New Hampshire Legislative Commission On Worldwide Combined Reporting for Unitary Business Under the Business Profits Tax

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An Overview of the Logic and History of Worldwide Combined Reporting

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Introduction

- "A Page of History is Worth a Volume of Logic"
  - Justice Oliver Wendell Holmes, *New York Trust Co. v. Eisner*, 256 U.S. 345, 349 (1921)
- Goal of presentation is to summarize both logic and history of worldwide combined reporting as reflected in
  - U.S. Supreme Court case law addressing the constitutionality of worldwide combined reporting
  - State legislation addressed to worldwide combined reporting

Apportionment of the Income of Multinational Corporate Unitary Businesses

- From mid-1970s through mid-1990s, constitutionality of worldwide combined reporting was one of the most contentious issues in the state tax field
  - Many states, including most notably California, had extended the combined reporting concept to affiliated unitary corporate groups, including foreign corporations with operations abroad
  - Multinational corporate taxpayers contended that this violated the Commerce Clause as applied to foreign corporations because
    - It created the risk of international multiple taxation
    - It prevented the United States from "speaking with one voice" in foreign commerce because worldwide combined reporting violated the international norm of arm's-length separate accounting for attributing the income of affiliated corporate entities

Worldwide Combined Reporting of a U.S.-Based Multinational Corporation: *Container*

- *Container Corp. of America v. Franchise Tax Board* (1983)
  - Paper board packaging company, incorporated in Delaware, headquartered in Chicago, doing business in California, with overseas foreign subsidiaries engaged in global unitary business
  - Application of California's three-factor formula to income determined on a combined basis was "fair" in a constitutional sense
  - Risk of international multiple taxation by adoption of combined reporting was constitutionally acceptable
    - It was not "inevitable"
    - Possibility of multiple taxation exists under arm's-length approach
    - "It would be perverse … to require California to give up one allocation method that sometimes results in double taxation in favor of another allocation method that also sometimes results in multiple taxation"
  - Rejection of other concerns: foreign retaliation; frustration of federal policy

Worldwide Combined Reporting of a Foreign-Based Multinational Corporation: *Barclays*

- *Barclays Bank PLC v. Franchise Tax Board* (1994)
  - Barclays Group was a multinational banking enterprise including more than 220 corporations in 60 nations, including two corporations doing business in California
  - California sought to determine the liability of the taxable California entities, which Barclays conceded were part of a worldwide unitary business, based on worldwide combined reporting
  - Barclays contended that California was required to use the arm's-length separate accounting method (reflected in U.S. and global income tax regimes) as applied to foreign-based corporations and that failure to do so would violate Commerce Clause restraints applicable to foreign commerce

Worldwide Combined Reporting of a Foreign-Based Multinational Corporation: *Barclays*

- *Barclays Bank PLC v. Franchise Tax Board* (1994)
  - "Domestic" constitutional issues
    - Alleged disproportionate compliance burdens on out-of-state corporations
    - Alleged "standardless discretion" from "reasonable approximations" standard
  - "International" constitutional issues
    - International multiple taxation
      - As in *Container*, risk of multiple taxation was "real" but not "inevitable"
      - Arm's-length, separate accounting method does "solve" the problem and California cannot be required to give up one allocation method that sometime results in multiple taxation for another that sometimes does
    - The "one voice" doctrine
      - California's method did not create an automatic asymmetry in international taxation
      - Taxpayers were plainly subject to tax and the amount was more a function of the rate than the allocation
      - No specific indications of congressional intent to preempt the tax

State Legislation Restricting Worldwide Combined Reporting
(The "page of history ... worth a volume of logic")

- California's 1983 victory in *Container* sustaining the constitutionality of worldwide combined reporting led to its demise in some states and restriction in many others
- Worldwide Unitary Working Group (1984)
  - Governing principles
    - Water's edge combination for both U.S. and foreign-based companies
    - Increased federal administrative cooperation with the states to promote full taxpayer disclosure and accountability
    - Competitive balance for U.S. multinationals, foreign multinationals, and purely domestic businesses
  - Failure to reach agreement on
    - Whether 80-20 companies should be included in combined reports
    - Whether foreign source dividends paid by corporations excluded from the combined report should be included in the state tax base

State Legislation Restricting Worldwide Combined Reporting
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- Worldwide Unitary Working Group's 1984 Report Recommendations
  - States should adopt legislation or regulations limiting combined apportionment of both U.S. and foreign-based multinationals to a water's edge group
  - If "there are not sufficient signs of … progress by the states," federal legislation embodying a water's-edge limitation would be recommended
- When states did not promptly enact legislation adopting water's-edge limitations on unitary combination, U.S. Treasury proposed legislation restraining worldwide combined reporting

State Legislation Restricting Worldwide Combined Reporting
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- States' Post-*Container* Response to Threat of Federal Legislation Restricting Worldwide Combined Reporting and Political Pressure from Multinational Corporations
  - In 1983, Florida adopted worldwide combined reporting following *Container*, but repealed those provisions in 1984
  - In 1984 Oregon, one of the first states to adopt worldwide combined reporting, responded to strong pressure from the Japanese, by replacing its combined reporting regime with a state consolidated reporting based on the federal consolidated group, thereby eliminating foreign corporations from the state filing group and excluding income of foreign corporations from the Oregon apportionable tax base

State Legislation Restricting Worldwide Combined Reporting
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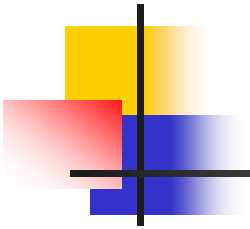
- In 1985, Arizona and Colorado limited combined reporting to water's edge income
- By 1986, California, the once feared "tiger" of worldwide reporting, as well as, Idaho, Indiana, Montana, New Hampshire, North Dakota, and Utah had followed suit
- In 1988, Minnesota likewise limited its unitary approach to domestic corporations, excluding both "[t]he net income and apportionment factors … of foreign corporations … which are part of a unitary business"
- In 1991, Alaska adopted water's edge legislation

State Legislation Restricting Worldwide Combined Reporting
(The "page of history … worth a volume of logic")

- No state currently applies worldwide combination without an elective or mandatory water's-edge or domestic corporation limitation
  - Exception of Alaska's application of mandatory worldwide combination to taxpayers engaged in production or transportation of oil and gas
  - Considerable variations from state to state as to the composition of the water's-edge group, the definition of a 80/20 corporations (e.g., whether the sales factor is included in determining the percentage), and the definition of tax havens

Concluding Observations

- "A Page of History is Worth a Volume of Logic"
  - States' headlong rush to discard or restrict worldwide combined reporting did not grow out of the states' philosophical conversion from formulary apportionment to separate accounting as the appropriate methodology of taxing a worldwide multicorporate unitary enterprise
  - The states yielded to economic and political pressures and the threats of multinationals, particularly foreign-based enterprises, that they would not locate new plants in states that applied the unitary method to the apportionment of their incomes, and the political threat of federal legislation that would restrict the use of worldwide apportionment by the states



Questions/Comments?

Thank you for your attention.