Legislative BULLETIN

 | Opportunity and Prosperity for All

April 21, 2009

Making Business Taxes Fairer

Implementing combined reporting will help local businesses and the state budget

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EXECUTIVE SUMMARY:

- MULTI-STATE CORPORATIONS THAT DO BUSINESS in North Carolina can move profits to subsidiaries in other states to avoid paying corporate income taxes.
- MANDATORY COMBINED REPORTING NULLIFIES these tax-avoidance strategies, raising additional revenue for the state and leveling the playing field for small North Carolina businesses.
- NORTH CAROLINA IS VULNERABLE to costly tax litigation because it currently requires combined reporting for only selected corporations, and the amount of potential liability grows each year North Carolina fails to enact mandatory combined reporting for all corporations.

AT A TIME WHEN THE STATE IS STRAPPED FOR CASH and mom-and-pop businesses are struggling to stay open, it makes no sense for North Carolina to continue allowing large multi-state corporations to avoid paying their fair share of taxes. That's why the General Assembly needs to level the playing field between small and large businesses and force these corporations to play by the rules by implementing "mandatory combined reporting."

Combined reporting simply requires corporations to be honest when filing state corporate income taxes. Current tax law in North Carolina allows parent corporations and their subsidiaries to file separate tax returns, which enables them to move profits out of the state. This way, they avoid paying for the roads they use to transport their goods, the schools that educate their workers, and the police officers who protect their property.

Now, during the budget process, is when state leaders need to consider this change. Because enactment of combined reporting is a policy change that raises additional state tax revenues, it does not require a separate piece of legislation in order to be considered and adopted. It just needs to be included in the finance package of either the house or senate budgets and then in the final budget package approved by both chambers and sent to the governor.

The Current Law

North Carolina levies a 6.9% tax on corporate profits generated from doing business within the state's borders. In fiscal year 2006-07 the corporate income tax generated $1.4 billion in revenue for the state's general fund.

Most large corporations have a parent company and subsidiaries. Some corporations artificially and intentionally take advantage of their structure in order to move profits from one subsidiary to another in order to avoid state taxes. Combined reporting treats the parent and subsidiaries as a single company for the purposes of state income taxes, nullifying these tax-avoidance strategies. Small businesses that operate only in North Carolina cannot take advantage of these strategies and therefore are at a competitive disadvantage.

It is difficult to estimate how much additional tax revenue would be generated if the state implemented combined reporting, particularly since the Secretary of Revenue has the ability to require specific corporations to file combined reports. However, when states have prepared estimates they have generally concluded that the adoption of combined reporting would increase revenue from the corporate income tax receipts by 10 to 25 percent. In 2007, an economist with the North Carolina Institute for Emerging Issues estimated the state would gain $144 million in additional tax revenues.

Several bipartisan bodies and expert tax policy organizations have endorsed combined reporting, including the Multi-State Tax Commission, the Income Tax Subcommittee of the State and Local Fiscal Modernization Commission and the Revenue Laws Study committee of the General Assembly. In addition, the NC Department of Revenue has requested this policy change from the General Assembly.

Combined Reporting in Other States

A recent study by the Center on Budget and Policy Priorities examined North Carolina' s largest manufacturing employers and determined that the vast majority of them (60 of 75) maintain a facility in at least one state that mandates combined reporting. In fact, many of the corporations examined maintain facilities in multiple combined-reporting states. CBPP found that almost half - 36 out of 75 - have facilities in five or more combined reporting states. Therefore, claims that switching to mandatory combined reporting would negatively affect business activity in North Carolina are unfounded.

The majority of states that levy corporate income taxes have instituted mandatory combined reporting. This year Wisconsin made the switch, so now 23 of the 45 states with corporate-income and similar business taxes have implemented this common-sense policy.

The Legal Threat

Failing to enact combined reporting has left North Carolina vulnerable to costly tax litigation. Current law allows the NC Secretary of Revenue to select certain corporations and force them to file a combined report if he suspects the company is using the ability to file separate reports for related entities as a way to avoid paying the appropriate amount of state income taxes. Since gaining this authority a few years ago, the Secretary has forced dozens of corporations to do so, resulting in more than $370 million back taxes paid.

Several corporations, including Wal-Mart and Food Lion (Delhaize), have challenged the state's ability to force only selected organizations to file combined reports, claiming that requiring this of some but not all corporations violates the US constitution. If North Carolina loses on the basis of this claim, it will have to repay the more than $370 million it has collected. Moreover, the amount of potential liability to the state grows each year that North Carolina fails to enact mandatory combined reporting for all corporations.

STUDY: North Carolina has lowest business tax burden in United States

US AVERAGE:	4.9%
North Carolina:	3.6% – National Rank: 50 (lowest)
OTHER SOUTHEAST STATES	
Florida:	5.2%
Georgia:	4.0%
South Carolina:	4.7%
Tennessee:	4.5%
Virginia:	3.9%

A recent study by the Ernst & Young and the Council on State Taxation found North Carolina has the lowest business tax burden as measured by the share of state and local taxes paid by businesses as a share of gross state product.