FAS 109, Single Sales Factor Apportionment, and Deferred Corporate Tax Deductions

As the Legislature considers elements of a possible tax package, it is worth focusing on a number of interrelated corporate tax issues that are now - or may become - part of the mix. At the heart of these interrelated issues is a problematic, state-level corporate tax break referred to as FAS 109. After several previous delays in implementation, this tax break became an active element of our state tax code as of January 1, 2022. While its annual cost – very roughly, about $20 million per year - is not large relative to some other corporate tax breaks, FAS 109 sets a very bad precedent, one that may result in far more expensive tax breaks in the future. (Notably, the Department of Revenue has estimated that 80 percent of the benefit of FAS 109 will go to just nine corporations, with 50 percent of the benefit going to just 3 corporations.)

What are the options for correcting the problems created by FAS 109? The best option would be to repeal FAS 109 entirely, including retroactively for tax year 2021. The second-best option would be to delay again the effective date for implementation for at least 5 years (10 years would be better) and to disallow 2021 claims. The third-best option would be to allow 2021 claims but delay future year claims by at least 5 years (10 years would be better). (Worth noting is the fact that previous delays in implementation of FAS 109 have met with little pushback from corporations. Corporations have said consistently that what's most important is not the actual receipt of the tax benefit but rather the ability to carry the tax benefit on their corporate accounting records, because this, they claim, is what could affect their stock prices.)

So, what is FAS 109 and how did it wind up in the Massachusetts tax code? Back in 2008, Massachusetts legislators approved a package of tax changes, including adoption of mandatory "combined reporting" for multi-state corporations. Combined reporting requires corporations to provide Massachusetts tax authorities with a complete picture of their tax-relevant business activities across all taxing jurisdictions. This prevents corporations from gaining a tax advantage from shifting income (on paper) among subsidiary businesses located in different tax jurisdictions.

As part of the negotiations surrounding adoption of combined reporting, corporate lobbyist succeeded in pushing legislators to agree to a phased reduction in the corporate tax rate, thereby securing a major concession for corporations in exchange for agreeing to provide Massachusetts tax authorities with more complete information regarding corporate taxable profits. Additionally, lobbyists convinced legislators to provide a further concession: adoption of the FAS 109 tax break. The argument made was that, even with a rate reduction in place, combined reporting would raise taxes for some corporations and that this tax increase could result in a small decline in the stock values of effected, publicly traded corporations. The Commonwealth, it was argued, should compensate these corporations for this possible decline in stock value.

As national tax experts have explained, there is no evidence that any such stock value declines actually have occurred. More importantly, it is not the responsibility of the Commonwealth to compensate corporations for possible fluctuations in stock values resulting from changes in the Massachusetts tax code. (This seems especially obvious when the change in question is one that, like combined reporting, is aimed simply at requiring corporations to provide accurate information to our tax authorities.) The federal government certainly does not provide any such tax breaks (known generically as “deferred corporate tax deductions”). This is further, strong evidence that such compensation is unwarranted.

Likely more important, however, than the obvious and unwarranted cost of FAS 109 itself is the dangerous precedent this policy establishes. If FAS 109 remains part of our state tax code, what is to prevent corporate lobbyists from demanding similar compensation when other changes are made to our state corporate tax code?

Here is where the FAS 109 issue ties directly into current discussions around a new, legislative tax package. A longstanding goal of corporate lobbying groups in Massachusetts has been the adoption of universal single sales factor apportionment (SSF). If adopted, SSF would change the way all multistate corporations operating in Massachusetts calculate how much of their total national profits result from their Massachusetts-based operations, and thus how much corporate income tax they owe to the Commonwealth. (Currently, a subset of industries in Massachusetts uses SSF when calculating their Massachusetts corporate income taxes.) Touted as a job creating policy change, in fact, SSF has a poor record of meeting promised job creation targets. The Department of Revenue has estimated that SSF cost the Commonwealth over $380 million a year in 2017 and that adoption of universal, mandatory SSF would cost the Commonwealth an additional $34 million annually in lost revenue.

Were universal SSF to become part of the current tax package, not only would the Commonwealth lose another $34 million in revenue, it is possible that corporate lobbyists - either now or in the future – also would seek the additional benefit of an accompanying tax break similar to FAS 109: something to compensate the minority of publicly-traded corporations that would see a tax increase, rather than a tax savings, under SSF and which therefore could argue that they might see a related decline in stock value. Similar demands could be made as well in response to future changes to our corporate tax code.

For all these reasons, the FAS 109 tax break is very poor policy and worse precedent. Though some corporations may have begun claiming the FAS 109 tax break in their 2021 Massachusetts tax filings, this is not a significant impediment to correcting the state tax code. Corporations regularly file amended returns, and the relatively small number of affected corporations can do so now with regards to FAS 109. Not only should legislators preserve the revenue that otherwise would be lost to FAS 109, legislators likewise should avoid allowing the very bad precedent that full implementation of FAS 109 would create.