

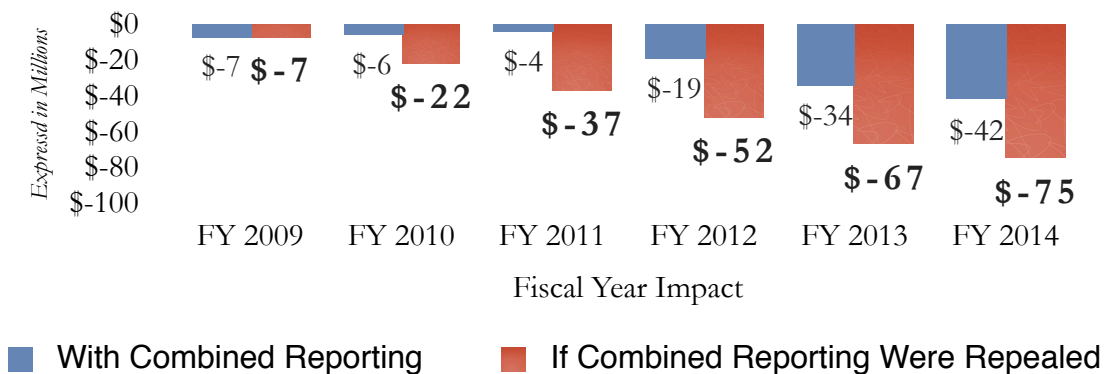
Combined Reporting: How It Works and Why We Still Need It

Background

Last year the state legislature passed SB 749, which will make West Virginia a “combined reporting” state for corporate tax purposes effective in 2009. SB 749 also included a sharp reduction in the business franchise tax rate from .55 percent to .20 percent over the next six years. The combined reporting measure will close several corporate tax loopholes and increase state revenue by an estimated \$33 million. In contrast, business franchise tax reduction will cost the state \$75 million per year. The net loss to the state General Revenue will be \$43 million annually.

Some elements of the business community have called for the repeal of the combined reporting requirements.¹ **Figure 1** below illustrates what the revenue loss would be over time if combined reporting were repealed. Over a six year period, the General Fund would lose an estimated \$259 million if combined reporting were repealed; the state would lose \$112 million if combined reporting is retained.²

Figure 1: Revenue Impact Loss of SB 749 on General Revenue Fund



How Have Corporations Avoided Paying Their Fair Share?

Large multi-state corporations doing business in West Virginia have been exploiting flaws in West Virginia’s tax code that allow them to minimize their tax payments. A 2003 study by the Multistate Tax Commission (MTC) found that West Virginia loses more in corporate income taxes each year due to corporate tax sheltering than any other state in the nation. West Virginia lost 57.8 percent of its corporate income tax collections (as a share of revenue) in 2001 due to tax shelters and states in

¹ Senate Bill 749 and Unitary Combined Reporting: A Critical Analysis and Recommendations for Change” WV Chamber of Commerce . Available at www.wvchamber.com/Portals/0/WVC/Policy/Combined%20Reporting%20Critical%20Analysis_Aug202007.pdf

² WV State Tax Department, State Fiscal Note for SB 749

the aggregate lost as much as \$7.1 billion in corporate income tax revenue, according to the report.³

Tax avoidance strategies include:

- Establishing trademark holding companies such as the one Toys ‘R’ Us uses to avoid state taxes by transferring profits to a tax-free Delaware subsidiary that collects licensing fees for use of its Geoffrey Giraffe icon.
- Using “transfer pricing,” where one subsidiary sells goods to another subsidiary at inflated prices to concentrate profits in subsidiaries in low-tax rate states.

Tax reform strategies that broaden the corporate tax base by eliminating unfair and expensive loopholes can help offset lost revenue due to business tax cuts and help West Virginia balance its budget without increasing taxes on families. Requiring combined reporting was the single best option available to lawmakers seeking to stamp out tax avoidance strategies by multi-state corporations.

What is Combined Reporting?

Combined reporting is a method of state taxation that requires corporations to calculate their taxes by combining the profits and activities of all commonly owned affiliates or subsidiaries, including those in other states. Because this treats each subsidiary as a member of a group, companies can no longer shift money between subsidiaries to hide profits and avoid paying taxes in West Virginia. Combined reporting elevates substance over form - meaning that tax liabilities are determined by the substance of business activities in the state, not by the business’s organizational structure.

Does Combined Reporting Hurt Economic Development?

There is no evidence that states with combined reporting have suffered a loss of jobs or decreased economic performance as a result. In fact, 9 out of 10 states with positive gains in manufacturing employment since 1990 have had combined reporting requirements in effect.⁴ Moreover, most of the states whose economies have seen the fastest economic growth between 1990 and 2005 use combined reporting. While this doesn’t prove combined reporting had a positive effect on economic growth, it certainly suggests that it does not impede economic growth.⁵ Combined reporting will also level the playing field for smaller West Virginia businesses that don’t have the resources to set up out-of-state tax shelters but that compete against large multi-state companies that are able to pay little in West Virginia tax.

Combined Reporting is Becoming the Norm

Four years ago only 16 states, representing 29 percent of the U.S. economy (GDP) used combined reporting. Now 21 states have adopted the practice - representing 51 percent of the economy. Seven additional states are considering the change.

For more information contact Ted Boettner at 304.720.8682 or tboettner@wvpolicy.org

⁴ Mazerov, Michael. “Growing Number of States Considering A Key Corporate Tax Reform.”, Sept 12, 2007. Center on Budget and Policy Priorities.

⁵ Robert G. Lynch, William Schweke, Nicholas W. Jenny, and Noah Berger, *Building A Strong Economy: The Evidence on Combined Reporting, Public Investments, and Economic Growth*, Economic Policy Institute/Massachusetts Budget and Policy Center, June 2007