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States Can Fight Corporate Tax Avoidance by Requiring Worldwide Combined Reporting

By Michael Mazerov

To reduce their federal corporate income taxes, every year large multinational corporations shift hundreds of billions of dollars in profits earned in the United States onto the books of subsidiaries formed in foreign tax havens like Bermuda, the Cayman Islands, and Ireland. Because nearly all state corporate taxes are based on the taxable profits a corporation reports on its federal return, each year states lose at least $10 billion — and perhaps as much as $15 billion — of revenue due to this profit shifting, estimates suggest. This is substantial revenue states could be using to provide K-12 teachers with better pay and smaller class sizes, low-income college students with more adequate financial aid, uninsured individuals with health coverage, residents and businesses with better road maintenance, and other critical services.

Corporate profit shifting also gives large multinational corporations a tax advantage over purely domestic businesses, which are often small and lack the resources or ability to set up their own foreign shell companies. Lowering their taxes by shifting profits to tax havens enhances multinational corporations' competitive advantages over their domestic counterparts, including their superior access to capital and other resources.

States, however, have an effective remedy. They can dramatically reduce international tax avoidance by implementing a policy called "worldwide combined reporting" (WWCR). This method of tax accounting treats a parent corporation and most of its separately incorporated subsidiaries — including those established in foreign countries — as a single integrated economic enterprise (which, in reality, they are), requiring them to combine their profits as the first step in calculating their tax.

Worldwide combined reporting applies to corporations' *foreign* subsidiaries a policy that three-fifths of states with corporate taxes already apply to *U.S.* subsidiaries to prevent abusive interstate profit shifting. It nullifies the tax reduction from interstate and international profit shifting by enabling a state to tax a share of the combined profit of the members of the corporate group that operate in the state as well as those located in tax haven states (such as Nevada and Wyoming, which lack corporate income taxes) and overseas tax havens.

Twelve states had implemented worldwide combined reporting by the early 1980s,[1] but they abandoned it under pressure from multinational corporations and the Reagan Administration. Alaska still requires oil companies to compute their state income tax using worldwide combined reporting,[2] and ten states plus the District of Columbia allow corporations to use worldwide combined reporting when it reduces their tax liability[3] — as it does in some cases for companies that aren't using tax haven avoidance schemes. In the early 1980s and again in the early 1990s, the U.S. Supreme Court upheld the constitutionality and fairness of worldwide combined reporting as a method of taxing multinational corporations.

There are two primary reasons why states with corporate income taxes would benefit from requiring all corporations with foreign parents or subsidiaries to calculate their tax liability using worldwide combined reporting:

- Abusive international profit shifting is a pervasive problem that worldwide combined reporting can substantially solve, recouping billions of dollars in badly needed revenue for states.
- Requiring worldwide combined reporting would remove an unfair advantage of multinational corporations, which have the resources and ability to set up operations in foreign tax havens that purely domestic businesses — which are often small — don't have.

While several alternative approaches to addressing international profit shifting have been adopted or proposed, worldwide combined reporting is a more comprehensive solution, and its legality (unlike some of the alternatives) has been fully established.

What Is Worldwide Combined Reporting?

Worldwide combined reporting (WWCR) is a tax accounting method that states can require multinational corporations (MNCs) to use when calculating how much tax they owe on their annual profits. WWCR treats a parent corporation and most[4] of its subsidiary companies — including those established in foreign countries — for tax purposes as the integrated economic enterprise they are, requiring them to combine their profits as the first step in calculating their tax. It is mechanically

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[1] U.S. General Accounting Office, "Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving," July 1, 1982, https://www.gao.gov/assets/ggd-82-38.pdf. Page 31 of the report lists 13 states as "employing" WWCR: Alaska, California, Colorado, Idaho, Illinois, Indiana, Massachusetts, Montana, New Hampshire, New York, North Dakota, Oregon, and Utah. However, in 1984 a Massachusetts court held (in *Polaroid Corp.* vs. *Commissioner of Revenue*) that the state lacked authority to require combined reporting, and the Indiana governor issued a letter forswearing it. Subtracting those two states from the 13 and adding Florida, which enacted worldwide combined reporting in 1983 but repealed it in 1984, produces a count of 12 states that required combined reporting at some point in the early 1980s.

[2] Alaska Statutes, Section 43.20.144, https://law.justia.com/codes/alaska/2022/title-43/chapter-20/article-2/section-43-20-144/; and Alaska Administrative Code, Section 15.20.300, (https://tax.alaska.gov/programs/documentviewer/viewer.aspx?251s.

[3] A review of state corporate tax statutes finds that California, Idaho, Montana, New Mexico, and North Dakota default to WWCR but allow taxpayers to file on a "water's edge" (domestic-only) basis. Connecticut, the District of Columbia, Massachusetts, New Jersey, Utah, and West Virginia default to water's edge combined reporting but allow taxpayers to file using WWCR.

[4] The courts have held that to be included in combined reporting, out-of-state corporations must have common ownership with the in-state members *and* must be engaged in some part of the same "unitary business." For example, a vertically integrated oil company, where one member of the corporate group does the drilling, another does the refining, and another owns the gas stations, is a classic example of unitary group that a state could tax on a combined basis even if only one of those entities is located within its borders. But a conglomerate corporation composed of a parent corporation that manufactures batteries and a subsidiary that operates health clubs would be less likely to constitute a unitary business — although it could still be deemed unitary if, for example, assets of one line of business were used as collateral for loans to the other.

similar to the "consolidated" tax filing of U.S.-incorporated parents and subsidiaries that corporations already use for federal tax purposes.[5]

Like the federal government and most foreign countries, nearly all states (45, plus the District of Columbia) tax corporate profits.[6] When a corporation earns income in more than one state or country — by producing goods and services and/or having customers in multiple jurisdictions — rules must be established to determine how much of that income each of those jurisdictions can tax. From the advent of state corporate income taxes in the 1910s, many states realized it wasn't workable to require corporations to track the specific goods and services they sold in each state, what the sales prices were, what it cost to produce each one, and what the resulting profit on each sale was. Such "specific accounting" was administratively burdensome and gave corporations too much power to manipulate the states in which they reported making sales and incurring expenses.[7]

Instead, most states soon required corporations to report their total annual nationwide profit, with each state then taxing a share of that total calculated with an "apportionment" formula based on objective, easily measured indicators of the corporation's activity within the state. Nearly all states now use the corporation's sales as the sole measure of that activity; for example, if 10 percent of Walmart's total nationwide sales are made to California customers in a particular year, 10 percent of Walmart's profit in that year will be taxable there. The nationwide profit used in the calculation is almost always the profit reported on the corporation's federal income tax return (usually with some state-specific adjustments).

Most corporations of any significant size are legally structured as a "parent" corporation largely owned by individual stockholders[8] that, in turn, is the sole or majority owner of the stock of multiple separately incorporated subsidiaries. Tax administrators in some states discovered early on that such corporations were able to reduce their income tax payments by manipulating the sales price of transactions among the various members of the corporate group.

California was one of the first to uncover such manipulation. It discovered Hollywood studios selling or licensing movies at artificially low prices to subsidiaries they had established in low- or no-tax states, which then distributed the film reels to movie theaters throughout the country. Little profit showed up on the books of the California studios; most of it showed up on the books of the distribution affiliates. An attorney for the California tax agency determined that the most straightforward way to shut down this manipulation was to require the movie studios to combine their profits with those of the distribution subsidiaries before doing the apportionment calculation,

[5] Federal tax law does not permit the consolidation of *non*-U.S. corporations, but they *are* consolidated for investor financial reporting mandated by the Securities and Exchange Commission.

[6] Texas does not have a traditional corporate income tax but is treated as a combined reporting state throughout this report because its franchise tax requires its use. The states lacking corporate income taxes are Nevada, Ohio, South Dakota, Washington, and Wyoming.

[7] Specific accounting is also problematic because there is no objective way to assign to a specific state the overhead expenses that are shared among all production locations, or the savings in expenses arising from economies of scale, or (per economist Ronald Coase's famous "theory of the firm") the additional profit arising from the synergies generated by operating as an integrated, "command-and-control" enterprise rather than as separate firms exchanging goods and services at arm's length in a market.

[8] Of course, many individuals own stock indirectly through their participation in pension funds or their ownership of stock mutual funds.

and "combined reporting" was born.[9] Combined reporting was initially applied on an *ad hoc* basis in instances when a corporate income tax auditor concluded that abusive tax avoidance was occurring, but by the mid-1960s it was standard California practice.[10]

States Pressured to Retreat From WWCR in 1980s

By the early 1980s, roughly 15 states had followed California's lead by requiring combined reporting, either across the board or *ad hoc* after an audit. Twelve (including California) were applying it on a worldwide basis, meaning they included foreign parents (if the parent was foreign) and foreign subsidiaries in the combined group.[11] (See Figure 1.)

Multinational corporations fiercely resisted WWCR — especially those headquartered abroad, which pressured their governments into threatening economic retaliation against the United States if states continued to require WWCR. That pressure escalated after the U.S. Supreme Court upheld WWCR's constitutionality in 1983. The following year the Worldwide Unitary Taxation Working Group convened by the Reagan Administration and composed of federal and state officials called on the WWCR states to retreat to domestic or "water's edge" combined reporting — that is, to no longer include foreign parents and subsidiaries in combined groups.[12] By the late 1980s, only Alaska required WWCR, and only for oil companies.[13] In addition, ten states plus the District of Columbia continue to allow corporations to use WWCR if they choose.[14]

[9] Frank M. Keesling, "The Combined Report and Uniformity in Allocation Practices," speech to the 1974 annual meeting of the Multistate Tax Commission, Appendix G to the FY1994 MTC Annual Report. (Keesling was the attorney who devised combined reporting.) See also: Linda Greenhouse, "Court Lets States Tax Companies on Portion of Worldwide Income," *New York Times*, June 28, 1983, which states, "California pioneered the unitary method in the 1930's to prevent the Hollywood movie studios from escaping California taxes by transferring assets out of the state."

[10] Benjamin F. Miller, "Worldwide Unitary Combination: The California Practice," in Charles E. McLure, Jr., ed., *The State Corporation Income Tax: Issues in Worldwide Unitary Combination*, Hoover Institution Press, 1984, pp. 137-140.

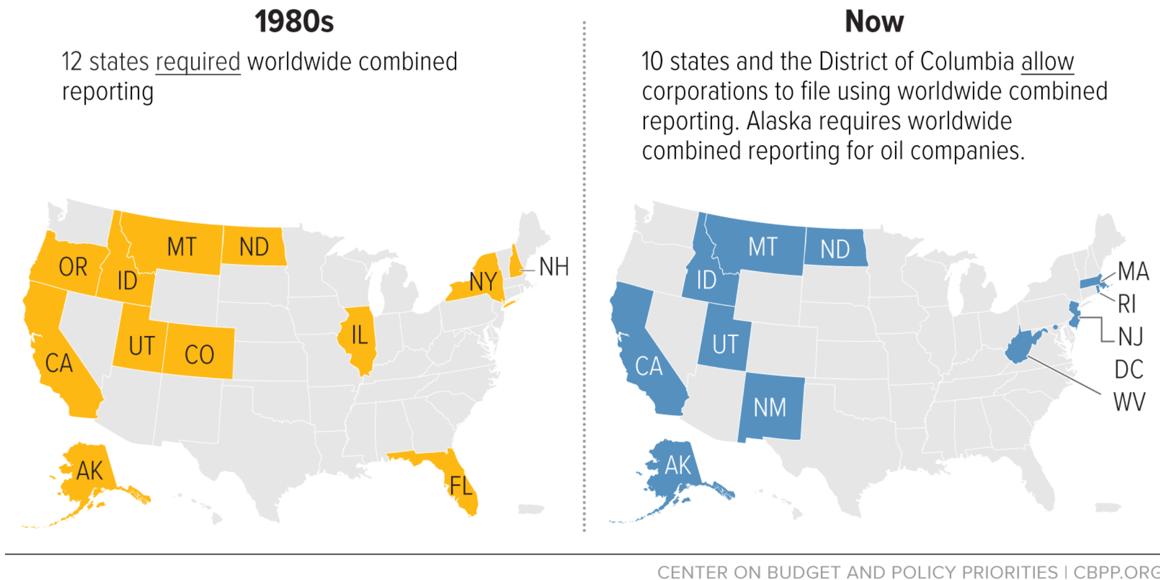
[11] U.S. General Accounting Office.

[12] During the working group's deliberations, it was widely conceded that even if states withdrew from WWCR to water's edge combined reporting, they were justified in including foreign tax haven subsidiaries in their water's edge groups. In his final report, Treasury Secretary Donald Regan noted that all five of the alternative water's edge policy "bundles" put forth as potential solutions to the WWCR controversy by state and industry representatives proposed to include in a water's edge group "certain tax haven corporations presumed to be part of the unitary business." ("Final Report of the Worldwide Unitary Taxation Working Group: Chairman's Report and Supplemental Views," August 1984, pp. 30 and 51, https://ia601300.us.archive.org/28/items/finalreportofwor00unit/finalreportofwor00unit.pdf.) All parties conceded the legitimacy of including in the water's edge group not only subsidiaries incorporated in foreign tax haven nations, but even other unitary subsidiaries formed in *non*-tax-haven countries doing business in tax havens above threshold amounts.

[13] See Note 2.

[14] See Note 3.

FIGURE 1



Growing Awareness of Profit Shifting Has Led More States to Act

States' vulnerability to corporate profit shifting burst into public consciousness in 1994, when the South Carolina Supreme Court published its decision in *Geoffrey* vs. *South Carolina*. The case revealed that a company with which millions of people were personally familiar, Toys R Us, had engaged in aggressive state corporate income tax avoidance. It had created a subsidiary in Delaware to which it had transferred ownership of its Geoffrey Giraffe and other trademarks; the subsidiary then charged all the Toys R Us stores a royalty to display the trademarks, based on the stores' level of sales. The royalty was a tax-deductible expense, reducing taxable income of all the stores, while the royalty income of the Delaware trademark subsidiary was tax exempt under that state's law.[15] In short, Toys R Us reduced its aggregate U.S. state corporate income tax liability by shifting profit earned by the stores into an untaxed subsidiary.

[15] Delaware's corporate income tax exempts corporations whose only activities consist of managing and receiving income from intangible assets such as trademarks, patents, and loans.

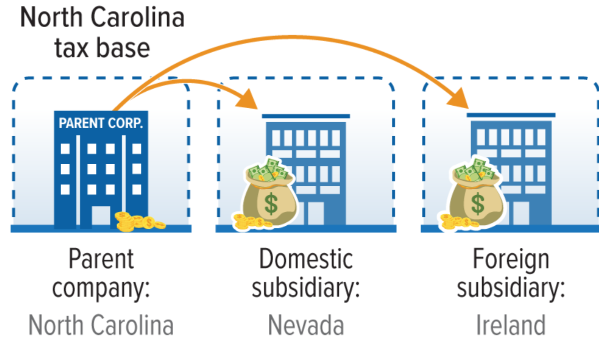
FIGURE 2

Three State Approaches to Taxing Multinational Corporations

Profit shifting to lower-tax jurisdictions

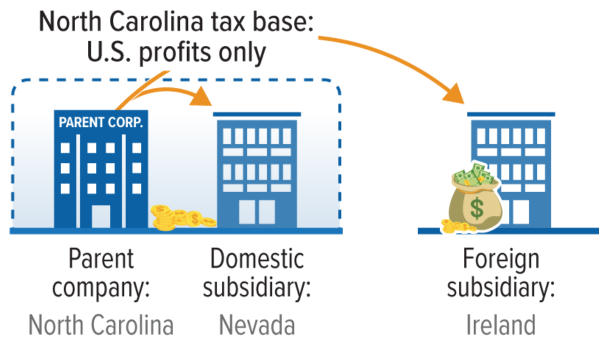
Separate entity reporting

Profit of parent company and each of its subsidiaries is reported independently. This method enables tax avoidance by allowing corporations to shift profits to states and countries with low or no corporate income taxes.



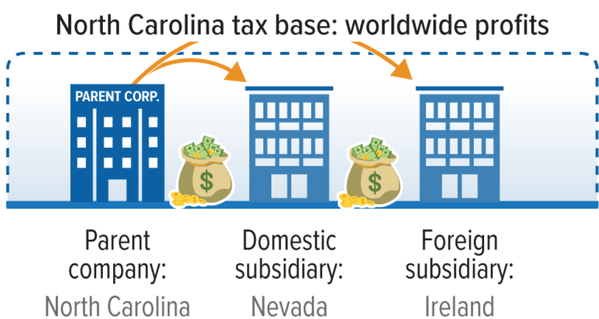
Water's edge combined reporting (domestic)

Tax liability is based solely on the company's profits reported by the U.S. parent and U.S. subsidiaries, enabling profits shifted to the company's foreign subsidiaries to remain hidden from taxation.



Worldwide Combined Reporting (complete)

Tax liability is based on a company's income reported both domestically and in foreign countries. This filing method nullifies the tax reduction from pervasive interstate and international profit shifting.



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The Toys R Us interstate profit shifting did not adversely affect the revenues of water's edge combined reporting states because the profits of the subsidiary owning the stores were combined with the profits of the Delaware subsidiary. But "separate entity" states — those that hadn't even adopted water's edge combined reporting — *were* hurt. (See Figure 2 for an overview of the three

main filing methods.) More and more of them became aware through press coverage[16] and tax audits that this trademark scheme and similar tax shelters[17] had been widely implemented by Fortune 1000 companies and began challenging them through litigation and changes to their tax laws.

Finally, in 2004, Vermont abandoned this piecemeal approach and became the first state in almost 20 years to switch to water's edge combined reporting. Since 2004, many more states have done so; at present, 28 states plus the District of Columbia and New York City require combined reporting.[18] Bills to implement the policy in additional states are introduced in state legislatures every year.

Worldwide Combined Reporting Would Address Massive State Revenue Loss

Abusive international profit shifting is a serious problem that worldwide combined reporting can substantially solve, recouping billions of dollars in badly needed state revenue.

International Profit Shifting Is Pervasive and Costly

Corporations can easily implement the same kinds of strategies they use to shift U.S.-earned profits onto the books of subsidiaries located in low- or no-tax *states* to shift profits to foreign parent and subsidiary corporations located in low- or no-tax *nations*.[19] Such strategies erode the federal corporate income tax base, and the federal government's approach to shutting them down has been largely ineffective. (See box, "Key Federal Mechanism for Preventing International Profit Shifting Is Ineffective.") These strategies also erode state corporate tax bases because state tax codes almost always use the federal definition and measure of taxable corporate profit.[20] Thus, any underreporting of U.S. profits for federal tax purposes due to international profit shifting automatically results in under-reporting for state tax purposes for water's edge combined reporting and separate entity states alike. (The latter of course are victimized by *interstate* profit shifting as well.)

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[16] See, for example, Glenn Simpson, "A Tax Maneuver in Delaware Puts Squeeze on Other States," *Wall Street Journal*, August 9, 2022.

[17] See Michael Mazerov, "State Corporate Tax Shelters and the Need for 'Combined Reporting,'" CBPP, October 26, 2007, https://www.cbpp.org/research/state-corporate-tax-shelters-and-the-need-for-combined-reporting. See also: Don Griswold, "Innovation Principles for Multistate CIT Planning," Parts 1 through 4, *Tax Notes State*, May 16, May 30, June 20, and July 4, 2022.

[18] See CBPP, "28 States Plus D.C. Require Combined Reporting for the State Corporate Income Tax," https://www.cbpp.org/28-states-plus-dc-require-combined-reporting-for-the-state-corporate-income-tax. Texas does not have a traditional corporate income tax but is counted as a combined reporting state here because it requires combined reporting for its franchise tax (referred to as a "margins tax") to prevent potential interstate profit shifting.

[19] As economist Kimberly Clausing has explained:

> Companies have many different ways to shift profits offshore. Simple methods include mispricing international trade transactions that occur within the multinational company, such that purchases from low-tax affiliates are overpriced and purchases from high-tax affiliates are underpriced. . . . Companies may also structure their finance such that interest deductions are more likely for those affiliates in high-tax countries, reducing taxable income accordingly. Companies may also use cost-sharing arrangements or other methods to transfer intellectual property to low-tax foreign jurisdictions, where the resulting profits can then be reported. Finally, companies have been adept at creating opaque chains of ownership and hybrid organizational structures to generate so-called stateless profit that goes untaxed in any jurisdiction.

Kimberly A. Clausing, "Taxing Multinational Companies in the 21st Century," in *Tackling the Tax Code: Efficient and Equitable Ways to Raise Revenue*, Hamilton Project, 2020, p. 242, https://www.brookings.edu/wp-content/uploads/2020/01/Clausing_Book_LO_FINAL.pdf.

[20] Prior to enactment of the 2017 federal tax law, the profits of foreign subsidiaries generally were not included in the taxable profit of their U.S. parents until they were "repatriated" in the form of dividends. Beginning in 2018, the taxable profit of the parent no longer even includes such dividends, although it does include certain earnings of foreign subsidiaries under the new "Global Intangible Low-Taxed Income" provision (see discussion below).

Key Federal Mechanism for Preventing International Profit Shifting Is Ineffective

Federal policymakers understood early on that the federal income tax was vulnerable to abusive international profit shifting within multi-corporate groups. Section 482 of the Internal Revenue Code, a principal mechanism the federal government uses to try to shut it down, was enacted in 1921, just eight years after the federal corporate income tax itself.

Section 482 grants the IRS broad authority to directly reallocate profits from foreign companies to their U.S. affiliates and to adjust, for tax purposes, the "transfer prices" a U.S. corporation charges or pays its foreign affiliates for purchases of merchandise, licenses, management fees, loans, rentals, and other transactions to properly reflect the income that should have been reported as earned within the United States. The benchmark for establishing the correct income reallocations or transfer prices is that they should be as close as possible to those that would have prevailed had the U.S. company engaged in the same transactions with a completely independent company. This is known as the "arm's length standard."

Despite periodic efforts to strengthen it, Section 482 has never been effective at preventing abusive international profit shifting. First, there are simply too many cross-border transactions to police. International trade has grown exponentially since the federal corporate income tax was enacted, as has the share of it occurring within multinational corporate groups.[a] Second, the personnel, technology, and other resources Congress has given the IRS to enforce Section 482 have lagged far behind the capabilities of the accountants, lawyers, and economists available to large MNCs to set up profit shifting strategies, render them as opaque to IRS auditors as possible, and defend them in court.

Third, the theoretical "arm's length" transfer price has been subject to vast disagreement with respect to the international sale or licensing of intellectual property (trademarks, patents, proprietary know-how, etc.) of companies like Amazon, Apple, Google, Microsoft, Pfizer, and Starbucks. These types of transactions are the major determinant of how large a share of their worldwide profits many of the world's largest, most profitable MNCs earn within the United States.

The IRS rarely challenges a major MNC's transfer pricing practices, and when it does, litigation can drag on for a decade or more and involve hundreds of hours of contentious, highly fact-intensive testimony by economists, accountants, and industry experts, and the submission of thousands of pages of evidence. MNCs exploit the enormous leeway the arm's length standard provides to report substantial shares of their profits in foreign nations that impose little or no tax, with relatively little fear of successful IRS challenges.[b]

[a] According to economist Gabriel Zucman, "With billions of intragroup transactions every year, tax authorities cannot conceivably check that they are all correctly priced." Gabriel Zucman, "Taxing across Borders: Tracking Personal Wealth and Corporate Profits," *Journal of Economic Perspectives*, Vol. 28, No. 4, Fall 2014, https://pubs.aeaweb.org/doi/pdf/10.1257%2Fjep.28.4.121.

[b] Economist Kimberly Clausing writes:

At the root of the problem lies the arm's length standard, which is both a deeply appealing ideal and a fiction. . . . The very premise of this concept is faulty, as multinational enterprises exist in part to generate profits beyond what would be possible for domestic companies operating at arm's length. In addition, the global nature of market activity makes it difficult to ascertain where profit is truly generated, and the intangible nature of much economic value adds even more ambiguity. These factors, alongside a lax regulatory and legal environment, give multinational companies substantial discretion about where they report their profits for tax purposes, making the tax department a "profit center" for many multinational companies.

Kimberly Clausing, "The International Tax Agreement of 2021: Why It's Needed, What It Does, and What Comes Next?" Peterson Institute for International Economics, Policy Brief 23-4, April 2023, p. 2, https://www.piie.com/sites/default/files/2023-04/pb23-4.pdf.

Extensive evidence demonstrates that federal law does little to deter abusive international profit shifting and that federal and state governments combined lose tens of billions of dollars annually as a result. For example:

- **Profit shifting costs the federal government substantial revenue annually.** In 2017, international profit shifting just by MNCs with U.S. parents cost the federal government at least $60 billion in corporate income tax revenue and possibly as much as $94 billion, a 2020 study by economist and former U.S. Treasury Department official Kimberly Clausing estimated. [21] (Foreign-parent MNCs with major operations in the U.S., such as foreign automakers and pharmaceutical manufacturers, undoubtedly shift additional billions of dollars of profits out of the U.S. to low- or no-tax foreign countries.) The study further concluded that "as of the end of 2019, there is no evidence of a reduction in profit shifting" attributable to provisions of the 2017 federal Tax Cuts and Jobs Act (TCJA) aimed at deterring it, and that "neither profit shifting, nor corporate tax competition, will end with [TCJA]."
- **U.S. MNCs claim that an enormous share of their foreign profit is earned in a handful of small tax havens**. U.S.-headquartered MNCs report earning roughly 50 percent of their total foreign profits in just nine well known tax havens (Bermuda, British Virgin Islands, Cayman Islands, Ireland, Luxembourg, Netherlands, Puerto Rico,[22] Singapore, and Switzerland), even though less than 10 percent of the corporations' employees and less than 25 percent of their physical assets are in those jurisdictions, according to a 2023 study by University of California, Berkeley economist Gabriel Zucman and colleagues. Moreover, the study concluded (as did the Clausing study cited above) that the amount of profit improperly shifted to these countries changed very little over the 2015-2020 period despite the 2017 TCJA.[23] A second 2023 Zucman study estimates that $369 billion of U.S. MNC profit was shifted to 13 tax havens in 2022.[24]
- **The Treasury Department found that the TCJA provisions aimed at reducing profit shifting have had little impact.** A 2021 U.S. Treasury Department report found:

  More U.S. profits are housed in tiny tax havens than in the major economies of China, India, Japan, France, Canada, and Germany combined. . . . Despite attempts to rein in profit shifting, tax havens are as available today as they were prior to the 2017 tax reform. For U.S. multinational companies, the share of total foreign income in seven prominent havens is nearly identical in the two years after TCJA (2018 and 2019) as it was in the five years prior to the law, at 61 percent of after-tax income, or 1.5 percent of GDP [gross domestic product].[25]
- **The amount of profit that MNCs claim they earn in some tax havens dwarfs the size of those countries' economies**. The profit supposedly earned by U.S.-based MNCs in Barbados, Bermuda, the Cayman Islands, Jersey, and Mauritius in 2018 was many times larger

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[21] Kimberly A. Clausing, "Profit Shifting Before and After the Tax Cuts and Jobs Act," *National Tax Journal*, December 2020. These amounts have since fallen because the 2017 tax law cut the corporate tax rate from 35 percent to 21 percent, so the U.S. loses less revenue per dollar of shifted profits, but the losses are still significant.

[22] Although Puerto Rico is a U.S. territory, for federal income tax purposes it is treated as a foreign jurisdiction.

[23] Javier Garcia-Bernardo, Petr Jansky, and Gabriel Zucman, "Did the Tax Cuts and Jobs Act Reduce Profit Shifting by US Multinational Companies?" unpublished working paper, July 19, 2023, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4554525.

[24] Annette Alstadsaeter *et al*., "Global Tax Evasion Report 2024," EU Tax Observatory, October 2023, Table 2.2, p. 47, https://www.taxobservatory.eu//www-site/uploads/2023/10/global_tax_evasion_report_24.pdf.

[25] The seven tax havens in this study are: Bermuda, the Cayman Islands, Ireland, Luxembourg, the Netherlands, Singapore, and Switzerland. U.S. Department of the Treasury, "The Made in America Tax Plan," April 2021, p. 9, https://home.treasury.gov/system/files/136/MadeInAmericaTaxPlan_Report.pdf.

than the entire economic output of those countries, a 2022 Congressional Research Service study found.[26]

- **The largest MNCs make extensive use of tax haven subsidiaries**.[27] Seventy-six of the Fortune 100 corporations report in their U.S. Securities and Exchange Commission filings that they have at least one subsidiary in one or more of nine major foreign tax havens. (See Appendix Table 1.) Walmart has subsidiaries in both the Cayman Islands and Singapore,[28] despite not having stores in either location.[29] Exxon has six in the Netherlands and two in Singapore. CVS has five in Bermuda, two in Ireland, one in Luxembourg, and one in Singapore. Johnson & Johnson has 93 tax haven subsidiaries, including 24 in Ireland, 23 in Switzerland, and 19 in the Netherlands. HP has subsidiaries in all nine foreign tax havens, including 26 in the Netherlands. Blackstone has a staggering *326 subsidiaries* in the Cayman Islands and 67 in Luxembourg.[30]
- **High-tech companies appear to be particularly aggressive profit shifters**. A series of careful forensic accounting studies performed since 2020 by transfer pricing economist Stephen L. Curtis and colleagues concluded that just six U.S. MNCs — Apple, Cisco, eBay, Facebook, Google, and Microsoft — may have underpaid their U.S. corporate income taxes by $277 billion over varying periods from 2009 through 2022.[31] This figure rises to $495

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[26] Jane G. Gravelle, "Tax Havens: International Tax Avoidance and Evasion," Congressional Research Service, updated January 6, 2022, p. 19, https://crsreports.congress.gov/product/pdf/R/R40623/25.

[27] Richard Phillips *et al.*, "Offshore Shell Games 2017: The Use of Offshore Tax Havens by Fortune 500 Companies," U.S. Public Research Interest Group Education Fund and Institute on Taxation and Economic Policy, October 2017, https://itep.sfo2.digitaloceanspaces.com/offshoreshellgames2017.pdf. This report compiled the use of tax haven subsidiaries by the entire Fortune 500. However, those compilations, as well as those in Appendix Table 1, are likely undercounts. A 2020 paper comparing the subsidiaries in public Securities and Exchange Commission-mandated 10-K reports to those in confidential filings to the IRS found that while most companies complied with the SEC rules, underreporting was more likely when the subsidiaries were located in tax havens, particularly when the companies were covered extensively in the media. See: Scott D. Dyreng *et al.*, "Strategic Subsidiary Disclosure," *Journal of Accounting Research*, June 2020. This study observes that penalties for non-compliance with SEC subsidiary disclosure requirements are "trivial."

Examples can be readily found of corporations that appear to be flouting the SEC subsidiary disclosure rules. For example, one notable feature of the list of corporate subsidiaries in Appendix Table 1 is Amazon's assertion to the SEC that it has no significant foreign subsidiaries (https://www.sec.gov/Archives/edgar/data/1018724/000101872423000004/amzn-20221231xex211.htm). Yet its website states: "Amazon has a whole host of companies worldwide that we are proud to call part of the Amazon family. Check out our list of impressive subsidiaries including names you may not have known were part of Amazon." (https://www.amazon.jobs/en/business_categories/subsidiaries.) The same webpage has a subheading "Find Jobs in Subsidiaries," which, at this writing, lists over 250 positions. Note 27 references a study documenting Walmart's failure to include many of its foreign subsidiaries in its SEC filings. And for a discussion of non-reporting of the foreign subsidiaries of major U.S. defense contractors, see Martin Broek, "Tax Evasion and Weapon Production: Mailbox Arms Companies in the Netherlands," Transnational Institute, May 2016, https://www.tni.org/files/publication-downloads/issue-brief-arms-trade-web.pdf.

[28] Walmart 10-K annual report filed with the Securities and Exchange Commission for the fiscal year ending January 31, 2024, at https://www.sec.gov/Archives/edgar/data/104169/000010416924000056/wmtexhibit21fy24.htm. It's worth noting that Walmart's 10-K for the previous year indicated that the Luxembourg subsidiary had been incorporated in the Cayman Islands (https://www.sec.gov/Archives/edgar/data/104169/000010416923000020/wmtexhibit21fy23.htm); this is indicative of the ease with which MNCs can manipulate their corporate structures to minimize their taxes. Moreover, a 2015 study found that Walmart actually had *dozens* of subsidiaries incorporated in tax havens. See Frank Clemente and Marc Auerbach, "The Walmart Web: How the World's Biggest Corporation Secretly Uses Tax Havens to Dodge Taxes," Americans for Tax Fairness, June 2015, https://americansfortaxfairness.org/files/TheWalmartWeb-June-2015-FINAL1.pdf.

[29] See the "Properties" section of the Walmart 10-K for the fiscal year ending January 31, 2023, at https://www.sec.gov/Archives/edgar/data/104169/000010416923000020/wmt-20230131.htm#ic0762e37664541589e0e296d7f31d4ab_46.

[30] See https://www.sec.gov/Archives/edgar/data/1393818/000119312524044485/d734131dex211.htm.

[31] These studies are summarized in Reuven S. Avi-Yonah *et al.,* "Commensurate with Income: IRS Nonenforcement Has Cost $1 Trillion," *Tax Notes Federal*, May 22, 2023.

billion when estimated penalties and accrued interest are added. The underpayments resulted from the MNCs' failure to comply with IRS regulations governing "cost sharing arrangements" with their foreign subsidiaries to co-develop and use various forms of intellectual property. The article concludes, "If only six taxpayers could represent a half-trillion dollars in collectible funds, it should not be a stretch to believe that total noncompliance could account for as much as $1 trillion or more."

The IRS believes that Microsoft alone has underpaid its federal income tax by tens of billions of dollars. In October 2023 the IRS announced that Microsoft owed $28.9 billion in additional federal corporate income taxes (plus penalties and interest) for the 2004-2013 period.[32] The two sides have been fighting the issue in the courts for over a decade, and the case will likely drag on for many more years before it's resolved. [33]

- **Major drug manufacturers appear to be particularly aggressive profit shifters as well.** As economist Brad W. Setser told a Senate hearing in 2023, "After the enactment of the Trump corporate tax cuts, American pharmaceutical companies in particular have doubled down on business models based on offshore production to shift profits on drugs sold in the U.S. market to their offshore subsidiaries."

  Setser noted that the major U.S.-listed pharmaceutical companies reported earning over $90 billion in foreign profits in 2022 but only around $10 billion in U.S. profits. "Such a pattern is all the more striking because the United States is well known to have the highest pharmaceutical prices in the world," he explained, adding:

  > The cost of pharmaceutical production does not vary significantly from jurisdiction to jurisdiction, so the profit margin on high priced U.S. sales would normally be expected to be much higher than the margin on foreign sales. It consequently is particularly noticeable that the bulk of the American pharmaceutical industry appears to barely make any money on their U.S. operations, while reporting large profits in countries that more intensively regulate pharmaceutical pricing.[34]

States Can Recoup Billions of Dollars Each Year

Research suggests that states could recoup $10 billion to $15 billion in lost revenue annually if every state enacted worldwide combined reporting.

Based on Congressional Budget Office (CBO) estimates of the scale of international profit shifting and the effect of the 2017 federal tax changes,[35] a 2019 Institute on Taxation and Economic

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[32] Microsoft Form 8-K filed with the U.S. Securities and Exchange Commission, October 11, 2023, https://www.sec.gov/Archives/edgar/data/789019/000119312523254151/d530324d8k.htm.

[33] See: Paul Kiel, "The IRS Decided to Get Tough Against Microsoft. Microsoft Got Tougher," ProPublica, January 22, 2020; and Paul Kiel, "How a Maneuver in Puerto Rico Led to a $29 Billion Tax Bill for Microsoft," ProPublica, October 13, 2023. The first article also details how Microsoft and its corporate allies successfully lobbied Congress to limit the IRS's future use of several of the tools and tactics it used in its dispute with the company.

[34] Brad W. Setser, "Cross-border Rx: Pharmaceutical Manufacturers and U.S. International Tax Policy," prepared statement to the U.S. Senate Finance Committee, May 11, 2023, pp. 5, 7. The aggressive tax avoidance of drug companies is particularly noteworthy given how much of the basic research they build on is funded by the federal National Institutes of Health and how much of their market consists of Medicare and Medicaid purchases funded with federal and state tax dollars.

[35] The ITEP estimate was based on CBO estimates that MNCs artificially shifted $300 billion in profits out of the United States annually and that the international tax provisions of TCJA would reduce that amount by $65 billion, for a net shift of $235 billion. See

Policy (ITEP) report estimated that states could recoup about $14 billion in annual revenue if they all required worldwide combined reporting.[36] Subsequent state actions have slightly reduced states' revenue losses from international profit shifting and thus the potential revenue gains from adopting worldwide combined reporting. However, the ITEP figure remains a reasonable rough estimate given that recent estimates of profit shifting are higher than the CBO estimate on which the ITEP study relied.[37]

The California Department of Finance estimates that its failure to require WWCR cost the state $3.7 billion in forgone revenue in the 2023-2024 fiscal year.[38] It is worth noting that this figure exceeds the ITEP report's estimated revenue loss for California ($2.8 billion).

Other research also provides evidence of substantial potential revenue gains from adopting WWCR. A 2020 academic study found that five of the six states that had taken a partial step toward WWCR by requiring the inclusion in combined reports of subsidiaries formed in a limited group of foreign tax havens boosted their corporate income tax collections by 17.8 percent on average.[39]

In sum, there is overwhelming evidence that abusive international profit shifting remains widespread. States lose billions in revenue each year because their corporate taxes are based on the amount of profit MNCs claim to earn within the United States and because the IRS has extreme difficulty in ensuring corporations report the proper amount. As 12 states once did, all states with corporate income taxes should therefore require worldwide combined reporting to solve the international profit shifting problem on their own.

Worldwide Combined Reporting Would Reduce a Tax Advantage of Multinational Corporations

By requiring worldwide combined reporting, states can remove a tax advantage that multinational corporations have over their purely domestic counterparts, which are often small.

CBO, "The Budget and Economic Outlook: 2018 to 2028," April 2018, pp. 124 and 127, https://www.cbo.gov/system/files/2019-04/53651-outlook-2.pdf.

[36] Richard Phillips and Nathan Proctor, "A Simple Fix for a $17 Billion Loophole," Institute on Taxation and Economic Policy, U.S. PIRG Education Fund, SalesFactor.org, and American Sustainable Business Council, 2019, https://itep.sfo2.digitaloceanspaces.com/A_Simple_Fix_for_a_17_Billion_Loophole_USPIRGEF_ITEP.pdf. The $17 billion figure encompasses $3 billion in additional revenue if the 17 remaining separate entity states adopt water's edge combined reporting and $14 billion in additional revenue if all states then adopt worldwide combined reporting.

[37] The ITEP study was written before it was known how many states ultimately would conform with TCJA provisions aimed at recouping some of the revenue lost to international profit shifting and how much federal revenue those provisions would generate. Thus, ITEP's $14 billion figure should be adjusted downward to reflect the effect this conformity has already had on state revenue, though the adjustment would be small since no large state has conformed. It should also be adjusted downward to reflect the fact that some states include in their tax base the dividends that foreign subsidiaries of MNCs pay to their U.S. parents, which also would not be subject to tax under WWCR. On the other hand, more recent estimates of post-TCJA profit shifting are considerably larger than the $235 billion CBO estimate on which the ITEP study relied. For example, the 2023 Zucman *et al.* study cited earlier in this paper estimates that U.S.-headquartered MNCs alone shifted $369 billion in profits to tax havens in 2022.

[38] California Department of Finance, "Tax Expenditure Report, 2023-24," https://dof.ca.gov/wp-content/uploads/sites/352/2023/10/2023-24TaxExpenditureReport.pdf, p. 16. The loss is projected to rise to $4.3 billion in the 2025-26 fiscal year.

[39] Stephen J. Lusch and James Stekelberg, "State Tax Haven Legislation and Corporate Income Tax Revenues," *Public Finance Review*, 2020, p. 372. The study concluded that West Virginia had not realized a gain in revenue by adopting tax haven legislation.

Small businesses typically lack the resources or ability to set up and operate subsidiaries in foreign tax havens to reduce their taxes, but they may compete with large corporations that can and do. For example, Starbucks, a competitor to most small independent coffee shops, has a Cayman Islands subsidiary.[40] By lowering their tax bills and raising their profits through aggressive international tax avoidance, large corporations may be able to enhance their existing advantages over their in-state competitors, such as their ability to attract low-cost capital.[41]

As Kimberly Clausing recently observed, the ability to lower their U.S. taxes by shifting income offshore "gives US multinational companies a large tax advantage relative to domestic companies, [which] are (on average) far smaller. . . . Reforming international tax rules to ensure that large, dominant multinational companies pay adequate tax on their foreign income is . . . essential for creating a level competitive playing field."[42]

Other academic experts have made similar points. In 2023, as the Minnesota legislature was considering adopting WWCR, a group of law professors that included Clausing and University of Michigan Law Professor Reuven Avi-Yonah, two of the leading academic experts on federal international tax policy and profit shifting, submitted a letter to legislators that stated in part:

> A fair and efficient corporate tax system would not favor the biggest and most profitable corporations over smaller domestic competitors. It would also not advantage and reward the most aggressive tax avoiders over those focused on creating economic value. Yet that is the system Minnesota currently has, and so we are pleased to see Minnesota moving towards a reform that would address the unfairness and inefficiency of its current corporate tax system . . . . Worldwide Combined Reporting.[43]

The measure was passed by both houses of the Minnesota legislature but later dropped in a conference committee.

Minimizing tax advantages for large MNCs may be particularly important for businesses owned by people of color and women, which already face multiple barriers to formation, survival, and growth. For example, businesses owned by people of color are less likely to receive venture capital investments and have greater difficulty in accessing capital and markets more broadly.[44] And a recent

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40 See https://www.sec.gov/Archives/edgar/data/829224/000082922423000058/sbux-1012023xexhibit21.htm.

41 For example, suppliers of new equity capital to a corporation will generally do so based on their expected after-tax rate of return. Therefore, if a corporation can reduce its federal and state tax liability through profit shifting, it has more profit available with which to pay dividends — enabling it to obtain more capital per dollar of dividends or obtain a fixed amount of capital with a lower dividend pay-out.

42 Testimony to the U.S. Senate Budget Committee, January 17, 2024.

43 Letter to Minnesota Senate Tax Chair Rest, House Tax Chair Gomez, Tax Conference Committee Members, May 9, 2023, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4446650.

44 Kimberly Zeuli *et al.,* "Helping Entrepreneurs of Color Grow Their Businesses," Initiative for a Competitive Inner City, December 2018, https://icic.org/wp-content/uploads/2018/12/ICIC_Ascend2020_Report_r8_final_post.pdf. See also: David Baboolall *et al.,* "Building Supportive Ecosystems for Black-owned US Businesses," McKinsey Institute for Black Economic Mobility, October 29, 2020, https://www.mckinsey.com/industries/public-sector/our-insights/building-supportive-ecosystems-for-black-owned-us-businesses.

Babson College study found that while women are now equal or majority owners of 45 percent of all U.S. companies, less than 3 percent of companies funded by venture capital have a woman CEO.[45]

Worldwide Combined Reporting Is Superior to Alternatives

Worldwide combined reporting is not the only approach to reducing state revenue losses from international profit shifting. But compared to the alternatives that have been adopted or proposed, WWCR is both legally certain and a more comprehensive solution.

WWCR Is Unquestionably Legal

The U.S. Supreme Court has twice upheld the constitutionality of worldwide combined reporting. In 1983 it upheld the application of WWCR to MNCs with U.S. parents in *Container Corporation* vs. *California*; in 1994 it upheld the application of WWCR to MNCs with foreign parents in *Barclays Bank* vs. *California*. There is no reason to think the Court would revisit those decisions. Nor have the corporate representatives opposing state adoption of WWCR raised this possibility.[46]

The alternatives to WWCR that some states have adopted *are* vulnerable to legal challenges. For example, 15 states and the District of Columbia have attempted to recoup some of their lost revenue by partially or completely conforming to the Global Intangible Low-Taxed Income (GILTI) provision of the 2017 federal tax law,[47] which aims to discourage U.S. corporations from sending profits and investment offshore by ensuring that they pay a minimum tax on certain foreign income. Yet almost immediately upon passage of the 2017 law, MNC representatives began threatening GILTI-conforming states with litigation,[48] and they continue to threaten litigation every time a new state considers conforming, such as when Minnesota backed off from enacting WWCR in 2023 in favor of GILTI conformity.[49] More recently, corporate representatives have suggested that state conformity to the new corporate alternative minimum tax enacted in the 2022 Inflation Reduction Act would also be unconstitutional.[50]

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[45] Michael Chmura, "Entrepreneurial Women Need Disruptive Financial Models," Babson Thought & Action, January 22, 2020, https://entrepreneurship.babson.edu/diana-international-impact-report/.

[46] See, for example, the September 25, 2023 testimony by Karl Frieden, General Counsel of the Council on State Taxation, in opposition to New Hampshire's adoption of WWCR, at https://gencourt.state.nh.us/statstudcomm/committees/1572/documents/Frieden,%20COST%20Slide%20Deck.pdf.

[47] See the map of conforming states on p. 8 of Katherine Loughead, "Biden Administration Changes to GILTI and FDII Will Yield Automatic State Tax Increases," Tax Foundation, May 2021, https://files.taxfoundation.org/20210524172026/Biden-Administration-Changes-to-GILTI-and-FDII-Will-Yield-Automatic-State-Tax-Increases.pdf. The count of 15 states removes Connecticut, Massachusetts, New York, and Tennessee from the Tax Foundation tally of 20 conforming states because they include a trivial 5 percent of GILTI in taxable income. It also removes New Jersey, which repealed its conformity with GILTI. It adds Minnesota, which enacted conforming legislation in May 2023.

[48] Less than three months after GILTI's December 2017 enactment, the Council on State Taxation (COST) — the trade association that represents the largest multistate corporations on state tax policy and legal matters — sent a letter to the Georgia legislature suggesting that state conformity with GILTI was unconstitutional. See https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-comments-and-testimony/03062018-ga-letter-to-gen-assembly-re.-foreign-income-taxation.pdf. And in October 2018, COST published a detailed article making the case. See Joseph X. Donovan *et al.,* "State Taxation of GILTI: Policy and Constitutional Ramifications," *Tax Notes State*, October 22, 2018.

[49] See: Karl A. Frieden and Fredrick J. Nicely, "Minnesota's New Approach to Taxing Foreign Income Is Unfair and Unwise," *Tax Notes State*, August 21, 2023. The authors write that Minnesota's GILTI conformity "likely violates the commerce clause under U.S. Supreme Court precedents related to discrimination, fair apportionment, and foreign commerce."

[50] Marilyn Wethekam and Karl Frieden, "States Should Not Conform to the New Federal Corporate AMT," *Tax Notes State*, September 25, 2023, pp. 993-4.

Given these measures' commonalities with worldwide combined reporting,[51] it seems unlikely such challenges would succeed. In any event, WWCR should represent states' first and best option.

WWCR Is More Effective

Among the other options for states seeking to recapture revenue lost to international profit shifting is taking a mid-way step toward full WWCR by including in the combined group any foreign subsidiaries that do business in some of the more notorious tax haven countries, rather than all related foreign corporations. Also, most state corporate tax laws include a provision, similar to Internal Revenue Code Section 482, that permits the revenue department to adjust intra-group transfer prices to reallocate income improperly shifted to foreign tax havens. And many states' laws include so-called "addback" provisions allowing the revenue department to disallow deductions for royalty and interest payments to other members of a corporate group under certain conditions. But these alternatives to WWCR, in addition to the risk of legal challenges discussed above, all have serious practical disadvantages:

- **The current GILTI rules are weak**. Tax experts have identified several problems with the way the current GILTI rules work. For example, international tax attorney Rebecca Kysar pointed out in a 2018 analysis that foreign income subject to GILTI receives a 50 percent deduction off the normal 21 percent corporate rate, so income is effectively taxed at a 10.5 percent rate. "Given the wide differential between the domestic rate and the minimum tax rate," she concluded, "there remains substantial motivation to shift profits."[52] Kysar further noted that the structure of the minimum tax allows multinationals to blend their high profits from investments in intangible assets with their low profits from investments in tangible assets, "thereby . . . escaping the GILTI regime. This ability to blend high-return with low-return income will further encourage offshoring and profit shifting."

  Despite widespread awareness of these and other flaws in GILTI, none of the critical proposed fixes have yet been enacted.[53] Moreover, GILTI usually does nothing to address profit shifting by MNCs with *non*-U.S. parents.

- **Adding "tax haven" countries to water's edge combined reporting has significant shortcomings**. Conceptually, including foreign tax haven subsidiaries in combined reporting is a sensible interim step toward adopting full WWCR, but its execution has been flawed. The three states that have used a specific list of tax haven countries (Colorado, Montana, and Oregon) have relied on one developed by the European Union that is no longer maintained and omits some of the worst offenders, such as Ireland, Luxembourg, the Netherlands, and Switzerland. The other five jurisdictions that enacted such a provision (Alaska, Connecticut, District of Columbia, Rhode Island, and West Virginia) use somewhat vague and subjective criteria to define a tax haven. This leaves significant discretion to corporations to argue that a

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[51] Both GILTI and the Inflation Reduction Act's corporate alternative minimum tax consolidate the income of foreign subsidiaries (with each other and with the U.S. parent, respectively), which is a hallmark of WWCR. GILTI also uses a formula to assign a portion of that consolidated income to the U.S. tax base.

[52] Rebecca M. Kysar, "Critiquing (and Repairing) the New International Tax Regime," *Yale Law Journal*, October 25, 2018.

[53] The Kysar article discusses potential GILTI reforms. The Biden Administration has pushed for them on several occasions, most recently in its FY2025 budget proposals. See: U.S. Department of the Treasury, "General Explanations of the Administration's Fiscal Year 2025 Revenue Proposals," March 11, 2024, p. 28, https://home.treasury.gov/system/files/131/General-Explanations-FY2025.pdf.

particular country is *not* a tax haven and puts the burden of proof on state revenue departments to show that it is.

- **States can't enforce Section 482-like transfer pricing authority any more effectively than the IRS can**. As discussed above, past IRS attempts to challenge MNC transfer pricing practices have led to litigation that lasts for years and requires the services of expensive outside accountants, economists, and industry experts; the IRS has a poor track record in such litigation.[54] Although states have brought such cases as well, they have considerably fewer resources than the IRS with which to pursue them and an even poorer win/loss record. Moreover, it is not clear that a state has ever tried to challenge a corporation's transfer price on a *foreign* transaction; all well-known cases involve state-to-state transfer pricing.
- **"Addback" laws contain loopholes and do not affect many forms of international profit shifting.** Addback laws mitigate profit shifting that involves payments of interest and royalties from one member of a corporate group to another by denying tax deductions for the payments under certain conditions. But the exceptions written into the laws, usually due to corporate lobbying, are often so numerous as to gut them entirely.[55] One common exception allows deductions if the payments are between related companies located in countries that have executed tax treaties with each other. Yet the United States has tax treaties with Ireland, the Netherlands, and Switzerland — all well-known destinations for profits shifted out of the U.S.

  Furthermore, many mechanisms for international profit shifting don't rely on payments of royalties and interest, such as paying inflated prices for physical inputs and services purchased from a related company in a low- or no-tax foreign country. Addback laws do nothing to limit such practices.

Beyond their serious practical limitations and the risk of extended legal challenges, alternative approaches to mitigating abusive international profit shifting have faced intense opposition from MNCs, which have lobbied to prevent their enactment or to have them repealed.[56] In 2024, following intense corporate lobbying, the New Jersey legislature repealed both its GILTI conformity and its addback statute, leaving the state essentially defenseless against international profit shifting.[57]

[54] "Between 1979 and 1994, the IRS consistently lost every major transfer pricing case it litigated, including those against U.S. Steel Corp., Bausch & Lomb Inc., HCA Healthcare, Eli Lilly and Co., G.D. Searle LLC, Ciba-Geigy AG, Sundstrand Corp., and Merck & Co. Inc. After the new transfer pricing regulations were issued in 1994, there was a hiatus in transfer pricing litigation. When cases resumed, the IRS continued losing, including against DHL Corp. (1998), UPS (1999), Compaq (1999), Xilinx Inc. (2005), Veritas Software Corp. (2009), Medtronic Inc. (2016), and Amazon.com Inc. (2017)." Reuven S. Avi-Yonah and Gianluca Mazzoni, "Coca-Cola: A Decisive IRS Transfer Pricing Victory, at Last," *Tax Notes Federal*, December 14, 2020.

[55] Corporate representatives also widely claim that addback provisions are unconstitutional. For an early cataloging of the potential for legal challenges, see Thomas H. Steele and Pilar M. Sansone, "Surveying Constitutional Theories for Challenges to the Addback Statutes," *State Tax Notes*, February 28, 2004. There have been numerous legal challenges to these laws, some successful and some unsuccessful.

[56] Indeed, much of the business community does not even accept the legitimacy of *water's edge* combined reporting, even though it has been used since the 1930s and is now the law in three-fifths of the states with corporate income taxes. The Council on State Taxation, a trade association that is the state corporate tax policy arm of the Fortune 1000, has an official policy position opposing any form of mandatory combined reporting, including water's edge. See: https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/revised-mandatory-unitary-combined-reporting-with-consolidated-filing-election.pdf.

[57] KPMG, "Corporation Business Tax Changes Enacted: Assembly Bill 5323 Makes Significant Revisions to Corporation Business Tax Laws," July 10, 2023, https://kpmg.com/us/en/home/insights/2023/07/tnf-new-jersey-significant-corporation-business-tax-changes-enacted.html.

Corporate lobbying also succeeded in pressuring both Montana and Oregon to repeal the inclusion of tax haven subsidiaries in combined reporting. And as noted above, MNCs began pressuring Minnesota to repeal its GILTI conformity within months of the policy's adoption.

Given that the alternatives to WWCR are less effective in addressing the problem and face equally vigorous opposition from MNCs, states have little to gain in pursuing half-measures. They should prioritize enacting WWCR.

Worldwide Combined Reporting Is Consistent With Existing State Taxation

Worldwide combined reporting is fundamentally consistent with the way all states tax corporations operating in more than one state, an approach known as "formula apportionment." No state requires multistate corporations to track which goods and services they sold to state residents, at what price, and what it cost to make each one — and therefore what the profit on each sale was. Instead, all states require them to apportion a share of their *nationwide* profit to the state for taxation, based on a formula that looks to the share of the corporation's objectively measurable activities that took place in the state. If a state requires combined reporting, the formula is applied to the combined profit of the parent and subsidiaries; if it doesn't, the formula is applied separately to each taxable member of the group.

States require formula apportionment to prevent corporations from manipulating their internal bookkeeping (for example, their assignment of overhead expenses to one state rather than another) to reduce their state income taxes. But if a state doesn't also require combined reporting, it negates a basic goal of formula apportionment. For example, a state without combined reporting must allow a member of the corporate group to deduct its payments to a non-taxable, out-of-state member of the group for the purchase of a product for resale — even though corporations obviously don't earn profits by selling to themselves.

Once a state decides to require combined reporting for members of a corporate group located in another *state*, there is no reason not to require combined reporting for members of a corporate group located in another *country*. Those foreign affiliates may well conduct the same activities as domestic subsidiaries that are subject to combination. Moreover, since one potential benefit to corporations of combined reporting is that it allows them to offset profits in one entity with losses in another on a current basis, it could be argued that failing to require worldwide combined reporting is unfair to (and perhaps discriminates against) corporations with money-losing or less profitable foreign operations.[58]

In sum, just as water's edge combined reporting is a logical — indeed essential — extension of formula apportionment,[59] worldwide combined reporting is a logical extension of water's edge.

State Action to Address International Profit Shifting Is Long Overdue

For more than 40 years, states waged a concerted, coordinated effort to close an indefensible loophole in their sales tax laws that prevented them from taxing mail-order catalog and, later,

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[58] For an in-depth discussion of this and related issues, see: James H. Peters, "The Water's Edge Combined Reporting Method: A Troublesome Concept," *State Tax Notes*, August 20, 2001.

[59] Indeed, most of the early states to require combined reporting adopted it as a logical extension of formula apportionment, with no explicit statutory authority, and the courts upheld the practice on that basis.

Internet purchases. The loophole, created by U.S. Supreme Court decisions, cost them billions of dollars in vitally needed revenue each year and put their local retailers at a serious disadvantage in competing with big corporations like L.L. Bean and, later, Dell Computer and Amazon.

To win that fight, states needed action at the federal level. Ultimately the Supreme Court reversed itself in the 2018 *Wayfair* decision requiring all large Internet businesses to charge sales taxes on online purchases, but achieving that result took two separate test cases almost 20 years apart. In that 20-year interval, states lost billions of dollars of revenue that could have helped finance smaller class sizes for a generation of schoolchildren, health care for those without it, and many other critical services. States also saw many of their local book, camera, music, and other Main Street retailers driven out of business by the price advantage remote sellers gained by not having to charge sales tax.

Today, states are again seeing an important revenue source — their corporate income taxes — seriously eroded by a major structural flaw that enables wealthy multinational corporations to shift profits earned in the United States to foreign tax havens and their smaller, in-state businesses again put at a competitive disadvantage as a result. States are losing at least as much revenue from these schemes each year as they lost from their inability to tax Internet purchases.[60] Yet in this case, the solution is completely in their hands because the Supreme Court upheld the constitutionality and fundamental fairness of worldwide combined reporting 40 years ago.

It's long past time that states enact — in some cases, reenact — worldwide combined reporting to ensure that multinational corporations pay what they should, rather than saddle working families with diminished services and having to pay more than their fair share.

[60] The most widely cited estimate for sales tax revenue losses from untaxed Internet sales was $11.4 billion in 2012. Note, however, that this was for state and local governments combined. See: Donald Bruce, William F. Fox, and LeAnn Luna, "State and Local Government Sales Tax Revenue Losses from Electronic Commerce," unpublished, April 13, 2009.

APPENDIX TABLE 1

Most Fortune 100 Companies Have Subsidiaries in Well-Known Foreign Tax Havens

Company	Total # of tax haven subsidiaries acknowledged	Bermuda	British Virgin Islands	Cayman Islands	Hong Kong	Ireland	Luxemb.	Netherl.	Singapore	Switzerl.	# of tax havens in which company has at least 1 subsidiary
Walmart	2			1					1		2
Amazon	0										0
ExxonMobil	8							6	2		2
Apple	5				1	4					2
UnitedHealth Group	24			4	1	7	7	4	1		6
CVS Health	13	5			3	2	1		2		5
Berkshire Hathaway	13					2	1	8	1	1	5
Alphabet	0										0
McKesson Corporation	3	2				1					2
Chevron Corporation	4	4									1
AmerisourceBergen	8					1	2	1	1	3	5
Costco	0										0
Microsoft	4					4					1
Cardinal Health	10	1				3		2	2	2	5
Cigna	3	2			1						2
Marathon Petroleum	1	1									1
Phillips 66	5			2		1			1	1	4
Valero Energy	9		4			3		2			3
Ford Motor Company	2							1		1	2
The Home Depot	0										0
General Motors	4				1	1			1	1	4
Elevance Health	3					3					1
JPMorgan Chase	2						2				1
Kroger	0										0
Centene	2			1	1						2

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Verizon Communications	0										0
Walgreens Boots Alliance	4					1	2	1			3
Fannie Mae	0										0
Comcast	27				3	6		7	7	4	5
AT&T	0										0
Meta Platforms	5					4			1		2
Bank of America	12	1		1	3	2		1	3	1	7
Target Corporation	0										0
Dell Technologies	33	1		1	3	11	1	7	6	3	8
Archer Daniels Midland	34		1	6	2	6		9	5	5	7
Citigroup	8				2	2		1	3		4
United Parcel Service	2							1	1		2
Pfizer	63		2		3	15	8	27	4	4	7
Lowe's	0										0
Johnson & Johnson	77			2	3	24	1	19	5	23	7
FedEx	16				4	2	1	7	1	1	6
Humana	0										0
Energy Transfer Partners	6	4						2			2
State Farm	0										0
Freddie Mac	0										0
PepsiCo	88	12	1	6	9	6	11	33	3	7	9
Wells Fargo	1					1					1

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The Walt Disney Company	9		1	1	2			4	1		5
ConocoPhillips	18	3		10				4	1		4
Tesla	17			3	2	1	1	7	2	1	7
Procter & Gamble	21				2	1	1	6	3	8	6
Albertsons	0										0
General Electric	39	2				10	3	12	6	6	6
MetLife	0										0
Goldman Sachs	13		1	1	2	1	1	5	2		7
Sysco	24	2		3	3	5	8	1	2		7
Bunge Limited	32	8	4	3	1			10	1	5	7
RTX Corporation	8						1		3	4	3
Boeing	3	1						2			2
StoneX Group	19	1	1	2	3	3	1	4	2	2	9
Lockheed Martin	0										0
Morgan Stanley	1			1							1
Intel	7			1	2			4			3
HP	54	1	1	4	3	7	1	26	7	4	9
TD Synnex	29		4	2	6	2	1	7	5	2	8
IBM	16	1			1	5	1	3	3	2	7
HCA Healthcare	8	1	1				5			1	4
Prudential Financial	83	4	2	25	2	4	36	1	8	1	9
Caterpillar	50	2	2	1	7	3	9	8	9	9	9
Merck & Co.	90	6			2	15	1	41	6	19	7
World Fuel Services	19		2	3	1	2	1	5	4	1	8

APPENDIX TABLE 1

Most Fortune 100 Companies Have Subsidiaries in Well-Known Foreign Tax Havens

Company	Total # of tax haven subsidiaries acknowledged	Bermuda	British Virgin Islands	Cayman Islands	Hong Kong	Ireland	Luxemb.	Netherl.	Singapore	Switzerl.	# of tax havens in which company has at least 1 subsidiary
New York Life Insurance Company	0										0
Enterprise Products	0										0
AbbVie	76	11		4		21	16	16	3	5	7
Plains All American Pipeline	2						2				1
Dow Chemical Company	37				3		1	24	6	3	5
AIG	20	8			1	2	4		3	2	6
American Express	15				1	1		11		2	4
Publix	0										0
Charter Communications	0										0
Tyson Foods	20			1	8		6	4	1		5
John Deere	3						2		1		2
Cisco	33	4	2		5	3	1	12	4	2	8
Nationwide Mutual Insurance Company	0										0
Allstate	5	3					1		1		3
Delta Air Lines	5	1		4							2
Liberty Mutual	0										0
TJX	6	2			1	2		1			4
Progressive Corporation	1	1									1
American Airlines	7	1		3			3				3
CHS	8	3			1		1		2	1	5
Performance Food Group	0										0
PBF Energy	0										0

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Company	Total # of tax haven subsidiaries acknowledged	Bermuda	British Virgin Islands	Cayman Islands	Hong Kong	Ireland	Luxemb.	Netherl.	Singapore	Switzerl.	# of tax havens in which company has at least 1 subsidiary
Nike	5							5			1
Best Buy	3	1			1		1				3
Bristol-Myers Squibb	49	3		1	2	14		11	2	16	7
United Airlines	10			7			3				2
Thermo Fisher Scientific	188	4		20	19	15	45	59	17	9	8
Qualcomm	3								3		1
Abbott Laboratories	95	15	2	3	5	15	17	22	6	10	9
Total tax haven subsidiaries	1652	122	31	127	126	244	211	454	165	172	

Sources: Fortune 500 list of the largest U.S. corporations for 2023; Exhibit 21 of Securities and Exchange Commission Form 10-K annual reports for most recent year available as of December 2023.See Notes 27 and 28.