

Closing a Corporate Tax Loophole Through Combined Reporting

June 2015

Connecticut's current tax structure enables large, multistate corporations to avoid paying their fair share of state taxes. Under current Connecticut taxes, corporations can artificially shift profits to subsidiaries in states that do not have corporate income taxes. This accounting gimmick enables these corporations to avoid paying corporate income taxes on the business they conduct in Connecticut.

Corporations that use this loophole deprive the state of revenue needed to fund public services like education, health care, transportation, public safety, and more that support families, communities and businesses. Businesses that use these services but avoid paying state taxes that fund them shift the responsibility onto families and local businesses, hurting our state's business environment and quality of life. Failing to close this loophole costs the state an estimated \$60 to \$90 million per year in lost revenue.

Mandatory combined reporting would effectively close this tax loophole by treating parent corporations and their subsidiaries as a single entity for tax purposes. Such a requirement prevents multi-state corporations from transferring profits earned in Connecticut to affiliates in another state, allowing such profits to be taxed.

Closing this loophole helps to level the playing field for local, Connecticut-based companies who are at a competitive disadvantage to multi-state corporations. Small, in-state businesses often compete with large corporations that engage in substantial tax avoidance. Requiring mandatory combined reporting eliminates one of these tax loopholes, making it easier for locally-based businesses to compete in Connecticut.

Most states with corporate income taxes, including every state in the Northeast, already require combined reporting. Currently, 24 of the

45 states with corporate income taxes feature mandatory combined reporting, including New York, Massachusetts and Rhode Island. In Connecticut, corporations may now calculate their tax due with and without combined reporting and elect the method that results in less tax, but pay a \$500,000 "preference" tax to do so. Mandatory combined reporting would end this option.

The vast majority of Connecticut's largest employers are already subject to mandatory combined reporting in other states in which they operate. This accounting change will not impose difficult, new administrative burdens on multi-state corporations, as over 85% of them operate in states that require combined reporting. These companies have chosen to locate and remain in states with this reporting requirement.

Economic growth rates are comparable and even superior in states that require combined reporting. From 2000 to 2014, 10 of the 15 states that had the best record of retaining manufacturing jobs required combined reporting, while just two of the 15 states that lost the greatest share of manufacturing jobs were combined reporting states.

Requiring combined reporting would not overburden businesses in Connecticut. According to the latest study by the Council on State Taxation, the total state and local business tax burden in Connecticut, as a share of private sector gross state product, is tied for second lowest in the nation, 27% lower than the national average. Requiring combined reporting will not change the fact that businesses in Connecticut are, on average, taxed less than businesses in other states.

Connecticut should make a commonsense fix of a tax loophole with combined reporting to fund critical state services, bring the state in line with the rest of the Northeast, and help to level the playing field for local businesses.