A Simple Fix for a $17 Billion Loophole

How States Can Reclaim Revenue Lost to Tax Havens

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American Sustainable Business Council

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Executive Summary

Every year, corporations use complicated schemes to shift U.S. earnings to subsidiaries in offshore tax havens—countries with minimal or no taxes—in order to reduce their state and federal income tax liability by billions of dollars.

Meanwhile, smaller, wholly-domestic U.S. businesses cannot game the system in the same way. The result is that large multinational businesses compete on an uneven playing field, avoiding taxes that their small competitors must pay. Innovation in the marketplace is replaced by innovation in the tax code.

The companies that abuse tax havens benefit from America's markets, public infrastructure, educated workforce, security and rule of law—all supported in one way or another by tax dollars. When it comes to supporting the services we all depend on for a stable, secure and thriving community, ordinary taxpayers and domestic competitors end up picking up the tab for tax dodgers, either in the form of higher taxes, more debt or cuts to public spending.

While much attention is paid to the impact of tax haven abuse on federal revenue, offshore tax havens also reduce state revenue because state tax codes are often tethered to federally defined taxable income. Instead of reducing the problems of offshore tax dodging, recent changes to federal law increase the incentive for companies to stash their profits abroad.[1] But even as Congress has missed opportunities to address tax haven abuse, there are changes states can make to reduce the impact of offshore tax dodging on state budgets.

Our report explores several options for states to address profit shifting. The main mechanism which states have created to address multi-jurisdictional profit shifting is known as "Combined Reporting." In a Combined Reporting system, companies report their total domestic profits, including all their subsidiaries, to which the state applies a formula to calculate how much of that profit is attributable to business activities in a given state to determine taxable profits in that state. Twenty-seven states and the District of Columbia have enacted Combined Reporting systems, most recently Kentucky and New Jersey in 2018 (effective Jan. 1, 2019).[2]

While combined reporting is a vital strategy for preventing domestic corporate tax avoidance, there are two ways the Combined Reporting system can be expanded to address offshore tax haven abuse.

- **Require Worldwide Combined Reporting, Also Known as "Complete Reporting."** Already an option for many states operating with a Combined Reporting system, this is the simplest and most comprehensive way to eliminate profit shifting to dodge taxes. A worldwide report requires a company to report their total, global profits, and the portion of that overall business done in a given jurisdiction. If a state makes up 2 percent of a company's global business, then 2 percent of their taxable profit would be subject to the state's tax rate. Worldwide Combined Reporting is the most comprehensive and effective tool to address tax haven abuse that states have.

- **Extend Domestic Formula to Include Known Tax Havens.** Also known as the Tax Haven List approach, this reform mandates that companies include their U.S. profits held in offshore tax havens when calculating taxes. In many states, companies calculate their tax liability based on their income held in subsidiaries incorporated within the water's edge (within the United States). By declaring a statutory list of tax havens, states can tax corporate profits held in offshore tax havens.

Montana and Oregon passed laws that curb offshore tax haven abuse and collected some millions of dollars in tax revenue that otherwise would be lost, though Oregon has since repealed this rule. Montana continues to treat a proportionate share of the income that corporations book to known tax havens as domestic income for state tax purposes.

Using the Tax Haven List approach allows Montana to collect more than $8 million per year in corporate taxes that would have otherwise gone uncollected.[3]

After Oregon passed similar reforms in 2013, which raised $28.4 million in additional revenue in 2014, legislators repealed the rule in 2018 under pressure from corporate lobbying.[4] [5] Now, Oregon is considering the more comprehensive approach with new legislation to require Worldwide Reporting to improve their ability to apply taxes fairly to all types of businesses.[6]

Enacting Worldwide Combined Reporting or Complete Reporting in all states, this report calculates, would increase state tax revenue by $17.04 billion dollars. Of that total, $2.85 billion would be raised through domestic Combined Reporting improvements, and $14.19 billion would be raised by addressing offshore tax dodging (see Table 1). Enacting Combined Reporting and including known tax havens would result in $7.75 billion in annual tax revenue, $4.9 billion from income booked offshore.

Local businesses tend not to hide their profits with complex international tax schemes, but they do compete against other businesses who exploit those loopholes. Enacting Worldwide Combined Reporting would even the playing field in addition to generating critical revenue.

Table 1: Combined State Revenue Increases from Three Types of Reform

	Revenue Gain from Enacting Combined Reporting	Revenue Gain From Worldwide Combined Reporting	Total Revenue Gain From Closing Loopholes
All States	$2,850,000,000	$14,188,000,000	$17,038,000,000

Introduction

Every person and every corporation in America benefits from government services—from schools to paved roads to courts and public health. When it comes to paying the tab, we need to make sure the rules are applied evenly and fairly, but even though all of America's corporations use government services, some avoid paying taxes for them by moving their profits into offshore havens—a scheme that is not available to smaller competitors.

The practice of exploiting tax havens is unfair to wholly-domestic businesses in addition to straining federal and state budgets, the latter of which mostly do not have the option of running up debt year to year. Twenty-five states faced budget shortfalls in 2018, and some of those have deep structural deficits.[7]

In Oregon, a bi-annual deficit of $1.7 billion has put pressure on public priorities. Meanwhile, in Illinois, large structural problems caused by years of budget woes have undercut long-term planning around mission-critical state programs like education and mental health.

Dr. Kimberly Clausing of Reed College released findings in October of 2018 that American companies will continue to shift $298.9 billion per year of income out of the country under new tax rules passed in 2017,[8] reducing what companies pay in federal income taxes by $59.8 billion each year. [9]

Since corporations pay state income taxes largely based on their federally defined taxable income, these revenue losses hurt states as well. Federal legislation to address tax haven abuse has failed to move forward and the recently enacted "Tax Cuts and Jobs Act" (TCJA) failed to substantially reduce the cash booked offshore.[10] Meanwhile, innovative states are advancing new methods to collect taxes—which are rightfully owed—on these profits held offshore. If these changes had been adopted by all states, a total of $17.04 billion in additional revenue would have been generated in 2018.

The following pages are a roadmap for how all states can collect taxes that are due on corporate profits held in offshore havens, and an assessment of the benefits states would enjoy by doing so.

How States Have Developed Methods to Tax Complex Companies Fairly

States have long striven to accurately tax large, complex multi-jurisdictional businesses. One early example of such a complex business was the railroad industry in the nineteenth century. An individual tract of land with a small amount of wood, steel rail and iron on it isn't worth all that much: its role in the larger rail system provides the real value. To prevent companies from downplaying their assets, states pushed to look at the whole picture of business activity across multiple states. In addition, to prevent businesses from operating as many different connected corporations to game the rules, states required companies to combine the different subsidiary corporations into a unitary business filing.

The Supreme Court ruled in favor of these approaches, permitting states to look at the business in its entirety—its subsidiaries and activity across many states. The Supreme Court likewise allowed states to create a formula to determine the appropriate portion of business attributed to the state.[11] In the case of railroads, a state could calculate the percentage of business in the state using the percentage of the company's tracks in that state. This approach became known as "Combined Reporting" using "formulary apportionment."

Combined Reporting helps states limit the ability of corporations to exploit domestic tax dodging schemes such as the Delaware loophole and real estate investment trusts based in the United States (see "Domestic Schemes for Dodging State Taxes," page 5). Since a majority of states with corporate income taxes already require Combined Reporting, most multistate companies already prepare combined reports and administration is relatively straightforward. All states using the same Combined Reporting system would likely reduce tax preparation time.

In the 1970s and 1980s, as businesses grew more complex, increasingly multinational instead of just multi-state, states began exploring how to grow their Combined Reporting systems to apply to income booked offshore. Worldwide Combined Reporting includes income from all subsidiaries of multinational corporations, whereas domestic Combined Reporting ignores everything that happens beyond the "water's edge."

States are not allowed to tax corporate profits legitimately made in other states or foreign countries, but the purpose of Worldwide Reporting is not to tax foreign income. Worldwide Reporting aims to prevent shifting of income that states have a right to tax. In 1983, the U.S. Supreme Court affirmed this view on Worldwide Reporting in Container Corporation of America vs. Franchise Tax Board. The Court held the interdependence of economic activity, asserting that there is no objective way to calculate where each dollar of income is made in businesses operating in several jurisdictions, and that states have a right to require unified Worldwide Reporting.[12]

There was considerable opposition to unified world reporting, and some corporations lobbied for help from the Reagan White House. Unfortunately, multinational lobbying succeeded in pushing states to move away from the Worldwide Combined Reporting system in favor of allowing companies to opt to exclude any income generated beyond the water's edge from taxation.[13]

Loopholes That Allow Profit-shifting to Tax Havens Cost States Billions of Dollars

The core of the problems faced by states in collecting corporate taxes is the use of tax havens to reduce taxable profits.

Tax havens are countries or jurisdictions with very low or nonexistent taxes—often small island nations like Bermuda, the Cayman Islands and Seychelles—to which firms transfer their earnings to avoid paying taxes in the United States.[14] According to CBO estimates, under updated rules, companies will continue to shift $235 billion in profits offshore each year to avoid

Domestic Schemes for Dodging State Taxes

Anytime a company can shift profits from one place to another, it has a strong incentive to move that profit where it will not be subject to tax, including shifting profits to states like Delaware, Nevada and Wyoming, which don't tax certain corporate income. Many businesses operating in other states transfer profits to holding companies in Delaware, for example, to reduce their tax liability in the states where they do most of their business. Unraveling some tax schemes can be particularly hard because these states routinely require less information to register a corporation than to apply for a driver's license, obscuring the true owners of shell companies.[50]

Another common domestic scheme for skirting tax obligations, popular among chain retail companies, is to establish a real-estate investment trust, which is exempt from paying taxes on dividends to investors. The trust owns land and buildings for the company, which pays rent to the trust, deducting this cost as a business expense from its state taxes. The trust's income is subsequently paid back to the company as a tax-free dividend in many states, keeping all of the money in-house but cheating the states of the taxes they would normally be owed.[51] Combined Reporting reforms help states close loopholes that allow these tactics.

taxes.[15] Prior to the enactment of the new tax rules, Fortune 500 companies managed to accumulate $2.6 trillion in untaxed profits offshore on which they were avoiding over $750 billion in U.S. taxes.[16]

With their armies of tax lawyers and accounting specialists, companies have many strategies for booking profits offshore. Some transfer their patents or trademarks to subsidiaries located in tax havens and spend their domestically earned income to pay tax-deductible royalties to the subsidiary to use the patents or trademarks in America. Other companies engage in "earnings stripping" in which companies in the United States borrow money from subsidiaries in a tax haven and then deduct their interest payments from their taxable income.[17]

Offshore tax haven abuse has been a point of conflict in the debate over federal tax reform for years, but states are also affected because their tax codes are closely tethered to the federal one. To reduce the cost of enforcement and compliance, states calculate taxes using similar definitions of income as

Table 2: Revenue Gain from Worldwide Combined Reporting

All States	**$14,188,000,000**
Alabama	$174,000,000
Alaska	$84,000,000
Arizona	$144,000,000
Arkansas	$131,000,000
California	$2,798,000,000
Colorado	$197,000,000
Connecticut	$158,000,000
Delaware	$96,000,000
District of Columbia	$105,000,000
Florida	$679,000,000
Georgia	$290,000,000
Hawaii	$38,000,000
Idaho	$63,000,000
Illinois	$1,328,000,000
Indiana	$246,000,000
Iowa	$178,000,000
Kansas	$120,000,000
Kentucky	$194,000,000
Louisiana	$109,000,000
Maine	$52,000,000
Maryland	$313,000,000
Massachusetts	$669,000,000
Michigan	$321,000,000
Minnesota	$418,000,000
Mississippi	$145,000,000
Missouri	$120,000,000
Montana	$36,000,000
Nebraska	$92,000,000
New Hampshire	$177,000,000
New Jersey	$714,000,000
New Mexico	$47,000,000
New York	$1,346,000,000
North Carolina	$222,000,000
North Dakota	$47,000,000
Oklahoma	$115,000,000
Oregon	$175,000,000
Pennsylvania	$729,000,000
Rhode Island	$35,000,000
South Carolina	$118,000,000
Tennessee	$438,000,000
Utah	$103,000,000
Vermont	$31,000,000
Virginia	$241,000,000
West Virginia	$49,000,000
Wisconsin	$303,000,000

those used at the federal level,[18] meaning that when corporations do not report income to the federal government, it typically goes unreported to the states, too.

In 2018, offshore tax dodging cost states $14.19 billion in lost tax revenue. California lost the most, at $2.8 billion, while New York and Illinois each lost more than $1.3 billion. In all, 32 states lost more than $100 million to offshore tax dodging that year (See Table 2).

Since most states have balanced budget requirements, every dollar of state revenue that is lost to offshore tax havens must be made up elsewhere, either through cuts to spending on state services and infrastructure, or higher taxes on ordinary taxpayers.[19]

As states see a backlash against education funding cuts, highlighted by the 2018 teacher demonstrations in Arizona, Kentucky, North Carolina, Oklahoma and Colorado, there is increasing pressure to find equitable and popular revenue sources.[20]

States, Including Montana and Oregon, Take New Action to Address Tax Havens

As states continue to face budget pressure, and comprehensive reform on offshore tax dodging has not materialized on the federal level, states have taken matters into their own hands. Montana and Oregon have enacted Tax Haven List reform, targeting profits booked to known offshore tax havens.

Montana was the first to adopt this approach in 2003. In a bill that garnered broad bipartisan support in the state Legislature, Montana's lawmakers required companies with subsidiaries in certain foreign tax havens to include those profits in their combined reporting.[21] The law also requires the Montana Department of Revenue to provide the state legislature with a biennial review and recommendation of additional countries to include on the state's formal list of tax havens. [22]

The Tax Haven List approach has helped Montana restore some equity to its corporate tax system and limit abuse of offshore tax havens, saving Montana's ordinary taxpayers millions. A fiscal note to the state Legislature calculated that by addressing the use of specific tax havens, Montana would collect $4.4 million in additional revenue in the fiscal year 2014, climbing up to $8.9 million in the fiscal year 2017. [23]

In July 2013, Oregon became the second state to enact Tax Haven List reform. Following in Montana's footsteps, Oregon passed a bill with almost unanimous legislative support identifying specific foreign tax havens that must be accounted for in a corporation's combined report. As in Montana, corporations with subsidiaries in particular tax havens would be required to include net income from those locations on their in-state tax returns.[24]

Unfortunately, the Oregon reforms were repealed in 2018, costing the state $20 million in expected tax revenue.[25] The list of tax haven countries in the statute caused lobbying from listed nations as well as from affected companies, represented by The Council On State Taxation—an industry lobbying operation representing more than 600 corporations.[26] Connecticut, Rhode Island, West Virginia and the District of Columbia have also passed rules which allow their tax collectors to determine whether a country should be listed as a tax haven, but lobbying has also limited the impact of these reforms.[27]

Over the last five years, a number of other states have considered similar legislation. In Massachusetts, a bipartisan group of 57 legislators backed a Tax Haven List bill, and thousands of residents weighed in to support it.[28] [29] In Colorado, a bill to tax income booked to tax-havens passed the House, before being stalled in the Senate.[30] In 2016, legislators in Maine, Minnesota, Kansas and Kentucky also had active bills in consideration.[31]

In most of these states, there was formal opposition from multinational corporations as well as from foreign governments who found their countries listed on the tax haven list. Oregon is now exploring the Worldwide Combined Reporting approach, which has the benefit of not being controversial abroad.[32]

The Need for Federal Action on Tax Havens

While states can and should take action to curb tax haven abuse, even more revenue is being lost to offshore tax avoidance on the federal level. While many lawmakers promised that the Tax Cuts and Jobs Act would significantly reduce offshore tax avoidance, the Joint Committee on Taxation found that rather than increasing revenue, the permanent international provisions of the legislation will reduce revenue by $14 billion over the next 10 years.[33]

One potential avenue for reducing international tax avoidance and recapturing lost revenue would be to enact a worldwide tax system, wherein U.S. companies pay the same tax rate on their domestic and offshore income.[34] Equalizing the rates means eliminating special deductions for offshore income under the Tax Cuts and Jobs Act, such as the 50 percent deduction on global low-taxed intangible income (GILTI). It

Small Businesses Prefer Fairness in Tax Code to Cuts

When it comes to tax reform, most small businesses are more concerned with how larger companies game the system than they are with the overall rate of taxation. A survey by Greenberg Quinlan Rosner Research on behalf of Small Business Majority found that seven in 10 small business owners feel their business is harmed when larger businesses avoid taxes. The survey also found that 85 percent believe the tax code unfairly benefits large corporations over small businesses.[52]

Specifically, offshore tax avoidance is a central concern. Three-fourths of businesses in the Small Business Majority survey reported that they felt large corporations “should not be able to choose to declare some or all of their income in a foreign country in order to lower their taxes.”[53]

would also require reforms that address corporate inversions and close other tax loopholes that benefit foreign companies operating in the United States.

Another approach would be to abandon the reliance on profit shifting limitation legislation such as variations of the Tax Cut and Jobs Act and adopt on the federal level the formulary apportionment method used currently on the state level. In other words, the federal government would calculate a company's taxable income by apportioning its global income based on factors, such as the company's sales, payroll, and assets based in the United States (most states use sales-emphasized formulas).[35]

When California passed sales factor apportionment by state initiative, many corporations opposed it because it would have increased many corporations' tax burdens.[36] Some believe the United States would benefit from a single sales factor approach.[37] Under such a system, if a company's shareholder reports show 60 percent of its global sales in the United States, then 60 percent of its global pre-tax income would be taxable in the country. Domestic businesses have expressed support for a better method of taxing business activity in U.S. markets regardless of corporate domicile.[38]

A thorough examination of these options should be considered in any future federal legislation to combat the present loss of American corporate tax revenues and level the playing field for domestic and multinational businesses.

International Efforts to Address Tax Dodging

As tax officials around the world struggle to contain tax dodging, multinational efforts have emerged to tackle tax haven abuse. The Organization for Economic Cooperation and Development (OECD), an intergovernmental organization that helps member nations coordinate on shared economic policy, was tasked with developing a Base Erosion and Profit Shifting (BEPS) Action plan as part of global meetings in 2012 and 2013.[54]

One of the most heavily debated recommendations for inclusion in the BEPS Action Plan was a "Country by Country" Reporting requirement to elucidate what companies pay in taxes in which countries, making reporting very different pictures of their activities to different governments more difficult.[55] In June of 2017, representatives of 76 countries ratified an agreement to combat tax avoidance by amending bilateral tax treaties, though the United States was not one of them.[56]

The United States can help advance international tax fairness by taking more of a leadership role within the BEPS process, as well as implementing public Country by Country reporting. Federal legislation to require public Country by Country reporting is expected to be debated in 2019.

States Can Limit or Eliminate Offshore Tax Dodging by Updating Tax Codes

In order to address tax shifting by complex multi-jurisdictional businesses, states can enact Combined Reporting, and then expand it to address offshore tax haven abuse by requiring Worldwide Reporting for multinational businesses. Alternatively, they can include income booked to specific tax havens by passing Tax Haven List legislation, though this approach captures less revenue.

Additional States Enacting Combined Reporting Reform Would Generate $2.85 Billion

Combined Reporting is a critical first step to addressing profit shifting into low-tax jurisdictions. This system is already in place in 27 states and the District of Columbia. When companies are not asked to combine their activities across related subsidiaries and apportion their profits based on relative business activity state-by-state, there is a strong incentive to shift domestic profits to zero-tax states such as Nevada and Wyoming. If the 18 states which tax corporate profits but do not currently use Combined Reporting were to enact these reforms it would have added $2.85 billion in state tax revenue in 2018 (see Table 3).

Combined Reporting formulas can vary from state to state. A sample bill enacting Combined Reporting can be found in Appendix A.

Worldwide Combined Reporting Approach Would Add Another $14.19 Billion to State Budgets

After a Combined Reporting system is in place for domestic business activity, there remains a strong incentive for businesses to book profits to offshore subsidiaries located in tax havens. The most fair, accurate and simple way to reduce profit shifting is to take the whole picture into account—the total profit of the combined worldwide business—to determine the portion of worldwide profit earned in the jurisdiction in question.

Table 3: Revenue Gain from Enacting Combined Reporting

All States	**$2,850,000,000**
Alabama	$104,000,000
Arkansas	$79,000,000
Delaware	$49,000,000
Florida	$477,000,000
Georgia	$194,000,000
Indiana	$205,000,000
Iowa	$86,000,000
Louisiana	$58,000,000
Maryland	$200,000,000
Mississippi	$82,000,000
Missouri	$61,000,000
New Mexico	$18,000,000
North Carolina	$151,000,000
Oklahoma	$32,000,000
Pennsylvania	$469,000,000
South Carolina	$75,000,000
Tennessee	$345,000,000
Virginia	$165,000,000

This approach, Worldwide Combined Reporting, will be introduced in Oregon this year. Remnants of Worldwide Combined Reporting exist in other states, but are not compulsory. California, Idaho, Montana and North Dakota require companies to file Worldwide Combined reports, unless companies elect to file a "water's edge" report.[39] In essence, these states offer a loophole that allows corporations to escape the Worldwide Combined Reporting requirement.[40] In North Dakota, for instance, corporations are nominally required to report their worldwide income, but can elect to report only income up to the water's edge in exchange for paying a slightly higher tax rate.[41] Alaska requires Worldwide Combined Reporting for oil companies only.[42]

Worldwide Combined Reporting is considered the gold standard for closing tax loopholes—and our report finds it would raise nearly three times more revenue than other options, revenue currently lost to tax avoidance.

To enact this approach, the state must:

1. **Require corporations to include the income of all foreign subsidiaries.** Many corporations are already required to file information about the income of all their foreign subsidiaries with the federal government on IRS Form 5471. State tax agencies could simply add a line to their tax forms requiring corporations to file the same federally reported information with states.

2. **Apply the state's apportionment formula to determine the share of reported profits it will tax.** States do not levy taxes on the total income of a corporation because if they did, corporations that do business in multiple states would see their entire profit taxed multiple times. To determine which portion of corporate income is attributable to the state, some use an apportionment rule that considers the portion of national sales, payroll and property that are located in the state. Others use a similar rule but give extra weight to in-state sales. Some states use the so-called single sales factor (SSF) rule that considers only the share of sales the corporation makes in the state.[43]

How to Enact Tax Haven List Reform

While Worldwide Combined Reporting was sharply debated in the 1980s, including income booked to known tax havens in the Combined Reporting calculation was a point of relative consensus.[44] For those states unwilling to embrace the more comprehensive approach of Worldwide Com-

Table 4: Revenue Gains from Weak and Strong Tax Haven List Reform

State	Revenue from "Weak" Tax Haven List	Revenue from "Strong" Tax Haven list
Alabama	$23,000,000	$57,000,000
Alaska		$6,000,000
Arizona	$17,000,000	$41,000,000
Arkansas	$18,000,000	$44,000,000
California	$456,000,000	$1,116,000,000
Colorado	$24,000,000	$58,000,000
Connecticut		$59,000,000
Delaware	$11,000,000	$27,000,000
District of Columbia		$36,000,000
Florida	$107,000,000	$263,000,000
Georgia	$44,000,000	$107,000,000
Hawaii	$8,000,000	$20,000,000
Idaho	$10,000,000	$24,000,000
Illinois	$130,000,000	$318,000,000
Indiana	$46,000,000	$113,000,000
Iowa	$19,000,000	$48,000,000
Kansas	$17,000,000	$43,000,000
Kentucky	$21,000,000	$51,000,000
Louisiana	$13,000,000	$32,000,000
Maine	$8,000,000	$19,000,000
Maryland	$45,000,000	$111,000,000
Massachusetts	$99,000,000	$242,000,000
Michigan	$54,000,000	$132,000,000

State	Revenue from "Weak" Tax Haven List	Revenue from "Strong" Tax Haven list
Minnesota	$55,000,000	$135,000,000
Mississippi	$18,000,000	$45,000,000
Missouri	$14,000,000	$34,000,000
Montana		$13,000,000
Nebraska	$12,000,000	$29,000,000
New Hampshire	$26,000,000	$63,000,000
New Jersey	$95,000,000	$233,000,000
New Mexico	$4,000,000	$10,000,000
New York	$181,000,000	$444,000,000
North Carolina	$34,000,000	$84,000,000
North Dakota	$3,000,000	$7,000,000
Oklahoma	$7,000,000	$17,000,000
Oregon	$29,000,000	$70,000,000
Pennsylvania	$106,000,000	$259,000,000
Rhode Island		$8,000,000
South Carolina	$17,000,000	$41,000,000
Tennessee	$78,000,000	$191,000,000
Utah	$15,000,000	$36,000,000
Vermont	$4,000,000	$9,000,000
Virginia	$37,000,000	$91,000,000
West Virginia		$8,000,000
Wisconsin	$43,000,000	$106,000,000
TOTAL	**$1,948,000,000**	**$4,900,000,000**

bined reporting, an alternative to getting back some of the lost revenue could be to follow the path laid by several states in enacting legislation to list known tax havens, and tax profits booked there.

In addition, both states with Tax Haven List legislation and those considering enacting it should expand the set of tax haven countries that have typically been included in state lists. Our analysis of IRS data looking at where corporations report their profits found that including Ireland, the Netherlands, Switzerland, Hong Kong, and Singapore—all known tax havens—could more than double the effectiveness of Tax Haven List legislation (see Table 4). We estimate that every state enacting a tax haven list based on the weaker lists would raise approximately $1.95 billion in revenue. In contrast, all states enacting a stronger tax haven list would raise $4.9 billion.

Tax Haven List reform can be done by passing legislation to target income booked to tax havens for states that already have a Combined Reporting system. To do so, states must:

1. **Determine a list of tax haven countries** for state tax purposes that is updated regularly. Nonpartisan entities such as the National Bureau of Economic Research, the Organization for Economic Cooperation and Development (OECD), and the Internal Revenue Service have compiled similar lists of tax havens based on common characteristics, eliminating the need for state officials to develop expertise on foreign tax regimes. These lists have been cited in studies on tax havens by the nonpartisan Government Accountability Office and the Congressional Research Service. Reviews of tax havens conducted by the Montana Department of Revenue in 2010 and 2012 also provide a broad review of tax haven studies that can benefit other states. There is considerable disagreement around who gets named a tax haven, and having a weaker list significantly reduces the revenue gains.

2. **Require corporations to include the income of foreign subsidiaries** based in state-identified tax havens on their state tax returns. Similarly to Worldwide Combined Reporting, state tax agencies could simply add a line to their tax forms requiring corporations to file with states the same information on subsidiaries based in state-identified tax havens they report federally.

3. **Calculate the income subject to taxation** based on the sum of domestic and tax haven income.

4. **Apply the state's typical apportionment formula** to determine the share of reported profits it will tax.

All States Should Close Tax Loopholes and Even the Playing Field

If all states that tax corporate profits moved to a Worldwide Combined Reporting or Complete Reporting system, they would collect $17.04 billion, level the playing field for businesses, and eliminate incentives for companies to relocate or establish subsidiaries overseas.

The likely amount of additional revenue each state would collect varies based on: (1) whether they have enacted reforms that limit tax dodging already; (2) the total corporate taxes collected; (3) the state corporate income tax rate; and (4) the portion of gross state product.

In every state, the revenue raised would make a difference in meeting spending priorities or deciding whether or not to raise taxes and fees for residents.

As has happened so many times before, state-level initiatives may turn out to be the most effective way to induce federal lawmakers to overcome partisan and lobbying pressures to take action, potentially triggering federal action that can address parts of the problem states cannot.

Table 5: Revenue Gains from Three Types of Reform by State

State	Revenue Gain from Enacting Combined Reporting	Revenue Gain From Worldwide Combined Reporting	Total Revenue Gain From Closing Loopholes
All States	$2,850,000,000	$14,188,000,000	$17,038,000,000
Alabama	$104,000,000	$174,000,000	$278,000,000
Alaska		$84,000,000	$84,000,000
Arizona		$144,000,000	$144,000,000
Arkansas	$79,000,000	$131,000,000	$210,000,000
California		$2,798,000,000	$2,798,000,000
Colorado		$197,000,000	$197,000,000
Connecticut		$158,000,000	$158,000,000
Delaware	$49,000,000	$96,000,000	$145,000,000
District of Columbia		$105,000,000	$105,000,000
Florida	$477,000,000	$679,000,000	$1,156,000,000
Georgia	$194,000,000	$290,000,000	$484,000,000
Hawaii		$38,000,000	$38,000,000
Idaho		$63,000,000	$63,000,000
Illinois		$1,328,000,000	$1,328,000,000
Indiana	$205,000,000	$246,000,000	$451,000,000
Iowa	$86,000,000	$178,000,000	$264,000,000
Kansas		$120,000,000	$120,000,000
Kentucky		$194,000,000	$194,000,000
Louisiana	$58,000,000	$109,000,000	$167,000,000
Maine		$52,000,000	$52,000,000
Maryland	$200,000,000	$313,000,000	$513,000,000
Massachusetts		$669,000,000	$669,000,000

Table 5 (continued): Revenue Gains from Three Types of Reform by State

State	Revenue Gain from Enacting Combined Reporting	Revenue Gain From Worldwide Combined Reporting	Total Revenue Gain From Closing Loopholes
Michigan		$321,000,000	$321,000,000
Minnesota		$418,000,000	$418,000,000
Mississippi	$82,000,000	$145,000,000	$227,000,000
Missouri	$61,000,000	$120,000,000	$181,000,000
Montana		$36,000,000	$36,000,000
Nebraska		$92,000,000	$92,000,000
New Hampshire		$177,000,000	$177,000,000
New Jersey		$714,000,000	$714,000,000
New Mexico	$18,000,000	$47,000,000	$65,000,000
New York		$1,346,000,000	$1,346,000,000
North Carolina	$151,000,000	$222,000,000	$373,000,000
North Dakota		$47,000,000	$47,000,000
Oklahoma	$32,000,000	$115,000,000	$147,000,000
Oregon		$175,000,000	$175,000,000
Pennsylvania	$469,000,000	$729,000,000	$1,198,000,000
Rhode Island		$35,000,000	$35,000,000
South Carolina	$75,000,000	$118,000,000	$193,000,000
Tennessee	$345,000,000	$438,000,000	$783,000,000
Utah		$103,000,000	$103,000,000
Vermont		$31,000,000	$31,000,000
Virginia	$165,000,000	$241,000,000	$406,000,000
West Virginia		$49,000,000	$49,000,000
Wisconsin		$303,000,000	$303,000,000

Methodology

Estimating the Potential Revenue to Be Gained Through Worldwide Combined Reporting

The starting point for the estimate on how much revenue is lost in the states due to offshore tax avoidance, and thus could be gained through Worldwide Combined Reporting (also known as Complete Reporting), is the Congressional Budget Office's (CBO) recent estimate that after the passage of the Tax Cuts and Jobs Act (TCJA), U.S. companies will continue to avoid taxes on $235 billion in profits shifted offshore annually.[45] This figure represents the pool of income that would be recaptured under Worldwide Combined Reporting. The CBO estimate represents a midpoint estimate between figures estimated recently in a report by Professor Kimberly Clausing, who put the figure closer to $300 billion,[46] and another report by Professor Gabriel Zucman, who put the figure at $142 billion.[47]

The next step in making our state-by-state estimates of the potential revenue gain was to allocate the $235 billion in shifted profits to each state. First, we allocated 16.2 percent of the shifted profits to those states (Nevada, Ohio, South Dakota, Texas, Washington, and Wyoming) without a traditional corporate income tax. The 16.2 percent figure represents these states' average proportion of gross state product from 2013-2017. Second, for those states with a corporate income tax, we divided the amount of corporate income tax revenue collected at the top marginal corporate tax rate in each year from 2013-2017 to get an estimate of taxable corporate income in each state. We then averaged the taxable income estimate for each state over those five years and divided it by the total five-year average of income across all the states to determine the proportion of the shifted profits that should be allocated to each state.

Unfortunately, no reliable dataset exists that allocates corporate profits by state, so this implied income calculation served as a way of approximating the proportion of corporate profits in each state. Third, we multiplied the estimated proportion of profits shifted to each state by that state's top marginal corporate tax rate. Finally, for those five states (Alaska, Connecticut, Montana, Rhode Island and West Virginia) and the District of Columbia where some form of Tax Haven List legislation exists, we subtracted our estimate for the revenue gained in those states from having a weak tax haven list (the methodology of which is discussed below).

To explain how this worked, it may be illuminating to walk through an example. According to our calculation, California's average proportion of implied corporate income was 16.1 percent. We multiplied this 16.1 percent by $196,954,031,789, the amount of profits shifted minus the 16.2 percent of these profits allocated to states without traditional corporate income taxes. The result was that we estimated that $31,647,725,252 in corporate profits are shifted out of California each year. To get the estimate of how much returning these profits to California through Worldwide Combined Report would raise, we simply multiplied that figure by California's 8.84 percent top marginal corporate tax rate. This calculation concludes that Worldwide Combined Reporting in California would raise $2,797,658,912. Given that these calculations are estimates, we then rounded all the numbers to the millions, in this case estimating that Worldwide Combined Reporting would raise $2,798,000,000 in revenue for California.

Estimating the Potential Revenue to Be Gained Through Domestic Combined Reporting

For those 18 states that have a traditional corporate income tax, but do not currently have any form of Combined Reporting, it was critical to estimate the impact of Combined Reporting on the domestic level, in addition to the impact of the provision on the international level. We estimate that each state without domestic Combined Reporting would see a 20 percent increase in revenue from the change. The 20 percent figure is based on state government-conducted studies looking at the potential impact of Combined Reporting in Maryland and Rhode Island.[48] [49] Those studies found that applying a strong version of Combined Report (referred to as Finnigan Combined Reporting) could raise revenue in those states by 30 percent or more in a given year. The studies also showed that unfavorable economic conditions could, in some years, dampen the revenue raised. Given the variety of companies in individual states, the different apportionment formulas states have, and the potential import of negative economic conditions, we settled on the conservative estimate that the amount of revenue raised would be 20 percent, substantially lower than the percent increase in most years found by the Rhode Island and Maryland studies.

Estimating the Potential Revenue to Be Gained Through Strong and Weak Tax Haven List Legislation

We calculated the effect of Tax Haven List legislation based on an average of the revenue increases seen in states that have implemented such legislation and from estimates in several states considering adoption of the legislation. Specifically, we took a weighted average of the revenue raised from the tax haven legislation in Oregon and Montana and the projected revenue increases from proposed legislation in Maine, Colorado and Kentucky. This approach found that states on average would see an increase in revenue of 4.5 percent. We believe that this estimate is conservative considering that the two estimates based on real collections, Oregon and Montana, show an increase in revenue of 6 and 8 percent respectively, while the states that projected future revenues estimated increases only in the 3 to 4 percent range.

To estimate the impact of strengthening the tax haven list, we used data from the IRS on the geographic distribution by country of U.S. controlled foreign corporation income. These data reveals that adding Hong Kong, Ireland, the Netherlands, Singapore and Switzerland (all of which are currently excluded from tax haven lists as implemented) to the tax haven lists would increase the pool of income by 245 percent. Given this fact, we estimate that the percent increase in revenue from a strong tax haven list would be 11 percent—nearly 2.5 times the 4.5 percent raised by the weak list.

For those five states and the District of Columbia that have some form of tax haven legislation already, we assume across the board that adopting the weak list approach will not generate any additional revenue. In addition, in calculating the amount each of these jurisdictions would raise from a strong tax haven list, we subtract the 4.5 percent increase from the weak tax haven list already in place.

Given that Montana is the only state that currently employs the tax haven list approach and has a recent, robust estimate for how much it raises, we opted to use its estimate of $8.9 million as the starting point for its weak and strong tax haven list estimates, rather than a 4.5 percent increase in its tax revenue.

Appendix A

Multistate Tax Commission Proposed Model Statute for Combined Reporting

As approved by the Multistate Tax Commission August 17, 2006

As amended by the Multistate Tax Commission July 29, 2011

Section 1. Definitions.

A. "Person" means any individual, firm, partnership, general partner of a partnership, limited liability company, registered limited liability partnership, foreign limited liability partnership, association, corporation (whether or not the corporation is, or would be if doing business in this state, subject to [state income tax act]), company, syndicate, estate, trust, business trust, trustee, trustee in bankruptcy, receiver, executor, administrator, assignee or organization of any kind.

B. "Taxpayer" means any person subject to the tax imposed by [State Corporate income tax act].

C. "Corporation" means any corporation as defined by the laws of this state or organization of any kind treated as a corporation for tax purposes under the laws of this state, wherever located, which if it were doing business in this state would be a "taxpayer." The business conducted by a partnership which is directly or indirectly held by a corporation shall be considered the business of the corporation to the extent of the corporation's distributive share of the partnership income, inclusive of guaranteed payments to the extent prescribed by regulation.

D. "Partnership" means a general or limited partnership, or organization of any kind treated as a partnership for tax purposes under the laws of this state.

E. "Internal Revenue Code" means Title 26 of the United States Code of [date] [and amendments thereto] without regard to application of federal treaties unless expressly made applicable to states of the United States.

F. "Unitary business" means [a single economic enterprise that is made up either of separate parts of a single business entity or of a commonly controlled group of business entities that are sufficiently interdependent, integrated and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts.] Drafter's note: This portion of the definition is drafted to follow MTC Reg. IV(b), defining a "unitary business." A state that does not wish to define unitary business in this manner should consider alternative language. In addition, this MTC Regulation defining unitary business includes a requirement of common ownership or control. A state which treats ownership or control requirements separately from the unitary business requirement will need to make additional amendments to the statutory language. Any business conducted by a partnership shall be treated as conducted by its partners, whether directly held or indirectly held through a series of partnerships, to the extent of the partner's distributive share of the partnership's income, regardless of the percentage of the partner's ownership interest or its distributive or any other share of partnership income. A business conducted directly or indirectly by one corporation is unitary with that portion of a business conducted by another corporation through its direct or indirect interest in a partnership if the conditions of the first sentence of this section 1.F. are satisfied, to wit: there is a synergy, and exchange and flow of value between the two parts of the business and the two corporations are members of the same commonly controlled group.

G. "Combined group" means the group of all persons whose income and apportionment factors are required to be taken into account pursuant to Section 2.A. or 2.B. in determining the taxpayer's share of the net business income or loss apportionable to this State.

H. "United States" means the 50 states of the United States, the District of Columbia, and United States' territories and possessions.

I. "Tax haven" means a jurisdiction that, during the tax year in question has no or nominal effective tax on the relevant income and:

(i) has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime;

(ii) has tax regime which lacks transparency. A tax regime lacks transparency if the details of legislative, legal or administrative provisions are not open and apparent or are not consistently applied among similarly situated taxpayers, or if the information needed by tax authorities to determine a taxpayer's correct tax liability, such as accounting records and underlying documentation, is not adequately available;

(iii) facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy;

(iv) explicitly or implicitly excludes the jurisdiction's resident taxpayers from taking advantage of the tax regime's benefits or prohibits enterprises that benefit from the regime from operating in the jurisdiction's domestic market; or

(v) has created a tax regime which is favorable for tax avoidance, based upon an overall assessment of relevant factors, including whether the jurisdiction has a significant untaxed offshore financial/other services sector relative to its overall economy.

Section 2. Combined reporting required, when; discretionary under certain circumstances.

A. Combined reporting required, when. A taxpayer engaged in a unitary business with one or more other corporations shall file a combined report which includes the income, determined under Section 3.C. of this act, and apportionment factors, determined under [provisions on apportionment factors and Section 3.B. of this act], of all corporations that are members of the unitary business, and such other information as required by the Director.

B. Combined reporting at Director's discretion, when. The Director may, by regulation, require the combined report include the income and associated apportionment factors of any persons that are not included pursuant to Section 2.A., but that are members of a unitary business, in order to reflect proper apportionment of income of entire unitary businesses. Authority to require combination by regulation under this Section 2.B. includes authority to require combination of persons that are not, or would not be if doing business in this state, subject to the [State income tax Act].

In addition, if the Director determines that the reported income or loss of a taxpayer engaged in a unitary business with any person not included pursuant to Section 2.A. represents an avoidance or evasion of tax by such taxpayer, the Director may, on a case by case basis, require all or any part of the income and associated apportionment factors of such person be included in the taxpayer's combined report.

With respect to inclusion of associated apportionment factors pursuant to Section 2.B., the Director may require the exclusion of any one or more of the factors, the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this State, or the employment of any other method to effectuate a proper reflection of the total amount of income subject to apportionment and an equitable allocation and apportionment of the taxpayer's income.

Section 3. Determination of taxable income or loss using combined report.

The use of a combined report does not disregard the separate identities of the taxpayer members of the combined group. Each taxpayer member is responsible for tax based on its taxable income or loss apportioned or allocated to this state, which shall include, in addition to other types of income, the taxpayer member's apportioned share of business income of the combined group, where business income of the combined group is calculated as a summation of the individual net business incomes of all members of the combined group. A member's net business income is determined by removing all but business income, expense and loss from that member's total income, as provided in detail below.

A. Components of income subject to tax in this state; application of tax credits and post apportionment deductions.

i. Each taxpayer member is responsible for tax based on its taxable income or loss apportioned or allocated to this state, which shall include:

(a) its share of any business income apportionable to this State of each of the combined groups of which it is a member, determined under Section 3.B.,

(b) its share of any business income apportionable to this State of a distinct business activity conducted within and without the state wholly by the taxpayer member, determined under [provisions for apportionment of business income],

(c) its income from a business conducted wholly by the taxpayer member entirely within the state,

(d) its income sourced to this state from the sale or exchange of capital or assets, and from involuntary conversions, as determined under Section 3.C.ii.(g), below,

(e) its nonbusiness income or loss allocable to this State, determined under [provisions for allocation of non-business income],

(f) its income or loss allocated or apportioned in an earlier year, required to be taken into account as state source income during the income year, other than a net operating loss, and

(g) its net operating loss carryover or carryback. If the taxable income computed pursuant to Section 3 results in a loss for a taxpayer member of the combined group, that taxpayer member has a [state] net operating loss (NOL), subject to the net operating loss limitations, carryforward and carryback provisions of [provisions on NOLs]. Such NOL is applied as a deduction in a prior or subsequent year only if that taxpayer has [State] source positive net income, whether or not the taxpayer is or was a member of a combined reporting group in the prior or subsequent year.

ii. Except where otherwise provided, no tax credit or post-apportionment deduction earned by one member of the group, but not fully used by or allowed to that member, may be used in whole or in part by another member of the group or applied in whole or in part against the total income of the combined group; and a post-apportionment deduction carried over into a subsequent year as to the member that incurred it, and available as a deduction to that member in a subsequent year, will be considered in the computation of the income of that member in the subsequent year, regardless of the composition of that income as apportioned, allocated or wholly within this state.

B. Determination of taxpayer's share of the business income of a combined group apportionable to this State.

The taxpayer's share of the business income apportionable to this State of each combined group of which it is a member shall be the product of:

i. the business income of the combined group, determined under Section 3.C., and

ii. the taxpayer member's apportionment percentage, determined under [provisions on apportionment factors], including in the [property, payroll and sales factor]numerators the taxpayer's [property, payroll and sales, respectively,] associated with the combined group's unitary business in this state, and including in the denominator the [property, payroll and sales] of all members of the combined group, including the taxpayer, which property, payroll and sales are associated with the combined group's unitary business wherever located. The [property, payroll, and sales] of a partnership shall be included in the determination of the partner's apportionment percentage in proportion to a ratio the numerator of which is the amount of the partner's distributive share of partnership's unitary income included in the income of the combined group in accordance with Section 3.C.ii.(c). and the denominator of which is the amount of the partnership's total unitary income.

C. Determination of the business income of the combined group.

The business income of a combined group is determined as follows:

i. From the total income of the combined group, determined under Section 3.C.ii., subtract any income, and add any expense or loss, other than the business income, expense or loss of the combined group.

ii. Except as otherwise provided, the total income of the combined group is the sum of the income of each member of the combined group determined under federal income tax laws, as adjusted for state purposes, as if the member were not consolidated for federal purposes. The income of each member of the combined group shall be determined as follows:

(a) For any member incorporated in the United States, or included in a consolidated federal corporate income tax return, the income to be included in the total income of the combined group shall be the taxable income for the corporation after making appropriate adjustments under [state tax code provisions for adjustments to taxable income].

(b) (1) For any member not included in Section 3.C.ii.(a), the income to be included in the total income of the combined group shall be determined as follows:

(A) A profit and loss statement shall be prepared for each foreign branch or corporation in the currency in which the books of account of the branch or corporation are regularly maintained.

(B) Adjustments shall be made to the profit and loss statement to conform it to the accounting principles generally accepted in the United States for the preparation of such statements except as modified by this regulation.

(C) Adjustments shall be made to the profit and loss statement to conform it to the tax accounting standards required by the [state tax code]

(D) Except as otherwise provided by regulation, the profit and loss statement of each member of the combined group, and the apportionment factors related thereto, whether United States or foreign, shall be translated into the currency in which the parent company maintains its books and records.

(E) Income apportioned to this state shall be expressed in United States dollars.

(2) In lieu of the procedures set forth in Section 3.C.ii.(b)(1), above, and subject to the determination of the Director that it reasonably approximates income as determined under [the State tax code], any member not included in Section 3.C.ii.(a) may determine its income on the basis of the consolidated profit and loss statement which includes the member and which is prepared for filing with the Securities and Exchange Commission by related corporations. If the member is not required to file with the Securities and Exchange Commission, the Director may allow the use of the consolidated profit and loss statement prepared for reporting to shareholders and subject to review by an independent auditor. If above statements do not reasonably approximate income as determined under [the State tax code] the Director may accept those statements with appropriate adjustments to approximate that income.

(c) If a unitary business includes income from a partnership, the income to be included in the total income of the combined group shall be the member of the combined group's direct and indirect distributive share of the partnership's unitary business income.

(d) All dividends paid by one to another of the members of the combined group shall, to the extent those dividends are paid out of the earnings and profits of the unitary business included in the combined report, in the current or an earlier year, be eliminated from the income of the recipient. This provision shall not apply to dividends received from members of the unitary business which are not a part of the combined group.

(e) Except as otherwise provided by regulation, business income from an intercompany transaction between members of the same combined group shall be deferred in a manner similar to 26 CFR 1.1502-13. Upon the occurrence of any of the following events, deferred business income resulting from an intercompany transaction between members of a combined group shall be restored to the income of the seller, and shall be apportioned as business income earned immediately before the event:

(1) the object of a deferred intercompany transaction is

(A) re-sold by the buyer to an entity that is not a member of the combined group,

(B) re-sold by the buyer to an entity that is a member of the combined group for use outside the unitary business in which the buyer and seller are engaged, or

(C) converted by the buyer to a use outside the unitary business in which the buyer and seller are engaged, or

(2) the buyer and seller are no longer members of the same combined group, regardless of whether the members remain unitary.

(f) A charitable expense incurred by a member of a combined group shall, to the extent allowable as a deduction pursuant to Internal Revenue Code Section 170, be subtracted first from the business income of the combined group (subject to the income limitations of that section applied to the entire business income of the group), and any remaining amount shall then be treated as a nonbusiness expense allocable to the member that incurred the expense (subject to the income limitations of that section applied to the nonbusiness income of that specific member). Any charitable deduction disallowed under the foregoing rule, but allowed as a carryover deduction in a subsequent year, shall be treated as originally incurred in the subsequent year by the same member, and the rules of this section shall apply in the subsequent year in determining the allowable deduction in that year.

(g) Gain or loss from the sale or exchange of capital assets, property described by Internal Revenue Code Section 1231(a)(3), and property subject to an involuntary conversion, shall be removed from the total separate net income of each member of a combined group and shall be apportioned and allocated as follows.

(1) For each class of gain or loss (short term capital, long term capital, Internal Revenue Code Section 1231, and involuntary conversions) all members' business gain and loss for the class shall be combined (without netting between such classes), and each class of net business gain or loss separately apportioned to each member using the member's apportionment percentage determined under Section 3.B., above.

(2) Each taxpayer member shall then net its apportioned business gain or loss for all classes, including any such apportioned business gain and loss from other combined groups, against the taxpayer member's nonbusiness gain and loss for all classes allocated to this State, using the rules of Internal Revenue Code Sections 1231 and 1222, without regard to any of the taxpayer member's gains or losses from the sale or exchange of capital assets, Section 1231 property, and involuntary conversions which are nonbusiness items allocated to another state.

(3) Any resulting state source income (or loss, if the loss is not subject to the limitations of Internal Revenue Code Section 1211) of a taxpayer member produced by the application of the preceding subsections shall then be applied to all other state source income or loss of that member.

(4) Any resulting state source loss of a member that is subject to the limitations of Section 1211 shall be carried forward [or carried back] by that member, and shall be treated as state source short-term capital loss incurred by that member for the year for which the carryover [or carryback] applies.

(h) Any expense of one member of the unitary group which is directly or indirectly attributable to the nonbusiness or exempt income of another member of the unitary group shall be allocated to that other member as corresponding nonbusiness or exempt expense, as appropriate.

Section 4. Designation of surety.

As a filing convenience, and without changing the respective liability of the group members, members of a combined reporting group may annually elect to designate one taxpayer member of the combined group to file a single return in the form and manner prescribed by the department, in lieu of filing their own respective returns, provided that the taxpayer designated to file the single return consents to act as surety with respect to the tax liability of all other taxpayers properly included in the combined report, and agrees to act as agent on behalf of those taxpayers for the year of the election for tax matters relating to the combined report for that year. If for any reason the surety is unwilling or unable to perform its responsibilities, tax liability may be assessed against the taxpayer members.

Section 5. Water's-edge election; initiation and withdrawal.

A. Water's-edge election.

Taxpayer members of a unitary group that meet the requirements of Section 5.B. may elect to determine each of their apportioned shares of the net business income or loss of the combined group pursuant to a water's-edge election. Under such election, taxpayer members shall take into account all or a portion of the income and apportionment factors of only the following members otherwise included in the combined group pursuant to Section 2, as described below:

i. the entire income and apportionment factors of any member incorporated in the United States or formed under the laws of any state, the District of Columbia, or any territory or possession of the United States;

ii. the entire income and apportionment factors of any member, regardless of the place incorporated or formed, if the average of its property, payroll, and sales factors within the United States is 20 percent or more;

iii. the entire income and apportionment factors of any member which is a domestic international sales corporations as described in Internal Revenue Code Sections 991 to 994, inclusive; a foreign sales corporation as described in Internal Revenue Code Sections 921 to 927, inclusive; or any member which is an export trade corporation, as described in Internal Revenue Code Sections 970 to 971, inclusive;

iv. any member not described in [Section 5.A.i.] to [Section 5.A.iii.], inclusive, shall include the portion of its income derived from or attributable to sources within the United States, as determined under the Internal Revenue Code without regard to federal treaties, and its apportionment factors related thereto;

v. any member that is a "controlled foreign corporation," as defined in Internal Revenue Code Section 957, to the extent of the income of that member that is defined in Section 952 of Subpart F of the Internal Revenue Code ("Subpart F income") not excluding lower-tier subsidiaries' distributions of such income which were previously taxed, determined without regard to federal treaties, and the apportionment factors related to that income; any item of income received by a controlled foreign corporation shall be excluded if such income was subject to an effective rate of income tax imposed by a foreign country greater than 90 percent of the maximum rate of tax specified in Internal Revenue Code Section 11;

vi. any member that earns more than 20 percent of its income, directly or indirectly, from intangible property or service related activities that are deductible against the business income of other members of the combined group, to the extent of that income and the apportionment factors related thereto; and

vii. the entire income and apportionment factors of any member that is doing business in a tax haven, where "doing business in a tax haven" is defined as being engaged in activity sufficient for that tax haven jurisdiction to impose a tax under United States constitutional standards. If the member's business activity within a tax haven is entirely outside the scope of the laws, provisions and practices that cause the jurisdiction to meet the criteria established in Section 1.I., the activity of the member shall be treated as not having been conducted in a tax haven.

B. Initiation and withdrawal of election

i. A water's-edge election is effective only if made on a timely-filed, original return for a tax year by every member of the unitary business subject to tax under [state income tax code]. The Director shall develop rules and regulations governing the impact, if any, on the scope or application of a water's-edge election, including termination or deemed election, resulting from a change in the composition of the unitary group, the combined group, the taxpayer members, and any other similar change.

ii. Such election shall constitute consent to the reasonable production of documents and taking of depositions in accordance with [state statute on discovery].

iii. In the discretion of the Director, a water's-edge election may be disregarded in part or in whole, and the income and apportionment factors of any member of the taxpayer's unitary group may be included in the combined report without regard to the provisions of this section, if any member of the unitary group fails to comply with any provision of [this act] or if a person otherwise not included in the water's-edge combined group was availed of with a substantial objective of avoiding state income tax.

iv. A water's-edge election is binding for and applicable to the tax year it is made and all tax years thereafter for a period of 10 years. It may be withdrawn or reinstituted after withdrawal, prior to the expiration of the 10 year period, only upon written request for reasonable cause based on extraordinary hardship due to unforeseen changes in state tax statutes, law, or policy, and only with the written permission of the Director. If the Director grants a withdrawal of election, he or she shall impose reasonable conditions as necessary to prevent the evasion of tax or to clearly reflect income for the election period prior to or after the withdrawal. Upon the expiration of the 10 year period, a taxpayer may withdraw from the water's edge election. Such withdrawal must be made in writing within one year of the expiration of the election, and is binding for a period of 10 years, subject to the same conditions as applied to the original election. If no withdrawal is properly made, the water's edge election shall be in place for an additional 10 year period, subject to the same conditions as applied to the original election.

Accessed: http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/Combined%20 Reporting%20-%20FINAL%20version.pdf

Appendix B

Montana Bill repealing Water's Edge Election, and thus requiring Worldwide Combined Reporting.

65th Legislature SB0105.01

SENATE BILL NO. 105

INTRODUCED BY D. BARRETT

A BILL FOR AN ACT ENTITLED: "AN ACT REPEALING THE WATER'S-EDGE ELECTION FOR CORPORATE INCOME TAX PURPOSES; ALLOWING A CURRENT WATER'S-EDGE ELECTION TO REMAIN IN EFFECT UNTIL IT EXPIRES; PROHIBITING A NEW WATER'S-EDGE ELECTION; AMENDING SECTIONS 15-31-121, 15-31-322, AND 15-31-324, MCA; REPEALING SECTIONS 15-31-321, 15-31-322, 15-31-323, 15-31-324, 15-31-325, AND 15-31-326, MCA; AND PROVIDING EFFECTIVE DATES."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Section 15-31-121, MCA, is amended to read:

"15-31-121. Rate of tax -- minimum tax ~~-- distribution of revenue~~. (1) ~~Except as provided in subsection (2), the~~ The percentage of net income to be paid under 15-31-101 is 6 3/4% of all net income for the tax period.

~~(2) For a taxpayer making a water's-edge election, the percentage of net income to be paid under 15-31-101 is 7% of all taxable net income for the tax period.~~

~~(3)~~(2) Each corporation subject to taxation under this part shall pay a minimum tax of not less than $50."

Section 2. Section 15-31-322, MCA, is amended to read:

"15-31-322. Water's-edge election -- inclusion of tax havens. (1) Notwithstanding any other provisions of law, a taxpayer subject to the taxes imposed under this chapter may apportion its income under this section if the water's-edge election is made before [the effective date of this section]. A return under a water's-edge election must include the income and apportionment factors of the following affiliated corporations only:

(a) a corporation incorporated in the United States in a unitary relationship with the taxpayer and eligible to be included in a federal consolidated return as described in 26 U.S.C. 1501 through 1505 that has more than 20% of its payroll and property assignable to locations inside the United States. For purposes of determining eligibility for inclusion in a federal consolidated return under this subsection (1)(a), the 80% stock ownership requirements of 26 U.S.C. 1504 must be reduced to ownership of over 50% of the voting stock directly or indirectly owned or controlled by an includable corporation.

(b) domestic international sales corporations, as described in 26 U.S.C. 991 through 994, and foreign sales corporations, as described in 26 U.S.C. 921 through 927;

(c) export trade corporations, as described in 26 U.S.C. 970 and 971;

(d) foreign corporations deriving gain or loss from disposition of a United States real property interest to the extent recognized under 26 U.S.C. 897;

(e) a corporation incorporated outside the United States if over 50% of its voting stock is owned directly or indirectly by the taxpayer and if more than 20% of the average of its payroll and property is assignable to a location inside the United States; or

(f) a corporation that is in a unitary relationship with the taxpayer and that is incorporated in a tax haven, including Andorra, Anguilla, Antigua and Barbuda, Aruba, the Bahamas, Bahrain, Barbados, Belize, Bermuda, British Virgin Islands, Cayman Islands, Cook Islands, Cyprus, Dominica, Gibraltar, Grenada, Guernsey-Sark-Alderney, Isle of Man, Jersey, Liberia, Liechtenstein, Luxembourg, Malta, Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, Netherlands Antilles, Niue, Panama, Samoa, San Marino, Seychelles, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Turks and Caicos Islands, U.S. Virgin Islands, and Vanuatu.

(2) The department shall report biennially to the revenue and transportation interim committee with an update of countries that may be considered a tax haven under subsection (1)(f)."

Section 3. Section 15-31-324, MCA, is amended to read:

"15-31-324. Water's-edge election period -- consent -- change of election. (1) A water's-edge election may be made by a taxpayer and is effective only if every affiliated corporation subject to the taxes imposed under this chapter consents to the election. Consent by the common parent of an affiliated group constitutes consent of all members of the group. An affiliated corporation that becomes subject to taxes under this chapter after the water's-edge election is considered to have consented to the election. The election must disclose the identity of the taxpayer and the identity of any affiliated corporation, including an affiliated corporation incorporated in a tax haven as set forth in 15-31-322(1)(f), in which the taxpayer owns directly or indirectly more than 50% of the voting stock of the affiliated corporation.

(2) ~~Except as provided in subsections (3) and (4), each water's-edge election must be for 3-year renewable periods.~~ <u>A water's-edge election made before [the effective date of this section] is in effect for 3 years</u>

from the date of the election and must be made within the first 90 days of the first tax year of the 3-year period. A water's-edge election may not be made on or after [the effective date of this section].

(3) A water's-edge election made before [the effective date of this section] may be changed by a taxpayer before the end of ~~each~~ the 3-year period only with the permission of the department. In granting a change of election, the department shall impose reasonable conditions that are necessary to prevent the avoidance of tax or clearly reflect income for the election period prior to the change.

~~(4) A taxpayer subject to the provisions of 15-31-322(1)(f) who has a water's-edge election that is in effect for tax periods beginning both before and after October 1, 2003, may rescind the election for any tax period beginning after October 1, 2003.~~"

NEW SECTION. **Section 4. Repealer.** The following sections of the Montana Code Annotated are repealed:

15-31-321. Definitions.
15-31-322. Water's-edge election -- inclusion of tax havens.
15-31-323. Apportionment factors -- inclusion of tax havens.
15-31-324. Water's-edge election period -- consent -- change of election.
15-31-325. Treatment of dividends.
15-31-326. Domestic disclosure spreadsheet -- inclusion of tax havens.

NEW SECTION. **Section 5. Effective dates.** (1) Except as provided in subsection (2), [this act] is effective on passage and approval.

(2) [Sections 1 and 4] are effective July 1, 2020.

- END -

Appendix C

77th OREGON LEGISLATIVE ASSEMBLY--2013 Regular Session

Enrolled

House Bill 2460

Introduced and printed pursuant to House Rule 12.00. Presession filed (at the request of House Interim Committee on Revenue)

CHAPTER ....

AN ACT

Relating to tax compliance; creating new provisions; amending ORS 317.267 and 317.715; and prescribing an effective date.

Be It Enacted by the People of the State of Oregon:

SECTION 1. No later than February 1, 2014, the Department of Revenue shall make a report on the use of out-of-state tax shelters to the Seventy-seventh Legislative Assembly. The department shall use all data available to the department to prepare the report, which shall:

(1) Describe methods by which taxpayers shift income otherwise taxable by this state to outside the state; and

(2) Make recommendations for addressing noncompliance attributable to out-of-state tax shelters.

SECTION 2. ORS 317.715 is amended to read:

317.715. (1) If a corporation required to make a return under this chapter is a member of an affiliated group of corporations making a consolidated federal return under sections 1501 to 1505 of the Internal Revenue Code, the corporation's Oregon taxable income shall be determined beginning with federal consolidated taxable income of the affiliated group as provided in this section.

(2)(a) For purposes of determining Oregon taxable income, the taxable income or loss of any corporation that is a member of a unitary group and that is incorporated in any of the following jurisdictions shall be added to federal consolidated taxable income:

(b) Andorra, Anguilla, Antigua and Barbuda, Aruba, the Bahamas, Bahrain, Barbados, Belize, Bermuda, the British Virgin Islands, the Cayman Islands, the Cook Islands, Cyprus, Dominica, Gibraltar, Grenada, Guernsey-Sark-Alderney, the Isle of Man, Jersey, Liberia, Liechtenstein, Luxembourg, Malta, the Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, the Netherlands Antilles, Niue, Samoa, San Marino, Seychelles, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, the Turks and Caicos Islands, the U.S. Virgin Islands and Vanuatu.

[*(2)*] **(3)** If the affiliated group, of which the corporation subject to taxation under this chapter is a member, consists of more than one unitary group, before the additions, subtractions, adjustments and modifications to federal taxable income provided for in this chapter are made, and before allocation and apportionment as provided in ORS 317.010 (10), if any, modified federal consolidated taxable income shall be computed. Modified federal consolidated taxable income shall be determined by eliminating from the federal consolidated taxable income of the affiliated group the separate taxable income, as determined under Treasury Regulations adopted under section 1502 of the Internal Revenue Code, and any deductions or additions or items of income, expense, gain or loss for which consolidated treatment is prescribed under Treasury Regulations adopted under section 1502 of the Internal Revenue Code, attributable to the member or members of any unitary group of which the corporation is not a member.

[*(3)(a)*] **(4)(a)** After modified federal consolidated taxable income is determined under subsection [*(2)*] **(3)** of this section, the additions, subtractions, adjustments and modifications prescribed by this chapter shall be made to the modified federal consolidated taxable income of the remaining members of the affiliated group, where applicable, as if all such members were subject to taxation under this chapter. After those modifications are made, Oregon taxable income or loss shall be determined as provided in ORS 317.010 (10)(a) to (c), if necessary.

(b) In the computation of the Oregon apportionment percentage for a corporation that is a member of an affiliated group filing a consolidated federal return, there shall be taken into consideration only the property, payroll, sales or other factors of those members of the affiliated group**, and of those corporations described in subsection (2) of this section,** whose items of income, expense, gain or loss remain in modified federal consolidated taxable income after the eliminations required under subsection [*(2)*] **(3)** of this section. Those members of an affiliated group making a consolidated federal return or a consolidated state return [*shall*] **may** not be treated as one taxpayer for purposes of determining whether any member of the group is taxable in this state or any other state with respect to questions of jurisdiction to tax or the composition of the apportionment factors used to attribute income to this state under ORS 314.280 or 314.605 to 314.675.

(5) The Department of Revenue shall adopt rules:

(a) To determine the computation of income or loss for a corporation that is a member of a unitary group and that is not otherwise required to file a consolidated federal return.

(b) To prevent double taxation or double deduction of any amount included in the computation of income under this section.

SECTION 3. ORS 317.267 is amended to read:

317.267. (1) To derive Oregon taxable income, there shall be added to federal taxable income amounts received as dividends from corporations deducted for federal purposes pursuant to section 243 or 245 of the Internal Revenue Code, except section 245(c) of the Internal Revenue Code, amounts paid as dividends by a public utility or telecommunications utility and deducted for federal purposes pursuant to section 247 of the Internal Revenue Code or dividends eliminated under Treasury Regulations adopted under section 1502 of the Internal Revenue Code that are paid by members of an affiliated group that are eliminated from a consolidated federal return pursuant to ORS 317.715 [*(2)*] **(3)**.

(2) To derive Oregon taxable income, after the modification prescribed under subsection (1) of this section, there shall be subtracted from federal taxable income an amount equal to 70 percent of dividends (determined without regard to section 78 of the Internal Revenue Code) received or deemed received from corporations if such dividends are included in federal taxable income. However:

(a) In the case of any dividend on debt-financed portfolio stock as described in section 246A of the Internal Revenue Code, the subtraction allowed under this subsection shall be reduced under the same conditions and in same amount as the dividends received deduction otherwise allowable for federal income tax purposes is reduced under section 246A of the Internal Revenue Code.

(b) In the case of any dividend received from a 20 percent owned corporation, as defined in section 243(c) of the Internal Revenue Code, this subsection shall be applied by substituting "80 percent" for "70 percent."

(c) A dividend that is not treated as a dividend under section 243(d) or 965(c)(3) of the Internal Revenue Code may not be treated as a dividend for purposes of this subsection.

(d) If a dividends received deduction is not allowed for federal tax purposes because of section 246(a) or (c) of the Internal Revenue Code, a subtraction may not be made under this subsection for received dividends that are described in section 246(a) or (c) of the Internal Revenue Code.

(3) There shall be excluded from the sales factor of any apportionment formula employed to attribute income to this state any amount subtracted from federal taxable income under subsection (2) of this section.

SECTION 4. On or before January 1 of each odd-numbered year, the Department of Revenue shall submit a report to the Legislative Assembly in the manner provided by ORS 192.245. The report shall include recommendations for legislation related to jurisdictions listed in ORS 317.715 (2)(b), including recommendations for additions to or subtractions from the list of jurisdictions in ORS 317.715 (2)(b).

SECTION 5. The amendments to ORS 317.267 and 317.715 by sections 2 and 3 of this 2013 Act apply to tax years beginning on or after January 1, 2014.

SECTION 6. This 2013 Act takes effect on the 91st day after the date on which the 2013 regular session of the Seventy-seventh Legislative Assembly adjourns sine die.

Endnotes & Citation

[1] While the Tax Cuts and Jobs Act (TCJA) has some mechanisms aimed at tackling offshoring, analysis of the impact of the tax plan shows that it increases certain incentives for offshoring overall. Most importantly, it allows multinational companies to pay a substantially lower tax rate on profits and operations offshore. Richard Phillips, "How to Fix the Broken International Corporate Tax Code," ITEP, July 17, 2018.

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[3] Fiscal Note, HB 0578, Montana Department of Revenue, 2015 Biennium. In this Fiscal Note, it is estimated that, in Fiscal Year 2017, repealing the tax haven list would cost $8,941,271 in lost revenue.

[4] "Legislature leaves Oregon largely defenseless against corporate abuse of tax havens," Oregon Center for Public Policy, June 5, 2018. https://www.ocpp.org/2018/06/05/tax-haven-corporate-abuse-oregon/

[5] Paul Shukovsky, "Oregon Tax Haven Blacklist Repealed, One State List Left," Bloomberg BNA, April 12, 2018. https://www.bna.com/oregon-tax-haven-n57982091081/

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[7] Ryan Maness, "Twenty-Five States Face Revenue Shortfalls in 2018," MulitiState Insider, Jan. 9, 2018. https://www.multistate.us/blog/twenty-five-states-face-revenue-shortfalls-in-2018

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[12] Container Corp v. FTB, 463 U.S. 159, 170 (1983).

[13] Office of the Secretary, Department of the Treasury, The Final Report of the Worldwide Unitary Taxation Working Group: Chairman's Report and Supplemental Views, August 1984.

[14] Jane G. Gravelle, "Tax Havens: International Tax Avoidance and Evasion," National Tax Journal 62(4): 727-753, December 2009.

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[16] "Offshore Shell Games 2017," ITEP and U.S. PIRG Education Fund, October 2017. https://itep.org/wp-content/uploads/offshoreshellgames2017.pdf

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[18] States have a history of decoupling from the federal tax code when it is to their benefit. For example, after the federal government began phasing out the estate tax, 13 states and the District of Columbia decoupled from the federal government's tax code to continue collecting revenue through the estate tax. For more, see Elizabeth C. McNichol, Center on Budget and Policy Priorities, Many States Are Decoupling from the Federal Estate Tax Cut, 28 March 2006.

[19] National Conference of State Legislatures, NCSL Fiscal Brief: State Balanced Budget Provisions, October 2010.

[20] Matt Pearce, "Red-state revolt continues: Teachers strike in Oklahoma and protest in Kentucky," The Los Angeles Times, April 2, 2018.

[21] Montana law currently identifies the following tax havens: Andorra, Anguilla, Antigua and Barbuda, Aruba, the Bahamas, Bahrain, Barbados, Belize, Bermuda, British Virgin Islands, Cayman Islands, Cook Islands, Cyprus, Dominica, Gibraltar, Grenada, Guernsey-Sark Alderney, Isle of Man, Jersey, Liberia, Liechtenstein, Luxembourg, Malta, Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, Netherlands Antilles, Niue, Panama, Samoa, San Marino, Seychelles, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Turks and Caicos Islands, U.S. Virgin Islands, and Vanuatu, per Montana Code Annotated §15-31-322 (1)(f)

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[25] "An Assessment of Oregon's Listed Jurisdiction Policy and its Cost Effectiveness," Oregon Legislative Revenue Office, March 2017.

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[45] "The Budget and Economic Outlook: 2018 to 2028," Congressional Budget Office, April 2018. https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/53651-outlook.pdf

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