MASSBUDGET *BRIEF*

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CORPORATE TAX REFORM: COMPARING HOUSE AND SENATE PROPOSALS

The House and Senate have appointed a conference committee to resolve the differences between the corporate tax reform legislation approved by the two branches. This *MassBudget Brief* describes the major differences between the two bills[1].

Both the House and the Senate endorsed significant tax policy reforms to reduce corporate tax avoidance in Massachusetts: combined reporting and what is known as "check-the-box" conformity. The basic structure of these reforms is explained in a previous *MassBudget Brief*: "Fiscal Year 2009 Tax Reform Proposals" (available at http://www.massbudget.org/TaxReformProposals.pdf). There are significant differences in the way the House and Senate bills would implement combined reporting. These differences are described in the chart below.

HOUSE	SENATE
COMBINED REPORTING CHANGES	
The "80/20 loophole"	
The House bill includes a provision that would allow corporate taxpayers to reduce their taxes by shifting profits to U.S. subsidiaries that have 80 percent of their payroll, property and sales outside the United States. This "80/20 loophole" has proven very costly in other states. The 80/20 loophole did not exist in either the tax reform bill filed by Governor Patrick or the bills endorsed by the Joint Committee on Revenue and the House Committee on Ways and Means. This provision was added to the bill by a floor amendment adopted when the bill was debated in the House.	The "80/20 loophole" does not exist in the Senate bill.

[1] In addition to the provisions described in this brief, the tax reform bills approved by both branches included a $1 per pack increase in the cigarette tax.

Authority / “Discretion” for DOR to disallow new tax avoidance techniques	
While combined reporting will significantly reduce opportunities for tax avoidance, corporations may seek new ways to avoid taxes by shifting income to entities that could be excluded from their combined filing, thereby allowing the income to be sheltered from state taxation. For example, some companies have their own insurance companies that are not subject to state income taxes. By realizing profits in these subsidiaries rather than in others, these corporations could eliminate taxes on those profits. The national model legislation (by the Multistate Tax Commission) recommends that revenue departments be authorized to include income in these subsidiaries as state taxable income when income is shifted to them for tax avoidance purposes. The Governor’s bill, the Joint Committee on Revenue bill and the House Ways and Means bill included this authority. It was removed from the final House bill via an amendment backed by members of the business community that argued the department of revenue should not have this authority to combat tax avoidance because it involves the exercise of discretion to identify when tax avoidance is occurring.	The Senate bill includes language similar to that proposed by the Multistate Tax Commission, the Governor, the Joint Committee on Revenue and the House Ways and Means Committee. The Senate language, however, limits the authority of the department of revenue to prohibit these types of tax avoidance by saying the department can act only when it is necessary “to avoid a *material distortion* of the unitary business income attributable to the commonwealth.” (emphasis added)
New Tax Break for Companies Because of Accounting Issues (FAS 109)	
The House bill includes a provision for a new tax break that was not in the proposed legislation of the Governor, the Joint Committee on Revenue, or the House Ways and Means Committee. This provision would give a new tax break to companies “if book-tax differences for the fiscal period ending during the year of enactment of this section result in an increase to a net deferred tax liability or decrease to a net deferred tax asset for any taxpayer affected by this section.” There is no publicly available explanation of what this provision could cost or what policy goals might justify the cost.	The Senate legislation does not include this provision.

Federal Consolidated Return Election	
Both the House and the Senate bills include a provision giving corporate taxpayers a tax reduction option that is available in almost no other state that requires combined reporting. Combined reporting requires that subsidiaries that are part of one core business file together, but it does not require that completely separate businesses owned by a common parent company file together. The House and Senate proposals both provide families of businesses with the option of filing one return together. Those businesses that can reduce their taxes by combining separate lines of business in one return will likely do so. The purpose of this provision is to provide greater certainty to businesses who are concerned that there could be disputes with the department of revenue over which businesses should be included in the state filing. By using the larger federal group, such disputes could be avoided. For Constitutional reasons, the state cannot require companies to use their federal consolidated return for state purposes, so the state can implement this only by making it optional. Because so few other states allow this option (it appears to be allowed only in Arizona) there is no clear evidence about what the cost will be to the state. The final House version of this provision removes language that had been in the legislation filed by the Governor and approved by the Joint Committee on Revenue and the House Ways and Means Committee that would have given DOR the authority to regulate when companies could use this option.	The Senate bill has language similar to that in the final House bill, but it includes some protection for the state by adding language that does not allow these taxpayers to reduce their taxes by more than 20 percent through this alternate filing option.

Combined Groups With Financial Institutions and non-Financial Institutions	
Because the way income is apportioned among states differs between financial institutions and non-financial institutions, the state needs to determine how to treat businesses that have some subsidiaries that are financial institutions and some that are not. The Governor's bill directed the department of revenue to develop regulations to address this issue. The House removed that authority and added language suggesting that there should not be adjustments made to reflect the different rules that apply to financial institutions and other companies.	The Senate followed the House in removing the department's authority to address this issue through regulations, but proposed putting into statute rules that would make reasonable adjustments to reflect the differences in apportionment rules for financial institutions and other types of corporations.

HOUSE	SENATE
SIGNIFICANT DIFFERENCES OTHER THAN COMBINED REPORTING	
Earned Income Tax Credit	
The House makes no changes to the Earned Income Tax Credit.	The Senate adopts a recommendation of the Governor to clarify that certain non-residents who have some Massachusetts income can claim the EITC on only that income.
Internet Hotel Resellers	
The House has no provision relating to Internet hotel resellers.	The Senate adopts a recommendation from the Governor that Internet sites that sell hotel rooms should impose the sales tax on the full price that they charge for the rooms, rather than at the lower price that they pay to the hotels.

Tax Rates	
The House reduces the corporate tax rate by 21 percent from 9.5 percent to 7.5 percent, and phases in the cut based on triggers relating to corporate tax revenue growth. The House also reduces the financial institution tax rate by 14 percent, from 10.5 percent to 9 percent, also with triggers.	The Senate cuts the corporate tax rate from 9.5 percent to 8 percent, a 17 percent reduction. The Senate also matches the House's 14 percent cut for financial institutions, bringing their rate to 9 percent as well. The Senate has these cuts occur automatically each year from calendar year 2010 through 2012. The Senate also reduces the tax rate for S-corps, which are generally smaller than publicly traded C-corps (which receive the tax reductions described above). While the way S-corps are taxed is different from the way C-corps are taxed, the Senate proposal would provide the two types of companies with comparable tax reductions.
Total Revenue	
The department of revenue has estimated that the total revenue the corporate provisions of the House bill would generate, netting out the revenue from adopting "combined reporting" and "check the box" (which is less in the House bill than the Senate bill because of the tax avoidance opportunities it allows) and the rate cuts proposed by the House, would be about $135 million in FY2009 and $41 million when the rate cuts are fully phased in.	The department of revenue has estimated that the total revenue the corporate provisions (and the provisions on hotel resellers and the EITC) of the Senate bill would generate, netting out the revenue from adopting "combined reporting" and "check the box" and the hotel reseller and EITC changes and the rate cuts proposed by the Senate, would be about $297 million in FY2009 and $169 million when fully implemented.