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MOST LARGE NORTH CAROLINA MANUFACTURERS ARE ALREADY SUBJECT TO "COMBINED REPORTING" IN OTHER STATES

Fears of Job Loss from Reducing Corporate Tax Avoidance Are Unwarranted

By Michael Mazerov

For the past seven years, there has been serious discussion in North Carolina of adopting an important reform in the state corporate income tax known as mandatory "combined reporting." Some North Carolina businesses and their lobbying organizations have opposed this change, claiming that it would result in some companies leaving the state or shunning North Carolina for new investment. However, the vast majority of the largest manufacturers in the state — the type of businesses that in theory are most likely to avoid states adopting tax policies they view as unfavorable — quite willingly subject themselves to mandatory combined reporting in other states. At least 60 of the 75 largest North Carolina manufacturers maintain a facility in at least one state that mandates combined reporting and therefore are subject to income taxes that implement this policy.

Most large corporations consist of a parent corporation and its subsidiaries. Combined reporting effectively treats the parent and most or all of its subsidiaries as a single corporation for state income tax purposes. In doing so, combined reporting nullifies a wide array of tax-avoidance strategies large multistate corporations have devised to artificially move profits out of the states in which they are earned and onto the books of subsidiaries located in states that will tax the income at a lower rate — or not at all.[1] North Carolina has been greatly victimized by these strategies. It was forced to litigate a case all the way to the U.S. Supreme Court to shut down an abusive tax shelter put in place by The Limited, and it currently is embroiled in similar litigation with Wal-Mart. If combined reporting had been mandatory, these costly court cases would have been unnecessary.

KEY FINDINGS

Former Governor Easley and tax policy study groups in North Carolina have periodically called for the enactment of "combined reporting" (CR), a corporate income tax reform aimed at nullifying tax shelters used by large multistate corporations. Some current legislators may be concerned that this could lead companies to leave the state or shun it for new investments. However, an investigation of the location decisions of the 75 largest North Carolina manufacturers demonstrates that such concerns are unwarranted:

- 60 of the 75 have chosen to maintain facilities in at least one combined reporting state.
- Almost half have facilities in 5 or more CR states, 17 have facilities in 10 or more, and 1 has facilities in *every one* of the CR states.
- 18 have long-maintained their *headquarters* in CR states, including Cisco Systems, Freightliner, and Georgia-Pacific.
- Several opponents of CR have facilities in numerous CR states, including Smithfield and Baxter Healthcare.

Some 16 states have mandated the use of combined reporting for at least two decades; six more have put it into effect in the last five years. The adoption of combined reporting was recommended in 2002 by the Governor's Commission to Modernize State Finances,[2] in 2007 by the Income Tax Subcommittee of the State and Local Fiscal Modernization Commission,[3] and in 2007 by the legislature's Revenue Laws Study Committee.[4] Former Governor Easley recommended the adoption of mandatory combined reporting as part of his FY08-FY09 budget package.[5]

Representatives of some major multistate corporations doing business in North Carolina have expressed opposition to combined reporting, claiming that it will subject them to difficult and costly tax compliance burdens and possibly lead to job losses as major employers leave North Carolina or reject the state for future investments.[6] Despite the growing number of states adopting this policy and previous endorsements of combined reporting by key policymakers in North Carolina, some current members of the General Assembly may be reluctant to mandate the use of combined reporting out of concern that it will adversely affect the state's economy.

This study presents compelling evidence that such concerns are unwarranted. It summarizes the results of a careful examination of the states in which the 75 largest North Carolina manufacturers have physical facilities and therefore are subject to the state's corporate income tax. Manufacturers were chosen as the focus of the research because, in theory, they have a greater ability than do retailers and service businesses to locate in states far away from their customers to take advantage of what they view as more favorable state tax policies. As documented in Figure 1, the study finds that:

- At least 60 of the 75 largest North Carolina manufacturers examined maintain facilities in at least one combined reporting state or are a member of a corporate group that has a facility in at least one combined reporting state. The "compliance burdens" and tax liabilities arising from combined reporting cannot be that great if these manufacturers — or the parent corporation that controls their decision-making — have willingly maintained a facility in one or more combined reporting states.

- Many of the corporations examined maintain facilities in *multiple* combined reporting states. Almost half — 36 out of 75 — have facilities in five or more combined reporting states, 17 have facilities in 10 or more such states, and 10 companies have facilities in 15 or more CR states.

- One company, Eaton Corporation, has facilities in *all 20* combined reporting states. (Two states that implemented combined reporting just as of January 1, 2009 are not included in the study.)

- Fully 18 of the companies have long-maintained their *headquarters* in combined reporting states, including Freightliner, Cisco Systems, Caterpillar, Georgia-Pacific, Sara Lee, and John Deere.

Taken together, these facts provide compelling evidence that North Carolina's adoption of combined reporting would not lead these companies to remove facilities or shun the state as a location for future investments.