Facts At a Glance: Corporate Tax Update II

Overview

In 2008 the Legislature enacted legislation designed to reduce corporate tax avoidance, primarily by adopting a system known as "combined reporting" that makes it more difficult for companies to reduce their state tax liability by shifting income between subsidiaries. The legislation also contained a phased-in reduction of the tax rates for corporations and financial institutions. The state Department of Revenue estimates that this legislation will be responsible for the state collecting $307 million more in tax revenue in Fiscal 2010 than would have been collected under prior law, which reflects an incremental revenue impact of $80.3 million from Fiscal 2009.

Cost of the Rate Reduction

The $307 million estimate is the result of two factors. The provisions of the law that aim to reduce corporate tax avoidance are projected to generate $362.6 million this year. On Jan. 1, 2010 the first rate reduction is scheduled to take effect. That rate cuts is expected to cost the Commonwealth $55.6 million during the six months of FY 2010 that it would be in effect.

Future Costs

The Department of Revenue recently determined that a particular provision of the law will have a significant cost during the years 2012 to 2018. This provision, which relates to the interaction of the new law with "Statement of Financial Accounting Standards (FAS) No. 109," is expected to cost the Commonwealth at least $535 million over those seven years. This issue is explained in more detail in a recent *MassBudget* report available here: http://massbudget.org/doc/694.

Other Issue

Proposals have been made to change the combined reporting law.

The most significant of these changes relate to companies that do business both in the US and in other countries. The law includes a set of rules to address what are called "water's edge" issues. In general, companies that file combined returns are expected to pay Massachusetts taxes on the Massachusetts share of their income earned in the US. They are not expected to pay taxes here on income earned abroad. There are difficult issues that arise in determining where income is earned. The law enacted in 2008 established rules to make those determinations. Changes have been proposed to allow the income of certain subsidiaries that have income from both the US and other countries to be excluded from the taxable income of the combined return filed in Massachusetts. The goal of these changes, presumably, would be to make sure that Massachusetts does not tax income that the companies believe was not really generated in the US. The Massachusetts Department of Revenue analysis of the changes warns that "The proposed changes would enable US group income to be shifted to overseas affiliated companies, which may be located in tax haven jurisdictions or other tax-advantaged structures." The department estimates that these changes to what are known as the "water's edge" rules would cost $94 million to $134 million in tax year 2009 and more in later years.

There have also been proposals to expand which types of companies can carry forward losses to reduce their taxes in future years. Historically this has been an option for most corporations, but not for financial institutions and utilities. The rules were not changed by the adoption of combined reporting. It has been suggested that because income of different types of companies is aggregated in combined reporting that these tax advantages should be extended to utilities and financial institutions that are required to file combined returns with other types of companies. The Department of Revenue estimates that extending this tax break to financial institutions and utilities would cost $29 million to $55 million in tax year 2009.

In addition, there have been proposals to change how companies are taxed on dividends paid between members of a combined group. Under the combined reporting law such dividends are generally not taxed. Those dividends can be taxed, at least partially, when they are from pre-2009 earnings (because they wouldn't have been subject to the tax consequences of combined reporting). Eliminating all dividends between members of a combined group would cost, according to Department of Revenue estimates, $23 million to $37 million in FY 2009.

Finally, there have been proposals to allow greater sharing of tax credits among members of a combined group. The department of revenue estimates that this change would cost $16 million to $36 million in tax year 2009.

MassBudget has posted several Massachusetts Department of Revenue documents on our website so that people have access to this additional information.

There is a Department of Revenue overview of the issues, with cost estimates, here: http://massbudget.org/doc/704.

There is a more detailed Department of Revenue discussion of most of the issues here: http://massbudget.org/doc/705.

The department's more detailed discussion of the "water's edge" issues is here: http://massbudget.org/doc/706.

The analysis in this brief is based on the most recent publicly available analysis by the Department of Revenue of proposed changes to the combined reporting law.