

**Testimony Supporting**  
**S.B. 485: An Act Concerning Tax Fairness**  
Jeffrey M. Tebbs<sup>†</sup>  
Finance, Revenue and Bonding Committee  
March 22, 2010

Senator Daily, Representative Staples, and distinguished Members of the Finance, Revenue, and Bonding Committee,

I am testifying today on behalf of Connecticut Voices for Children, a research-based public education and advocacy organization that works statewide to promote the well-being of Connecticut's children, youth, and families. I submit this testimony because the manner in which Connecticut raises and spends its revenues is of great importance to the state's children and families, just as it is to Connecticut's businesses.

**Connecticut Voices for Children supports SB 485, An Act Concerning Tax Fairness.**

**1. Connecticut's current system of single entity reporting leaves it exposed to "aggressive" corporate tax planning by multi-state and multi-national corporations.** As Charles McLure, a Senior Fellow at the Hoover Institution and former Reagan Administration Treasury Department official famously stated, single entity reporting is "an open invitation to tax avoidance."<sup>1</sup>

Under Connecticut's current system of predominantly single entity reporting,<sup>2</sup> multi-state corporations are able to artificially shift profits to subsidiaries operating in states that do not tax businesses.<sup>3</sup> Mandatory combined reporting remedies this problem by treating parent corporations and certain subsidiaries and affiliates as a single corporation for tax purposes.<sup>4</sup> With combined reporting, "the profits and losses of all entities in a unitary group are combined" for the purposes of apportionment. This combination renders the existence of multiple entities and any transfers between those related entities irrelevant.<sup>5</sup> Combined treatment of the parent corporation and its affiliates therefore counteracts the erosion of a state's corporate tax base that occurs under aggressive corporate tax planning.<sup>6</sup>

Two recent examples illustrate the manner in which single entity reporting permits significant tax avoidance by multi-state corporations.

**(a) The Trademark Holding Company Strategy.** Under a trademark holding company strategy, a multi-state corporation creates a subsidiary in a state that does not assess corporate taxes on holding companies, such as Nevada. The corporation then deposits the right to its trademarks in this subsidiary. An affiliated corporation in Connecticut issues royalty payments to the trademark

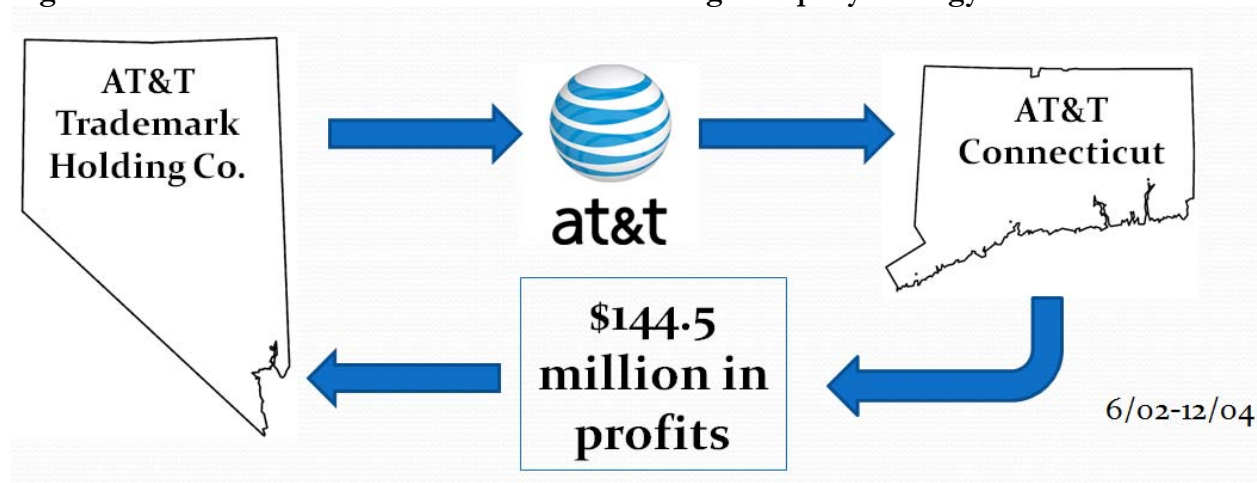
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<sup>†</sup> Research Associate for Tax Policy, Connecticut Voices for Children. This testimony was prepared through the Yale Law School Legislative Advocacy Clinic under the supervision of J.L. Pottenger, Jr., Nathan Baker Clinical Professor of Law and Shelley Geballe, Distinguished Senior Fellow at Connecticut Voices for Children and Clinical Visiting Lecturer at Yale Law School.

holding company in exchange for the right to use the corporate enterprise’s logo and brand name. The Connecticut affiliate deducts the royalty payment from its net income as an expense, thereby eliminating any Connecticut tax on that income. Concurrently, the out-of-state trademark holding company is not subject to tax in the state in which it is incorporated. Under Connecticut’s single entity reporting system, Connecticut’s Department of Revenue Services is required to ignore the out-of-state trademark holding company, even though it shares a common owner with the Connecticut affiliate. From a tax standpoint, the income vanishes.

Last summer, Connecticut’s Department of Public Utility Control conducted a routine audit of the financial statements of AT&T’s Connecticut operations and discovered that AT&T was attempting to use this well-known tax avoidance strategy.<sup>7</sup> According to the audit produced by the Barrington-Wellesley Group, Inc., AT&T’s Connecticut subsidiary made royalty payments of \$144.5 million to a Nevada trademark holding company for the use of the AT&T logo on the company’s Connecticut buildings and on bills sent to Connecticut customers over a two-and-a-half year period (June 2002 to December 2004).<sup>8</sup> Subsequent reporting revealed that AT&T’s Connecticut subsidiary persists in this practice, making \$46.7 million in intercompany royalty payments to a Nevada holding company in 2008.

**Figure 1. Illustration of AT&T’s Trademark Holding Company Strategy**



After AT&T’s tax avoidance plan was publicly exposed, Attorney General Blumenthal launched an investigation of AT&T’s Connecticut operations.<sup>9</sup> AT&T maintains that its actions are lawful, and the outcome of any potential litigation will depend on the interpretation of an existing statute designed to close this loophole. That law requires Connecticut-based companies to add back certain intra-enterprise payments for the use of intangibles.<sup>10</sup> In defending its trademark payments, AT&T is relying on an exclusion that permits it to deduct these trademark payments if it can demonstrate “by clear and convincing evidence that” adding back the payments to their Connecticut income is “unreasonable.”<sup>11</sup>

Since corporate tax returns are private, Connecticut residents rarely catch a glimpse of the complex legal maneuvering in which multi-state corporations engage to avoid Connecticut taxes. Although

these glimpses are rare, the use of complicated tax avoidance strategies is not. According to the audit report, the trademark holding strategy is exploited by numerous companies with household names including Limited Brands, Toys ‘R’ Us, ConAgra Foods, Home Depot, Kmart, Gap, Sherwin-Williams, Stanley Works, Staples, and Burger King.<sup>12</sup>

**(b) The Captive Real Estate Investment Trusts (REITs) Strategy.** In recent testimony before this Committee on H.B. 5494, Commissioner Nicholson described the “captive REIT” strategy as “allow[ing] a company to pay rent to itself, take a deduction for the rental expenses and receive the rent back through a nontaxable dividend. The circular flow of funds allows a company to save significant corporation taxes . . . .”<sup>13</sup>

Wal-Mart’s aggressive tax strategies over the past fifteen years provide a high-profile illustration of how the captive REIT strategy operates.<sup>14</sup> When Wal-Mart ran into resistance from the use of an “intangible holding company” scheme, it switched to exploiting the tax rules governing captive Real Estate Investment Trusts. Much of Wal-Mart’s real estate was deposited in a REIT. Subsidiaries in various states then paid rent to the REIT, which the subsidiaries could deduct from their taxable income. Simultaneously, however, the REIT’s rental income was non-taxable, provided it paid out a specified percentage of its income to shareholders as dividends. This tax shelter shaved an estimated \$230 million from Wal-Mart’s assessed taxes over a four-year time frame.<sup>15</sup>

In addition to the two examples discussed above, multi-state corporations artificially shift profits across jurisdictions through a host of additional tax planning mechanisms, including: transferring appreciated assets to a subsidiary in a tax haven; avoiding the inclusion of a subsidiary’s employees in state apportionment formulas through the use of “captive employee leasing compan[ies]”; and selling account receivables at a substantial “loss” to subsidiaries in a tax haven.<sup>16</sup>

**2. Mandatory combined reporting prevents the need to close loopholes on a case-by-case basis.** Under each of the tax planning strategies discussed above, large corporations exploit Connecticut’s single entity reporting system by shifting profits to affiliated corporations that Connecticut’s tax authorities are required by law to ignore. Mandatory combined reporting treats a parent corporation and all of its subsidiaries as part of a single enterprise. This integrated treatment nullifies the effect of transactions between related entities, thereby addressing this core deficiency in Connecticut’s corporate tax code.

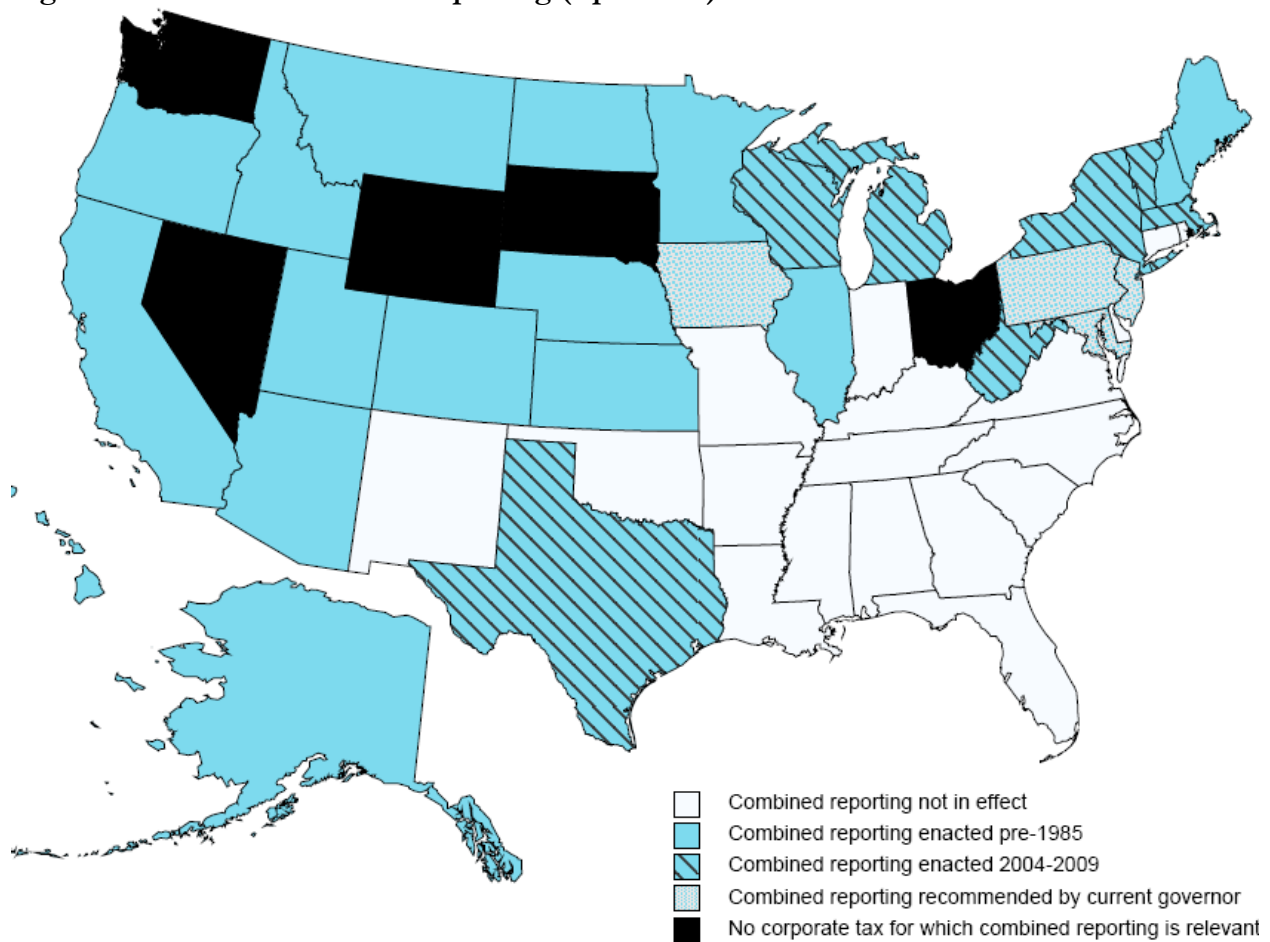
Of course, single entity reporting states have managed to close certain corporate loopholes on a case-by-case basis. As mentioned above, in 1998, Connecticut passed legislation restricting the circumstances under which certain intangible expenses and related interest expenses are deductible in calculating the corporation business tax.<sup>17</sup> These patches, however, often contain holes of their own. Moreover, the principal difficulty with this piecemeal approach “is that in the absence of combined reporting, multi-state corporations will always be able to develop new methods of transferring profits” to states and foreign countries that lack a corporate tax.<sup>18</sup>

DRS has asked this Committee to consider legislation that will target the captive REIT loophole (H.B. 5494). While we agree that the captive REIT loophole must be closed, we urge you to adopt mandatory combined reporting as the mechanism for achieving this goal. Because mandatory

combined reporting addresses the root of the tax avoidance problem rather than the symptoms, it represents an approach to enforcement that is resistant to innovations in corporate tax avoidance. Under a mandatory combined reporting regime, the Commissioner of Revenue will no longer be forced to waste precious resources litigating individual cases of abusive tax avoidance.

**3. Combined reporting has been successfully implemented in multiple jurisdictions across the nation.** At least twenty-three states now require combined reporting for corporate tax returns.<sup>19</sup> Sixteen states have effectively administered combined reporting regimes for more than two decades, and seven additional states have adopted combined reporting in the past five years.<sup>20</sup> In the past, the Connecticut Business & Industry Association has opposed mandatory combined reporting because “[m]ost of our competitor states in this region do not have unitary reporting methods.”<sup>21</sup> However, today, “peer” states in the Northeast require combined reporting, including New York, Massachusetts, New Hampshire, Vermont, and Maine (with New York, Massachusetts and Vermont adopting this requirement in the past five years)..

**Figure 2. Status of Combined Reporting (April 2009).**



**Source:** Center on Budget and Policy Priorities (2009).

**4. Failing to require combined reporting costs Connecticut between 5 and 20 percent of revenue from the corporation business tax.** The latest revenue estimates released by the General Assembly's Office of Fiscal Analysis on February 2, 2010 indicate that corporate taxes are estimated to generate \$706.6 million in revenue in the current fiscal year and \$694.9 million in revenue in FY 2011.<sup>22</sup> Official revenue estimates conducted in other states that have recently adopted or considered combined reporting (Iowa, Maryland, Massachusetts, New York, and Wisconsin) indicate that the mandatory combined reporting increases net corporate tax revenue by an average of 16.6 percent.<sup>23</sup> When Connecticut enacted and immediately repealed combined reporting in 2003,<sup>24</sup> the Office of Fiscal Analysis estimated that the legislation would generate \$40 million in additional revenue in FY 04<sup>25</sup> or 7.7% of actual collections (\$518M).<sup>26</sup>

The adoption of combined reporting in Connecticut would provide critical revenues in the midst of a rapidly deteriorating fiscal situation. Assuring adequate revenues will allow Connecticut to maintain essential services during this recession and avoid cuts in state spending that exacerbate the economic downturn.

A bit of context is important. As Figure 3 below illustrates, the share of General Fund tax revenues flowing from the corporation business tax fell dramatically starting in FY 1991; Connecticut's adoption of a broad-based personal income tax enabled the corporation business tax rate to be markedly reduced from 11.5% to 7.5%,<sup>27</sup> new tax credits to be adopted, and certain types of corporations to be wholly exempted from the tax.<sup>28</sup> As a result, corporate tax revenues have continued to slide over the past seventeen years.

**Figure 3. Corporate Tax Revenue as a Share of GF Tax Revenue (FY 1990-2008)**



**Sources:** Historical budget data derived from Office of Fiscal Analysis, *Connecticut Revenue and Budget Facts*, February 27, 2006, pp.6, 38; Governor's Midterm Budget Adjustments (FY2006-2007); Governor's Biennial Budget (FY2008 - FY2009); Governor's Budget Adjustments (FY 2009 Midterm).

**5. Mandatory combined reporting does not impede economic growth or development.** A joint report by the Economic Policy Institute and the Massachusetts Budget and Policy Center concluded that states that have adopted combined reporting have experienced comparable, if not superior, economic growth than states that have failed to adopt mandatory combined reporting. Indeed, five of the seven fastest growing states from 1990 to 2005 required combined reporting, and the average annual growth in state domestic product was higher in combined reporting states (3.3 percent) than the average growth in states without combined reporting (3.1 percent).<sup>29</sup> The results are similar with regard to employment growth: four of the five states with the fastest employment growth from 1992 to 2005 required combined reporting.<sup>30</sup>

These findings even extend to trends in manufacturing employment. In theory, manufacturers have a greater ability to relocate than retail and service businesses. In January 2009, Michael Mazerov of the Center on Budget & Policy Priorities released an analysis demonstrating that seven of the eight states that experienced growth in manufacturing employment from 1990 through 2007 required combined reporting throughout the period.<sup>31</sup>

As additional states have adopted mandatory combined reporting, the compliance cost of preparing a unitary return has fallen dramatically. At present, states with mandatory combined reporting are responsible for 53 percent of the national economy.<sup>32</sup> Many, if not most, multi-state corporations conducting business in Connecticut already prepare combined returns as a consequence of their operations in mandatory combined reporting states.

**6. Most of Connecticut's top employers are already subject to mandatory combined reporting in other states.** In previous debates, critics of mandatory combined reporting have raised two principal concerns. First, opponents contend that requiring multi-state corporations to file a combined tax return will impose a significant and unwarranted administrative burden on those firms. Second, opponents warn that Connecticut's top employers will relocate to other states if combined reporting is implemented.<sup>33</sup> Policymakers should not be swayed by either argument.

In a newly released study, Connecticut Voices for Children finds that the vast majority of Connecticut's largest employers already file combined tax returns in one or more states where combined reporting is required.<sup>34</sup> This study is included as an appendix to this written testimony, but the key findings are important to highlight here:

- Connecticut has 37 for-profit companies with at least 1,000 employees. 32 of these companies (86%) already operate in other states with mandatory combined reporting. 27 of these companies operate in 5 or more combined reporting states.
- In 2007, 18 Connecticut companies had more than \$2.5 billion in worldwide sales. All 18 of these companies currently operate in at least one combined reporting state.

Notably, 30 of the 37 largest Connecticut employers and 17 of the 18 Connecticut companies with more than \$2.5 billion in annual sales have facilities in at least one state that enacted mandatory combined reporting prior to 1985.<sup>35</sup> This strongly suggests that the administrative costs and additional tax liability that may be associated with mandatory combined reporting are not so substantial as to persuade these firms to relocate their facilities. Leading Connecticut companies continue to willingly conduct operations in one or more of these mandatory combined reporting states.

**7. Mandatory combined reporting would level the playing field for Connecticut-centered businesses competing against multi-state and multi-national corporations.** At present, Connecticut businesses that lack related subsidiaries operating in other states cannot engage in the elaborate tax avoidance schemes available to large, multi-national corporations that mandatory combined reporting is designed to combat. To argue that combined reporting would be detrimental to the economic health of Connecticut requires the assumption that equitably applying the tax law to both local businesses and multi-national corporations would impede economic growth. *All* businesses operating in Connecticut seek a well-trained workforce, as well as a well-functioning infrastructure. It is a clear violation of the principle of tax fairness to allow large multi-state corporations to avoid paying their fair share of the costs of these business essentials at the expense of smaller Connecticut businesses.

## Endnotes

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<sup>1</sup> Charles E. McLure, Jr., *The Nuttiness of State and Local Taxes – and the Nuttiness of Responses Thereto*, STATE TAX NOTES, September 16, 2002, 851.

<sup>2</sup> Connecticut law currently *allows* corporations that file a federal consolidated return to file a combined return in Connecticut; the combined Connecticut tax liability is determined after each corporation in the combined return individually apportions its income to Connecticut (i.e., the return is in the nature of a state consolidated return). Connecticut imposes a preference tax on corporations that choose to file a combined state return that is equal to the difference between the tax that would have been due if the entities had filed separately and the total tax due under the combined return, up to a maximum of \$500,000. In income year 2006, 1,014 corporations elected to file combined returns (the preference tax in that year was \$250,000). Had these corporations filed single entity returns, the corporation tax due would have been \$557.0 million. By electing to file combined returns, the total tax due before credits was reduced to \$348.6 million (including \$27.1 million in the preference tax). Notably, more than a third of the voluntary combined returns (366 of 1,014) reported only \$250 in tax due, i.e., Connecticut's minimum corporate tax. Connecticut law also allows certain corporations to file unitary returns, as of right or with the permission of the Department of Revenue Services. In such cases, the combined net income of the unitary group is apportioned to Connecticut as if it were one corporation. *See* State of Connecticut, Department of Revenue Services, Annual Report Fiscal Year 2007-2008, at 18-20.

<sup>3</sup> MICHAEL MAZEROV, CTR. ON BUDGET & POL'Y PRIORITIES, STATE CORPORATE TAX SHELTERS AND THE NEED FOR "COMBINED REPORTING" (2007), <http://www.cbpp.org/10-26-07sfp.pdf>

<sup>4</sup> *Id.* Connecticut currently allows combined reporting at the election of corporate taxpayers that file a federal consolidated return (see note 2).

<sup>5</sup> William F. Fox, LeAnn Luca, & Matthew N. Murray, *Emerging State Business Tax Policy: More of the Same, or Fundamental Change?*, STATE TAX NOTES, May 2007, at 393, 394..

<sup>6</sup> Fox, Luca, & Murray, *supra* note 5.

<sup>7</sup> *See* Lynn Doan, *Corporations Dodge State Tax Payments*, HARTFORD COURANT, July 5, 2009, at A1; Lynn Doan, *AT&T Investigated for Avoiding Connecticut Taxes; Trademark Royalties*, HARTFORD COURANT, June 17, 2009, at A10; Luther Turmelle, *SBC Avoided Paying Taxes to State on \$144.5M: Sent Money to Nevada Affiliate for 2 1/2 Years, Audit Shows*, NEW HAVEN REGISTER, June 16, 2009.

<sup>8</sup> Barrington-Wellesley Group, Inc., An Audit of the Southern New England Telephone Company's Affiliate Transactions for the Department of Public Utility Control, Mar. 1, 2007, at 78-79 available at [http://www.dpuc.state.ct.us/dpucinfo.nsf/3fcf2cde5ae350e98525742e004bf71e/aa6424b86eb823f885257297004be169/\\$FILE/Final%20Report%20to%20DPUC%203.2.07final.pdf](http://www.dpuc.state.ct.us/dpucinfo.nsf/3fcf2cde5ae350e98525742e004bf71e/aa6424b86eb823f885257297004be169/$FILE/Final%20Report%20to%20DPUC%203.2.07final.pdf).

<sup>9</sup> Doan, *Corporations Dodge State Tax Payments*, *supra* note 7.

<sup>10</sup> Pub. Act No. 98-110, § 20, (codified at CONN. GEN. STAT. ANN. § 12-218(c) (Westlaw 2010)).

<sup>11</sup> CONN. GEN. STAT. ANN. § 12-218(c)(1) (Westlaw 2010); Doan, *Corporations Dodge State Tax Payments*, *supra* note 7.

<sup>12</sup> Barrington-Wellesley Group, Inc., *supra* note 8, at 78.

<sup>13</sup> Written Testimony of Richard D. Nicholson, Comm'r, Dep't of Revenue Servs., Hearing before the Committee on Finance, Revenue, and Bonding, Mar. 15, 2010, at 2.

<sup>14</sup> Jesse Drucker, *Inside Wal-Mart's Bid to Slash State Taxes; Ernst & Young Devises Complex Strategies; California Pushes Back*, WALL ST. J., Oct. 23, 2007, at A1.

<sup>15</sup> *Id.*

<sup>16</sup> For a detailed description of the tax avoidance strategies discussed here, see ROBERT G. LYNCH, ET AL., MASS. BUDGET & POL'Y CTR. & ECON. POL'Y INST., BUILDING A STRONG ECONOMY: THE EVIDENCE ON COMBINED REPORTING, PUBLIC INVESTMENTS, AND ECONOMIC GROWTH (2007), [http://www.massbudget.org/file\\_storage/documents/BuildingStrongEconomyJune07.pdf](http://www.massbudget.org/file_storage/documents/BuildingStrongEconomyJune07.pdf).

<sup>17</sup> Pub. Act No. 98-110, § 20, (codified at CONN. GEN. STAT. ANN. § 12-218c (Westlaw 2009)).

<sup>18</sup> INST. ON TAXATION & ECON. POL'Y, COMBINED REPORTING OF STATE CORPORATE INCOME TAXES: A PRIMER (2008), <http://www.itepnet.org/pb24comb.pdf>.

<sup>19</sup> MICHAEL MAZEROV, CTR. ON BUDGET & POL'Y PRIORITIES, A MAJORITY OF STATES HAVE NOW ADOPTED A KEY CORPORATE TAX REFORM – "COMBINED REPORTING" (2009), <http://www.cbpp.org/files/4-5-07sfp.pdf>.

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<sup>20</sup> *Id.* See also MICHAEL MAZEROV, CTR. ON BUDGET & POL’Y PRIORITIES, MOST LARGE NORTH CAROLINA MANUFACTURERS ARE ALREADY SUBJECT TO “COMBINED REPORTING” IN OTHER STATES 2 (2009), <http://www.cbpp.org/1-15-09sfp.pdf>

<sup>21</sup> Testimony of Joseph Brennan, Senior Vice President of Public Policy, Connecticut Business & Industry Association, Hearing before the Committee on Finance, Revenue, and Bonding, March 28, 2005.

<sup>22</sup> OFFICE OF FISCAL ANALYSIS, FY 10–FY 14 GENERAL FUND & TRANSPORTATION FUND BUDGET PROJECTIONS 11 (2010), [http://www.cga.ct.gov/OFA/Documents/Statements/2010/February\\_2\\_statement\\_WEB.pdf](http://www.cga.ct.gov/OFA/Documents/Statements/2010/February_2_statement_WEB.pdf).

<sup>23</sup> In New York, the Division of the Budget estimated that combined reporting would generate \$328 million in additional corporate franchise tax revenue for FY 2007-08. A few months earlier, the Division of the Budget projected baseline corporate franchise revenue (in the absence of combined reporting) of \$4,080 million. The combined reporting initiative was thus expected to increase corporate franchise tax revenue by 8.0%. In Massachusetts, the Department of Revenue estimated that combined reporting would generate \$313 million in additional revenue on an annual basis, although only \$188 million would be collected in FY 2009 since combined reporting was slated to begin mid-way through the tax year.<sup>23</sup> Compared to a corporate tax baseline of \$1,216 million, the combined reporting initiative was expected to increase corporate tax revenue by 25.7%. Finally, the Wisconsin Legislative Fiscal Bureau, the Iowa Department of Revenue and Finance, and the Maryland Department of Legislative Services have issued projections in recent years that range from 13.0% to 19.6% gains in corporate tax revenue from combined reporting. The gold standard for estimating the impact of a combined reporting requirement has been established by the Pennsylvania Department of Revenue, which reviewed the combined returns filed by Pennsylvania corporations in another state with a unitary reporting requirement.

<sup>24</sup> In 2003, Connecticut actually adopted mandatory combined reporting, Pub. Act No. 03-1, §§ 90-91, but the success was short-lived. Combined reporting was repealed shortly thereafter by the budget implementation bill. Pub. Act No. 03-6, §§ 78-81, 244.

<sup>25</sup> The fiscal note for the 2003 combined reporting bill can be found through the Connecticut General Assembly’s “Advanced Legislative Document Search.” See <http://search.cga.state.ct.us/> (search for “combined reporting” under “Fiscal Notes.”)

<sup>26</sup> OFFICE OF FISCAL ANALYSIS, REVENUE AND BUDGET DATA 52 (2009).

<sup>27</sup> To cope with the current recession, Connecticut enacted a temporary 10% surcharge on certain large corporations. The effective rate on those corporations will be 8.25% through FY 2011. OFFICE OF FISCAL ANALYSIS, BUDGET BOOK, TAX AND REVENUE CHANGES 35 (2009).

<sup>28</sup> In 1993, Connecticut created the Limited Liability Company (LLC). OFFICE OF FISCAL ANALYSIS, CONNECTICUT REVENUE AND BUDGET DATA 56 (2009). LLCs provide the benefit of limited liability to businesses without subjecting them to the corporate income tax. In 1997, Connecticut phased out and eventually eliminated the corporate taxation of S-Corporations. *Id.* at 58.

<sup>29</sup> LYNCH, ET AL, *supra* note 16. Here, growth refers to growth in state GDP.

<sup>30</sup> *Id.* at 14.

<sup>31</sup> MAZEROV, *supra* note 20.

<sup>32</sup> Author’s calculations from Bureau of Economic Analysis, Gross Domestic Product by State, <http://www.bea.gov/regional/gsp/> (accessed Mar. 20, 2010). GDP data are for calendar year 2008.

<sup>33</sup> See, e.g., Testimony of Joseph Brennan, Senior Vice President of Public Policy, Connecticut Business & Industry Association, Hearing before the Committee on Finance, Revenue, and Bonding, March 28, 2005 (“And I just remember when this was passed in 2003, I’ve been working at CBIA 17 years and I never got a reaction like I got from that, and again, it’s not anything that people say publicly, but just talking behind closed doors. I have no doubt in my mind, and I’ve known a lot of you a long time. I do not use hyperbole here. You know, I have no doubt in my mind that it wouldn’t cause some serious relocations of employment in the State of Connecticut had that been adopted.”)

<sup>34</sup> JEFFREY M. TEBBS ET AL., CONN. VOICES FOR CHILDREN, MOST OF CONNECTICUT’S TOP EMPLOYERS ARE ALREADY SUBJECT TO MANDATORY COMBINED REPORTING IN OTHER STATES (2010).

<sup>35</sup> The sixteen states adopting mandatory combined reporting prior to 1985 are Alaska, Arizona, California, Colorado, Hawaii, Idaho, Illinois, Kansas, Maine, Minnesota, Montana, Nebraska, New Hampshire, North Dakota, Oregon, and Utah. The seven states adopting mandatory combined reporting in more recent years are Massachusetts, Michigan, New York, Texas, Vermont, West Virginia, and Wisconsin.



## Most of Connecticut's Top Employers Already Are Subject to Mandatory Combined Reporting in Other States Jeffrey M. Tebbs,<sup>†</sup> Joachim Hero, Elizabeth Kelly, and Eric Mitzenmacher

March 22, 2010

Corporate tax loopholes reduce the revenues that are available to support the education, public safety, health, environmental, and transportation services on which Connecticut's families and businesses rely. For several years, Connecticut has actively considered the adoption of mandatory combined reporting, a powerful tool for cracking down on common tax avoidance strategies used by multi-state corporations.<sup>1</sup> Today, the Finance Committee is convening a public hearing to evaluate proposed combined reporting legislation (Senate Bill 485).

In previous debates, critics of mandatory combined reporting have raised two principal concerns. First, opponents contend that requiring multi-state corporations to file a combined tax return will impose a significant and unwarranted administrative burden on those firms. Second, opponents warn that Connecticut's top employers will relocate to other states if combined reporting is implemented.<sup>2</sup>

Policymakers should not be swayed by either argument. Following an extensive review of public records, we find that the vast majority of Connecticut's largest employers already file combined returns in one or more states where combined reporting is required.<sup>3</sup>

Specifically, we examined the Securities & Exchange Commission filings and the company websites for (1) every Connecticut business with more than 1,000 employees that is part of a multi-state corporate enterprise<sup>4</sup> and (2) every Connecticut corporation that had more than \$2.5 billion in worldwide sales in 2007.<sup>5</sup> (Six companies appear on both lists.) We conclude that 32 of the 37 Connecticut for-profit companies with more than 1,000 employees conduct business in one or more mandatory combined reporting states (Figure 1). Indeed, 27 of these companies operate in five or more mandatory combined reporting states. Of the 18 Connecticut corporations with more than \$2.5 billion in worldwide sales, every single one operates in at least one mandatory combined reporting state, and 16 operate in four or more combined reporting states (Figure 2).

Notably, 30 of the 37 largest Connecticut for-profit employers and 17 of the 18 Connecticut companies with more than \$2.5 billion in annual sales have facilities in at least one state that enacted mandatory combined reporting prior to 1985.<sup>6</sup> This strongly suggests that the administrative costs and additional tax liability that may be associated with mandatory combined reporting are not so substantial as to persuade these firms to relocate their facilities. Leading

### Key Findings

- Connecticut has 37 for-profit companies with more than 1,000 employees. 32 of these companies (86%) already operate in states with mandatory combined reporting. 27 of these companies operate in 5 or more combined reporting states.
- In 2007, 18 Connecticut companies had more than \$2.5 billion in worldwide sales. All 18 of these companies currently operate in at least one combined reporting state.

<sup>†</sup> Author for correspondence. This issue brief was prepared through the Yale Law School Legislative Advocacy Clinic under the supervision of J.L. Pottenger, Jr., Nathan Baker Clinical Professor of Law, and Shelley Geballe, Distinguished Senior Fellow at Connecticut Voices for Children and Clinical Visiting Lecturer at Yale Law School.

Connecticut companies continue to willingly conduct operations in one or more of these mandatory combined reporting states.

## **Mandatory Combined Reporting Has Been Successfully Implemented in a Majority of States with a Corporation Business Tax**

In recent years, several states have rebuffed the argument that firms will leave if a state adopts mandatory combined reporting. Since Connecticut enacted and repealed mandatory combined reporting in 2003, seven states have adopted combined reporting laws (Massachusetts, Michigan, New York, Texas, Vermont, West Virginia, and Wisconsin).<sup>7</sup> Most peer states in the Northeast now have mandatory combined reporting, including New York, Massachusetts, New Hampshire, Vermont, and Maine.<sup>8</sup> In total, 23 of the 45 states with corporate income taxes have implemented this vital policy.<sup>9</sup> These states represent more than 53% of the national economy.<sup>10</sup>

### **Conclusion**

Combined reporting is a reliable mechanism for halting several prominent corporate tax avoidance strategies. Under Connecticut's current system of predominantly single entity reporting,<sup>11</sup> multi-state corporations are able to artificially shift their profits to subsidiaries operating in states that do not tax businesses.<sup>12</sup> Mandatory combined reporting remedies this problem by treating parent corporations and certain subsidiaries and affiliates as a single corporation for tax purposes.<sup>13</sup> With combined reporting, "the profits and losses of all entities in a unitary group are combined," and an apportionment formula is then applied to determine what segment of the unitary enterprise's income is attributable to economic activity in Connecticut.

Treating the enterprise as a single entity eliminates the impact of any transfers between the affiliated companies.<sup>14</sup> Combined treatment of the parent corporation and its affiliates therefore counteracts the erosion of a state's corporate tax base that occurs under aggressive corporate tax planning.<sup>15</sup> Combined reporting also levels the playing field for local, Connecticut-based businesses, which are now at a competitive disadvantage to the multi-state companies who exploit Connecticut's single entity reporting system to reduce the taxes they owe Connecticut.

This original study debunks the myth that adopting mandatory combined reporting will impose untenable administrative burdens on Connecticut companies or prompt large employers to leave Connecticut. Most of Connecticut's largest employers already file combined reports in one or more states with mandatory combined reporting. Connecticut should forge ahead and adopt this critical policy.

**Figure 1. Connecticut Companies With More Than 1,000 Employees**

Connecticut Employer [Parent Corp.]	Long-Time Combined Reporting (CR) States																New CR States						# of CR States	HQ		
	AK	AZ	CA	CO	HI	ID	IL	KS	ME	MN	MT	NE	NH	ND	OR	UT	MA	MI	NY	TX	VT	WV			WI	
Aetna Inc.																									12	CT
Aetna Pharmacy [Aetna Inc.]																									12	CT
Alstom Power Inc.																									7	Fra.
Anthem Blue Cross Blue Shield [Wellpoint, Inc.]																									11	IN
Boehringer Ingelheim Corp.																									0	Ger.
Boehringer Ingelheim Pharm. Inc. [Boehringer Ingelheim Corp.]																									0	Ger.
Bozzuto's Inc.																									0	CT
Dominion Millstone Power Sta. [Dominion Resources, Inc.]																									8	VA
Dooney & Bourke																									6	CT
ESPN, Inc. [Walt Disney Co.]																									13	CA
GE Consumer & Industrial [General Electric Co. Inc.]																									19	CT
General Electric Co. Inc.																									19	CT
Hamilton Sunstrand Corp. [United Technologies Corp.]																									9	CT
Hartford Financial Svc. Grp., Inc.																									9	CT
Hartford Life, Inc. [Hartford Financial Svc. Grp., Inc.]																									9	CT
The Hartford [Hartford Financial Svc. Grp., Inc.]																									9	CT
Health Net of the Northeast [Health Net, Inc.]																									6	CA
Healthtrax Inc.																									2	CT
Lake Compounce [Palace Entertainment Holdings, Inc.]																									5	CA
Lego Systems Inc. [LEGO Holding]																									2	Den.
Mass Mutual Life Insurance Co.																									17	MA
Microwarehouse Inc. [CDW Corp.]																									9	IL
Connecticut Light & Power Co. [Northeast Utilities]																									2	MA
People's United Financial Inc.																									4	CT

**Figure 1 (Continued). Connecticut Companies With More Than 1,000 Employees**

Connecticut Employer [Parent Corp.]	Long-Time Combined Reporting (CR) States																New CR States						# of CR States	HQ		
	AK	AZ	CA	CO	HI	ID	IL	KS	ME	MN	MT	NE	NH	ND	OR	UT	MA	MI	NY	TX	VT	WV			WI	
Pepperidge Farm Inc. [Campbell Soup Co.]			■				■									■		■		■				■	6	NJ
Pfizer Inc.												■				■									7	NY
Philips Medical Systems Inc.		■	■	■			■			■															10	Neth.
Pitney Bowes Document Mssgng & Pitney Bowes Management Svc. [Pitney Bowes Inc.]		■	■	■			■			■															14	CT
Pitney Bowes Inc.		■	■	■			■			■															14	CT
Pratt & Whitney [United Technologies Corp.]		■	■	■			■					■													9	CT
Sikorsky Aircraft Corp. [United Technologies Corp.]		■	■	■			■					■													9	CT
Stanadyne Corp.																									0	CT
The Travelers Companies, Inc.	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	20	NY
Trefz Corp.	No Public Data Available.																									
Tyco Healthcare – U.S. Surgical (now Covidien PLC)			■														■	■	■		■				6	Ire.
United Technologies Corp.		■	■	■			■					■													9	CT
William Raveis Real Estate, Inc.																									2	CT

**Figure 2. Connecticut Companies With More Than \$2.5BN in Sales**

Connecticut Employer [Parent Corp.]	Long-Time Combined Reporting (CR) States															New CR States						# of CR States	HQ			
	AK	AZ	CA	CO	HI	ID	IL	KS	ME	MN	MT	NE	NH	ND	OR	UT	MA	MI	NY	TX	VT			WV	WI	
General Electric Co. Inc.																									19	CT
United Technologies Corp.																									9	CT
Hartford Financial Svc. Grp., Inc.																									9	CT
Aetna Inc.																									12	CT
Xerox Corp.																									11	CT
Praxair Inc.																									6	CT
Terex Corp.																									4	CT
Northeast Utilities																									2	MA
Pitney Bowes Inc.																									14	CT
W.R. Berkley Corp.																									5	CT
EMCOR Group Inc.																									9	CT
The Stanley Works																									6	CT
Chemtura Corp.																									4	CT
United Rentals Inc.																									21	CT
Odyssey Re																									5	CT
United Natural Foods																									6	RI
Silgan Corp.																									7	CT
Phoenix Companies Inc.																									1	CT

## Methodological Appendix

This study is modeled on two recent studies of New Mexico and North Carolina conducted by Michael Mazerov, a Senior Fellow at the Center on Budget & Policy Priorities in Washington, D.C.<sup>16</sup> Although we are grateful to Mr. Mazerov for explaining the methodology employed in his studies, we retain sole responsibility for the accuracy of our findings.

The research necessary to complete this study occurred in February and March 2010. We derived the list of Connecticut's top corporations by worldwide sales from the list compiled by Connecticut Magazine in January 2008.<sup>17</sup> We extracted the list of Connecticut businesses with more than 1,000 employees from the Connecticut Department of Labor database of employers.<sup>18</sup> We excluded from the list non-profit, government, and tribal employers as they are not subject to the corporation business tax. We also excluded for-profit business enterprises where neither the parent nor any of the subsidiaries were registered as C-Corporations. This decision excluded a number of Connecticut's largest employers, including PriceWaterhouseCoopers and Servicom LLC. We also specifically excluded two larger companies that are structured as pass-through entities and for which no public information was available regarding the legal status of any potential affiliates (e.g., Fremont Riverview LLC and Lincoln Waste Solutions LLCs). Finally, we excluded Ceci Brothers, Inc. Although the Connecticut Department of Labor lists Ceci Brothers as employing 1,000-4,999 employees, the Hoover's company listing on the firm lists only five full-time employees,<sup>19</sup> and we were unable to glean any additional information about the size or location of the company's operations from published public records.<sup>20</sup> Despite these exclusions, it remains possible that some of the firms included in this issue brief are not subject to Connecticut's corporation business tax.

Among the for-profit businesses remaining, if an individual subsidiary employed more than 1,000 workers in Connecticut, we treated that subsidiary as a separate company, even if sister subsidiaries also conducted business in Connecticut. For instance, the operations of Hamilton Sunstrand Corp., Pratt & Whitney, Sikorsky Aircraft Corp., and the corporate management of United Technologies Corp. are counted separately in the results. Since each affiliated company employed a substantial number of Connecticut workers, we concluded that it was appropriate to list them separately. If related entities are collapsed into singly entries, we obtain comparable results: 24 of Connecticut's top 28 employers operate in one or more combined reporting states.

We relied principally upon two sources of information for identifying the additional states in which these Connecticut companies have facilities: (1) the annual "10-K" reports filed by publicly traded corporations with the Securities & Exchange Commission and (2) the companies' own websites. Every Form 10-K has a section titled "Properties" in which the corporation describes its major facilities. Although this section sometimes contains a generic description, in many cases companies identify the specific locations of their major facilities.

We supplemented information extracted from Form 10-K with a review of firm websites. Many company websites feature a page listing the location of their facilities. If no such page existed, we reviewed sections of the websites regarding vacant job positions with the firm. We included those states with job listings for non-sales positions. We disregarded sales positions, since, according to Mazerov, "the presence of a corporation's sales personnel in a state does not automatically establish corporate income tax liability for the company as a result of federal Public Law 86-272."<sup>21</sup>

We only listed a Connecticut company as operating in a combined reporting state if we were able to gather written documentation from the company that it had a facility in that state. Since companies may have facilities in locations that we did not detect through our research, this study represents the minimum number of locations in which a multi-state enterprise is subject to combined reporting.<sup>22</sup>

We will update and correct this report if any of our conclusions were reached in error.

## Endnotes

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<sup>1</sup> In 2003, Connecticut actually adopted mandatory combined reporting, Pub. Act. No. 03-1, §§ 90-91, but the success was short-lived. Combined reporting was repealed shortly thereafter by the budget implementation bill. Pub. Act. No. 03-6, §§ 78-81, 244.

<sup>2</sup> See, e.g., Testimony of Joseph Brennan, Senior Vice President of Public Policy, Connecticut Business & Industry Association, Hearing before the Committee on Finance, Revenue, and Bonding, March 28, 2005 (“And I just remember when this was passed in 2003, I’ve been working at CBIA 17 years and I never got a reaction like I got from that, and again, it’s not anything that people say publicly, but just talking behind closed doors. I have no doubt in my mind, and I’ve known a lot of you a long time. I do not use hyperbole here. You know, I have no doubt in my mind that it wouldn’t cause some serious relocations of employment in the State of Connecticut had that been adopted.”)

<sup>3</sup> This study is modeled after two studies conducted by Michael Mazerov of the Center on Budget & Policy Priorities. See MICHAEL MAZEROV, CTR. ON BUDGET & POL’Y PRIORITIES, VAST MAJORITY OF LARGE NEW MEXICO CORPORATIONS ARE ALREADY SUBJECT TO “COMBINED REPORTING” IN OTHER STATES (2010), <http://www.cbpp.org/files/1-26-10sfp.pdf> [hereinafter NEW MEXICO STUDY]; MICHAEL MAZEROV, CTR. ON BUDGET & POL’Y PRIORITIES, MOST LARGE NORTH CAROLINA MANUFACTURERS ARE ALREADY SUBJECT TO “COMBINED REPORTING” IN OTHER STATES (2009), <http://www.cbpp.org/files/1-15-09sfp.pdf>.

<sup>4</sup> We extracted the list of Connecticut businesses with more than 1,000 employees from the Connecticut Department of Labor website in February 2010. Conn. Dep’t of Labor, Labor Market Information from the Office of Research, Search for Employers, <http://www1.ctdol.state.ct.us/lmi/empsearch.asp>.

<sup>5</sup> The list of Connecticut’s top corporations by worldwide sales was compiled by Connecticut Magazine in January 2008. *The Top 100*, CONN. MAGAZINE, [http://www.zwire.com/site/news.cfm?newsid=17747943&BRD=2329&PAG=461&dept\\_id=600736&rfti=6](http://www.zwire.com/site/news.cfm?newsid=17747943&BRD=2329&PAG=461&dept_id=600736&rfti=6).

<sup>6</sup> Those sixteen states are Alaska, Arizona, California, Colorado, Hawaii, Idaho, Illinois, Kansas, Maine, Minnesota, Montana, Nebraska, New Hampshire, North Dakota, Oregon, and Utah.

<sup>7</sup> NEW MEXICO STUDY, *supra* note 3. Before the most recent set of states adopted mandatory combined reporting, the Connecticut Business & Industry Association argued that adopting combined reporting would place Connecticut at a disadvantage relative to its competitors. See Testimony of Joseph Brennan, *supra* note 2 (“[A] minority of states have some form of unitary, not a majority. Most of those are west of the Mississippi. Most of our competitor states in this region do not have unitary reporting methods.”). Given the rapid adoption of combined reporting in recent years, including in New York, Massachusetts, and Vermont, this argument has lost any salience it might have had.

<sup>8</sup> MICHAEL MAZEROV, CTR. ON BUDGET & POL’Y PRIORITIES, A MAJORITY OF STATES HAVE NOW ADOPTED A KEY CORPORATE TAX REFORM – “COMBINED REPORTING” (2009), <http://www.cbpp.org/files/4-5-07sfp.pdf>.

<sup>9</sup> *Id.*

<sup>10</sup> Author’s calculations from Bureau of Economic Analysis, Gross Domestic Product by State, <http://www.bea.gov/regional/gsp/> (accessed Mar. 20, 2010). GDP data are for calendar year 2008.

<sup>11</sup> Connecticut law currently *allows* corporations that file a federal consolidated return to file a combined return in Connecticut; the combined Connecticut tax liability is determined after each corporation in the combined return individually apportions its income to Connecticut (i.e., the return is in the nature of a state consolidated return). Connecticut imposes a preference tax on corporations that choose to file a combined state return that is equal to the difference between the tax that would have been due if the entities had filed separately and the total tax due under the combined return, up to a maximum of \$500,000. In income year 2006, 1,014 corporations elected to file combined returns (the preference tax in that year was \$250,000). Had these corporations filed single entity returns, the corporation tax due would have been \$557.0 million. By electing to file combined returns, the total tax due before credits was reduced to \$348.6 million (including \$27.1 million in the preference tax). Notably, more than a third of the voluntary combined returns (366 of 1,014) reported only \$250 in tax due, i.e., Connecticut’s minimum corporate tax. Connecticut law also allows certain corporations to file unitary returns, as of right or with the permission of the Department of Revenue Services. In such cases, the combined net income of the unitary group is apportioned to Connecticut as if it were one corporation. See State of Connecticut, Department of Revenue Services, Annual Report Fiscal Year 2007-2008, at 18-20.

<sup>12</sup> MICHAEL MAZEROV, CTR. ON BUDGET & POL’Y PRIORITIES, STATE CORPORATE TAX SHELTERS AND THE NEED FOR “COMBINED REPORTING” (2007), <http://www.cbpp.org/10-26-07sfp.pdf>

<sup>13</sup> *Id.* Connecticut currently allows combined reporting at the election of corporate taxpayers that file a federal consolidated return (see note 11).

<sup>14</sup> William F. Fox, LeAnn Luca, & Matthew N. Murray, *Emerging State Business Tax Policy: More of the Same, or Fundamental Change?*, STATE TAX NOTES, May 2007, at 393-94.

<sup>15</sup> *Id.*

<sup>16</sup> See *supra* note 3.

<sup>17</sup> See *supra* note 5.

<sup>18</sup> See *supra* note 4.

<sup>19</sup> Ceci Brothers, Inc., Company Profile from Hoover’s, [http://www.hoovers.com/company/Ceci\\_Brothers\\_Inc/rscschskx-1.html](http://www.hoovers.com/company/Ceci_Brothers_Inc/rscschskx-1.html) (last visited Mar. 21, 2010).

<sup>20</sup> In addition to reviewing SEC filings and the company’s website, we consulted ten major business databases available through the Lexis-Nexis and Westlaw electronic research services.

<sup>21</sup> NEW MEXICO STUDY, *supra* note 3, at 8.

<sup>22</sup> *Id.*