CoPIRG
Standing Up To Powerful Interests

1543 Wazee St., Ste. 330 Denver, CO 80202
www.copirg.org (303) 573-7474 (ph)
info@copirg.org (303) 573-3780 (fx)

Close the Water's Edge Loophole

Colorado taxpayers could recover $15 million a year from a simple reform to crack down on offshore tax dodging.

How will closing the water's edge loophole benefit Colorado?

- Keep $15 million in Colorado every year
- Eliminate an incentive for moving business offshore
- Help level the playing field for Colorado small businesses that compete with multinational corporations
- Protect regular taxpayers from picking up the tab for tax dodgers

What is the water's edge loophole?

A loophole that allows companies to hide income made domestically by pretending that money was made offshore or "beyond the water's edge."

Who takes advantage of this loophole?

Mainly large, multinational companies that can afford armies of tax lawyers and accounting specialists that identify loopholes for companies to shift profits offshore. Some make their taxable income disappear by transferring their patents or trademarks to shell companies located in tax havens and then paying domestically earned income to use that intellectual property 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.

Have other states taken action?

Oregon and Montana both have closed this loophole**.** The Oregon policy was 3-pages long.

- According to Dan Bucks, the former chief of the Montana Department of Revenue who administered the law for the state from 2005 to 2013, **"Montana's tax haven law brings a measure of tax justice to small businesses, farmers and ranchers, retirees and wage earners who already pay taxes on income they earn in Montana.** Without the law, these Montanans would pay more to make up for taxes wrongly avoided by large corporations shifting their Montana income to tax havens."

How do you close this loophole?

1. **Determine a list of tax haven countries for state tax purposes that should be 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 notorious tax havens.Biennial 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.
2. **Require corporations to include the income of foreign subsidiaries based in state-identified tax havens on their state tax returns**. Corporations are already required to file information about the income of all of their foreign subsidiaries with the federal government on IRS Form 5471. The state of Colorado could ask for that information for the state-identified tax haven countries. Thus, the additional reporting would not be burdensome or costly for corporations or state tax collectors.
3. **Calculate the income subject to taxation based on the sum of domestic income and income listed in tax havens.**
4. **Apply Colorado's typical apportionment formula to determine the share of reported profits it will tax.** Colorado taxes corporate income based only on the percentage of sales that a company makes in our state. That same percentage would be applied to the portion of income listed in tax havens that would be subject to Colorado tax under the law.