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Reforming Minnesota's Tax Treatment of Foreign Subsidiaries of U.S. Corporations

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The Center on Budget and Policy Priorities¹ appreciates the opportunity to submit testimony for the record in support of current proposals to reform Minnesota's tax treatment of foreign subsidiaries of U.S. corporations.

Corporations Should Be Required to Include in Their Unitary Groups Subsidiaries Formed in Foreign Tax Havens

Evidence is rapidly accumulating that multinational corporations are managing to shift massive amounts of profits earned in the United States and other host countries to subsidiaries formed in foreign tax haven countries.² By limiting itself to water's edge combined reporting, Minnesota has rendered itself substantially defenseless against these practices. Short of adopting full worldwide combined reporting, Minnesota should mitigate the damage to its tax base by requiring corporations to include in their unitary groups subsidiaries formed in readily identifiable foreign tax havens – as proposed in current Senate File 1237/HF 1440.

Three other combined reporting states – Alaska, Montana, and West Virginia – already have such a requirement in their corporate tax laws. As discussed in a March 19 letter to Senators Skoe and Rest and Representative Lenczewski from former Montana Revenue Director Dan Bucks, Montana's requirement has not generated any significant controversy nor engendered any significant compliance problems for corporations. This to be expected, since many multinational corporations do business in states in which they have an option to include *all* foreign subsidiaries in their combined groups, that is, to elect WWCR, and many of them find it advantageous to make such an election.

¹ The Center is a non-partisan, non-profit policy research institute that focuses on the impact on low-income families and individuals of federal and state budgets, programs, and tax policies.

² See, for example, Jane G. Gravelle, "Tax Havens: International Tax Avoidance and Evasion," Congressional Research Service, January 23, 2013.

During the deliberations of the Reagan Administration's Worldwide Unitary Taxation Working Group, it was widely conceded that even if states withdrew from WWCR to water's edge combined reporting, they were fully justified in including 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."³ It is worth noting that 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. SF 1237 and HF 1440 embody this latter provision.

Tax haven abuse has grown exponentially since the time of the Working Group as more and more corporations have become international in scope and the industry of tax attorneys and accountants specializing in international tax planning has expanded. If the legitimacy of including tax haven subsidiaries in water's edge unitary groups was acknowledged thirty years ago, the justification for such a policy today is even greater. Minnesota should follow the lead of Alaska, Montana, and West Virginia in adopting such a requirement; other states are likely to follow.

³ "Final Report of the Worldwide Unitary Taxation Working Group: Chairman's Report and Supplemental Views," August 1984, p. 30 (item A.5).