FACTS AT A GLANCE

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A Few Commonly Asked Questions about Combined Reporting

What is combined reporting?

Combined reporting is the most accurate method of determining the amount of corporate profits that are subject to taxation in a given state. As such, it is also the most effective means of preventing corporations from artificially shifting profits from one state to another to avoid their fair share of state tax burdens. Under combined reporting, all corporate income taxpayers in the Commonwealth would be required to list all of the profits realized by all of their related subsidiaries, regardless of where those subsidiaries are located. The Massachusetts apportionment formula would then be applied to the full amount of profits listed in the combined report in order to determine how much of those profits are taxable in the Commonwealth.

What would combined reporting accomplish in Massachusetts?

Combined reporting would prevent corporations from using tax sheltering schemes to shift profits out of the Commonwealth in order to reduce their tax liabilities inappropriately. A recent study conducted by the Multistate Tax Commission (MTC) – a joint agency of 45 state governments – found that, taken together, the states lost as much as $12.4 billion in 2001 due to corporate tax sheltering. While Massachusetts has recently closed some tax loopholes, others remain and new ones will continue to be created. Charles McLure, a Senior Fellow at the Hoover Institution and a leading Treasury Department official in the Reagan Administration, has called the failure to use combined reporting "an open invitation to tax avoidance."

How much revenue would combined reporting generate?

Specific estimates of the fiscal impact that combined reporting would have in Massachusetts are not available; however, assessments of combined reporting conducted by public agencies in Maryland, Iowa, Wisconsin, Florida and Vermont indicate that it would increase corporate income tax revenue in those states from about 13 percent to nearly 25 percent. If its effect in Massachusetts fell within that same range, combined reporting could yield between $107 million and $257 million per year once fully implemented, although recently enacted changes in law may reduce that figure slightly.

Do other states use combined reporting?

At present, sixteen states, including Maine and New Hampshire, require corporate taxpayers to use combined reporting. Vermont will begin using it in 2006. California has been using combined reporting longer than any other state; it began employing combined reporting administratively in 1937. In the words of Michael McIntyre, a professor of law at Wayne State University, combined reporting "has been a success in every state that has adopted it."

Who would be affected by combined reporting?

Combined reporting is designed to close the corporate tax loopholes used by companies that conduct business in Massachusetts but that own subsidiaries across the country. Companies based in Massachusetts, but that do not have any such subsidiaries – that is, most small businesses in the state – would not be affected by this approach to corporate taxation.

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Don't corporations face a high tax burden in Massachusetts?

The total tax burden that Massachusetts businesses face has not only fallen in recent years, but it is lower than the burden that companies in many other states face. In FY 1992, the taxes paid by Massachusetts businesses amounted to 4.5 percent of personal income – an often-used proxy for corporate profits. By FY 2002, they had dropped to 4.1 percent, down from FY92 and significantly below their FY 1995 peak of 5.1 percent. In addition, a recent study conducted by Ernst & Young estimates that businesses paid 37.5 percent of all taxes in the Commonwealth in FY03; the same study indicates that the share of state and local taxes paid by businesses in the fifty states as a whole was noticeably higher – 42.7 percent. In fact, methodological flaws with that study may actually lead it to overstate the taxes paid by businesses. Nevertheless, it offers some insights into how the one of the leading business-oriented organizations in the nation perceives the Massachusetts tax structure

Would combined reporting deter companies from locating in Massachusetts? Would it harm economic growth?

Combined reporting would neither deter companies from locating in the Commonwealth nor darken the prospects of those companies already conducting business in the Commonwealth. In general, corporate income taxes represent a fairly small fraction of the total costs businesses incur; as a result, changes in those taxes have little to no effect on the decisions that businesses make. One of the most comprehensive studies on this topic was conducted in 1996 by Robert Tannenwald, Assistant Vice President and Economist at the Federal Reserve Bank of Boston; it examined business tax burdens in 22 states and found that those burdens had no statistically significant impact on the location of new investments. In addition, in a 2004 Associated Press story, Clint Stretch, the Director of Tax Policy at Deloitte & Touche, indicated that a survey the firm conducted of business executives' views on federal tax cuts shows that they "look at the broad economic climate, not just tax policy, before deciding on investments." The story goes on to quote him as saying, "'You don't build a widget maker unless you think you can sell widgets.'"