Iowa Fiscal Partnership *backgrounder*

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LOOPHOLES IN TAX TALK

Stopping the Spin on 'Combined Reporting'

Interest in plugging corporate tax loopholes in Iowa has prompted some objections that don't hold water.

THE PROBLEM THAT NEEDS FIXING

- Iowa is passing up $60 million to $100 million a year by allowing multistate companies to shelter their Iowa income from Iowa tax. These are the latest figures available from the Iowa Department of Revenue.[1]
- While billed as "legal," these strategies identify and exploit cracks in Iowa's tax code to allow companies to avoid taxes that are paid by competitors that operate primarily in Iowa. Some states have decided that some of these strategies cross the line into illegal tax evasion, and have challenged the returns of corporations using them, a protracted and costly legal process that could be avoided through changing tax law.
- Twenty states have adopted something called "combined reporting," which allows protection against aggressive tax-avoidance strategies by big corporations.[2] Iowa's neighbors in Nebraska, Illinois, Minnesota and Kansas have adopted it.
- If Iowa were to join those 20 states and plug corporate tax loopholes, 99 percent of the added revenue would come from corporations headquartered outside of Iowa.[1]

STRAIGHT TALK: OF COURSE IT'S A LOOPHOLE

The Iowa Association of Business and Industry (ABI), which opposes a change in the law, claims that tax-avoidance strategies do not use "loopholes," but simply use legal options open to them.[3]

What's happening in Iowa is profit-shifting by multistate corporations. They move profits around to low- or no-tax states, which allows them to shelter income from tax in states where the income was made. They do this in many cases by setting up shell corporations in Delaware, a practice that has no real purpose other than to divert profits from Iowa and transform them into non-taxable income. Since Iowa's business taxes are based solely on sales in the state's borders, Iowa can lose a lot of money this way – money that the tax code was designed to collect.

This is, by definition, a loophole in the tax code. And the effect is that others have to pay for it, either through lost services or higher taxes.

FAMILIES DON'T GET THESE BREAKS

An Iowa ABI official told a reporter: "Families go through the same process."[3] This is not true. When an Iowa family earns income in Iowa, it cannot shift accounting for that income to relatives in Texas, which has no income tax. Iowa businesses that have all their operations in Iowa also don't have that option. Such gimmicks are reserved only for corporations doing business in multiple states.

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THE FLORIDA MYTH

Opponents of combined reporting often drag out an old myth that Florida adopted combined reporting, only to quickly repeal it because of economic development problems. In fact, Florida adopted a different version of combined reporting — worldwide rather than "waters edge" or domestic combined reporting. It was repealed in Florida after intense political pressure from the Reagan administration, and at a time when other states that had adopted worldwide reporting retreated to the "waters edge" version that has remained in place in those states and that four other states recently adopted. It is noteworthy that not one of the 16 states that adopted combined reporting decades ago has repealed it. Furthermore, the Senate Finance Committee in Florida in 2004 recommended adopting combined reporting.

PLUGGING LOOPHOLES: GOOD FOR IOWA BUSINESSES AND JOBS

An ABI representative was quoted as stating that lawmakers would not be "interested in driving jobs and employers out of Iowa."[4] There is no evidence that combined reporting has done anything of the kind in the 16 states that have had combined reporting for decades. The combined-reporting states in fact have done much better than other states in preserving manufacturing employment over the past 15 years.

At the same time, passing this measure actually helps Iowa-based, Iowa-focused businesses in their competitive standing with out-of-state competitors, who would lose a tax advantage over them.

KEEPING STORIES STRAIGHT

ABI representatives have given conflicting views on whether combined reporting represents a "tax increase." News reports quoted different ABI representatives on the same day, with one calling the proposal a "tax increase" and another saying, "Some companies would pay more, some would pay less."[3,4]

> ***For the record, combined reporting is not a tax increase. Combined reporting is an accountability tool that simply allows Iowa to enforce the existing tax code against tax-avoidance gimmicks.***

[1] Jay Munson, "Combined Reporting: An Option for Apportioning Iowa Corporate Income Tax," Iowa Department of Revenue, March, 2007.
[2] Peter Fisher, "Leveling the Playing Field," Iowa Fiscal Partnership, April 11, 2007 <http://www.iowafiscal.org/research/070411.html>.
[3] Donnelle Eller, The Des Moines Register, April 12, 2007 <http://www.desmoinesregister.com/apps/pbcs.dll/article?AID=/20070412/BUSINESS/704120402/1029>.
[4] David Pitt, The Associated Press, Mason City Globe Gazette website, April 12, 2007 <http://hosted.ap.org/dynamic/stories/I/IA_TAX_LOOPHOLE_IAOL-?SITE=IAMAS&SECTION=AMERICAS>.

Iowa Fiscal Partnership

The Iowa Fiscal Partnership is a joint initiative of the Iowa Policy Project and the Child & Family Policy Center, two nonprofit, nonpartisan Iowa-based organizations that cooperate in analysis of tax policy and budget issues facing Iowans. IFP reports are available at http://www.iowafiscal.org.

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