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BTC Brief

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NO REWARDS FOR CORPORATE TAX AVOIDANCE:

State Policymakers Should Resist Calls to Extend Lax Corporate Tax Rules to Prior Tax Dodges

*Timely,
accessible,
and credible
analysis of
state and local
budget and tax
issues*

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KEY FINDINGS:

- A recent special report from senior officials with KPMG LLP indicates that promoters of corporate tax shelters want to apply new, lax corporate tax rules retroactively to previous tax years, which would absolve corporations from paying taxes owed on past tax-shelter abuses.
- Applying North Carolina's new corporate tax rules retroactively to prior years could put at risk over \$400 million in paid and unpaid state corporate tax revenue from prior years. The loss of revenue would trigger a new round of harmful cuts to public schools, community colleges and universities, health care, and other vital state-funded services.
- The new corporate tax rules passed by lawmakers in June created significant tax uncertainty for many corporations by dramatically changing the rules under which corporate subsidiaries would need to file a single, joint North Carolina tax return (i.e. a "combined return").
- Enacting mandatory combined reporting would steer North Carolina back on a sustainable path and away from a corporate tax system that allows a subset of big, multistate corporations to avoid paying their fair share for the public investments and services that benefit them and all others in the state.

Tax-Dodge Promoters Likely to Push to Further Weaken Corporate Tax Rules

A coalition of large multinational corporations won a major concession from North Carolina's policymakers back in June with the passage of House Bill (HB) 619. The bill, which was signed into law by Governor Perdue, placed significant restrictions on the ability of the NC Secretary of Revenue to shut down abusive corporate tax shelters like those used by Walmart, The Limited Brands, and Food Lion¹ to elude paying millions of dollars in corporate taxes owed on profits earned in North Carolina.²

A recent special report from senior officials with KPMG LLP, the corporate accounting firm behind some of the most egregious corporate tax shelter schemes of Worldcom, BankBoston, and others,³ indicates that advocates of corporate tax dodging want to push further: to absolve corporations from paying taxes owed even on past tax shelter abuses.⁴ The report signals their intention to make their case to lawmakers serving on the NC General Assembly's Revenue Laws Study Committee, which is scheduled to hold its first meeting of the new fiscal year on October 5th.

State Policymakers Recently Reaffirmed Applying Tax Changes in Future Years Only

A last-minute amendment to HB 619 on the floor of the Senate, which was further clarified in another amendment passed in the recent special session,⁵ pushed the effective date of the new constraints on the Secretary of Revenue to tax years starting on or after January 1, 2012.

These amendments prevented the new lax corporate tax rules from applying retroactively to over \$400 million in state corporate tax payments either already paid under the Department of Revenue's 2009 "Resolution Initiative," under appeal or recently assessed against companies using corporate income-shifting strategies.⁶ The direct consequence of weakening corporate tax rules retroactively would be to reward past corporate tax dodges with a multi-million-dollar windfall for a small group of corporations and their mostly out-of-state shareholders. The loss of revenue would trigger a new round of harmful cuts to public schools, community colleges and universities, health care, and other vital state-funded services.

New Rules Create Unwanted Uncertainty for Many Corporate Taxpayers

The ostensible purpose of the new corporate tax rules put in place by HB 619 was to create "certainty" for multi-state corporations conducting business in North Carolina, but the Department of Revenue's 2009 Resolution Initiative had gone a long way toward ensuring tax certainty for many of the largest corporations with operations in North Carolina. That's because the Resolution Initiative set forth tax-filing procedures, mutually agreed upon by large multi-state corporations and the NC Department of Revenue, that the 124 participating corporate taxpayers could use to file their tax returns in future years for as long as the corporations' forms remained constant. A major part of these Resolution Initiative agreements settled which corporate subsidiaries would be included in a corporation's North Carolina tax return. The passage of HB 619 actually created significant tax uncertainty for these corporations by dramatically changing the rules under which corporate subsidiaries would need to file a single, joint North Carolina tax return (i.e. a "combined return").

This creation of additional uncertainty for many corporate taxpayers is the likely reason why lawmakers, at the behest of Governor Perdue,⁷ amended the new corporate tax rules in the special September session to allow a corporate subsidiary to voluntarily file a combined tax return with its corporate parent based on the joint agreement of the corporation and the Secretary of Revenue.⁸ The corporations most likely to take advantage of this ability to voluntarily file combined returns with their corporate subsidiaries are those that simply prefer to continue filing their tax returns in accordance with their 2009 Resolution Initiative agreement. The multi-state corporations that elect not to voluntarily file combined returns will, in many cases, be rejecting tax certainty in favor of opportunities to use accounting maneuvers and tax shelters to reduce their North Carolina tax payments.

North Carolinians and Most Corporations Would Be Better Off Under Combined Reporting

Allowing multi-state corporations to avoid state corporate taxes gives them an unfair advantage over locally owned businesses that must pay their taxes, starves public services and investments of needed revenue, and results in North Carolinians and locally owned businesses paying higher taxes to cover the corporations' share.

Alternatively, instituting combined reporting would create a corporate tax system that is better suited to the modern economy, ensures that all corporations pay their fair share, and treats corporation taxpayers more equitably.⁹ Even a report by the Council on State Taxation—the coalition of multi-national corporations arguably most responsible for the new rules weakening the Secretary of

Revenue's authority to curb corporate tax abuse— gave most combined-reporting states a higher grade for tax administration fairness than North Carolina.¹⁰

For North Carolinians and the businesses that operate in the state to compete and thrive in the years ahead, both will rely on effective public investments in transportation, public education, health and safety. At the very least, lawmakers should refuse calls by a subset of corporations and big accounting firms to weaken corporate tax rules retroactively, resulting in a windfall for a few corporations and a major blow to North Carolina's public investments. Reversing course by enacting mandatory combined reporting would steer North Carolina back on a sustainable path.

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 - 2 Edwin McLenaghan. "Bill Passed in Senate Finance & Headed to Floor Today Could Derail Efforts to Curb Corporate Tax Dodging." The Progressive Pulse. June, 9, 2011. <http://pulse.ncpolicywatch.org/2011/06/09/bill-passed-in-senate-finance-headed-to-floor-today-could-derail-efforts-to-curb-corporate-tax-dodging/>
 - 3 Michael Mazerov. "State Corporate Tax Shelters and the Need for Combined Reporting." October 2007. Center on Budget and Policy Priorities. Available at <http://www.cbpp.org/10-26-07sfp.htm>
 - 4 Ann Holley and Sarah McGahan. "Have the Tables Turned on Forcible Combination in North Carolina?" State Tax Today. July 18, 2011.
 - 5 AOC Omnibus Courts Act 2011 (NC) s 8 <<http://ncleg.net/Sessions/2011/Bills/Senate/HTML/S580v4.html>> (27 September 2011)
 - 6 Public records request by author to NC Department of Revenue (July 1, 2011). Available upon request to report author.
 - 7 Laura Leslie. "Lawmakers head home after 3-day session." WRAL.com:@NCCapitol. September 15, 2011. <http://www.wral.com/news/state/nccapitol/blogpost/10131053/>
 - 8 AOC Omnibus Courts Act 2011.
 - 9 Edwin McLenaghan. "BTC Brief: Shutting Down Corporate Tax Shelters: North Carolina Should Follow the Lead of Other States by Adopting Key Corporate Tax Reform." NC Budget and Tax Center. June 13, 2011. Available at <http://www.ncjustice.org/?q=node/872>
 - 10 Scott Mooneyham. "What's fair in state taxes?" The Herald. June 26, 2011. <http://www.theherald-nc.com/2011/06/26/19004/whats-fair-in-state-taxes.html>