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Testimony of
Don Griswold, Senior Fellow, Center on Budget and Policy Priorities
before the
Vermont House Committee on Ways and Means
<u>Hearing on Corporate Tax Issues</u>
January 19, 2024

Chair Kornheiser, Vice Chair Canfield, and members of the House Committee on Ways and Means:

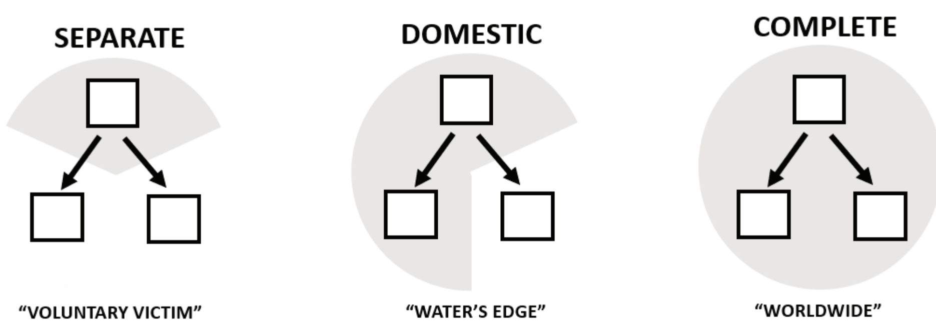
My name is Don Griswold. State corporate tax avoidance was my career for three decades. I was executive tax counsel at Berkshire Hathaway, leader of a Big 4 accounting firm's 600-person "state tax minimization" group, and an adjunct professor at Georgetown University Law Center where I taught my students that—despite Vermont's leadership years ago in adopting a form of combined reporting—corporate income tax avoidance in the Green Mountain State remains perfectly legal for the rich and powerful, and easier than shooting fish in a barrel.

But I'm now a senior fellow at the nonpartisan Center on Budget and Policy Priorities, where I analyze the policy implications for states that, like Vermont, still make corporate income tax virtually optional for sophisticated global corporate business enterprises while requiring in-state small businesses to pay full freight. And I educate policymakers about the one simple policy solution that eliminates this discrimination by making these powerful multinationals pay their fair share.

The solution is Worldwide Combined Reporting.

Based on your modernization of Vermont's corporate income tax law last year, I expect that this committee knows these issues well. Let's organize this overview into three issues: (1) the problem, (2) Vermont's incomplete historical response to the problem, and (3) the solution that can eradicate avoidance of Vermont corporate income tax once and for all.

As we consider these issues, please keep in mind this simple snapshot of your policy options when it comes to corporate tax reporting, which I'll explain as we go along:



The Problem is Profit-Shifting

It's common knowledge that powerful multinationals have for decades avoided hundreds of billions of dollars in federal and state income tax. They pay huge fees to sophisticated advisers to develop an endless variety of complex schemes that shift their profits offshore—beyond the reach of federal and state tax authorities—into tax havens that brazenly cannibalize other jurisdictions' revenues.

In each of the three diagrams above, a tax avoider's identical profit-shifting scheme is represented by two arrows leading from the parent of the multinational enterprise (the top box) down to two subsidiaries:

- *A domestic subsidiary (each box on the lower left) has been set up in a U.S. state outside Vermont; it operates effectively as a tax haven or tax shelter. The left arrow represents profit-shifting within the U.S.—perhaps a royalty paid (and deducted) by the parent to the domestic subsidiary in exchange for the right to use trademarks that the parent had previously transferred to that subsidiary.*

- *Similarly, a foreign subsidiary (each box on the lower right) has been set up in a foreign nation that operates effectively as a tax haven or tax shelter. The right arrow represents offshore profit-shifting—perhaps a royalty paid (and deducted) by the parent to the foreign subsidiary in exchange for the right to use patents that the parent had previously migrated (over time) to that subsidiary.*

Vermont's corporate income tax, like that of most other states, piggybacks on the federal tax calculation, so the profit-shifting for federal tax avoidance produces Vermont tax avoidance too. Some sobering facts, based on economic studies and forensic accounting by respected experts:

- The federal government lost $60 to $94 billion of tax revenues in 2017 to offshore profit-shifting by multinationals with U.S. parents. (That number doesn't include offshoring by the U.S. subsidiaries of foreign multinational parent corporations—like Vermont household names Subaru, Nestle, and German-owned T-Mobile.)[1]

- Speaking of household names among Vermonters, U.S.-parent multinationals Apple, Cisco, eBay, Facebook, Google, and Microsoft underpaid their U.S. corporate income taxes by $277 billion by skirting rules aimed at reducing offshoring from 2009 through 2022. With penalties and interest, that's nearly half a trillion (with a "T") dollars of tax avoidance by just six taxpayers.[2] Recall: Vermont automatically piggybacks on its apportioned share.

- Even closer to home: Ben & Jerry's is owned by multinational consumer products behemoth Unilever—which claims that it doesn't use tax havens for tax avoidance but can't deny having subsidiaries in Jersey and the Isle of Man, two well-known U.K tax havens.[3]

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[1] K. Clausing, "Profit Shifting Before and After the Tax Cuts and Jobs Act," National Tax Journal (December 2020).

[2] See, R. Avi-Yonah, D. Chamberlain, S. Curtis, and J. Kadet, "Commensurate with Income: IRS Nonenforcement Has Cost $1 Trillion," Tax Notes Federal (May 22, 2023.)

[3] Unilever website at https://www.unilever.com/planet-and-society/responsible-business/responsible-taxpayer/#:~:text=Based%20on%20this%20definition%20as,in%20the%20Isle%20of%20Man.)

- Subsidiaries based in some of the world's most notorious tax havens lurk in the org charts of many a powerful multinational that sets up shop in Vermont, selling to Vermont customers and benefiting from local police and fire protection. Walmart, for example, has subsidiaries in the Cayman Islands and Singapore; Exxon in the Netherlands and Singapore; CVS in Bermuda, Ireland, Luxembourg, Puerto Rico, and Singapore.[4]

- Finally, a stunning 50 percent of the total foreign profit of U.S.-based multinationals was claimed by these companies to have been earned in just nine notorious foreign tax havens—Bermuda, the British Virgin Islands, the Cayman Islands, Ireland, Luxembourg, the Netherlands, Puerto Rico, Singapore, and Switzerland.[5]

And remember: All this offshoring of profits by multinationals enables them to avoid tax in Vermont and other states because of the piggybacking of state tax calculations on the federal. The Institute on Taxation and Economic Policy examined multi-year data to estimate that Vermont would have collected an additional $31 million in 2018, had it closed the offshore profit-shifting loophole by enacting worldwide combined reporting.[6] Its nationwide estimate was a pickup of $17 billion. These numbers are due for an update, which we hope ITEP may generate this year.

Importantly, the problem of unfettered profit-shifting is not limited to reductions in public funds that could have been devoted to projects for the common good and to the building of an inclusive prosperity. Policy decisions to leave such pervasive tax avoidance unchecked may perpetuate public distrust of a tax system that appears rigged, which in turn may undermine fiscal citizenship and sap popular confidence in government for the common good.

<u>Vermont's Incomplete Historical Response Leaves the Problem Unsolved</u>

For many years, Vermont left itself wide open to both domestic and offshore profit-shifting because, like so many other states, it followed the "separate filling" reporting method.

<u>In the "Separate / Voluntary Victim</u>" visual (page 1, diagram on left), the grey-shaded area represents the full extent of Vermont's pre-2006 authority to calculate a multinational's Vermont tax liability. The only entity within Vermont's tax net here is the U.S.-based parent company, which has operations in the state. Both the domestic and offshore profit-shifting achieve tax avoidance because Vermont's separate-filing reporting statute did not allow the state to reach either the U.S. subsidiary (perhaps in Delaware) or the foreign subsidiary (perhaps in the Cayman Islands).

Effective in 2006, however, Vermont demonstrated strong fiscal leadership by enacting an important first step toward reducing corporate tax avoidance—"water's edge combined reporting."[7]

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[4] Sources here are each of these multinationals' most recent annual 10-K report to the U.S. Securities and Exchange Commission, exhibit 21.

[5] Javier Garcia-Bernardo, Petr Jansky, Gabriel Zucman, "Did the Tax Cuts and Jobs Act Reduce Profit Shifting by US Multinational Companies?" unpublished working paper, July 19, 2023.

[6] A Simple Fix for a $17 Billion Loophole: How States Can Reclaim Revenue Lost to Tax Havens (Institute on Taxation and Economic Policy, 2019).

[7] M. Mazerov, "A Majority of States Have Now Adopted a Key Corporate Tax Reform—'Combined Reporting'," Center on Budget and Policy Priorities (April 2009).

In the "Domestic / Water's Edge" visual (page 1, center diagram), the grey-shaded area shows that Vermont could in 2006 (and still can today) treat the parent and the domestic subsidiary as a single taxpayer, combining their income and apportionment data in a single tax calculation. This was an important step toward tax fairness.

But this diagram also demonstrates that water's edge (even with the 2023 closure of the "80/20 company" loophole) still leaves wide open the massive loophole for piggybacking on offshore profit-shifting.

The Complete Solution is Worldwide Combined Reporting

We understand that the House Committee on Ways and Means may now be considering closing the remaining loophole for massive tax avoidance by adopting worldwide combined reporting (WWCR).

In the "Complete / Worldwide" visual (page 1, right), the grey-shaded area shows that the contemplated update to Vermont's corporate income tax reporting methodology would—assuming the statute is properly drafted—make all profit-shifting entirely ineffective, completely eradicating corporate income tax avoidance in the Granite State.

WWCR eliminates the opportunity for sophisticated avoiders to manipulate the fundamental building blocks of structural tax avoidance (legal entities and the transactions among them) because WWCR ignores these legal fictions and instead taxes based on economic reality. What is that reality? Virtually every multinational operates as a single, unitary business enterprise, where all activity—wherever that activity is conducted and in whatever manipulable legal form—aims for the singular goal of increasing shareholder value.

Put another way: WWCR makes profit-shifting as meaningless as moving your wallet from right pocket to left when the state lawfully taxes its share of all the cash in your pants.

Conclusion

WWCR is "complete reporting." Require this complete reporting of all profits everywhere, and then calculate Vermont's "apportioned" slice of those profits (based on Vermont's percentage share of the multinational's total global sales,) and you'll come up with a tax base that satisfies U.S. constitutional requirements, that eradicates avoidance of Vermont corporate income tax, and that fairly represents economic reality.

The Center is a non-profit, non-partisan research and policy institute that pursues federal and state policies designed to reduce poverty and inequality and to restore fiscal responsibility in equitable and effective ways. We apply our expertise in budget and tax issues and in programs and policies that help low-income people by informing policy debates in order to achieve better policy outcomes.

Thank you for the opportunity to submit this testimony.