighting”) of the sales factor. In an increasing number of states, however, the property and payroll factors are being dropped from the formula under the unproven rationale that their inclusion discourages corporations from placing property and jobs in a state.⁵⁰ The adoption of a sales-only apportionment formula can create a situation in which major corporations with large facilities in a state that place significant demands on state services pay virtually nothing in state corporate income taxes. The Model Act requires corporations in sales-only formula states to calculate (based on the standard UDITPA language) and report an estimated property and payroll factor. Policymakers, the media, and interested citizens could then determine how much tax particular corporations are saving as a result of using a sales-only formula. Again, this information would be valuable in evaluating the pros and cons of maintaining such a formula versus reverting to UDITPA’s property/payroll/sales formula.
- **In states in which tax credits can be “carried over” for use in future years, the amount of accumulated credits.** It is quite possible for a corporation to be eligible for corporate tax credits that exceed its pre-credit tax liability in a particular tax year. Some states allow some or all unused credits to be accumulated and “carried over” for use in future years. The Model Act requires corporations to disclose annually, on a credit-by-credit basis, the amount of credits they have accumulated. This information could be valuable for at least two reasons. First, it might be needed to provide an accurate picture of a corporation’s tax liability. For example, a corporation claiming a large jobs-creation credit in a year in which it held employment steady might in fact be eligible to do so because the credit was a carryover from an earlier year in which it *had* increased employment. Second, the information could be useful in evaluating the policy rationale for the credit itself. Large carryovers for most recipients of a particular credit might, for example, imply that the credit was overly generous.

How Would Information Be Made Public?

Section 7 of the Model Act sets forth the terms of public disclosure of the tax-related information submitted by corporations.

It states, first, that the information is a matter of public record.

Second, it requires that the Secretary of State make the information available on an ongoing basis in the form of a searchable Internet database. (The creation of the database will be substantially facilitated by the fact that corporations must file the information in electronic form, eliminating the need for manual data re-entry by state employees). The Internet database requirement is vital to the meaningful and effective use of the information by potential users. Even the limited corporate tax information that is available under the Massachusetts “anonymous disclosure” law discussed previously is essentially useless because it is maintained only in the form of hard copies that are reportedly not organized or maintained in any systematic way.⁵¹ The failure of the Massachusetts disclosure law to specify the form in which the data would be maintained and made public was an enormous flaw. Likewise, direct, unmediated public access to the information is essential. As in Massachusetts, the usefulness of the “bottom-line” corporate tax liability information that must be disclosed in Wisconsin has been almost completely eliminated by the fact that Wisconsin citizens must ask the limited staff of the state department of revenue to search for this data for a particular corporation. This may require repeated queries (each of which requires the payment of a fee) if, as an illustration, the corporation’s legal name is not “XYZ, Inc.” or “XYZ Corp.” but, rather, “XYZ Corporation, Inc.” and the first two queries listed the wrong name. It is prohibitively expensive and time-consuming for interested persons in Wisconsin to obtain corporate tax information for more than a handful of corporations at a time.⁵² A public database, in contrast, would allow a user to quickly modify her search to try slightly different corporate names until a “hit” was obtained.

Third, the Model Act requires the Secretary of State to make the information for a particular corporation available in hard copy for anyone who wishes to purchase it in that form and, more importantly, to sell (at cost) the entire database for all filing corporations in a particular year on computer-readable media. The availability of complete, “raw” data is essential if researchers are to be able to manipulate it in ways that a public database is unlikely to permit. For example, researchers may well need to be able to draw a random sample of the filings to feasibly execute studies in a large state with hundreds of thousands of corporations — such as California or Texas.

Finally, as discussed above, the Model Act requires the Secretary of State to delay release of the filed tax information to significantly reduce its utility to potential competitors of filing corporations that are not themselves subject to the disclosure law. Under this provision, for example, the information filed by two corporations with 2006 tax years ending on, respectively, September 30, 2006 and December 31, 2006, could not be made publicly available until January 1, 2009.

How Would Compliance with the Disclosure Law Be Enforced?

The Model Act includes four provisions aimed at ensuring that affected corporations fully and accurately comply with the disclosure requirement. First, it requires that the accuracy of the disclosure statements be attested to in writing by the chief operating officer of the corporation. Second, it requires that the disclosure statement be subject to audit by the state department of revenue (acting as an agent of the Secretary of State) during the normal corporate tax audit process. Third, it authorizes the Secretary of State to establish a system of penalties applicable to the chief operating officer for attesting to the accuracy of an inaccurate statement and to the corporation for

filing it. Fourth, it requires the Secretary of State to publish the name of and penalty imposed upon any corporation punished for failing to file the statement or filing an inaccurate one.

Miscellaneous Provisions of the Model Act

Finally, as discussed above, the Model Act permits out-of-state corporations that make sales in the state but that are not required to file a corporate tax return to file a more limited disclosure statement that simply identifies the business, discloses into which of five specified ranges its dollar sales into the state fell in the relevant tax year, and describes why it is not required to file a tax return. The purpose of allowing the corporation to indicate the range into which its sales in the state falls rather than the precise dollar amount is, once again, to reduce the usefulness of the information to potential competitors. The Model Act also provides that the Secretary of State may provide a list of reasons why a corporation making sales in the state might consider itself to be exempt from a corporate tax filing obligation, which the corporation could then check off. These might include “Activities in state are limited to those protected by Public Law 86-272,” and “Corporation has no employees or property or representatives in the state and considers itself to be tax-exempt under the Commerce Clause of the U.S. Constitution.”

VI. Conclusion

Compelling evidence exists that the corporate income tax is playing a fading role in financing state government services and that the effective rate at which states tax corporate profits is declining as well. Indeed, a number of state investigations have found that a large majority of corporations filing tax returns in a given year pay the minimum corporate income tax — which is often zero.⁵³

Policymakers and advocates concerned about these trends attribute them to such factors as state conformity with provisions of federal tax law that have intentionally cut corporate taxes, proliferating state-specific tax policy changes aimed at enticing corporations to locate jobs and facilities within their borders, and increasing corporate sophistication in taking advantage of loopholes and weaknesses in state corporate tax laws. The business community, on the other hand, attributes the apparent erosion to such factors as the substitution of non-taxable limited liability companies and Subchapter S corporations for taxable “C” corporations as the legal structure of choice for new businesses and the use of losses incurred in the 2001 recession to offset current corporate profits.

Some of this controversy might be resolved if state revenue agencies made more systematic efforts to analyze the wealth of data they receive when corporations file tax returns. But these departments generally see their role as enforcing existing tax laws, tend to shy away from tax policy-related disputes, and, in any case, are severely resource-constrained. Outside analysts and investigative journalists are best equipped to conduct research aimed at determining what is really happening to state corporate tax systems and why. In order to do this work effectively, these individuals must have access to a certain amount of currently-confidential corporate tax return-based information. They also must be able to identify the corporations themselves so that tax data can be matched and compared with other publicly-available information, such as financial data from corporate annual reports. Perhaps more importantly, experience with both federal and state corporate tax reform efforts suggests that even when research reveals that corporate tax restructuring is needed, the public is not likely to mobilize to demand change and policymakers are not likely to respond to such demands unless they can be presented with concrete examples of corporations that appear to be taking undue advantage of current law.

In short, company-specific tax disclosure may well be the precondition to meaningful progress in restoring the state corporate income tax to a significant role in financing state services. A significant role for the tax is needed, both because most states continue to face large structural budget gaps in the future due to such factors as rising health care costs and an aging population, and because the corporate income tax is one of the few revenue sources available to states that can offset the regressivity of such other major revenue sources as sales taxes, property taxes, and gasoline taxes. A robust corporate income tax is also needed to ensure that the disproportionately-wealthy, mostly out-of-state owners of multistate corporations doing business in a state pay for the services provided by the state to the corporations they own.

This report has presented for consideration a model corporate tax disclosure statute. Its provisions seek to balance the public's need for information related to critical tax policy issues against the need to minimize corporate compliance burdens and the possibility of placing some corporations at an economic disadvantage vis-à-vis their competitors. The report also has laid out a detailed case for company-specific disclosure and demonstrated that most of the anticipated objections to such disclosure have little if any validity. Armed with this information, policymakers and interested citizens in numerous states will, it is hoped, start a vigorous debate about the role that disclosure could play in revitalizing state corporate taxation.

Appendix A: The Model State Corporate Income Tax Disclosure Act

1 **Section 1: Definitions**

2
3 1. As used in this Title, “corporation” means any entity subject to the tax imposed by [reference
4 state corporate income or franchise tax statute] or by Section 11 of the Internal Revenue Code of
5 1986 as amended, except that “qualified personal service corporations,” as defined in section 448 of
6 the Internal Revenue Code of 1986, as amended, shall be exempt from this Title.

7 2. As used in this Title, “doing business in this state” means owning or renting real or tangible
8 personal property physically located in this state; having employees, agents, or representatives acting
9 on the corporation’s behalf in this state; making sales of tangible personal property to purchasers
10 that take possession of such property in this state, performing services for customers located in this
11 state, performing services in this state, earning income from intangible property that has a business
12 situs in this state, engaging in regular and systematic solicitation of sales in this state; being a partner
13 in a partnership engaged in any of the preceding activities in this state; or being a member of a
14 limited liability company engaged in any of the preceding activities in this state.

15 **Section 2: Tax Disclosure Statement Required**

16 The following corporations, if doing business in this state, shall file with the Secretary of State
17 the statement described by Section 3 of this Title:

18 (1) All publicly traded corporations, including corporations traded on foreign stock
19 exchanges; and

20 (2) All corporations fifty percent or more of the voting stock of which is owned, directly or
21 indirectly, by a publicly-traded corporation;

22 **Section 3: Content of Tax Disclosure Statement**

23 The statement required by Section 2 of this Title shall be filed annually in an electronic format
24 specified by the Secretary of State no more than 30 days following the filing of the tax return
25 required by [reference to state corporate income or franchise tax statute], or, in the case of a
26 corporation not required to file such a tax return, within 90 days of the filing of such corporation’s
27 federal tax return, including such corporation’s inclusion in a federal consolidated return. The
28 statement shall contain the following information:

29 (1) The name of the corporation and the street address of its principal executive office;

30 (2) If different from (1), the name of any corporation that owns, directly or indirectly, 50
31 percent or more of the voting stock of the corporation and the street address of the former
32 corporation's principal executive office;

33 (3) The corporation's 4-digit North American Industry Classification System code number;

34 (4) A unique code number, assigned by the Secretary of State, to identify the corporation,
35 which code number will remain constant from year to year;

36 [Note: The following (5) and (6) are applicable to non-combined-reporting states]

37 (5) The following information reported on or used in preparing the corporation's tax return
38 filed under the requirements of [reference state corporate income or franchise tax statute],
39 or, in the case of a corporation included in a state consolidated tax return, reported on or
40 used in preparing the state consolidated tax return filed under the requirements of [reference
41 state corporate income or franchise tax statute], or, in the case of a corporation not required
42 to file a tax return under the requirements of [reference to state corporate income or
43 franchise tax statute], the information that would be required to be reported on or used in
44 preparing the tax return were the corporation required to file such a return:

45 (a) Total receipts; [Note: or substitute state term for total gross income]

46 (b) Total cost-of-goods-sold claimed as a deduction from gross income;

47 (c) Taxable income prior to net operating loss deductions or apportionment;

48 (d) Property, payroll, and sales apportionment factors; [Note: as applicable to state]

49 (e) Calculated overall apportionment factor in the state;

50 (f) Total business income apportioned to the state;

51 (g) Net operating loss deduction, if any;

52 (h) Total non-business income and the amount of non-business income allocated to
53 the state;

54 (i) Total taxable income;

55 (j) Total tax before credits;

56 (k) Tax credits claimed, each credit individually enumerated; [Note: individual
57 enumeration might be limited to credits reducing pre-credit liability for all
58 corporations taxable in the state collectively by more than 5-10 percent]

59 (l) Alternative minimum tax [if applicable];

- 60 (m) Tax due;
- 61 (n) Tax paid;
- 62 (o) Amount of tax due paid under protest, if applicable.

63 (6) The following information:

64 (a) Total deductions for management services fees, for rent, and for royalty, interest,
65 license fee, and similar payments for the use of intangible property paid to any
66 affiliated entity that is not included in the state consolidated income tax return, if
67 any, that includes the corporation, and the names and principal executive office
68 addresses of the entities to which the payments were made;

69 (b) The sales factor that would be calculated for this state if the corporation [or
70 consolidated group] were required to treat as sales in this state sales of tangible
71 personal property to the Federal Government and sales of tangible personal property
72 shipped or delivered to a customer in a state in which the selling corporation is
73 neither subject to a state corporate income tax or state franchise tax measured by net
74 income nor could be subjected to such a tax were the state to impose it; [Note: only
75 to be reported in states not having in effect the standard “throwback rule” under the
76 Uniform Division of Income for Tax Purposes Act]

77 (c) A description of the source of any nonbusiness income reported on the return
78 and the identification of the state to which such income was reported;

79 [(d) A listing of all corporations included in the consolidated tax return that includes
80 the corporation, if such a return is filed, and their state identification numbers
81 assigned under the provisions of this section;]

82 (e) Full-time-equivalent employment of the corporation in the state on the last day of
83 the tax year for which the return is being filed and for the three previous tax years;

84 (f) In the case of a publicly-traded corporation incorporated in the United States or
85 an affiliate of such a publicly-traded corporation, profits before tax reported on the
86 Securities and Exchange Commission Form 10-K for the corporation or the
87 consolidated group of which the corporation is a member for the corporate fiscal
88 year that contains the last day of the tax year for which the return is filed;

89 [(g) The property and payroll factors for this state calculated as required by the
90 Uniform Division of Income for Tax Purposes Act as embodied in Article IV of the
91 Multistate Tax Compact and Multistate Tax Commission regulations applying
92 thereto.] [Note: this provision to be included in single sales factor formula states
93 only]

94 (h) Accumulated tax credit carryovers, enumerated by credit.

95 *[Note: The following (5) and (6) are applicable to combined-reporting states]*

96 *(5) The following information reported on or used in preparing the corporation's tax return filed under the*
97 *requirements of [reference state corporate income or franchise tax statute], or, in the case of a corporation not*
98 *required to file a tax return under the requirements of [reference to state corporate income or franchise tax*
99 *statute], the information that would be required to be reported on or used in preparing the tax return were the*
100 *corporation required to file such a return:*

101 *(a) Total receipts of the unitary group of which the corporation is a member; [Note: or substitute*
102 *state term for total gross income]*

103 *(b) Total cost-of-goods-sold claimed as a deduction from gross income by the unitary group of which*
104 *the corporation is a member;*

105 *(c) Taxable income of the unitary group of which the corporation is a member prior to net operating*
106 *loss deductions or apportionment;*

107 *(d) Property, payroll, and sales apportionment factors of the corporation as calculated on the*
108 *combined report; [Note: as applicable to state]*

109 *(d) Calculated overall apportionment factor in the state for the corporation as calculated on the*
110 *combined report;*

111 *(f) Total business income of the corporation apportioned to the state;*

112 *(g) Net operating loss deduction, if any, of the corporation apportioned to the state;*

113 *(h) Total non-business income of the corporation and the amount of non-business income allocated to*
114 *the state;*

115 *(i) Total taxable income of the corporation;*

116 *(j) Total tax before credits;*

117 *(k) Tax credits claimed, each credit individually enumerated; [Note: individual enumeration might*
118 *be limited to credits reducing pre-credit liability for all corporations taxable in the state collectively by*
119 *more than 5-10 percent]*

120 *(l) Alternative minimum tax [if applicable];*

121 *(m) Tax due;*

122 *(n) Tax paid;*

123 *(o) Amount of tax due paid under protest, if applicable.*

124 *(6) The following information:*

125 (a) Total deductions for management services fees, for rent, and for royalty, interest, license fee, and
126 similar payments for the use of intangible property paid to any affiliated entity that is not included in
127 the unitary combined group that includes the corporation and the names and principal office
128 addresses of the entities to which the payments were made;

129 (b) The sales factor that would be calculated for this state on the combined report if the corporation
130 were required to treat as sales in this state sales of tangible personal property to the Federal
131 Government and sales of tangible personal property shipped or delivered to a customer in a state in
132 which the selling corporation is neither subject to a state corporate income tax or state franchise tax
133 measured by net income nor could be subjected to such a tax were the state to impose it; [Note: only
134 to be reported in states not having in effect the standard "throwback rule" under the Uniform
135 Division of Income for Tax Purposes Act]

136 (c) A description of the source of any nonbusiness income reported on the return and the
137 identification of the state to which such income was reported;

138 (d) A listing of all corporations included in the unitary group that includes the corporation, their
139 state identification numbers assigned under the provisions of this section, if applicable, and a listing
140 of all variations in the unitary group that includes the corporation used in filing corporate income or
141 franchise tax returns in any of the following states: Alaska, Arizona, California, Colorado,
142 Hawaii, Idaho, Illinois, Kansas, Maine, Minnesota, Montana, Nebraska, New Hampshire,
143 North Dakota, Oregon, Utah, Vermont;

144 (e) Full-time-equivalent employment of the corporation in the state on the last day of the tax year for
145 which the return is being filed and for the three previous tax years;

146 (f) In the case of a publicly-traded corporation incorporated in the United States or the affiliate of
147 such a publicly-traded corporation, profits before tax reported on the Securities and Exchange
148 Commission Form 10-K for the corporation or the consolidated group of which the corporation is a
149 member for the corporate fiscal year that contains the last day of the tax year for which the return is
150 filed;

151 [(g) Property and payroll factors for the corporation for this state calculated on the basis of combined
152 reporting and as required by the Uniform Division of Income for Tax Purposes Act as embodied in
153 Article IV of the Multistate Tax Compact and Multistate Tax Commission regulations applying
154 thereto.] [Note: this provision to be included in single sales factor formula states only]

155 (h) Accumulated tax credit carryovers, enumerated by credit.

156 **Section 4: Alternative Statement Option for Corporations Not Required to File Tax Return**

157 In lieu of the statement described in Section 3, a corporation doing business in this state but not
158 required to file a tax return under the requirements of [reference state's corporate income or
159 franchise tax statutes] may elect to file a statement with the Secretary of State containing the
160 following information:

161 (1) The information specified in Section 3, items (1) through (4), inclusive;

162 (2) An explanation of why the corporation is not required to file a corporate income tax
163 return in this state, which explanation may take the form of checking one or more possible
164 explanations drafted by the Secretary of State;

165 (3) Identification of into which of the following ranges the corporation's total gross receipts
166 from sales to purchasers in this state fell in the tax year for which this statement is filed:

167 (a) Less than \$10 million;

168 (b) \$10 million to \$50 million;

169 (c) More than \$50 million to \$100 million;

170 (d) More than \$100 million to \$250 million;

171 (e) More than \$250 million.

172 **Section 5: Supplemental Information Permitted**

173 Any corporation submitting a statement required by this Title shall be permitted to submit
174 supplemental information that, in its sole judgment, could facilitate proper interpretation of the
175 information included in the statement. The mechanisms of public dissemination of the information
176 contained in the statements described in Section 7 of this Title shall ensure that any such
177 supplemental information be publicly available and that notification of its availability shall be made
178 to any person seeking information contained in a statement.

179 **Section 6: Amended Tax Disclosure Statements Required**

180 If a corporation files an amended tax return, the corporation shall file a revised statement under
181 this section within sixty calendar days after the amended return is filed. If a corporation's tax
182 liability for a tax year is changed as the result of an uncontested audit adjustment or final
183 determination of liability by the [name state's administrative appeals body] as provided for in
184 [reference administrative appeals portion of state statute] or by a court of law as provided for in
185 [reference legal appeals portion of state statute], the corporation shall file a revised statement under
186 this section within sixty calendar days of the final determination of liability.

187 **Section 7: Public Access to Tax Disclosure Statements**

188 The statements required under this Title shall be a public record. The Secretary of State shall
189 make all information contained in the statements required under this Title for all filing corporations
190 available to the public on an ongoing basis in the form of a searchable database accessible through
191 the Internet. The Secretary of State shall make available and set charges that cover the cost to the
192 state of providing copies on appropriate computer-readable media of the entire database for
193 statements filed during each calendar year as well as hard copies of an individual annual statement
194 for a specific corporation. No statement for any corporation for a particular tax year shall be
195 publicly available until the first day of the third calendar year that follows the calendar year in which
196 the particular tax year ends.

197 **Section 8: Enforcing Compliance**

198 The accuracy of the statements required under this Title shall be attested to in writing by the
199 chief operating officer of the corporation and shall be subject to audit by the [department of
200 revenue] as the agent of the Secretary of State in the course of and under the normal procedures
201 applicable to corporate income tax return audits. The Secretary of State shall develop and implement
202 an oversight and penalty system applicable to both the chief operating officer of the corporation and
203 the corporation itself to ensure that corporations doing business in this state, including those not
204 required to file a return under the requirements of [reference state corporate income or franchise tax
205 statute], shall provide the required attestation and disclosure statements, respectively, in a timely and
206 accurate manner. The Secretary of State shall publish the name and penalty imposed upon any
207 corporation subject to a penalty for failing to file the required statement or filing an inaccurate
208 statement. The Secretary of State shall promulgate appropriate rules to implement the provisions of
209 this Title under the rulemaking procedures described in [reference state administrative procedures
210 act].

Appendix B: Key Differences between the Separate Entity, Consolidated, and Combined Reporting Methods of Levying State Corporate Income Taxes

Most major corporations known to the average citizen — General Motors and Exxon for example — are actually multi-corporate groups composed of a “parent” corporation and a number “subsidiary” corporations owned by the parent. States take three basic approaches to dealing with the fact that corporations subject to their income taxes may be a member of such a corporate group. The three approaches are known as the “separate entity,” “consolidated,” and “combined reporting” methods of taxation. The following is an overview of these methods, with an emphasis on the key conceptual differences between them. As actually practiced by the states, there are many nuances not captured here and some exceptions to what is stated here. A much more extensive discussion may be found in John C. Healy and Michael S. Schadewald, *2006 Multistate Corporate Tax Guide on CD ROM*, CCH, Inc..

Separate Entity

“Separate entity” states ignore the existence of the corporate group. They treat each individual corporation subject to their income tax as a separate taxpayer. Even though the corporation’s profit may be affected by purchases from or sales to its affiliated parent, subsidiary, or sister corporations, a separate entity state accepts the corporation’s own statement of its taxable profits derived from its own books. (Separate entity states often have authority to make ad hoc adjustments to these books for tax purposes, however, if they believe intra-group sales are being manipulated to avoid taxes.)

A share of the individual corporation’s nationwide profit is assigned to the state for taxation — “apportioned” — using a formula. Under one formula in use, if 10 percent of a corporation’s nationwide property, 10 percent of its nationwide payroll, and 25 percent of its nationwide sales are in a particular state, then 15 percent — the average of these three “apportionment factors” — of its nationwide profit will be taxable in that state. Under separate-entity taxation, the apportionment factors are determined only by looking at the property, payroll, and sales of the individual corporate taxpayer.

Consolidation

If a state mandates (or, more typically, allows an election of) “consolidated reporting,” it will treat commonly-owned corporations *that are subject to its corporate income tax* as a *single* corporation for tax purposes. As under the separate-entity approach, whether each individual corporation is subject to the income tax depends on the nature and scale of the activities it conducts within the state’s borders. Once this threshold of taxability or “nexus” has been crossed by two or more related corporations, however, their profits are added together. This addition eliminates any impact on the

combined profit of the “consolidated group” of any purchases and sales within the group that might have taken place. (For example, a \$1 sale of a product from the parent to a consolidated subsidiary creates no profit for the consolidated group because it is offset by a \$1 expense of the subsidiary. Profit equals sales minus expenses.)

In order for two or more related corporations to be consolidated, they not only must all be taxable in the state, but they must also satisfy a threshold of common ownership. This is usually the 80 percent ownership test that must be satisfied for corporations to be consolidated for federal corporate income tax purposes. For example, if a parent corporation and one of its subsidiaries are both taxable in a particular state that mandates consolidated reporting, the parent must own at least 80 percent of the voting stock of the subsidiary before it can file a consolidated return with the subsidiary. Similarly, two subsidiaries of a common parent corporation that are both taxable in a particular state cannot file a consolidated return unless a common parent owns at least 80 percent of the voting stock of each of them.

If two or more corporations are consolidated for state income tax purposes, their combined profit is apportioned to the state using their *combined* apportionment factors. (Only sales outside the group affect the sales factor, however.)

Combined Reporting

The third approach, combined reporting, is similar to consolidated reporting in that the profits of commonly-owned corporations are added together prior to apportionment of the combined income. It differs from consolidated reporting in three key ways, however.

First, in order to have their profits added together and their apportionment factors calculated jointly, common ownership of corporations is not enough. The corporations whose profit is to be combined must also be part of a “unitary business,” in which there is some economic synergy resulting from sales or other interactions between the corporations. The classic example of a unitary business is a “vertically-integrated” oil company, in which one subsidiary develops and operates oil fields and sells the crude oil to a subsidiary that owns a refinery. The refining subsidiary refines the crude oil into gasoline, fuel oil, and jet fuel, and then sells it to a marketing subsidiary. The marketing subsidiary then sells the refined products to independently-owned gas stations, fuel oil distributors, and airlines.

Court cases have led to several broad definitions of what constitutes a unitary business, which some states have tried to clarify further by adopting expanded statutory or regulatory language. It is inherently a somewhat subjective concept, however, and, as a result, corporations have substantial discretion in deciding which of their sister, parent, or subsidiary corporations they will include in their unitary combined group when they file their tax returns. Particularly the first time they audit a specific corporation, states sometimes disagree with the corporation’s composition of its unitary group. In the event of a disagreement, the issue is resolved through negotiation or, sometimes, litigation.

Second, corporations do not *themselves* have to be taxable in a particular combined reporting state in order to have their profits added to the profits of corporations that *are* taxable in the combined

reporting state. The U.S. Supreme Court has held that a state may apportion to itself a share of the combined profits of corporations with and without nexus *so long as* the non-nexus corporations are part of the same “unitary business” as the corporation or corporations that *do* have nexus in the state.

Third, combined reporting states generally treat each individual member corporation in a unitary corporate group as a separate taxpayer in calculating tax liability. When that is the case, these corporations calculate their individual apportionment factors by determining the shares of the unitary group’s total payroll, property and sales that their own individual payroll, property and sales represent. (This assumes that the combined reporting state mandates the use of all three factors.) The three factors are averaged under the requirements of state law, and then the overall, averaged factor is applied to the combined taxable income of the *unitary group*.

Lines 96-155 of the Model Act, which are intended to be applicable in combined reporting states, assume that the state is one in which individual corporate members of a unitary group are effectively treated as individual taxpayers. That is not always the case; some states’ combined reporting requirements are mechanically analogous to typical consolidated filing approaches in effectively obliterating individual corporate identities and treating the entire unitary group as one taxpayer. In such a state, the Model Act would have to be modified further to match the state’s combined reporting approach.

Endnotes

¹ Steven Maguire, *Average Effective Corporate Tax Rates: 1959 to 2005*, Congressional Research Service, Updated September 6, 2006. The effective state corporate income tax rate documented in this report is modestly understated and its rate of decline over time is modestly overstated. The effective state corporate income tax rate is calculated by dividing state corporate profits tax revenues by a measure of corporate profits. The understatement of the effective corporate tax rate is due to the fact that the profits of Subchapter S corporations are included in the measure of profits in the denominator, but taxes imposed on those profits are not included in the numerator because they take the form of state personal income taxes rather than state corporate income taxes. (Subchapter S corporations are not subject to corporate income taxes; their profits are “passed-through” to the personal income tax returns of their owners.) Moreover, since the share of total corporate profits reported by S corporations has risen over the last decade, the rate of decline in the effective corporate tax rate estimated by CRS is overstated.

Further refinement of the CRS methodology would be needed to estimate the extent of the bias. However, federal corporate income tax receipts and state corporate income tax receipts are both reduced by the growth in S corporation profits, yet federal corporate income tax receipts have grown significantly faster than state corporate income tax receipts over the past decade. (See Figure 2.) This suggests that there are state-specific factors other than the growth in S corporations that are contributing to the decline in the effective rate of state corporate income taxation.

² Florida Senate Committee on Finance and Taxation, *Why Did Florida’s Corporate Income Tax Revenue Fall While Corporate Profits Rose?*, November 2003, p. 3.

³ Oklahoma Tax Commission, *Oklahoma Corporate Income Tax Issue Paper*, November 22, 2004, p. 5.

⁴ Michael Leachman, *Corporate Tax Dodge: The Decline of the Oregon Corporate Income Tax and the Shift to Individual Taxpayers*, Oregon Center for Public Policy, Revised May 27, 2005, p. 6.

⁵ Peter S. Fisher, *Revitalizing Iowa’s Corporate Income Tax*, Iowa Fiscal Partnership, April 2006, p. v.

⁶ Like S-corporations, LLCs are “pass-through entities.” The businesses themselves are tax-exempt. Instead, their profits are “passed through” to the income tax returns of their owners. LLCs may be owned by both corporations and individuals. S-corporations may only be owned by individuals.

⁷ The federal corporate income tax rate has remained constant since 1993, and there have been only a few state corporate income tax rate cuts since then as well. From 1993 to 2000 (when federal corporate income tax receipts peaked before the 2001 recession), federal corporate income tax revenues grew at an annual rate of 6.8 percent, while state corporate taxes grew only 4.9 percent annually. Since bottoming-out after the 2001 recession, federal corporate income tax revenues have grown 34.3 percent annually; state corporate tax revenues lagged well behind with 17.7 percent annual revenue growth.

⁸ For a recent critical analysis of the cost-effectiveness of state tax incentives, see: William Hoyt, Christopher Jepsen, and Kenneth R. Troske, *An Examination of Incentives to Attract and Retain Businesses in Kentucky*, report submitted to the Kentucky Cabinet for Economic Development, January 18, 2007.

⁹ See: Michael Mazerov, *Many States Could Avoid an Unnecessary Revenue Loss During the Current Fiscal Crisis by Disallowing Business Operating Loss Carrybacks*, Center on Budget and Policy Priorities, May 20, 2003, and Nicholas Johnson, *State Revenue Losses from the Federal “Domestic Production Deduction” Will Double in 2007: States Could Save Billions by Disallowing this Deduction*, Center on Budget and Policy Priorities, January 2, 2007.

¹⁰ See the table titled “Company-Specific Subsidy Disclosure in the States,” available at www.goodjobsfirst.org/pdf/disclosure_chart.pdf.

¹¹ These two examples assume that nominal, statutory corporate income tax rates were identical in the states in which the comparisons were being made. If this were not the case, then the analysis would have to involve comparing the ratios of the effective tax rate to the nominal tax rate in the relevant states. Of course, it would be desirable that the types of comparisons being suggested here be made for as many corporations and states as possible.

Royalty addback statutes and combined reporting are explained in Michael Mazerov, *Closing Three Common Corporate Income Tax Loopholes Could Raise Additional Revenue for Many States*, Center on Budget and Policy Priorities, Revised May 21, 2003 (hereafter referenced as “*Three Loopholes* report.” Combined reporting is also discussed in Appendix B.

¹² Glenn R. Simpson, “A Tax Maneuver in Delaware Puts Squeeze on Other States,” *Wall Street Journal*, August 9, 2002.

¹³ See, for example, Jeffrey Birnbaum and Alan Murray, *Showdown at Gucci Gulch*, Random House, 1987, pp. 11-13.

¹⁴ The Institute for Wisconsin's Future, a fiscal analysis group there, recently made public data on state corporate tax payments it had obtained from the state department of revenue under the provisions of the state's disclosure law. It found that two-thirds of state corporate tax return filers paid no state corporate income tax in 2003 and named among those corporations Kohl's department stores, Harley-Davidson, and Kraft Foods. Wisconsin Manufacturers and Commerce, the state's major business trade association, responded that "there could be many reasons why companies didn't pay state income tax — including that subsidiary companies paid it and that the companies didn't make a profit." See: Mark Pitsch, "Two of Three Companies Pay No State Income Tax," *Capital Times*, December 5, 2006. Without additional information, it is difficult or impossible to evaluate the accuracy of MWC's response.

¹⁵ Richard D. Pomp, *Corporate Tax Policy and the Right to Know*, (Albany, New York: Fiscal Policy Institute) 1993, p. 38. Hereafter referred to as the "Pomp report." Available at www.fiscalpolicy.org/CorporateTaxPolicy&TheRightToKnow.pdf. The Pomp report was re-published as "The Disclosure of State Corporate Income Tax Data: Turning the Clock Back to the Future," *Capital University Law Review*, Spring 2003, pp. 373-464. The law review article lacks the executive summary included in the original version of the paper published by the Fiscal Policy Institute but includes a "postscript" that is not present in the FPI version concerning the repeal by the Massachusetts legislature of the disclosure law enacted by the voters in 1992. The 1993 Pomp report was written, in part, to respond to Robert P. Strauss, "State Disclosure of Tax Return Information: Taxpayer Privacy Versus the Public's Right to Know," *State Tax Notes*, July 5, 1993. Strauss responded in "The Political Economy of Business Tax Return Privacy," *State Tax Notes*, February 27, 1995. Pomp responded with "The Political Economy of Tax Return Privacy — Revisited," *State Tax Notes*, June 12, 1995. The arguments made in these four papers still dominate the current debate about state corporate tax disclosure.

¹⁶ Pomp report, p. 40. Footnotes and paragraph break omitted.

¹⁷ Seven members of the Massachusetts Special Commission on Business Tax Policy voted in favor of anonymous disclosure, and five members voted against it.

¹⁸ *Forbes Magazine*, November 2005.

¹⁹ Pomp report, p. 45. Footnotes in original omitted. A fifth reason in the list, "companies have the option of disclosing either gross profit or tax credit carryovers under Massachusetts law" is also omitted from the quote because it was specific to the Massachusetts law under consideration and widely considered to be a poorly-thought-out provision that would not be replicated in future disclosure proposals in other states.

²⁰ Pomp report, p. 44.

²¹ Moreover, in many cases, the profit margins that will be reported will be aggregated not only across multiple products, but across multiple states. That is, a specific corporation with sales in multiple states will report its overall profit margin, which will then be apportioned by formula to all the states in which it is taxable. A competitor will not be able to discern the profit margin earned in any particular state, which will make strategic pricing decisions aimed at grabbing market share from a competitor even more problematic.

²² Pomp report, p. 48.

²³ With regard to business location decisions, Pomp observes: "There are many provisions in a tax code that are adopted to improve the business climate. Some of these provisions were even adopted at the specific request of a corporation, in an attempt by a legislature to induce the corporation to invest in a state (or to remain or expand its operations in a state). It is disingenuous to use the business climate argument in support of the adoption of these provisions and then use the same argument to prevent the public from evaluating in a meaningful way the effectiveness of such provisions." Pomp report, p. 49.

²⁴ Pomp report, p. 49.

²⁵ Pomp report, p. 49.

²⁶ Robert Tannenwald, et. al, *Corporate Tax Disclosure: Good or Bad for the Commonwealth?*, reported prepared for the Massachusetts Special Commission on Business Tax Policy, May 28, 1993, p. 27. Reprinted in *State Tax Notes* magazine, July 5, 1993.

²⁷ The statement is available at http://www.statetax.org/Template.cfm?Section=Policy_Statements&Template=/

²⁸ In its 2006 policy statement in opposition to corporate tax disclosure, COST provides an example of what it alleges to be distorted use of company-specific tax information:

[I]n New Jersey, tax return information was used to allege that “Public Company A” employed thousands of workers and earned significant income but was paying the State’s minimum tax. In fact, those employees worked for and those profits were earned by a subsidiary of the public company; that subsidiary paid a substantial amount of tax to the state.

In fact, the administration of then-Governor James McGreevey fully disclosed at the time that some subsidiary corporations of the large corporations they had identified as minimum tax payers *were* paying somewhat more than the minimum tax to New Jersey. At the press conference at which he released his corporate tax reform proposal, McGreevey himself stated: “After critically evaluating these returns [of the 50 corporations with the largest New Jersey payrolls], the state evaluated 737 subsidiaries of these 50 corporations and found that 543 of them, or 71 percent, also paid the \$200 CBT [Corporation Business Tax] minimum.” In other words, McGreevey acknowledged that 29 percent of the subsidiaries paid more than the minimum tax. (See: Risa Williams, “New Jersey Governor Defends His Corporate Tax Plan,” *State Tax Notes Today*, April 11, 2002.) Furthermore, the state budget, which laid out the tax reform plan in writing, stated: Of the 50 largest employers, as measured by the number of employees, 15 paid less than \$50,000 in corporate income taxes, even including all of their subsidiaries. Nine of those employers paid less than \$400 per related company.” Again, these sentences acknowledge that corporate groups as a whole were paying more than the minimum tax. (See: New Jersey Office of Management and Budget, *Fiscal 2003 Budget in Brief*, April 2002, p. 21.)

Moreover, the author was personally involved in the 2002 New Jersey debate and does not recall any business representatives seeking to make the point that subsidiaries of the alleged non-paying parent corporations were paying New Jersey corporation business tax. (A Nexis search covering the first half of 2002 looking for articles that contained the keywords of “New Jersey,” “corporation business tax,” and “subsidiaries” revealed no articles in which business representatives were quoted making this observation.) The point about tax payments by subsidiaries seems fairly straightforward and probably could have been conveyed to the media and the public without too much difficulty if New Jersey’s business community had chosen to do so. Indeed, Wisconsin business representatives were widely quoted in local media making the same argument in response to a November 2006 study alleging that many profitable Wisconsin corporations were not paying income tax to the state.

²⁹ Pomp report, pp. 47-8.

³⁰ Remarks of Commissioner of Internal Revenue Mark W. Everson before the National Press Club, March 14, 2006. Emphasis added.

³¹ See: Robert P. Strauss, “State Disclosure of Tax Return Information: Taxpayer Privacy Versus the Public’s Right to Know,” *State Tax Notes*, July 5, 1993. See also: Robert P. Strauss, “The Political Economy of Business Tax Return Privacy,” *State Tax Notes*, February 27, 1995.

³² Richard D. Pomp, “The Political Economy of Tax Return Privacy — Revisited,” *State Tax Notes*, June 12, 1995, p. 2391. Footnotes omitted.

³³ See the source cited in Note 26, on pp. 29-33.

³⁴ See the *Three Loopholes* report.

³⁵ Pomp report, p. 36.

³⁶ Pomp report, p. 37.

³⁷ Pomp report, p. 37.

³⁸ Pomp report, p. 37.

³⁹ Pomp report, p. 36.

⁴⁰ Pomp report, p. 32.

⁴¹ Pomp report, p. 35.

⁴² Pomp report, p. 42.

⁴³ Pomp report, p. 42.

⁴⁴ Peter Fisher, “Tax Incentives and the Disappearing State Corporate Income Tax,” *State Tax Notes*, March 4, 2002, pp. 767-774.

⁴⁵ For a detailed description of combined reporting, see: Michael J. McIntyre, Paul Mines, and Richard D. Pomp, “Designing a Combined Reporting Regime for a State Corporate Income Tax: A Case Study of Louisiana,” *State Tax Notes*, September 3, 2001, pp. 741-769.

⁴⁶ See the *Three Loopholes* report for examples of “non-business” income and a discussion of state problems in taxing it.

⁴⁷ Again, see the *Three Loopholes* report for an expanded discussion of problems in state corporate taxation of “non-business” income.

⁴⁸ See: *Three Loopholes* report; Glenn R. Simpson, “Irish Subsidiary Lets Microsoft Slash Taxes in U.S. and Europe,” *Wall Street Journal*, November 7, 2005; Jesse Drucker, “Walmart Cuts Taxes by Paying Rent to Itself,” *Wall Street Journal*, February 1, 2007.

⁴⁹ For a more extensive discussion of this issue, see the *Three Loopholes* report.

⁵⁰ See: Michael Mazerov, *The “Single Sales Factor” Formula for State Corporate Taxes: A Boon to Economic Development or a Costly Giveaway?* Center on Budget and Policy Priorities, revised September 2005.

⁵¹ Conversation with Jeff McLynch, Massachusetts Budget and Policy Center, December 5, 2006.

⁵² For the study cited in Note 14, it took the Institute for Wisconsin’s Future approximately 14 months to acquire the tax payment information for approximately 200 corporations. The turn-around time for a batch of 20 companies was as long as six weeks. Conversation with IWF Research Director Jack Norman, December 5, 2006.

⁵³ See, for example, *All Gain, No Pain: California’s “No Tax” Corporations*, California Budget Project, September 23, 2004. Available at www.cbp.org/pdfs/2004/0409allgain.pdf.