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(202) 484-5221
lheavy@cost.org

February 28, 2024

VIA EMAIL

Chair Emilie Kornheiser
House Ways and Means Committee
Vermont State House

Re: Opposition to Efforts to Impose Mandatory Worldwide Combined Reporting

Dear Chair Kornheiser:

On behalf of the Council On State Taxation (COST), I am writing to express opposition to efforts to repeal the “water’s-edge” provision in Vermont’s corporate income tax statute and impose a mandatory worldwide unitary combined reporting tax scheme on Vermont’s corporate taxpayers. With one partial exception, no other state or country in the world currently utilizes mandatory worldwide combined reporting to calculate corporate income.¹ Mandatory worldwide combined reporting would have an unpredictable (and possibly negative) effect on State revenue, would impose significant administrative burdens on both businesses and the State, and would place Vermont at a huge competitive disadvantage among states. Vermont should reject this approach.

About COST

COST is a nonprofit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of over 500 major corporations engaged in interstate and international business. COST’s objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multistate and multinational business entities. Many COST members have operations in Vermont that would be negatively impacted by this legislation.

Worldwide Unitary Combined Reporting: Historical Context

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 ten years all those states moved away from mandatory worldwide combined reporting, granting taxpayers the right to file (or elect to file)

¹ Alaska is the only state that mandates worldwide combined reporting, but only for oil companies that either explore, produce, or own a pipeline interest in the state.

using the water's-edge methodology. This position has held fast in the states over the last 40 years.

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. In particular, the British and Japanese governments threatened retaliatory tax measures against the U.S. to counter the trend toward mandatory worldwide combined filing.

Although the U.S. Supreme Court upheld the constitutionality of 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. The Working Group was led by Treasury Secretary Donald Regan and comprised 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.

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.

Global Profit Shifting and State Corporate Tax Revenues

Proponents of mandatory worldwide combined reporting assert that the filing method recoups tax revenues lost to states through profit-shifting by U.S.-based multinational entities. However, international initiatives to significantly limit profit-shifting are currently underway on a global basis.

Over the last few decades, 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 Base Erosion and Profit Shifting (BEPS) project recommending measures to address tax avoidance by multinational entities, improve the coherence of international tax rules, and ensure a more transparent international tax environment. During its initial deliberations, the OECD considered the use of mandatory worldwide combined filing, but ultimately decided not to move forward with this approach. Similarly, the current OECD Pillar 1 and 2 proposals for

reforming international taxation steer clear of any consideration of mandatory worldwide combined filing.

Among the solutions that specifically address global profit shifting is a global 15 percent minimum tax (GMT) on the income of large multinational entities in every country in which they operate. According to a January 9, 2024, OECD Taxation Working Paper, because the 15 percent GMT significantly reduces the incentive to shift profits, global profit shifting will be reduced by nearly 50 percent. More importantly, the percentage of profits in low-tax jurisdictions (those with tax rates below 15 percent) is expected to fall by two-thirds, with a concomitant increase in global corporate income tax revenues of nearly \$200 billion.

Additionally, in 2017 the U.S. Government adopted sweeping tax reform with the passage of the Tax Cuts and Jobs Act (TCJA) that sharply curtailed the incentive to shift profits outside the United States by implementing a federal rate reduction from 35 to 21 percent, a tax on global intangible low-taxed income (GILTI), a base-erosion and anti-abuse tax (BEAT) specifically targeting profit shifting, and a 15 percent alternative minimum tax on financial statement (book) income.

Several economic studies, issued prior to the adoption of the GMT, attempted 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. A 2019 report by a progressive-leaning think tank seized on the high point of these studies and extrapolated that number to individual states through a series of heroic 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. However, the report makes no effort to customize its estimates to reflect the laws of the individual states or make adjustments to reflect recent changes in national and international corporate income tax laws.

The report was written before the adoption and implementation of the GMT and uses data from tax years prior to the effective date of the TCJA and has not been adjusted to account for the resulting sharp reductions in profit shifting and low-taxed income. The report fails to acknowledge the unknown amount of foreign income or losses that would be included in the expanded tax base under the worldwide combined reporting method or the dilutive impact on the apportionment factor for assigning corporate income, as foreign sales would now be included in the denominator of the sales factor for all multinational businesses.

Most importantly, in the case of Vermont, the report does not reduce its estimates to reflect that the State already includes all or most foreign source income in its corporate income tax base through its taxation of 100 percent of foreign dividends (when repatriated to U.S. parent corporations), and 50 percent of GILTI through the State’s conformity to the TCJA.

Practical Problems with Mandatory Worldwide Combined Reporting

In addition to the foreign policy implications, states have also rejected the worldwide

combined reporting approach because of the inequities among taxpayers and imbedded compliance complexities. Compliance burdens vary from taxpayer group to taxpayer group depending on several group-specific factors, such as the international location of subsidiaries, the composition of the unitary group, merger and acquisition activity, company software systems, and income producing activities. For many multinational corporate groups, often comprising hundreds of subsidiaries, the compliance requirements are expensive and time-consuming.

Typical hurdles to overcome include: (1) a unitary analysis for each affiliate to determine the composition of the unitary group; (2) a combined calculation of worldwide apportionable income (in U.S. dollars) for all affiliated entities, many using different international accounting standards, and without the benefit of a federal taxable income figure for foreign subsidiaries; (3) application of the state apportionment formula, which entails several policy choices that can be second-guessed by audit teams; and (4) administrative and corporate governance issues to be addressed when combining foreign and domestic subsidiaries. The audit burdens imposed on a company will be equally difficult for state tax administrators who must invest significant resources to manage and evaluate best-guess scenarios when seeking reasonable approximations for the worldwide combined return.

Although proponents are quick to point out that some corporate groups elect to file on a worldwide basis in the minority of states that provide such an election, that decision requires an assessment of the administrative burden including compliance costs and availability of the required data. This will differ from company to company and is often dictated by a weighing of compliance costs and tax savings achieved by including foreign-based loss companies in the combined return.

Mandatory Worldwide Combined Reporting Rejected by Other States

In the past six years, three other states have rejected the move to mandatory worldwide combined reporting. In 2017, Indiana decided to forego mandatory worldwide combined reporting, with the observation that, though it might increase tax revenues in the short term, those gains were almost certain to be fleeting and result in no net gain over the longer term.² A 2023 Minnesota bill that would have adopted mandatory worldwide combined reporting passed the House but died in the Senate without a hearing or discussion in any Senate committee. In 2023, the New Hampshire Commission on Worldwide Combined Reporting for Unitary Businesses Under the Business Profits Tax rejected mandatory worldwide combined reporting stating that “WWCR is a grossly overbroad remedy for concerns that transfer pricing is misused for tax advantage, as it sweeps all foreign profits into the base, regardless of whether any transfer pricing has been used, or its extent, or its alleged misuse.”³

The conclusions in the New Hampshire Commission’s report should be of particular interest

² Office of Fiscal and Management Analysis, Indiana Legislative Services Agency, [A Study of Practices Relating to and the Potential Impact of Combined Reporting](#), Oct. 1, 2016.

³ [Final Report of the Commission on Worldwide Combined Reporting for Unitary Businesses Under the Business Profits Tax](#) RSA 77-A:23-b (HB 102, Chapter 12, Laws of 2022)

to the Vermont Legislature, because, like New Hampshire, Vermont already taxes all or most foreign source income through taxation of 100 percent of repatriated foreign dividends and 50 percent of GILTI. The New Hampshire Commission's Final Report directly addressed the import of the inclusion of foreign income in its business profits tax base: "[g]iven New Hampshire's taxation of foreign dividends and GILTI, which do capture a measure of foreign-earned income, and given the various mitigation steps that have been adopted in recent years, we are convinced that any incentives to engage in 'abusive' 'profit shifting' have been reduced significantly. We are also persuaded that opportunity to make further material progress in the quest to fully eliminate those incentives must rest primarily upon the federal government, which has ongoing international and diplomatic initiatives in play."⁴

Conclusion

Mandatory worldwide combined reporting is contrary to the approach to taxing corporate profits currently employed by all other states and nations with corporate income taxes. Its adoption would have an unpredictable (and possibly negative) effect on State revenue, would impose significant administrative burdens on both taxpayers and the State, and would place Vermont at a huge competitive disadvantage among states as it would send a warning signal to multinational businesses that Vermont is a hostile environment for business expansion and relocation.

Respectfully,



Leonore Heavey

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

⁴ Id, at 16.