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Statement of Michael Mazerov, Senior Fellow, State Fiscal Policy Division, CBPP
Before the
Vermont House Committee on Ways and Means
Regarding Proposed Legislation to Mandate Worldwide Combined Reporting
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Chair Kornheiser, Vice Chair Canfield, Ranking Member Demrow, and members of the Committee, thank you for the opportunity to testify this morning regarding the proposed worldwide combined reporting legislation. I'm Michael Mazerov, Senior Fellow with the State Fiscal Policy division of the Center on Budget and Policy Priorities in Washington, D.C. The Center is non-profit, nonpartisan research and policy institute that advances federal and state policies to help build a nation where everyone has the resources they need to thrive and share in the nation's prosperity. We promote federal and state policies that will build a stronger, more equitable nation and fair tax policies that can support these gains over the long term. I have been on the Center staff since 1998, and my work has focused primarily on state taxation of businesses. Prior to that I was the Director of Policy Research at the Multistate Tax Commission for almost nine years.

My understanding at this writing is that the Committee now has under consideration a draft bill that would switch Vermont's corporate tax structure from domestic or "water's edge" combined reporting to mandatory worldwide combined reporting. I also understand that the bill is substantially based on the model bill the Multistate Tax Commission approved in 2021, but with its election to calculate tax on a water's edge basis removed.[1] This is an excellent decision. The MTC model was developed carefully over the course of two years, with significant input from the corporate community and state revenue department experts. There is growing interest among state policymakers in adopting worldwide combined reporting. We are encouraging all who contact us to base legislation on the MTC model to the greatest extent possible both because it was carefully developed and because doing so contributes to interstate tax uniformity – which mitigates the compliance burdens of multistate and multinational corporations.

This committee received an extensive briefing on worldwide combined reporting on January 19, 2024 from my colleague, Don Griswold, who is present today to answer additional questions that the committee may have. I'll therefore just set out briefly again what we see as the major arguments in favor of Vermont's adoption of worldwide combined reporting:

[1] The Multistate Tax Commission is an interstate compact aimed at coordinating state taxation of multijurisdictional companies that is governed by the directors of revenue in the member states. Vermont is a non-voting "Sovereignty Member."

- **Abusive international profit shifting remains a serious problem that is costing the federal government, Vermont, and all other states with corporate income taxes considerable revenue they should be collecting. It enables aggressive multinational corporations to avoid paying their fair share of tax. It thereby requires individual taxpayers, small businesses, and corporations not engaged in profit shifting to pay higher taxes than they otherwise would, results in less robust public education, health care, safety, transportation, and other critical services state residents could otherwise receive, or both**. Mr. Griswold's testimony sets out in detail some of the major academic and governmental research and data showing that profit shifting remains a major problem, notwithstanding major changes in federal law in the 2017 tax bill aimed at curbing it. I refer you to his testimony for that evidence.

- **Vermont's adoption and enforcement of worldwide combined reporting will recoup much of the revenue lost from profit shifting engaged in by multinational corporations that are highly likely to be Vermont corporate taxpayers**. Mr. Griswold's testimony reported that corporations like Walmart and CVS that presumably are Vermont corporate income taxpayers have subsidiaries in well-known foreign tax havens. For example, Walmart has a subsidiary in the Cayman Islands despite apparently not having a store there. It admittedly is challenging to estimate with a high degree of certainty the revenue that adoption of worldwide combined reporting will yield, because we are bringing into the corporate tax base the profits of foreign subsidiaries of Vermont taxpayers that are not currently filing U.S. tax returns. Moreover, Vermont is likely already reaping some of the potential additional revenue from worldwide combined reporting through its conformity to the GILTI provision of the 2017 federal tax bill, which also adds to the U.S. tax base some profit of foreign subsidiaries of U.S. companies.[2] These are arguments for being conservative in estimating and budgeting the revenue, not rejecting the policy. We can be confident that the revenue will be positive and meaningful, because the scale of profit shifting is so large. It is worth noting that California's official estimate holds that it is losing approximately $3 billion in revenue annually from its failure to require worldwide combined reporting.[3]

- **Mandating combined reporting helps ensure that small businesses without international operations compete on a level playing field with wealthy multinational corporations than can reduce their federal and state corporate tax liabilities through international profit shifting strategies**. As economist (and former Deputy Assistant U.S. Treasury Secretary for Tax Analysis) Kimberly Clausing recently observed:

> [M]ultinational companies have ample opportunities to shift income offshore that belongs in the U.S. tax base, lowering their tax burden at home. This gives US multinational companies a large tax advantage relative to domestic companies,

[2] "GILTI" is the acronym for Global Intangible Low-Taxed Income. The provision requires U.S. parent multinational corporations to calculate the combined profit of their controlled foreign subsidiaries. Fifty percent of any such combined profit in excess of a 10 percent return on foreign physical assets is deemed to be excess profit attributable to U.S. developed intangible assets that should have been in the U.S. tax base and therefore is taxable in the year it is earned.

[3] California Franchise Tax Board, "California Income Tax Expenditures: Compendium of Individual Provisions" for 2020 tax year, p. 26.

companies that are (on average) far smaller and far less likely to benefit from market power. The corporate tax base is very concentrated, with fewer than one half of one percent of corporations accounting for 87 percent of the tax base. Reforming international tax rules to ensure that large, dominant multinational companies pay adequate tax on their foreign income is essential for revenue, but it is also essential for creating a level competitive playing field, benefiting the many small, domestic companies that compete against large multinational companies.[4]

- **The U.S. Supreme Court has twice upheld the constitutionality and fundamental fairness of worldwide combined reporting as a corporate tax apportionment method, while the legality of certain alternative approaches to shutting down international profit shifting remains in doubt**. The Supreme Court upheld the constitutionality of worldwide combined reporting applied to U.S. parent multinational corporations in its 1983 *Container* decision and as applied to foreign parent multinationals in its 1994 *Barclays Bank* decision. Meanwhile, the corporate community continues to rattle sabers and implicitly threaten litigation against states that conform their tax laws to the 2017 GILTI provision or seek to include corporate subsidiaries formed in selected foreign countries in their otherwise "water's edge" combined groups.[5]

- **Worldwide combined reporting is a logical extension of the water's edge combined reporting method that Vermont adopted in 2004**. Once a state decides to mandate the combination of "unitary" members of a corporate group located in another *state* with those that are doing business within its borders, there is no principled reason whatsoever for not also requiring the inclusion in the combined group of commonly owned corporations located in another *country*.[6] Indeed, since one of the potential benefits to corporations of combined reporting is that it allows losses in one entity to offset profits in another on a current basis, it could be argued that failing to require combined reporting is unfair and perhaps discriminates against corporations with foreign money-losing unitary entities.

- **Potential alternatives to worldwide combined reporting for mitigating abusive international profit shifting have practical, legal, and political shortcomings**. International profit shifting is a huge problem because the primary approach the federal government has used to try to stop it – case-by-case adjustment (under Section 482 of the Internal Revenue Code) of the internal "transfer prices" of sales and purchases between U.S. parents and their foreign subsidiaries – is both theoretically flawed and administratively

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[4] Testimony to the U.S. Senate Budget Committee, January 17, 2024.

[5] See: Karl A. Frieden and Fredrick J. Nicely, "Minnesota's New Approach to Taxing Foreign Income Is Unfair and Unwise," State Tax Notes, August 21, 2023. See: letter from the Council on State Taxation to Montana legislators dated April 26, 2023, urging repeal of that state's tax haven "blacklist." https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-comments-and-testimony/20230406-cost-testimony-in-support-of-sb-246-repeal-tax-haven-final.pdf.

[6] The courts have held that to be includable in a combined report, out-of-state corporations not only must have common ownership with the in-state members but must also be engaged in some part of the same "unitary business." A vertically integrated oil company, with one member of the corporate group doing the drilling, another doing the refining, and another owning the gas stations would be a classic example of unitary group that a state having only one of those entities within its borders could nonetheless tax on a combined basis.

impractical. States have even fewer resources than the IRS does to adjust transfer prices and defend them in court, and so corporate representatives are being disingenuous when they claim that states already have the tools they need to nullify profit shifting. State conformity to the GILTI provision of the 2017 federal tax bill is another way that states can claw back some of the revenue loss from international profit shifting (Vermont is already doing so), but GILTI has some well-known structural flaws, and as noted above, the corporate community is already threatening legal challenges. (I have been told by corporate representatives that such challenges are already underway.) Nor does adoption of any of these alternatives mitigate corporate political resistance to fair tax policy. Minnesota seriously considered and then backed off from adoption of worldwide combined reporting last year in the face of concerted corporate opposition. It conformed to GILTI instead. Immediately upon that action, the corporate drumbeat for repeal of that conformity began.[7]

- **Corporations can comply with worldwide combined reporting, and states can enforce it**.

  - Under U.S. accounting standards, publicly traded corporations already must create for their stockholders consolidated financial statements for their U.S. and foreign operations, notwithstanding the different foreign country accounting standards that may apply to their foreign subsidiaries and the different currencies those foreign books are kept in.

  - Under current federal tax law, corporations already must calculate their taxes on a "consolidated basis," adding together the profits of U.S. parents and U.S. subsidiaries. Now, under GILTI, they must create essentially a "combined report" for all their foreign operations. So, for U.S. parent corporations, worldwide combined reporting effectively only requires the additional step of combining their consolidated U.S. profit with their foreign profit calculated for GILTI purposes.

  - By the early 1980s, a time when data processing technologies were much less robust than they are today, 10-12 states mandated worldwide combined reporting and had been doing so for several years. (All but Alaska were later successfully pressured by the Reagan Administration to withdraw to water's edge combined reporting.) Those states included small population states like Alaska, Idaho, Montana, and North Dakota, with (presumably) small revenue department staffs. Corporations were complying with worldwide combined reporting and states were enforcing it.

  - Alaska has mandated worldwide combined reporting for oil and gas companies for decades. Some 10 states allow an election between water's edge and combined reporting, and some corporations are only too happy to calculate their tax liability using worldwide combined reporting when they pay lower taxes as a result. For example, the Massachusetts Department of Revenue has told us that approximately 100 corporations elect worldwide combined reporting each year. The experience of Alaska and the elective worldwide combination states is further evidence that the often-alleged compliance burdens of worldwide combined reporting are exaggerated.

[7] See the first source cited in Note 5.

- Making the transition to worldwide combined reporting will undoubtedly involve a learning curve for state revenue department personnel, just as the transition to water's edge did almost 20 years ago. The legislature should be prepared to devote a portion of the additional revenue from its adoption to providing additional resources to the department for additional training and personnel with international tax expertise to write regulations, design forms, and conduct worldwide combined reporting audits.

In 2004, Vermont was a leader in the development of state corporate tax policy, breaking a logjam and becoming the first state in nearly 20 years to mandate water's edge combined reporting. That action was driven by impossible-to-ignore evidence about the massive scale of interstate profit shifting. Today, the entire world has awakened to the scale of international profit shifting, due to the kinds of research and data cited in Don Griswold's January 19th testimony. This awareness has manifested in the 2017 changes like GILTI that a Republican-controlled Congress felt compelled to enact even as it slashed the corporate tax rate and in the international agreement for a 15 percent corporate minimum tax that some 130 nations have agreed to and are in the process of implementing. Vermont's adoption of worldwide combined reporting legislation, the only workable and comprehensive solution to international profit shifting available to states, will make it a corporate tax policy leader once again.

Thank you again for the opportunity to testify in support of this vital legislation.