

Mandatory Unitary Combined Reporting

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Mandatory unitary combined reporting is not the panacea it is often purported to be. It discourages investment, has an uncertain impact on state revenues and employers' taxes, and is complicated and costly to administer for both taxpayers and states. These real costs outweigh any theoretical benefits that mandatory unitary combined reporting is alleged to provide.

Combined Reporting Discourages Investment: Combined reporting arbitrarily distorts employers' profits taxed by the state. Business investment—which drives job growth—is negatively affected by the distortions caused by combined reporting. Proponents' claims to the contrary would not pass muster in an introductory statistics course and are refuted by rigorous examination of this issue.¹

Revenue & Taxes Under Combined Reporting are Uncertain: Estimates of the state revenue impact of implementing combined reporting are highly uncertain. When Minnesota adopted combined reporting, the state projected increased revenues of \$63 million (with a range of \$23-103 million). Two years after combined reporting was implemented, the Department of Revenue estimated that the actual change in revenue resulting from the adoption of combined reporting was zero (\$0).

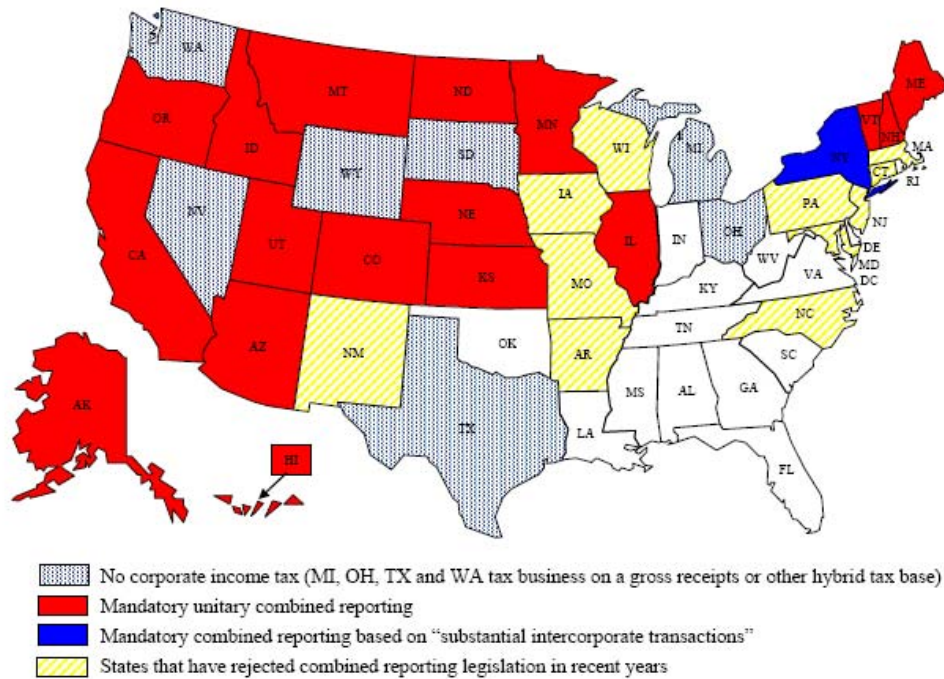
The effect of combined reporting on employers' taxes is also uncertain. The change is dependent upon the profit level of each member of the unitary group relative to the location of the members' apportionment factors. Complicated? You bet it is. The result is that some employers' taxes will go up and that others will go down.² Contrary to proponents' claims, the shift is not from "in-state" to "out-of-state" employers, but rather among multistate employers. In fact, "out-of-state" employers may benefit—in a recent Colorado case, an "out-of-state" employer saved more than \$8 million in one year by combining all of its subsidiaries.³ If combined reporting simply "closed loopholes," such a result would be impossible.

Combined Reporting is Complex and Costly: The complex nature of determining which employers are members of a "unitary group" causes combined reporting tax return preparation and audits to take much longer than separate company tax returns and audits, to require more corporate and state personnel to complete, and to result in lengthy appeals and costly litigation. In combined reporting states, an employer may not receive a final determination of taxes for a given year until 20 or more years after the fact. If that represents the "best" corporate income tax system, one can only imagine what the worst system is.

Combined Reporting is Not a Remedy: Combined reporting is a tax system, not a "loophole closer." State revenues from corporate income taxes have grown at an unprecedented rate in non-combined reporting states over the past few years, giving lie to the assertion that in those states such taxes are "optional." State revenue agencies already have sufficient authority to address any transactions designed solely to avoid tax, including the authority to require combined reporting. Finally, if the real intent of proposing combined reporting is—as many proponents claim—to address intercompany payments, targeted legislation can be adopted instead, as has been the case in 16 non-combined reporting states.⁴ These alternatives are also more predictable in terms of revenue collection.

Most States That Consider Combined Reporting Reject It: In the past several years, 11 states—Arkansas, Connecticut, Iowa, Maryland, Massachusetts, Missouri, New Jersey, New Mexico, North Carolina, Pennsylvania and Wisconsin—have all rejected combined reporting, in many cases multiple times.⁵

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Williams, Michael G., Charles W. Swenson and Terry L. Lease, "Effects of Unitary vs. Nonunitary State Income Taxes on Interstate Resource Allocation: Some Analytical and Simulation Results," Journal of the American Taxation Association, Vol. 23, No. 1, Spring 2001, pp. 39-60.

2

Research by the Pennsylvania Department of Revenue for the Pennsylvania Business Tax Reform Commission found that combined reporting would increase taxes on 2,100 Pennsylvania employers and reduce taxes on 2,730 other Pennsylvania employers.

http://www.revenue.state.pa.us/tax_reform/site/default.asp.

3

Cendant Corp. & Subsidiaries v. Colo. Dep't of Revenue, Dist. Ct., City & County of Denver, Colo., No. 07 CV 676, 1/7/08.

4

Sixteen states—AL, AR, CT, DC, GA, IN, KY, MD, MA, MS, NJ, NC, OH, RI, SC and VA—have adopted statutes requiring taxpayers to add back to income certain expenses paid to related parties.

5

Only two states—Vermont (2004) and West Virginia (2007)—have actually enacted combined reporting for corporate income taxes in the past 20 years. New York changed its laws regarding corporate tax reporting in 2007, but the New York law is unique and is premised on "substantial intercorporate transactions" between related entities rather than on a unitary relationship per se. Several other states—including Michigan, Ohio and Texas— have adopted some form of mandatory unitary combined reporting recently, but all are in the context of gross receipts or other hybrid business taxes and thus have dramatically different motivations and effects than is the case under a corporate income tax.