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April 26, 2023

VIA EMAIL
Minnesota Legislature
Senate Committee on Taxes

Re: COST Opposes Worldwide Combined Reporting; Article 1, Sec. 41-42 (SCS1811A-2)

Dear Chair Rest, Vice Chair Klein, Ranking Minority Member Weber, and Members of the Senate Committee on Taxes:

On behalf of the Council On State Taxation (COST), I am writing to oppose the amendment placed in Article 1, Sec. 41-42 of SCS1811A-2, which would require the inclusion of worldwide income for Minnesota's unitary combined corporate income tax filers. **No other state in the U.S. or country in the world currently utilizes such mandatory worldwide combined reporting to calculate all corporate income taxes.** Minnesota should reject this approach as well. Its adoption would place Minnesota at a huge competitive disadvantage among states and would send a warning flag to multinational businesses that the state is a hostile environment for business expansion and relocation.

About COST

COST is a nonprofit trade association consisting of over 500 multistate corporations engaged in interstate and international business. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities. COST has a significant number of members that own property, have employees, and make substantial sales in Minnesota.

Mandatory Worldwide Unitary Combined Reporting

Current state apportionment provisions allow taxpayers to elect to file their corporate income tax returns on a water's-edge basis, thereby limiting the determination of income subject to apportionment in the State to the income and apportionment factors of a group of unitary companies operating within the "water's-edge" of the United States. Article 1, Sec. 41-42 of SCS1811A-2, would require every corporation subject to the corporate income tax to report all income from foreign subsidiaries. Mandatory worldwide combined reporting is not a new concept; nearly a dozen states imposed the filing methodology by the early 1980's. In a series of actions beginning in 1984 and accelerating over the next few years, however, all of those states granted taxpayers the right to file (or elect to file) using the water's-edge methodology, a position that has held fast in the states ever since. Pressure against mandatory worldwide combination had been building through the 1970s and early 1980s among both foreign governments and foreign and domestic multinational business enterprises, threatening to instigate an

international tax war. The British and Japanese governments, in particular, threatened retaliatory taxing measures against the U.S. to counter the trend toward mandatory worldwide combined filing. Although the U.S. Supreme Court upheld California's imposition of mandatory worldwide combined reporting in 1983, pressure from the international community continued to build, spurring President Ronald Reagan to convene the Worldwide Unitary Taxation Working Group in 1984, led by Treasury Secretary Donald Regan and comprising representatives of the federal government, state governments, and the business community.

Although the Working Group found it difficult to reach an agreement on several issues, it did agree on a set of principles designed to guide the formulation of state tax policy. Among those principles was a recommendation that states only enact "water's-edge" unitary combination for both U.S. and foreign-based companies. As noted, under the water's-edge method, only the income and the apportionment factors derived from operations within the domestic United States (i.e., up to the "water's edge") are used to calculate state corporate income tax liability. That principle has held to the current day. No state has returned to a mandatory combined reporting regime for all business corporations, and even the Multistate Tax Commission's model combined reporting statute includes a water's-edge election.

In addition to the international geopolitical reasons, states have also rejected the worldwide combined reporting approach because of the inequities and imbedded complexities. These include the potential for double taxation of foreign source income; the complexities of determining which foreign entities -- sometimes numbering in the hundreds -- are "unitary" with their U.S. affiliates; and the accounting difficulties resulting from different exchange rates, foreign accounting methodologies, and technology platforms utilized by foreign affiliates. Minnesota's existing water's-edge filing regime is consistent with the regimes adopted by other combined reporting states, and there is no rational public policy reason for adopting a different approach for determining the tax base and apportionment factors for Minnesota's corporate income tax.

Global Profit Shifting and State Corporate Tax Revenues

Over the last twenty years, many countries lowered their corporate income tax rates to incentivize businesses to locate and expand there. As the disparity between corporate tax rates imposed by various countries grew, policy makers at the international level became concerned with the increased use of global profit shifting – the artificial shifting of income and activity from high-tax jurisdictions to low-tax jurisdictions. Efforts to combat global profit shifting have been underway at the Organization for Economic Cooperation and Development (OECD) for many years, culminating in its BEPS project recommending measures to address international "base erosion and profit shifting." During its deliberations, the OECD considered and rejected the use of mandatory worldwide combined filing. Similarly, the current OECD Pillar 1 and 2 proposals for reforming international taxation steer clear of any consideration of mandatory worldwide combined filing.[1] Finally, the U.S. Government, which adopted sweeping tax reform with the passage of the Tax Cuts and Jobs Act (TCJA) in 2017, lowered its top corporate income tax rate from 35 percent to 21 percent. The TCJA also moved the U.S. Government away from its prior worldwide tax filing regime to a quasi-territorial tax system that includes a more limited

[1] At the subnational level, only one country other than the U.S. among the world's 49 largest economies imposes a corporate income tax on any portion of foreign source operating income. See "Survey of Subnational Corporate Income Taxes in Major World Economies: Treatment of Foreign Source Income," prepared by PricewaterhouseCoopers LLP for the State Tax Research Institute, November 2019.

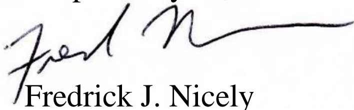
taxation of foreign source income principally through the inclusion in the corporate tax base of 50 percent of global intangible low-taxed income.

Many economic papers have contributed to these efforts by attempting to quantify the global impact of profit shifting. Not surprisingly, the results of these studies vary dramatically, and each study contains disclaimers regarding the complexity, difficulty, and uncertainty of its conclusions. The process is made even more difficult because of the fluid nature of international taxation, with many nations such as the United States making or considering significant changes to their corporate income tax laws relating to global commerce. Nevertheless, a recent report by a partisan think tank seized on the high point of these studies and extrapolated that number to individual states through a series of assumptions and estimates. It then presented those numbers to the states as "money left on the table," and there for the taking if the state would only enact the discredited and still-controversial filing method known as mandatory worldwide combined reporting. These estimates (and the report) should be viewed with great skepticism. Not only does the Institute on Taxation and Economic Policy report rely on highly generalized and problematic global tax data, but it makes no effort to customize its estimate to reflect the laws of particular states or make adjustments to reflect changes in national corporate income tax laws.[2]

Conclusion

The proposed amendment in Article 1, Sec. 41-42, inappropriately removes Minnesota's water's-edge provision that serves not only as a practical limitation on combined reporting, thereby reducing the incidence of double taxation and economic distortion, but it also keeps the State within the conventional norms of business taxation. Mandatory worldwide combined filing is contrary to the approach to taxing corporate profits currently employed by all other states and nations with corporate income taxes. Its adoption would place Minnesota at a huge competitive disadvantage among states and would send a warning flag to multinational businesses that the state is a hostile environment for business expansion and relocation. Minnesota should be encouraging foreign direct investment, not discouraging it. Economic integration is one of the greatest mediators of international conflict and tensions. Mandatory worldwide combined reporting will move the State in the opposite direction. COST respectfully opposes Article 1, Sec. 41-42 of SCS1811A-2.[3]

Respectfully,



Fredrick J. Nicely

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director

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[2] Institute on Taxation and Economic Policy and U.S. PIRG, "A Simple Fix for a $17 Billion Loophole: How States Can Reclaim Revenues Lost to Tax Havens", January 17, 2019, pp 17-18.

[3] COST is supportive of the proposed amendment in Article 1, Section 39, which appropriately provides a 30-day safe harbor to protect individuals such as emergency workers and first responders; trade union workers; non-profit staff; teachers; federal, state, and local government employees; and many others only temporarily working in the State.