Closing the Billion Dollar Loophole

How States Are Reclaiming Revenue Lost to Offshore Tax Havens

Georgia PIRG
Standing Up To Powerful Interests

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Due to an error, an earlier version of Closing the Billion Dollar Loophole was mistakenly reported to have been written and produced by Georgia PIRG Education Fund. In actuality, Georgia PIRG wrote and produced Closing the Billion Dollar Loophole.

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Executive Summary

Every year, corporations use complicated gimmicks 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. Tax haven abusers benefit from America's markets, public infrastructure, educated workforce, security and rule of law—all supported in one way or another by tax dollars. But they use tax havens to escape supporting these public structures and benefits. Ultimately, ordinary taxpayers end up picking up the tab, either in the form of higher taxes or cuts to public spending priorities.

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. With Congress often gridlocked, states should take action to reduce the impact of offshore tax havens on state budgets.

Montana and Oregon have passed laws to curb offshore tax haven abuse and collect tax revenue that otherwise would be lost. These two states simply treat a proportionate share of the income that corporations book to known tax havens as domestic income for state tax purposes, since it can be reasonably extrapolated that the income arose from business activity in those states.

Other states can also collect some of the revenue lost to offshore tax havens by adopting policies similar to those in Montana and Oregon. Specifically, states must:

- Close the "water's edge" loophole by mandating 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 (that is, within the United States). By declaring a statutory list of tax havens, states can tax corporate profits held in tax havens that lie past the water's edge.

- Before closing the water's edge loophole, states must adopt "combined reporting," which requires corporations to list the profits of all their subsidiaries on their tax forms. Combined reporting provides states with a ready formula that can be applied to tax haven income to determine which portion should be taxable by the state.

To date, 23 states and the District of Columbia have adopted combined reporting requirements, but of these jurisdictions only Montana and Oregon have also closed the water's edge loophole by creating a statutory list of tax haven countries to be accounted for in corporate combined reports. Montana is now collecting millions of dollars in additional tax revenue and Oregon is poised to do the same with its new law coming into force in 2014.

- Closing the water's edge loophole allowed Montana to collect $4.2 million in corporate taxes that would have otherwise gone uncollected in 2008. In 2010, the last year for which data are available, closing the water's edge loophole allowed Montana to collect an additional $7.2 million.

- After closing the water's edge loophole in 2013, Oregon's Legislative Revenue Office expects the state will collect $18 million in corporate taxes in the 2014 tax year that would have otherwise gone uncollected. In the 2015-2017 biennium, the Legislative Revenue Office expects the state will collect an additional $42 million.

Other states too should close the water's edge loophole. In doing so they could collect millions in additional tax revenue to reduce the tax burden on other taxpayers or increase needed services. In addition to Montana and Oregon, twenty-one states and the District of Columbia have combined reporting and could implement this reform. If they had joined Montana and Oregon in closing the water's edge loophole, they could have collected an additional billion dollars in combined revenues

Table ES-1. Closing the Water's Edge Loophole Would Have Generated Millions of Dollars of Additional Tax Revenue in 2012*

Rank	State	Potential Additional Tax Revenue (millions)
1	California	$246.4
2	New York	$141.6
3	Texas	$141.5
4	Illinois	$108.3
5	Massachusetts	$79.0
6	Alaska	$45.8
7	Minnesota	$33.0
8	Wisconsin	$27.6
9	New Hampshire	$26.1
10	Kansas	$21.9
11	Arizona	$20.1
12	Michigan	$18.9
13	District of Columbia	$17.9
14	Colorado	$15.3
15	North Dakota	$14.9
16	Utah	$12.9
17	West Virginia	$9.6
18	Idaho	$9.4
19	Nebraska	$7.3
20	Maine	$7.2
21	Hawaii	$5.5
22	Vermont	$4.8

* With one exception—Massachusetts—all revenue estimates in this table are for 2012, calculated using 2012 data. The Massachusetts figure represents the midpoint of an officially calculated range produced by the Massachusetts Department of Revenue using 2011 data. The 2012 figure calculated using our own conservative methodology ($62.1 million) aligns closely with the low end of the officially calculated range for 2011 ($64-$94 million). See note 45 for more information.

in 2012 (note that this figure was calculated using 2012 data for all states except Massachusetts where an official, state-generated estimate for 2011 was used instead) (see Table ES-1).

Closing the water's edge loophole would be a good start for states in reclaiming a portion of the state revenues lost to tax havens. In 2011, offshore tax havens cost states an estimated total of $20.7 billion in corporate tax revenue. California lost $3.3 billion to offshore tax havens—the most lost by any state. States that close the water's edge loophole could also put pressure on Congress to stop offshore tax haven abuse at the federal level.

Introduction

Every person and every corporation in America benefits from government services—from schools to paved roads to courts and public health. We all should contribute our share in taxes when it comes to paying the tab. Yet even though America's corporations use these government services, many avoid paying taxes for them by moving their profits into offshore havens.

Not only is the practice of exploiting tax havens unfair, but it strains federal and state budgets. In 2011, offshore tax havens prevented Colorado from collecting approximately $246 million in taxes, and—with 2012 general fund revenues $1 billion less than they were five years prior—state lawmakers had to cut public spending.[1] In the 2012-2013 budget the state's lawmakers could not fully fund programs for schools, so spending on K-12 schools did not keep up with inflation while spending on colleges and universities was cut by $5.8 million, or 1.1 percent.[2]

Had Colorado closed all offshore tax loopholes and collected the taxes that were rightfully owed by corporations, the additional $246 million in revenue could have funded the school programs and would have gone a long way toward closing Colorado's 2012 fiscal year budget gap of $450 million.[3]

While corporations' use of offshore tax havens has exacerbated budget and revenue problems in many states, recent attention has been more often paid to the huge sums in federal taxes that multinational corporations avoid by abusing tax havens; a recent academic analysis estimated that the Federal Treasury lost $90 billion in 2008 due to corporate tax haven use.[4] Since corporations pay state income taxes largely based on their federally defined taxable income, the revenue losses hit states as well. Many officials in states dependent on corporate tax revenue have spent decades awaiting federal tax reform to fix these problems.

Not content with waiting for Congress to act, a couple of innovative states have developed a simple way to collect taxes—which are rightfully owed—on these profits held offshore. If other states followed suit, together they would collect a billion dollars in additional tax revenue and create a more equitable tax system with a more level playing field for small business and fewer incentives to move business offshore. The following pages are a roadmap for how all states can collect tax revenue from corporate profits held in offshore havens, and an assessment of the benefits states would enjoy by doing so.

Americans and Small Businesses Want to Stop Offshore Tax Haven Abuse

Not surprisingly, Americans strongly voice their impatience with corporate abuse of tax havens in opinion surveys. A January 2013 Hart Research Poll found that 73 percent of Americans agree that we should "close loopholes allowing corporations and the wealthy to avoid U.S. taxes by shifting income overseas." The same poll found that 83 percent agreed that we should "increase [the] tax on U.S. corporations' overseas profits to ensure it is as much as [the] tax on their U.S. profits." This was the most popular policy of the 12 choices that were included in the poll.[5]

The small business community shows similarly strong support for measures to close offshore tax loopholes. Businesses should thrive based on their efficiency and ability to innovate, but ordinary small businesses suffer when they must compete on an uneven playing field against corporations that avoid taxes by employing high-priced lawyers, accountants and lobbyists. A 2012 poll found that 90 percent of small business owners believe big corporations use loopholes to avoid taxes that small businesses have to pay, and 92 percent think that it is a problem when "U.S. multinational corporations use accounting loopholes to shift their U.S. profits to their offshore subsidiaries to avoid taxes."[6]

Offshore Tax Havens Cost States Billions

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.[7] Income held by foreign subsidiaries of U.S.-based companies is not taxed until the money is declared as returned to the United States, used for stock repurchases, paid in dividends to shareholders, or invested back in the U.S. Even then many companies still find ways to dodge their tax obligations, either by taking advantage of tax holidays or using complicated repatriation schemes.[8] The amount of corporate money from around the world booked in offshore tax havens is vast—up to $1.9 trillion according to a 2013 survey.[9]

Corporate Profits Held "Offshore" Often Remain in the United States

Ironically, much of this offshore money may actually be deposited in special accounts called "international banking facilities" maintained by U.S. banks. The banks can lend this money overseas and earn profits on it. The money continues to be considered held offshore and not returned to the United States even though the cash may be in these special accounts of U.S. banks. A study of large U.S. multinational corporations by the Senate Permanent Subcommittee on Investigations found that nearly half of the profits considered "offshore" for tax purposes were actually in bank accounts or investments in the United States.[10]

With their armies of tax lawyers and accounting specialists, companies have many strategies for shifting 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.

Offshore tax haven abuse usually draws attention based on its impact on tax collections at the federal level. But many states are also affected because their tax codes are closely tethered to the federal one, which is rife with offshore tax loopholes. States calculate taxes using similar definitions of income as those used at the federal level for the sake of simplicity and to reduce the cost of enforcement and compliance.[11] However, this means that when corporations do not report income to the federal government, it typically goes unreported to the states, too.

In 2011 alone, tax havens cost states approximately $20.7 billion in lost corporate tax revenue. Worst hit was California which lost an estimated $3.3 billion in corporate income tax revenues.[12] New York lost $1.9 billion (see Table 1). In fact, 31 states lost over $100 million in estimated revenues that year.

Since most states have balanced budget requirements, every dollar of state revenue lost to offshore tax havens must be accounted for elsewhere, either through cuts to spending on state services and infrastructure, or higher taxes on ordinary taxpayers.[13] With states still struggling to overcome the economic recession, corporate tax dodging can have an especially large impact on state budgets already under tremendous fiscal strain.

Table 1. 31 States Lost Over $100 Million in Corporate Tax Revenue to Offshore Tax Havens in 2011

State	Revenue Losses (millions)
California	$3,341
New York	$1,932
Illinois	$1,538
Pennsylvania	$1,413
New Jersey	$1,409
Minnesota	$1,050
Massachusetts	$991
Florida	$777
Maryland	$547
North Carolina	$494
Virginia	$467
Connecticut	$465
Indiana	$463
Georgia	$451
Missouri	$439
Michigan	$415
Wisconsin	$406
Louisiana	$388
Tennessee	$371
Arizona	$286
District of Columbia	$284
Colorado	$246
Texas	$243
Arkansas	$229
Oregon	$225
Oklahoma	$189
Kentucky	$187
Nebraska	$168
Alabama	$151
Rhode Island	$130
Iowa	$112

Domestic Schemes for Dodging State Taxes

States do not just lose out when corporations shift their income to other countries. Corporations can often hide their money in domestic tax havens like Delaware, Nevada and Wyoming. Many businesses operating—even headquartered—in other states transfer profits to holding companies in Delaware, for example, to reduce their tax liability in the states where they are primarily located or active. According to *The New York Times*, the "Delaware loophole" cost states $9.5 billion over the course of a decade.[14] Unravelling these tax schemes can be particularly hard because these states require less information to register a corporation than to apply for a drivers' license, obscuring the true owners of shell companies.[15]

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 the 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.[16]

States Can Tax Corporate Revenues Held in Offshore Havens by Updating their Tax Codes

In order to tax some corporate revenue held in offshore tax havens, states can treat a proportionate share of the income that corporations book to known havens as domestic income. The two states that have done so most effectively—Montana and Oregon—have collected or will collect millions of dollars in additional tax revenue.

Combined Reporting and the History of State Attempts to Close Offshore Tax Loopholes

Many states have tried to collect the taxes they are fairly owed by corporations by changing the rules around how companies report their income at the state level.[17] To date, 23 states and the District of Columbia have adopted "combined reporting" requirements. These legal provisions require corporations to report the profits of their in-state and out-of-state subsidiaries together, since each part of the corporation contributes to its overall profitability. 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 10). 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 and simple.[18]

In the 1970s and 1980s, several states including California applied *worldwide* combined reporting to multinational companies, which required corporations to report profits from subsidiaries in the United States *and* offshore. This allowed states to collect tax revenue from domestically earned profits booked offshore.[19] Some foreign countries and multinational corporations opposed this requirement, though, and launched campaigns against worldwide combined reporting through lobbying at the state and federal levels, as well as litigation.

When the United States Supreme Court affirmed the constitutionality of worldwide combined reporting in a landmark case in 1983, *Container Corporation of America vs. Franchise Tax Board*, corporations appealed to the White House for help.[20] The result was the creation of the Worldwide Unitary Taxation Working Group, headed by the Secretary of the Treasury, which aimed to find a compromise between states and corporations. While common ground was found on some issues, there was disagreement over others, including how states should tax foreign dividends and U.S. corporations with more than 80 percent of their payroll and property outside of the country, as well as more fundamental issues such as how a tax haven country is defined.[21]

Ultimately the working group deferred consideration of federal legislative action and left the states to tackle the remaining disagreements.[22] A renewed lobbying effort ensued and succeeded in moving all states, one by one, to water down their combined reporting rules and allow corporations, in one manner or another, to report profits only from domestically incorporated entities—that is, to restrict reporting to the "water's edge."[23]

Remnants of worldwide combined reporting exist in some states. California, Idaho, Montana and North Dakota require companies to file worldwide combined reports, unless companies elect to file a "water's edge" report. In essence, these states offer a loophole that allows corporations to escape the worldwide combined reporting requirement.[24] 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.[25] Alaska requires worldwide combined reporting for oil companies only.[26]

While mandatory worldwide combined reporting remains the gold standard for corporate income reporting because it eliminates most tax avoidance schemes, closing loopholes in "water's edge" reporting is an effective and achievable alternative.

The basic loophole closing strategy proposed in this report has its roots in the Worldwide Unitary Taxation Working Group's report. Despite some fundamental disagreements, one point of consensus among all parties was that a "water's edge" combined report should include income from subsidiaries incorporated in tax havens (though the report did not succeed in defining that term).[27]

How to Close the Water's Edge Loophole

To prevent corporations from dodging their tax obligations by booking their profits beyond the water's edge, states that have *combined reporting laws* can *close the water's edge loophole*. To do so, states must:

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 tax havens based on common characteristics, eliminating the need for state officials to develop expertise on foreign tax regimes.[28] These lists have been cited in studies done on tax havens by the nonpartisan Government Accountability Office and the Congressional Research Service.[29] 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.[30]

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. State tax agencies could simply add a line to their tax forms requiring corporations to file the same federally reported information with states, though limited just to the subsidiaries based in state-identified tax havens. 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 and tax haven income.**

4. **Apply the state's typical 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. And some states use the so-called single sales factor (SSF) rule that considers *only* the share of national sales the corporation makes in the state.[31]

States Have Collected Tax Revenue from Closing the Water's Edge Loophole

In the last decade, two states have most effectively closed the water's edge loophole, promoting fairness in state tax codes and protecting state coffers from corporations trying to hide their profits offshore.

Montana led the way in 2003. In a bill that garnered broad bipartisan support in the state legislature, Montana's lawmakers pioneered the approach described above and voted to require companies with

Form CLT-4, Page 3 Period End Date M M D D Y Y Y Y FEIN

Computation of Montana Taxable Income and Net Amount Due

1. Taxable income reported on your federal tax return (line 28) (include a copy of signed federal Form 1120).. 1.		00
2. Additions		
2a. State, local, foreign and franchise taxes based on income (include breakdown of your Form 1120, line 17) 2a.	00	
2b. Federal tax exempt interest 2b.	00	
2c. Contributions used to compute qualified endowment credit 2c.	00	
2d. Income/loss of foreign parent and foreign subsidiaries for worldwide combined filers 2d.	00	
2e. Income/loss of unitary corporations not included in federal consolidated return 2e.	00	
2f. Premiums used to calculate the Insure Montana Credit 2f.	00	
2g. Deemed dividends—Water's Edge filers only (include Schedule WE) 2g.	00	
2h. Income/loss of corporations incorporated in tax havens—Water's Edge filers only 2h.	00	
2i. Federal capital loss carry-over utilized on federal return (include Schedule D) 2i.	00	
2j. All of your other additions (include a detailed breakdown) 2j.	00	
Add lines 2a through 2j and enter the result. **This is the total of your additions.** 2.		00

Montana's corporate tax form asks filers to report income from tax haven countries in question 2h.

subsidiaries in certain foreign tax havens to include those profits in their combined reporting.[32] 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.[33]

The bill has helped Montana restore some equity to its corporate tax system and limit abuse of offshore tax havens. Moreover, it has helped the state claim tax revenue that would otherwise have been lost to international income-shifting gimmicks. By closing the water's edge loophole, the 2003 tax haven law has saved Montana's ordinary taxpayers millions. A 2012 memorandum to the state legislature reports that by closing the water's edge loophole, Montana collected $4.2 million in corporate taxes that would have otherwise gone uncollected in 2008.[34] In 2010, the last year for which data are available, the revenue collected rose to $7.2 million.[35]

In July 2013, **Oregon** became the second state to use a statutory list of tax havens to close the water's edge loophole. 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 (see Appendix C for the text of the bill). This levels the corporate tax playing field, limiting the ability of bigger multinational corporations with high-powered legal and accounting teams to hide profits overseas.[36] As in Montana, corporations with subsidiaries in particular tax havens must include net income from those locations on their in-state tax returns.[37]

While it is too early to know exactly how much Oregon's law will save ordinary taxpayers each year, official projections indicate the savings will be significant. Oregon's Legislative Revenue Office (LRO) expects that the state will collect $18 million in corporate taxes in the 2014 tax year that would have gone uncollected without closing the water's edge loophole.[38] The LRO expects Oregon to collect an additional $42 million in the 2015-2017 biennium and an additional $49 million in the 2017-2019 biennium.[39]

Alaska, **West Virginia** and the **District of Columbia** also have laws on the books that attempt to curb corporate abuse of offshore tax havens, though those laws are weaker than those in Montana and Oregon because they lack a statutory list of tax haven countries. In Alaska, corporations file combined reports that must include income generated by subsidiaries incorporated, or that do business, in countries that do not have an income tax. They must also include the income of subsidiaries operating in places that levy taxes at a rate of 90 percent or less of the U.S. rate provided at least 50 percent of certain transactions are made to one or more members of the corporation's group of related companies, and the subsidiary does not conduct "significant economic activity" in the low-tax country.[40]

The laws of West Virginia and the District of Columbia require corporate taxpayers to account for income from subsidiaries doing business in "tax haven" countries. In both jurisdictions, this term is defined in ways that end up inviting litigation. In West Virginia, tax havens are defined as jurisdictions with no, or nominal, effective tax rates, or as identified by the Organization for Economic Cooperation and Development as a tax haven, or as having "harmful preferential" tax rules, an ill-defined term.[41] In the District of Columbia, tax havens are also defined in a somewhat convoluted manner with the law specifying criteria that the tax collection agency is charged with applying.[42] As in Alaska, leaving it to a government agency to decide what constitutes a tax haven based on complicated legislative language can leave the door open for corporate litigation.

All States Should Close Offshore Tax Loopholes and Recapture Revenue Lost to Offshore Tax Havens

All states with combined reporting should close the water's edge loophole. In doing so, they would collect more than a billion dollars in additional revenue, level the playing field for businesses in their state, 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) the total corporate taxes collected; (2) the apportionment formula used to determine the share of reported profits to be taxed; (3) the type of industries in the state; and (4) the degree to which each state's corporations use offshore tax havens.

Oregon officials calculated the additional tax revenue their state would receive by closing the water's edge loophole based on the additional tax revenue Montana received. Oregon officials adjusted for their state's greater volume of corporate tax revenues and the different income apportionment formulae used by Montana and Oregon.[43]

Twenty-one other states and the District of Columbia have combined reporting requirements and could implement this reform. If they had closed the water's edge loophole, they would have collected an additional $1.02 billion in revenue in 2012 (note that this figure was calculated using 2012 data for all states except Massachusetts where an official, state-generated estimate for 2011 was used instead). California alone would have collected almost a quarter of a billion dollars, the most of any state. Among other states, New York would have collected $142 million, whereas Colorado with its much smaller economy would have collected $15.3 million (see Table 2). While none of these figures represent a huge share of state revenues, in each state the amounts are significant enough to make a difference in meeting spending priorities or deciding whether or not to raise taxes and fees for residents.

The reclaimed revenue would bolster government coffers in any of these states, but it represents only a fraction of the total amount of estimated state revenue lost to offshore tax haven abuse for several reasons:

- Closing the water's edge loophole does not address illegal tax evasion

Table 2. Closing the Water's Edge Loophole Would Generate Millions of Dollars of Additional Tax Revenue in 2012*

Rank	State	Potential Additional Tax Revenue (millions)
1	California	$246.4
2	New York	$141.6
3	Texas[44]	$141.5
4	Illinois	$108.3
5	Massachusetts[45]	$79.0
6	Alaska	$45.8
7	Minnesota	$33.0
8	Wisconsin	$27.6
9	New Hampshire	$26.1
10	Kansas	$21.9
11	Arizona	$20.1
12	Michigan	$18.9
13	District of Columbia	$17.9
14	Colorado	$15.3
15	North Dakota	$14.9
16	Utah	$12.9
17	West Virginia	$9.6
18	Idaho	$9.4
19	Nebraska	$7.3
20	Maine	$7.2
21	Hawaii	$5.5
22	Vermont	$4.8

* With one exception—Massachusetts—all revenue estimates in this table are for 2012, calculated using 2012 data. The Massachusetts figure represents the midpoint of an officially calculated range produced by the Massachusetts Department of Revenue using 2011 data. The 2012 figure calculated using our own conservative methodology ($62.1 million) aligns closely with the low end of the officially calculated range for 2011 ($64-$94 million). See note 45 for more information.

from companies that fail to report income to the U.S. as booked in any jurisdiction;

- The lists of known tax haven countries used by Montana and Oregon include only the most egregious examples, and do not restrict tax haven abuse conducted through other countries;

- Closing the water's edge loophole does not address transfer pricing that makes profits (in all jurisdictions) appear smaller or nonexistent; and

- Companies sometimes shift U.S. profits to related corporate entities that don't count as subsidiaries or affiliates either because the IRS or state definitions are too narrow, or because the true corporate owners remain hidden behind shell companies.

Nevertheless, states need not sit on their hands complaining about federal inaction to address the problems of offshore tax dodging. They can take meaningful measures to collect some of these lost revenues and improve their tax systems.

As has happened so many times before, state initiatives may turn out to be the most effective way to finally induce federal lawmakers into overcoming partisan and lobbying pressures to take action, and eventual federal action can address other parts of the problem that will not be as easy as closing the water's edge loophole.

How the Federal Government Should Close Offshore Tax Loopholes

The most comprehensive solution to ending tax haven abuse at the federal level would be to no longer permit U.S. multinational corporations to indefinitely defer paying U.S. taxes on the profits they report as earned by their foreign entities. Instead, they should pay U.S. taxes on them immediately. "Double taxation" is not an issue because the companies already subtract any foreign taxes they've paid from their U.S. tax bill. This simple reform would eliminate the largest incentive to shift profits offshore.

Short of ending deferral, federal policymakers could close some of the offshore loopholes most frequently abused to disguise domestic profits as foreign. For example, policymakers could reform the so-called "check-the-box" rules to stop multinational companies from manipulating how they define their corporate status to minimize their taxes. Right now, companies can make inconsistent claims to maximize their tax advantage, telling one country they are one type of corporate entity while telling another country the same entity is something else entirely.[46]

Federal policy could also stop companies from licensing intellectual property (e.g. patents, trademarks, licenses) to shell companies in tax haven countries and then paying inflated fees to use them in the United States. This common practice allows companies to legally book profits that were earned in the U.S. to the tax haven subsidiary owning the patent.

Methodology

Estimating Additional Tax Revenue to Be Gained by Closing the Water's Edge Loophole

To calculate the additional corporate tax revenue state governments could receive from closing the water's edge loophole, we needed to answer three questions:

1. *How much additional corporate tax revenue has been collected by the states that have already closed the water's edge loophole?* To date, two states—Montana and Oregon—have closed the water's edge loophole using a combined reporting requirement coupled with a list of statutorily designated foreign tax havens. In its law's first year of implementation (2014), Oregon expects a 3.1 percent increase in corporate income tax revenue, according to the Oregon Legislative Revenue Office.[47] The office reported that Montana, because of its law, collected an additional 6.9 percent in corporate income tax revenue in 2010, the latest year for which data are available. The disparity between these figures is largely explained by differences in how these states apportion corporate income for state tax purposes. Montana uses the traditional three-factor formula that considers the share of a corporation's national sales, property and payroll that are attributable to Montana. Oregon, on the other hand, uses the single sales factor (SSF) formula. This taxes national income in proportion to the share of national sales that is attributable to Oregon. So a company with a large property and employee base in Oregon, but most of its sales elsewhere, would enjoy less tax liability under such a system. Generally speaking, SSF states can expect to collect less additional revenue than states that use the traditional three-factor formula as in Montana. As other information in the methodology will show, the kind of apportionment formula used by a state is particularly important when estimating how much additional corporate tax revenue it could have collected.

2. *Which corporate income apportionment formula was in use in each state in 2012, the most recent year for which we have comprehensive corporate income tax data?* CCH, an auditing and tax consultancy, provides tax information for businesses and publishes an annual list of state apportionment formulae, which is commonly referred to by state agencies and legislative research offices. We found the 2012 version of this list reproduced by the Connecticut General Assembly's Legislative Research Office. The Institution of Taxation and Economic Policy (ITEP) also published a list of state apportionment formulae in 2012. To ensure that we had the most authoritative and reliable information possible, and because CCH did not report an apportionment formula for the District of Columbia, we consulted both lists. When inconsistencies arose between the sources, we adopted the most conservative formula (or combination of formulae) reported for a given state, with the SSF formula being the most conservative (likely to lead to lowest increase in corporate tax revenue collections) and the three-factor formula the least.[48] For example, if one of our sources reported that the state of Nebraska used a three-factor apportionment formula and our other source reported that the state used the SSF formula, we adopted the SSF formula for our calculations.

3. *How much corporate income tax revenue was collected by the states in 2012, the most recent year for which we have comprehensive data available?* The U.S. Census Bureau publishes an annual survey of state government tax collections, available at www.census.gov/govs/statetax. The District of Columbia is not included in this survey. To determine its corporate income tax collections, we consulted the District of Columbia's *Revenue Chapter: FY 2012 Budget and Financial Plan* available at www.cfo.dc.gov. This reported $358,133,000 in corporate tax revenue in 2012.

   This study also calculated potential additional revenue for the state of Texas which levies a corporate franchise tax rather than a corporate income tax (for more, see note 44). To determine Texas' 2012 franchise tax collections, we consulted official state revenue reports, available via the state's transparency portal at www.texastransparency.org/State_Finance/Budget_Finance/Reports/. In 2012, Texas collected $4,564,730,635 in franchise tax revenue.

In producing state-by-state estimates of additional tax revenue, we assumed that all states that used the SSF apportionment formula would have collected 3.1 percent more corporate tax revenue (as Oregon expects to in 2014), and all states that used the three-factor formula would have collected an additional 6.9 percent (like Montana in 2010). For states that used the double-weighted sales formula (this is a three-factor rule that gives extra weight to the sales component), we used the average of these two percentage figures (5 percent). Some states used more than one apportionment formula, depending on the industry, or gave taxpayers the option to select how to apportion their income. In these cases, we made our estimate based on the most conservative formula on the books as described above. For example, in a state that used a combination of the double-weighted sales and SSF formulae, we considered the state an SSF state and assumed a 3.1 percent increase in revenue. Finally, some states used custom three-factor formulae that specify the weight to be

Table 3. Corporate Income Apportionment Rules by State in 2012[49]

State	Apportionment Rule
Alabama	Double-weighted sales
Alaska	Three-factor
Arizona	Double-weighted sales/80% sales, 10% property, 10% payroll
Arkansas	Double-weighted sales
California	Single sales factor (SSF)/ double-weighted sales
Colorado	SSF
Connecticut	SSF/double-weighted sales/other
Delaware	Three-factor
District of Columbia	Double-weighted sales
Florida	Double-weighted sales
Georgia	SSF
Hawaii	Three-factor
Idaho	Double-weighted sales
Illinois	SSF
Indiana	SSF
Iowa	SSF
Kansas	Three-factor
Kentucky	Double-weighted sales
Louisiana	SSF
Maine	SSF
Maryland	SSF/double-weighted sales
Massachusetts	Double-weighted sales/ SSF
Michigan	SSF
Minnesota	93% sales, 3.5% property, 3.5% payroll

State	Apportionment Rule
Mississippi	SSF/Other
Missouri	Three-factor/SSF
Montana	Three-factor
Nebraska	SSF
Nevada	No Corporate Income Tax
New Hampshire	Double-weighted sales
New Jersey	70% sales, 15% property, 15% payroll
New Mexico	Three-factor
New York	SSF
North Carolina	Double-weighted sales
North Dakota	Three-factor
Ohio	No Corporate Income Tax
Oklahoma	Three-factor/ double-weighted sales
Oregon	SSF
Pennsylvania	95% sales, 2.5% property, 2.5% payroll
Rhode Island	Three-factor
South Carolina	SSF
South Dakota	No Corporate Income Tax
Tennessee	Double-weighted sales
Texas	SSF
Utah	Three-factor/ double-weighted sales
Vermont	Double-weighted sales
Virginia	Double-weighted sales
Washington	No Corporate Income Tax
West Virginia	Double-weighted sales
Wisconsin	SSF
Wyoming	No Corporate Income Tax

Note: both sources of information for this table did not accurately report Massachusetts' or the District of Columbia's apportionment formulae. Since 1995, Massachusetts has allowed manufacturers and qualified mutual funds and defense contractors to use the SSF formula.[50] Effective January 1, 2011, the District of Columbia has used a double-weighted sales formula.[51] The table reflects this.

attributed to each factor. In all cases, these gave the largest weight to in-state sales. In Minnesota, for instance, corporate income was apportioned giving 93 percent weight to in-state sales, and 3.5 percent weight to both in-state property and payroll. To be conservative, we treated these states as SSF states and assumed a 3.1 percent increase in corporate income tax revenues.

By multiplying the 2012 corporate tax collection data by the appropriate percentage figures outlined in the preceding paragraph, we arrived at the estimates of additional revenue that each state would have collected had they had laws in place in 2012 similar to Montana's and Oregon's.

Note that the figures in this report are estimates based on the experiences of and analysis conducted by a small number of states. States could reasonably expect to see somewhat more or less additional tax revenue than what is estimated in this report due to state-specific circumstances such as variations in the industrial make-up of their economies and other state measures in place against abusive tax-dodging schemes.

Note also that in Massachusetts a more finely-tuned additional revenue estimate was available for 2011, calculated by the state's Department of Revenue in an internal analysis of the fiscal impact of the reform proposed in this report. In the interest of using the most accurate data available, we elected to report that estimate in this study rather than the estimate calculated using our own methodology. More precisely, we reported the midpoint of an officially calculated potential range of additional revenue (see note 45 for more information). Thus, our additional revenue estimates as presented in Table ES-1, Table 2 and Appendix B of this study are for 2012, with the exception of Massachusetts for which we report a 2011 revenue figure.

Calculating State Tax Revenue Lost to Offshore Tax Havens

In this report, we also present the estimated tax revenue that states lost to offshore tax havens in 2011. These data were originally calculated in Jordan Schneider and Elizabeth Ridlington, Frontier Group, and Phineas Baxandall and Dan Smith, U.S. PIRG Education Fund, *The Hidden Cost of Offshore Tax Havens: State Budgets Under Pressure from Tax Loophole Abuse*, January 2013. We reproduced the methodology used in that report to recreate these data here with one revision: in our updated calculations the federal effective tax rate was set at 30.5 percent. This is the 2008 median effective tax rate for the 13 companies—out of America's 100 largest—that did not have subsidiaries in offshore tax havens in 2007. We did not use the statutory 35 percent rate because doing so would not have taken into account the degree to which, even without the use of offshore tax havens, other federal tax loopholes and incentives lower corporations' effective tax rates. These 13 companies are: Amerisource Bergen Corporation; AT&T Inc.; CVS Caremark; Home Depot; Humana; Lockheed Martin Corporation; Lowe's; Macy's; Medco Health Solutions; Northrop Grumman Corporation; United Parcel Service, Inc.; Verizon Communications, Inc.; and Wal-Mart Stores; per United States Government Accountability Office (GAO), *International Taxation: Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions*, December 2008. For these companies' effective tax rates, see: Robert S. McIntyre et al., Citizens for Tax Justice, *Corporate Taxpayers & Corporate Tax Dodgers 2008-10*, November 2011. Note that the GAO report listed four additional companies (Enterprise GP Holdings, Fannie Mae, Freddie Mac and Johnson Controls) that did have subsidiaries in offshore havens, but Citizens for Tax Justice did not list their effective tax rate so we did not consider them here.

Appendix A:
State-by-State Tax Revenue Lost to Offshore Tax Havens

Based on how much income is federally reported in each state and on state tax rates, it is possible to estimate how much each of the state governments lose as a result of offshore tax dodging.

State	Revenue Losses (millions) in 2011
Alabama	$151
Alaska	$61
Arizona	$286
Arkansas	$229
California	$3,341
Colorado	$246
Connecticut	$465
Delaware	$49
District of Columbia	$284
Florida	$777
Georgia	$451
Hawaii	$57
Idaho	$58
Illinois	$1,538
Indiana	$463
Iowa	$112
Kansas	$56
Kentucky	$187
Louisiana	$388
Maine	$7
Maryland	$547
Massachusetts	$991
Michigan	$415
Minnesota	$1,050
Mississippi	$45
Missouri	$439

State	Revenue Losses (millions) in 2011
Montana	$35
Nebraska	$168
Nevada	N/A
New Hampshire	$98
New Jersey	$1,409
New Mexico	$72
New York	$1,932
North Carolina	$494
North Dakota	$46
Ohio	N/A
Oklahoma	$189
Oregon	$225
Pennsylvania	$1,413
Rhode Island	$130
South Carolina	$88
South Dakota	$1
Tennessee	$371
Texas	$243
Utah	$89
Vermont	$37
Virginia	$467
Washington	N/A
West Virginia	$55
Wisconsin	$406
Wyoming	N/A

N/A Indicates that the state does not collect corporate income taxes.

Appendix B:

State-by-State Potential Additional Tax Revenue Collected by Closing the Water's Edge Loophole***

State	Potential Additional Tax Revenue (millions) in 2012
Alabama*	$20.7
Alaska	$45.8
Arizona	$20.1
Arkansas*	$20.2
California	$246.4
Colorado	$15.3
Connecticut*	$19.4
Delaware*	$18.1
District of Columbia	$17.9
Florida*	$100.2
Georgia*	$18.3
Hawaii	$5.5
Idaho	$9.4
Illinois	$108.3
Indiana*	$29.7
Iowa*	$13.2
Kansas	$21.9
Kentucky*	$28.8
Louisiana*	$9.0
Maine	$7.2
Maryland*	$27.3
Massachusetts	$79.0
Michigan	$18.9
Minnesota	$33.0
Mississippi*	$12.3
Missouri*	$9.4
Montana	N/A
Nebraska	$7.3
Nevada	N/A
New Hampshire	$26.1
New Jersey*	$59.8
New Mexico*	$19.4
New York	$141.6
North Carolina*	$61.0
North Dakota	$14.9
Ohio	N/A
Oklahoma*	$22.3
Oregon	N/A
Pennsylvania*	$57.0
Rhode Island*	$8.4
South Carolina*	$7.8
South Dakota	N/A
Tennessee*	$61.3
Texas**	$141.5
Utah	$12.9
Vermont	$4.8
Virginia*	$41.9
Washington	N/A
West Virginia	$9.6
Wisconsin	$27.6
Wyoming	N/A
Total	**$1,680.4**
Total for states with existing combined reporting requirements	**$1,015.0**

N/A Indicates that the state does not collect corporate income taxes or has already enacted the reform.
* These states would also need to enact "combined reporting" requirements in conjunction with a list of statutorily recognized offshore tax havens in order to collect this additional tax revenue.
** The state of Texas does not collect a corporate income tax but rather levies a corporate franchise tax. When filing their franchise tax returns in Texas, companies are subject to a combined reporting requirement and apportion income as companies do in other states with a corporate income tax. The state could implement the reform discussed in this report and is thus included in our analysis. For more, see note 44.
***With one exception—Massachusetts—all revenue estimates in this table are for 2012, calculated using 2012 data. The Massachusetts figure is a 2011 estimate representing the midpoint of an officially calculated range produced by the Massachusetts Department of Revenue using 2011 data. The 2012 figure calculated using our own conservative methodology ($62.1 million) aligns closely with the low end of the officially calculated range for 2011 ($64-$94 million). See note 45 for more information.

Appendix C:
Full Text of Oregon House Bill 2460[52]

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.

Notes

1 Tim Hoover, "Colorado Legislators Cheer Budget, But Some Parts Still Draw Critics," *The Denver Post*, 29 April 2012.

2 Ibid.

3 Phil Oliff, Chris Mai and Vincent Palacios, Center on Budget and Policy Priorities, *States Continue to Feel Recession's Impact*, 27 June 2012.

4 Kimberly A. Clausing, "The Revenue Effects of Multinational Firm Income Shifting," *Tax Notes*, 28 March 2011.

5 Guy Molyneux and Geoff Garin, Hart Research Associates, *Tax Reform and the Federal Budget* (memorandum), 29 January 2013.

6 American Sustainable Business Council, Main Street Alliance, and Small Business Majority, *National Opinion Poll: Small Business Owners' Views on Taxes and How to Level the Playing Field with Big Business*, 6 February 2012.

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

8 Congress enacted a tax holiday for repatriated profits in 2005, per Robert C. Pozen, "A Sensible Plan to Bring U.S. Corporate Profits Home," *Brookings.edu*, 13 June 2012. Some companies also use complicated tax avoidance schemes when repatriating profits. These schemes have nicknames like the "Killer B" and the "Deadly D." The former, now blacklisted by the IRS, involved parent companies trading stock for cash accumulated by foreign subsidiaries. The latter requires the parent company to purchase another U.S. company which promises to pay the parent a large cash sum in the future as part of the deal. The target company promptly converts to a foreign one and can access the parent company's offshore cash by borrowing from its existing subsidiary. It can then use this cash to pay the parent the sum it promised when it was still a U.S. firm. This payment is tax-free. For more, see Robert W. Wood, "Bringing Overseas Money to the U.S.," *Forbes*, 2 May 2011, and Jesse Drucker, "Dodging Repatriation Tax Lets U.S. Companies Bring Home Cash," *Bloomberg*, 29 December 2010.

9 Audit Analytics, "Foreign Indefinitely Reinvested Earnings: Balances Held by the Russell 3000," *Audit Analytics*, 1 May 2013.

10 Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, United States Senate, *Repatriating Offshore Funds: 2004 Windfall for Select Multinationals*, (Washington, D.C.: U.S. Government Printing Office, 2012), 57-64; Office of Senator Carl Levin, *New Data Show Corporate Offshore Funds Not "Trapped" Abroad: Nearly Half of So-Called "Offshore" Funds Already in the United States* (press release), 14 December 2011.

11 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.

12 Jordan Schneider and Elizabeth Ridlington, Frontier Group, Phineas Baxandall and Dan Smith, U.S. PIRG Education Fund, *The Hidden Cost of Offshore Tax Havens: State Budgets under Pressure from Tax Loophole Abuse*, January 2013.

13 National Conference of State Legislatures, *NCSL Fiscal Brief: State Balanced Budget Provisions*, October 2010.

14 Leslie Wayne, "How Delaware Thrives as a Corporate Tax Haven," *The New York Times*, 30 June 2012.

15 United States Government Accountability Office, *Company Formations: Minimal Ownership Information Is Available or Collected*, April 2006.

16 Institute for Local Self-Reliance, *Closing State Corporate Tax Loopholes: Combined Reporting*, 2 June 2010, downloaded from www.ilsr.org; Jesse Drucker, "Wal-Mart Cuts Taxes by Paying Rent to Itself," *The Wall Street Journal*, 1 February 2007. Some states have closed this tax-free loophole for captive real estate investment trusts, and combined reporting often corrects this problem provided that the trusts are U.S. companies.

17 Guidance from Dan Bucks, former Director, Montana Department of Revenue, was particularly valuable in understanding the history of combined reporting as conveyed in this subsection.

18 The states that currently require combined reporting include: Alaska, Arizona, California, Colorado, District of Columbia, Hawaii, Idaho, Illinois, Kansas, Maine, Massachusetts, Michigan, Minnesota, Montana, Nebraska, New Hampshire, New York, North Dakota, Oregon, Texas, Utah, Vermont, West Virginia, and Wisconsin, per Institute on Taxation and Economic Policy, *Combined Reporting of State Corporate Income Taxes: A Primer*, August 2011.

19 See note 16, "Institute for Local Self-Reliance."

20 *Container Corporation of America v. Franchise Tax Board*, 103 S. Ct. 2933 (1983).

21 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.

22 Ibid.

23 Michael Mazerov, Center on Budget and Policy Priorities, *State Corporate Tax Shelters and the Need for "Combined Reporting*," 26 October 2007.

24 Additionally, Alaska requires worldwide combined reporting but only for oil, gas and pipeline companies, per William F. Fox and LeAnn Luna, National Conference of State Legislatures Task Force on State & Local Taxation of Communications and Interstate Commerce, *Combined Reporting*

with the Corporate Income Tax: Issues for State Legislatures, November 2010.

25 Michael S. Schadewald, "State Taxation of U.S.-Controlled Foreign Corporations: How Big Is the Tax Bite?" *International Tax Journal*, September-October 2010:73-82.

26 See note 24, "William F. Fox and LeAnn Luna."

27 See note 21.

28 Dhammika Dharmapala and James R. Hines, Jr., National Bureau of Economic Research, *Which Countries Become Tax Havens?* December 2006; Organization for Economic Cooperation and Development, *Towards Global Tax Co-operation: Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee of Fiscal Affairs: Progress in Identifying and Eliminating Harmful Tax Practices*, 2000; in 2006 a United States District Court order gave the Internal Revenue Service the authority to issue a "John Doe" summons, which included a list of tax havens and financial privacy jurisdictions, per *United States of America v. In the Matter of Tax Liabilities of John Does*, *et al.*, No. C 05-CV-04167-JW, N.D. California, 21 February 2006.

29 Government Accountability Office, *International Taxation: Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions*, December 2008; Jane G. Gravelle, Congressional Research Service, *Tax Havens: International Tax Avoidance and Evasion*, January 23, 2013.

30 Brenda J. Gilmer, Senior Tax Counsel, Montana Department of Revenue, *Corporation Tax Water's Edge Election – Tax Haven Countries* (memorandum), 10 November 2010; Dan Bucks, Director of Revenue, Montana Department of Revenue, *Biennial Recommendations Concerning Tax Haven Jurisdictions* (memorandum), 19 July 2012.

31 Institute on Taxation and Economic Policy, *Corporate Income Tax Apportionment and the "Single Sales Factor*," August 2012. In addition, a small handful of states use custom three-factor formulae that specify the weight to be attributed to each factor. In all cases these give, by far, the largest weight to in-state sales and, in the interest of simplicity and conservatism, are treated as SSF formulae in this paper. States with custom apportionment formulae for some or all of their businesses in 2012 were Arizona, Minnesota, New Jersey, Ohio and Pennsylvania, per Judith Lohman, Connecticut General Assembly, Office of Legislative Research, *OLR Research Report: Corporation Tax Income Apportionment Formulae*, 26 September 2012.

32 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).

33 The Policy Institute, *"Tax" Is Not a Four-Letter Word: Ideas for a More Progressive Taxation System in Montana*, January 2012.

34 $7.2million: see note 30, "Brenda J. Gilmer;" 6.9 percent: Paul Warner, Oregon Legislative Revenue Office, personal communication, 20 November 2013.

35 Ibid.

36 Unanimous support: "Your Government: 2013 Session: House Bill 2460," *The Oregonian*, downloaded from

gov.oregonlive.com; Oregon lists the same tax havens as Montana with the exception of Panama: Maria Koklanaris, "Oregon's New Tax Haven Law Expected to Pad State Coffers, Says DOR Official," *Tax Analysts*, 9 October 2013.

37 Ibid., "Maria Koklanaris."

38 Paul Warner, Legislative Revenue Office, *Revenue Impact of Proposed Legislation: Bill Number: HB2460-B*, 19 June 2013.

39 Ibid.

40 Alaska Stat. §43.20.073(a) (5).

41 Dan Bucks, former Director, Montana Department of Revenue, personal communication, 11 November 2013; Ted Boettner, Executive Director, West Virginia Center on Budget & Policy, personal communication, 11 November 2013. West Virginia's law: W. Va. Code §11-24-13f (a) (7); West Virginia's legal definition of a tax haven: W. Va. Code §11-24-3 (a) (38). Note: because the new combined reporting rule was passed as part of a package of corporate tax reforms, including cuts to the corporate and business franchise tax rates, the overall impact of the law on net revenues was expected to be negative, per Ted Boettner, West Virginia Center on Budget & Policy, *Combined Reporting: How It Works and Why We* Still *Need It*, February 2008. Subsequent communication with a West Virginia state official confirms that West Virginia's law has not had any positive impact on state tax revenues, per Mark Muchow, Deputy Secretary, West Virginia Department of Revenue, personal communication, 15 November 2013.

42 D.C. Code Ann. §47-1801.04(49).

43 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—like Montana—use an apportionment rule that considers the proportion 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. And some states, including Oregon, use the so-called single sales factor (SSF) rule that *only* considers the share of national sales the corporation makes in the state.

44 Consultation with Dan Bucks, former Director, Montana Department of Revenue, and implementer of the Montana law that forms the foundation of this report, confirmed that the reform proposed in this study could also be implemented in Texas, which levies a franchise tax—commonly referred to as the "margin tax"—rather than a corporate income tax. This levy is a hybrid assessment, part gross receipts tax and part corporate income tax, and is subject to combined reporting and income apportionment rules as if it were an income levy. It applies to all entities that do business in the state and taxes total revenue minus some types of "flow-through" income and the total cost of goods sold, compensation or 30 percent of total revenue, whichever is greater, per Texas Taxpayers and Research Association, *Understanding the Texas Franchise – or "Margin" – Tax*, October 2011.

45 In the fall of 2013, the Massachusetts Department of Revenue produced an internal analysis of the additional revenue the state would collect if it implemented the reform proposed in this report. The analysis used 2011 Massachusetts corporate tax returns for multinational corporate tax filers alongside the income reported on federal tax form 5471, which lists income booked to offshore jurisdictions. Based on a list of known tax havens and adjusted downward to account for companies' subsequent tax-avoidance strategies in reaction to the potential new rules, the office estimated a range of $64 million to $94 million annually in additional revenue. This study uses the midpoint of that

officially calculated range, $79 million, as the estimated additional revenue Massachusetts could collect. Note that using 2012 data and our own (deliberately conservative) methodology, we calculated $62.1 million in additional revenue for Massachusetts, a figure that aligns with the low end of the officially calculated range. Data and information on the Massachusetts Department of Revenue's internal analysis were gathered through personal communication with Kazim Ozyurt, Director, Office of Tax Policy Analysis, Massachusetts Department of Revenue, 6 January 2014.

46 Kevin Drawbaugh and Andy Sullivan, "Insight: How Treasury's Tax Loophole Mistake Saves Companies Billions Each Year," *Reuters*, 30 May 2013; Jeff Gerth, Megan Murphy and Vanessa Houlder, "Corporations Couldn't Wait to 'Check the Box' on Huge Tax Break," *Financial Times*, 26 September 2011.

47 See note 34, "Paul Warner."

48 See note 31, "Institution on Taxation and Economic Policy" and "Judith Lohman."

49 Ibid. Additional information was found pertaining to the apportionment formulae in use in Massachusetts in Michael Mazerov, Center on Budget and Policy Priorities, *The "Single Sales Factor" Formula for State Corporate Taxes: A Boon to Economic Development or a Costly Giveaway?*, September 2005, and in the District of Columbia in Grant Thornton, *State & Local Tax Alert: District of Columbia Budget Enacted with Retroactive Combined Reporting Provisions*, 19 September 2011, 5.

50 See note 49, "Michael Mazerov."

51 See note 49, "Grant Thornton."

52 H.B. 2460, 77th Leg., Reg. Sess. (Ore. 2013).