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Oregon Should Reinstate Its Tax Haven Law

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Oregon's conformity to changes made by the 2017 federal tax law would have resulted in a one-time loss of corporate income tax revenue. Senate Bill 1529, which Oregon Governor Kate Brown signed into law on April 10, was meant to convert that loss into a one-time revenue gain. Unfortunately, the bill also repealed the state's vital and effective law that has reduced multinational corporations' ability to pay less than the proper amount of income tax by artificially shifting profits to their subsidiaries in foreign tax haven nations. Oregon lawmakers should reinstate the tax haven provision during the 2019 session.

They should pass such legislation because:

- The legislature failed to consider the likelihood that the state will not soon receive the one-time revenue gain that motivated repeal of the tax haven rule because Oregon's authority to tax the income generating the revenue will likely be challenged in court.
- The legislature appears not to have understood that the provision creating the gain only recoups a revenue loss attributable to international tax avoidance that occurred in the past but does nothing to prevent future tax avoidance.
- The legislature was misled into thinking that, going forward, Oregon can "piggyback" on several provisions in the recent federal tax bill aimed at nullifying abusive international income shifting, even as corporate lobbyists making that argument appear poised to initiate litigation aimed at preventing states from doing so.
- The Legislative Revenue Office's (LRO) Revenue Impact Statement on the bill did not note that it repealed the tax haven provision, let alone provide an ongoing revenue loss estimate for it. A March 2017 LRO study found that the tax haven provision generated $28.4 million in revenue in 2014, the year it took effect.
- The House's consideration of the tax haven repeal provision may have been swayed by a misleading statement that appeared in testimony submitted by the Council on State Taxation (COST), a trade association of large multistate and multinational corporations. COST's testimony falsely implied that Oregon is the only state that currently has its specific form of a tax haven law in effect.

Governor Brown called the recently completed special session to consider legislation extending a tax break for some "pass-through" businesses to other types of previously ineligible pass-throughs.

That goal was misguided, and the bill that was enacted should be viewed as no more than a temporary fix. The original tax break was unwarranted, disproportionately benefits the rich,[1] has not boosted Oregon's economy, and should have been narrowed or repealed rather than expanded.[2] Likewise, *repeal* of the tax haven provision was an unwarranted giveaway to profitable multinational corporations that are exploiting foreign tax havens to shift profits earned in Oregon beyond the tax reach of the state.

A short legislative session that came so soon after Congress's enactment of an extremely complex federal tax law with far-reaching implications for Oregon's tax structure did not provide sufficient time for careful consideration of the policy choices that SB 1529 presented. It is therefore not surprising that significant misinformation about those choices circulated. Similarly, a one-day special session was a less-than-ideal forum in which to evaluate Oregon's current treatment of pass-through businesses and the need for and direction of potential reforms. A comprehensive review of Oregon's business tax structure — including the reconsideration of the tax haven law — should be on the legislature's 2019 agenda.

Oregon Unlikely to See "Windfall" Revenue from SB 1529 Soon

The primary impetus for SB 1529 was the need to decide how Oregon would conform its corporate income tax law to a provision of the 2017 federal tax law. This provision immediately subjected to federal taxation more than $2 trillion in profits that U.S.-parent multinational corporations have accumulated and are holding abroad. Ordinarily, these profits would have only been taxable when they were actually paid as dividends back to the U.S. parent ("repatriated"), but the new federal law subjected them to immediate taxation in tax year 2017 by "deeming" them to have been paid. However, to ensure that the "deemed dividends" were taxed at a lower rate than the regular federal corporate income tax rate, the federal legislation paired their full inclusion in gross income with a partially offsetting deduction of a substantial portion of the dividends.

Due to the way Oregon's law is written, the state was at risk of allowing both the new federal deduction *and* a pre-existing state deduction for dividends received, at a one-time cost of approximately $100 million. SB 1529 blocked the double deduction and thereby supposedly converted that loss into an estimated $140 million one-time gain by permitting the state to tax a share of the deemed dividends.

The floor debate in both houses of the legislature focused almost exclusively on how this "windfall" should be spent. Not a single question was raised about whether the windfall would actually appear. In fact, Oregon is unlikely to see much of that revenue anytime soon.[3] There are

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[1] See: Oregon Legislative Revenue Office, "Expanding Oregon's Pass-Through Tax Rates to Sole Proprietors," April 27, 2018.

[2] Discussion of these issues is beyond the scope of this report. See the following for a discussion of the problems with Oregon's existing tax break for pass-through business income: Juan Carlos Ordonez, "A Special Session Should Recognize Tax Injustice for Oregon Workers," *The Oregonian*, April 26, 2018, http://www.oregonlive.com/opinion/index.ssf/2018/04/a_special_session_should_recog.html?blm_aid=42107.

[3] The most recent state revenue forecast states that "Some repatriation revenue is already being received." (Oregon Department of Administrative Services, "Oregon Economic and Revenue Forecast," June 2018, p. 24, http://www.oregon.gov/das/OEA/Documents/forecast0618.pdf.) However, this statement was based on the assumption that greater-than-anticipated corporate tax collections resulted from repatriation income rather than from

numerous legal grounds upon which court challenges to any state's attempt to include "deemed dividend" income in its tax base could be based. And, in fact, corporate representatives foresee legal challenges if they are unsuccessful in lobbying states not to piggyback on the deemed repatriation provision (and other new international tax provisions included in the 2017 federal tax law, as discussed below). Joe Crosby, a prominent state tax attorney, said he thinks lawsuits are "inevitable . . . because undoubtedly, given the complexity, states are likely to do things that are questionable from a constitutional perspective."[4]

The McDermott, Will & Emery law firm (MWE) has organized a nationwide lobbying coalition aimed at shaping state responses to the federal tax changes to the corporate community's liking. The solicitation materials seeking membership in the coalition explicitly set out the grounds upon which challenges to state taxation of the deemed dividends (which it refers to as "previously deferred foreign earnings") could be brought:

> The previously deferred foreign earnings transition inclusion should not be included in the states' tax base because (a) it is not income paid to the domestic parent as a dividend; (b) inclusion of the transition amount could be unconstitutional without any apportionment factor representation; and (c) in separate return states, any inclusion of such income would be unconstitutional under [the U.S. Supreme Court's decision in] *Kraft*.[5]

While the coalition is oriented toward lobbying, MWE is one of the two or three leading firms in the country representing major multistate and multinational corporations in state tax litigation. SB 1529 does *not* provide for "apportionment factor representation," (which would take account of the receipts of the foreign subsidiaries and dilute the tax effect of including their profits in the tax calculation). Accordingly, Oregon is a clear target for such litigation.[6]

In short, the business community believes it has substantial grounds upon which to challenge the provision of SB 1529 that subjects "deemed dividends" to taxation and seems prepared to do so.[7]

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any specific evidence. Corporate income tax collections are highly volatile, and numerous factors could lead to such an outcome – particularly at a time when the new federal tax law has made numerous changes in the corporate tax base.

[4] Quoted in "How States Can Address Federal Tax Reform," *State Tax Notes*, February 12, 2018.

[5] STAR (State Taxes After Reform) Partnership, "Anticipating the State Tax Ramifications of Federal Tax Reform," https://www.star-partners.org/background.

[6] *Kraft* held that taxing dividends received from foreign subsidiaries but not domestic subsidiaries constituted unconstitutional discrimination against foreign commerce. Oregon does not appear to be significantly vulnerable to legal challenge based on the *Kraft* decision because a statement in the decision implied that it does not apply to states like Oregon that mandate the use of combined reporting.

[7] Other state tax practitioners also predict litigation should states attempt to conform to the deemed repatriation and other international provisions of the new federal law. According to a recent story in *Politico*, "Efforts by states to impose their own taxes on companies' foreign earnings will likely end up in court, said [Ernst & Young tax expert Steve] Wlodychak, pointing to a 1992 Supreme Court decision restricting states' ability to tax international income. 'There are some very, very serious constitutional questions that have to be determined,' he said." Brian Faler, "Federal Tax Cuts Trigger Stealth Tax Hikes in States," *Politico*, April 9, 2018, https://www.politico.com/story/2018/04/09/federal-tax-cuts-trigger-steath-tax-hikes-507348.

Anticipated "Windfall" Paved the Way for the Unwarranted Repeal of the Tax Haven Provision

SB 1529 also repealed Oregon's tax haven law, which both the Oregon and the national corporate community have fought aggressively since its 2013 enactment. This law requires corporations to add the profits of corporate subsidiaries formed in well-known foreign tax haven nations (listed by name) to total domestic profits subject to assignment to Oregon. The combined profit is then apportioned to Oregon via a formula that measures the corporation's activity in Oregon relative to its activity elsewhere. The goal of the tax haven law is to reduce the loss of Oregon corporate income revenue resulting from tax avoidance strategies that artificially shift profits earned in Oregon to subsidiaries formed in low- or no-tax countries.

It is not surprising that the business community has sought repeal of this requirement. Major Oregon corporations widely exploit tax havens to minimize both their federal and their state income taxes. A review of recent corporate annual reports to the Securities and Exchange Commission reveals that:

- Nike reported 39 subsidiaries in the Netherlands, two in Bermuda and one in Switzerland.[8]
- Intel Corporation reported seven subsidiaries in the Cayman Islands and three in the Netherlands.[9]
- Columbia Sportswear reported five in Switzerland, two in Luxembourg, and one in the Netherlands.[10]
- Precision Castparts, a lesser-known Fortune 500 company headquartered in Portland, reported three in Luxembourg, two each in the Caymans and Ireland, and one in Bermuda.[11]

According to Reed College economist Kimberly Clausing, a leading expert on international tax avoidance, these countries are all among the top seven destinations for artificially shifted corporate profits.[12]

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[8] See: https://www.sec.gov/Archives/edgar/data/320187/000032018717000090/nke-5312017xexhibit21.htm. As recently as 2014, Nike reported six subsidiaries in Bermuda. (See: https://www.sec.gov/Archives/edgar/data/320187/000032018714000097/nke-5312014xexhibit21.htm). A recent study found that "some firms fail to publicly disclose subsidiaries in some countries, even when the subsidiaries are significant and should be disclosed per Security [*sic*] and Exchange Commission rules. The propensity to omit significant subsidiaries is especially strong when subsidiaries are in tax havens and when the firm is more highly scrutinized by the media. . . ." Scott D. Dyreng *et al*., "Strategic Subsidiary Disclosure," March 2018, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3137138.

[9] See: https://www.sec.gov/Archives/edgar/data/50863/000005086318000007/a12302017q4-ex211.htm.

[10] See: https://www.sec.gov/Archives/edgar/data/1050797/000105079718000004/colm2017123110kexhibit211.htm.

[11] See: https://www.sec.gov/Archives/edgar/data/79958/000007995815000035/pcp2015052810kex21.htm.

[12] Kimberly A. Clausing, "The Effect of Profit Shifting on the Corporate Tax Base," *Tax Notes*, February 18, 2016, http://www.taxhistory.org/www/features.nsf/Articles/622F036AA4CAD8DF85257F5D006799D2?OpenDocument.

Ireland, the Netherlands, and Switzerland are not currently included in Oregon's list of tax haven nations that must be included in the calculation of corporate tax liability. However, based on additional criteria for defining tax havens enacted in 2015 (SB 61), the Oregon Department of Revenue has recommended that all three countries be added to the list, a recommendation the legislature has not acted upon. See: Oregon Legislative Revenue Office, "An Assessment of

Until this year, efforts to repeal the tax haven law had failed. This time, however, lawmakers were receptive to repealing the tax haven requirement because corporations would be paying additional tax due to the deemed repatriation provision. As noted, this ignores the possibility, and indeed the likelihood, that some individual corporations will litigate against the deemed repatriation provision in the not-too-distant future with the aim of having it completely invalidated.

More importantly, it appears that the legislature simply failed to understand that SB 1529 exchanges a *one-time* revenue "windfall" resulting in part from profits artificially shifted abroad *in the past* for a *permanent* relinquishing of an effective mechanism for preventing abusive income shifting *going forward*. Even the bill's lead sponsor, Senator Mark Hass, seems not to have not grasped this. In his floor remarks in support of the bill, he stated: "With money being repatriated, the tax haven law is moot and unnecessary."[13]

The tax haven law remains anything but "moot and unnecessary." It has been an effective tool in mitigating international income shifting. According to a March 2017 Legislative Revenue Office study, it generated $28.4 million in additional tax revenue in 2014, its first year.[14]

Efforts to "Piggyback" on Other New Federal Tax Provisions Aimed at Preventing International Tax Avoidance Also Likely to Be Challenged in Court

The 2017 federal tax law includes several provisions aimed at preventing abusive international income shifting in the future. In its written testimony supporting repeal of the tax haven provision, an MWE representative referred to one of these new provisions, "Global Intangible Low-Taxed Income" (GILTI). He stated: "the new federal GILTI regime provides the same anti-income shifting incentive as Oregon's tax haven provisions. Maintaining both is duplicative, complex, and adds nothing to Oregon tax policy." This claim may have convinced lawmakers that the tax haven provision was no longer needed.

Yet state piggybacking on GILTI is also in the corporate community's cross-hairs. MWE's coalition solicitation includes threats against GILTI that are almost identical to those quoted above regarding potential state taxation of the (deemed) repatriated dividends.[15]

COST has been even more explicit in raising the specter of litigation against any state that attempts to piggyback on GILTI. In a letter to all members of the Georgia legislature — sent *after* the Georgia legislature had passed and the governor had signed the bill that included the tax on GILTI — COST wrote:

Oregon's Listed Jurisdiction Policy and its Cost Effectiveness," Appendix A, https://www.oregonlegislature.gov/lro/Documents/RR%204-17%20Tax%20Havens.pdf.

[13] See: http://oregon.granicus.com/MediaPlayer.php?view_id=6&clip_id=24553&meta_id=1113782, at 18:00.

[14] Oregon Legislative Revenue Office, "An Assessment of Oregon's Listed Jurisdiction Policy and its Cost Effectiveness," March 2017, https://www.oregonlegislature.gov/lro/Documents/RR%204-17%20Tax%20Havens.pdf.

[15] STAR (State Taxes After Reform) Partnership, "Anticipating the State Tax Ramifications of Federal Tax Reform," https://www.star-partners.org/background.

> [T]he new [federal] taxation of foreign source income and related provisions is intended to shift the U.S. tax laws toward favoring domestic commerce over foreign commerce. While this may be a permissible goal for the federal government, states are limited by constitutional provisions such as the Foreign Commerce Clause that make it impermissible to favor domestic commerce over foreign commerce. Thus, while conformity to GILTI provisions may represent a modest short-term revenue boost (selective tax increase), *this revenue will be subject to extensive litigation* and may need to be refunded to taxpayers at a later date.[16]

Georgia lawmakers quickly repealed the tax on GILTI.

The new federal GILTI provisions and the other rules aimed at preventing international income-shifting just took effect on January 1, 2018, and the IRS has issued no guidance on how they will be implemented. Several tax experts who have looked at the rules believe they can be easily gamed,[17] and others have argued that overall the new "territorial" tax regime is likely to lead to more international tax avoidance, not less.[18] Nonetheless, the new federal provisions may be effective, and litigation may ultimately uphold states' authority to incorporate them in their own corporate income tax laws. But, clearly, these are both hypotheticals at present. Accordingly, it was premature for Oregon to repeal its tax haven law; doing so returned Oregon to a state of substantial defenselessness with regard to international tax avoidance strategies.

Finally, SB 1529 was amended to include a requirement that the Oregon Department of Revenue prepare an analysis of the relative effectiveness of the state's piggybacking on the new federal GILTI rules and the tax haven law in preventing international income shifting. This provision cannot be taken seriously as reasonable attempt to evaluate a critical tax policy choice in a timely manner. SB 1529 repealed the tax haven provision retroactively to January 1, 2017, while the evaluation could be delivered as late as December 1, 2020. By then, any data the Department of Revenue has collected on the revenue effects of the tax haven provision will be four years old and easily dismissed as such.

Revenue Impact Statements Didn't Mention Tax Haven Repeal or Provide Revenue Loss Estimate

None of the three Revenue Impact Statements pertaining to various versions of SB 1529 on the legislature's website mention that the bills would repeal the tax haven law.[19] Nor do they include any estimates of the loss of revenue that would result in future years as a result of repeal. These omissions are difficult to understand, for two reasons.

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[16] See: http://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. Emphasis added.

[17] See: Reuven Avi-Yonah *et al.*, "The Games They Will Play," December 22, 2017, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3089423.

[18] Chuck Marr, Brendan Duke, and Chye-Ching Huang, "New Tax Law Is Fundamentally Flawed and Will Require Basic Restructuring," Center on Budget and Policy Priorities, April 9, 2018, pp. 19-21, https://www.cbpp.org/sites/default/files/atoms/files/4-9-18tax.pdf. See also: Kimberly Clausing, "The GOP's Final Tax Bill Has Four Flaws," *The Hill*, December 18, 2017, http://thehill.com/opinion/finance/365404-the-gops-final-tax-bill-has-four-fatal-flaws.

[19] They are available at https://olis.leg.state.or.us/liz/2018R1/Measures/Analysis/SB1529.

First, as noted, a March 2017 analysis by the Legislative Revenue Office — the same organization responsible for preparing Revenue Impact Statements — estimated that the tax haven provision had generated $28.4 million in revenue in the first year it was in effect. Second, SB 1529 included a provision granting corporations a credit against the tax due on the (deemed) repatriated dividends for any tax that might already have been paid on the income from which the dividends were (deemed) "paid" due to the tax haven provision. Each of the Revenue Impact Statements attached a $20 million cost to that credit in the 2017-19 biennium, *a further acknowledgment that the tax haven provision was, in fact, currently generating revenue*.

The Revenue Impact Statements covered not only the current biennium, but the next two as well. It is difficult to understand why they reported no ongoing revenue losses from repeal of the tax haven law. It is reasonable to believe that the combination of statements by corporate lobbyists that Oregon's piggybacking on GILTI would substitute for the tax haven provision and the absence of a revenue loss figure in the Revenue Impact Statement misled many legislators into believing that no revenue loss would ensue.

COST Presented Misleading Statement on Tax Haven Law's Status

In written testimony on SB 1529 submitted for a February 26, 2018 meeting of the House Revenue Committee, COST stated:

> Tax haven provisions have also fallen out of favor with the states. Montana was the first state to adopt tax haven legislation back in 2003, and it took 10 years for another state (Oregon) to adopt similar provisions. While this type legislation gained a bit of popularity during 2013 and 2014, *only Oregon has adopted the blacklist approach*, and only four other states have adopted some type of tax haven legislation. . . .[20]

The italicized text is false. Oregon's tax haven provision, which named the specific countries for which controlled foreign corporations of U.S. parents must be included in Oregon unitary combined groups and which COST labels a "blacklist," was modeled on Montana's law (enacted 2003, effective 2004). Montana's "blacklist" remains in effect.[21]

A reasonable person who was not very familiar with the history of state enactments of tax haven laws would likely interpret the second and third sentences quoted above as meaning that Oregon was the only state that has *ever* enacted the "blacklist" approach. Even someone who was aware that Montana had had a "blacklist" upon which Oregon's law had been modeled would likely interpret those two sentences as implying that Montana's "blacklist" had been repealed.

These two misleading sentences not only falsely cast Oregon's "blacklist" approach to tax haven legislation as a complete outlier among the states, but they also served to reinforce one of COST's central arguments about why the provision should be repealed. In the first paragraph of its testimony, COST stated: "Not only is the tax haven blacklist approach arbitrary and misleading, but it is fraught with Constitutional infirmities that are on the brink of being litigated." COST devoted

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[20] Available at https://olis.leg.state.or.us/liz/2018R1/Downloads/CommitteeMeetingDocument/147444. Emphasis added.

[21] See: Montana Annotated Code section 15-31-322 at http://leg.mt.gov/bills/mca/title_0150/chapter_0310/part_0030/section_0220/0150-0310-0030-0220.html.

two paragraphs later in the testimony to this argument, under the specific heading of "Tax Haven Legislation Will Be Subject to a Constitutional Challenge." Someone who knew that Montana has had a similar "blacklist" continuously in effect since 2004 without its being ruled unconstitutional might well have questioned the likelihood that such litigation was "on the brink" of being initiated in Oregon, let alone that it was likely to be successful.

Legislature Should Reinstate Oregon's Tax Haven Law

The legislature's consideration of SB 1529 suffered from both *insufficient* information about its revenue impact and the legal vulnerability of Oregon's conformity to the deemed dividend and GILTI provisions of the new federal tax law, and *mis*information about the relationship between the repatriation and tax haven provisions and Oregon's law in relation to those of other states.

Repeal of the tax haven provision was premature at best and will damage Oregon's ability to protect itself from aggressive international income shifting. It should be reinstated, either in its prior form or in a modified form recommended by the Multistate Tax Commission (MTC), an interstate compact to which Oregon has long belonged. The MTC-recommended version of the law substitutes a set of criteria for defining tax haven nations for the specific list previously included in Oregon's law.[22] Reinstating a tax haven definition using the MTC criteria could be a reasonable compromise approach.

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[22] The MTC definition of a tax haven may be found at http://www.mtc.gov/getattachment/Uniformity/Adopted-Uniformity-Recommendations/Updated-Adopted-Recommendations/tax-haven-resolution-adopting.pdf.aspx. This definition is essentially identical to the criteria set forth in Section 317.717 of Oregon law that the Department of Revenue used to develop recommendations to the legislature for modification of the list until SB 1529 repealed the tax haven law.