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Combined Reporting

How Closing Corporate Loopholes Benefits Wisconsin

Institute for Wisconsin's Future

February 2009

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Jack Norman

Wisconsin citizens want strong communities, reasonable state and local taxes and a revenue system in which all individuals, businesses and organizations pay a fair share. IWF's Fair and Adequate series of reports examines how the current tax system works and what changes are needed to create a fair system that adequately funds the services needed for the common good.

Executive Summary

As Wisconsin grapples with economic crisis and a massive state budget deficit, state leaders are looking at new policies to increase revenue and ensure the state has resources to rebuild the economy. The corporate tax reform known as "combined reporting" was enacted in February 2009 and signed by Governor Doyle as one way to boost state income and make the state tax system more balanced. Combined reporting closes tax law loopholes that allow very large multi-state corporations to shift profits out of Wisconsin in order to minimize or avoid paying state income tax. It is already law in 22 states. This report looks at how combined reporting affects the state economy, business competitiveness and employment.

There are multiple benefits to combined reporting. Closing this loophole is expected to increase state revenue by more than $200 million between now and mid-2011. At a time when many essential public programs are at risk, combined reporting will help bring corporate support for the transportation, education and environmental infrastructure vital for economic recovery.

Combined reporting closes tax loopholes available only to firms with multi-state operations and sophisticated accounting and legal structures. This gives them an unfair advantage over smaller, state-based companies that do incur tax costs. Combined reporting provides a level tax-paying field for all companies.

In states where combined reporting has been in effect for decades, manufacturing employment is considerably stronger than in states without combined reporting. And Wisconsin's largest employers are already complying with this method of taxing corporate profits, since they operate in combined reporting states.

How will combined reporting impact business and employment?

1. The vast majority of Wisconsin's largest employers already have substantial operations in states where combined reporting is required. At least 80% of the state's 50 largest manufacturing employers, 9 out of the 10 biggest banks, and all 15 top retail employers already do business in combined reporting states.

2. Combined reporting states have had more success maintaining manufacturing jobs than states without combined reporting. Of the eight states where manufacturing employment has increased since 1990, seven have had combined reporting for over two decades.

3. Overall, U.S. manufacturing has dropped since 1990. In states without combined reporting, the median job loss has been more than 27%. However, for the 16 states which did have combined reporting, the median manufacturing job loss has been less than 6%.

In short, states that have had losses in manufacturing employment have lost those jobs for a variety of economic reasons, but combined reporting was not one of them.

Combined reporting ensures that all those who conduct profitable businesses in Wisconsin contribute to the cost of necessary public systems by paying income tax. Almost all of the state's large employers are already doing business in states that have combined reporting. The states with combined reporting retain their manufacturing job base better than states without combined reporting. Increased state revenue and real tax equity for businesses justify this reform.

Introduction

Wisconsin leaders are exploring a range of policy tools to address the state budget deficit while setting the stage for broad-based economic recovery. In February 2009, Wisconsin Gov. Jim Doyle joined with leaders of both houses of the Legislature to announce a budget-repair proposal that includes combined reporting, a change meeting both goals simultaneously. The bill, including combined reporting, became law that month.

This report examines several dimensions of combined reporting—how it works, how it benefits small and mid-sized Wisconsin businesses, and how the vast majority of large corporations in Wisconsin are already in compliance with the combined reporting laws in 22 other states without negative impact on the economy or employment levels..

What is combined reporting?

Combined reporting, which is already law in 22 other states, closes tax loopholes that allow very large multi-state corporations to shift profits from one subsidiary to another, enabling them to move profits out of Wisconsin and thereby minimize or avoid paying state income tax. With combined reporting, income for all firms in a corporate family is taken into account. As the Governor noted in his letter to legislative leaders, "Combined reporting treats corporations and their divisions, subsidiaries and affiliates as a single entity for corporate income tax purposes. This is expected to increase general fund tax revenues by $27.7 million in fiscal year 2008-09 and by $187.3 million over the 2009-11 biennium."[1]

Background

In recent years, discussion in Wisconsin about combined reporting has crossed party lines. Republican Gov. Tommy G. Thompson proposed this corporate income tax reform in the 1990s, though it was not enacted. Since then, corporate tax avoidance has increased dramatically due to the invention and proliferation of sophisticated tax-avoidance strategies. Some of these involve ploys such as having one branch of a firm pay large royalty fees to another branch of the firm simply for the right to use company trademarks, logos and slogans. The result is to transfer profits out of Wisconsin into states with lower or zero income tax. The substantial loss of revenue to the state—especially now when the deficit threatens important investments in such things as transportation, environmental clean-up, worker training and other systems vital to economic recovery—created pressure that has moved combined reporting to the top of the legislative agenda.

How does combined reporting benefit Wisconsin?

Combined reporting will do more than just increase state revenue. It will also level tax costs between local businesses and the multi-state corporations that take advantage of loopholes. And it will simplify tax compliance and collection. As summarized by three national tax experts, the "uniform treatment" involved in combined reporting leads to "a significant reduction in administrative burdens on the tax department and on complying taxpayers, and the removal of the competitive disadvantage currently imposed on local firms that are unable to engage in cross-border tax-avoidance.[2]

Combined reporting will make Wisconsin businesses more competitive, by removing the advantage now held by large corporations with out-of-state operations and sophisticated legal and accounting consultants. Combined reporting broadens the tax base among all corporations, reducing the burden on those now paying income tax. As Michael Mazerov, of the Center on Budget and Policy Priorities, has noted: "Small (often family-owned) corporations doing most or all of their business in the state in which they are located generally do not have the resources to set up 'Delaware Holding Companies,' 'captive REITs,' and other tax shelters that exploit the absence of combined reporting in the state. But their large, multi-state corporate competitors do."[3]

Are there side effects with combined reporting?

Opponents of combined reporting don't argue directly in favor of keeping tax loopholes open. They take an indirect route and assert that closing the loopholes "creates a significant disincentive to invest in and grow Wisconsin business." The quote is from a Feb. 2, 2009 press release from the Coalition to Save Wisconsin Jobs, an alignment of 17 business groups who describe themselves as "Employers United to Stop Combined Reporting."[4] They say their concern is saving jobs, not saving taxes. However, the business coalition's rhetoric does not match the facts.

Looking at the facts

This report looks closely at two sets of facts that contradict the opponents of combined reporting:

1. A large majority of Wisconsin's major employers—64 firms of the 75 studied—already operate in multiple states which have had combined reporting for decades. These employers haven't abandoned those states. They adjust to it as another fact of business life. If a company has maintained factories and other large operations in combined reporting states such as California, Texas, Illinois and Minnesota, why would they disinvest in Wisconsin if we adopt combined reporting?

2. States with combined reporting have much better success in maintaining their manufacturing job base than do states without combined reporting. Of the eight states which have increased manufacturing job totals since 1990, seven had combined reporting.

These points have already been established for Iowa and North Carolina in studies by Mazerov, which show that "fears of job loss from reducing corporate tax avoidance are unwarranted. " The data analysis in this report was based on Mazerov's studies of Iowa and North Carolina.[5]

Wisconsin's major employers maintain operations in combined reporting states

Seventy-five of Wisconsin's largest employers were examined to see in what other states they have physical facilities. This included 50 of the largest manufacturing employers, the 10 largest banks, and 15 of the largest retailers. The primary focus was on manufacturers, because, in theory, they are more capable of transferring operations away from one state to another than are retailers and other service providers, who generally must have branches in many states if they want to attract customers.

This group of companies examined was selected using data from the Wisconsin Department of Workforce Development (DWD) which identifies the largest employers in each of the three categories: manufacturing, banking and retail. The Appendix describes how the 75 firms were selected for manufacturers and retailers, and banks.[6] The Appendix also describes how it was determined in what states these companies have operations.

Findings

1. The vast majority of Wisconsin's largest manufacturing corporations have facilities in states where combined reporting is already in effect. At least 40 of the 50 manufacturers—80%—have a facility in at least one state that has combined reporting or are subsidiaries in a corporate group that has a facility in at least one combined-reporting state. By "facility" we mean a major operation such as a factory. Simply having a sales office did not count. At least 33 of the manufacturers—about two in three—have operations in at least two combined-reporting states. And 20 of the 50 have operations in at least four combined-reporting states. See Table 1 next page.

Table 1: Most of the largest manufacturing employers are already subject to combined reporting in other states

States marked with an X are where the company or its corporate family already has significant operations

Employer	AK	AZ	CA	CO	HI	ID	IL	KS	ME	MI	MN	MT	ND	NE	NH	NY	OR	TX	UT	VT
Apogee Wausau Group		X					X			X	X								X	
Appleton Papers			X					X									X			
Ashley Furniture Industries		X	X																	
Bemis Manufacturing																				
Briggs & Stratton																X		X		
Brunswick																				
Bucyrus International																				
CNH							X	X			X		X	X						
Cooper Power Systems		X					X									X		X		
Curwood											X			X						
Domtar			X				X			X								X		
Emerson Electric			X	X			X			X	X				X	X		X		
Fleet Guard											X					X				
Fort James	X	X	X	X			X	X		X	X	X	X	X	X	X	X	X	X	X
General Electric	X	X	X	X			X	X	X	X	X	X			X	X	X	X	X	X
General Motors		X	X	X			X	X		X	X					X	X	X		
Greenheck Fan			X								X									
Harley-Davidson		X					X											X		
Hutchinson Technology											X									
J.L. French Automotive Castings																				
Jennie-O Turkey			X				X	X			X			X						
Johnson Controls			X				X			X								X		
Journal Communications		X	X			X		X		X	X			X						
Karl Schmidt Unisia										X										
Kimberly-Clark			X			X												X	X	
Kohler			X														X	X		
Kolbe & Kolbe Millwork																				
Kraft Foods	X		X	X		X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Krueger International			X																	
Miller Electric Manufacturing																				
MMM	X		X				X			X	X			X		X		X		
NewPage									X	X	X									
Northern Engraving											X									
Oshkosh			X								X			X						
P&H Mining Equipment		X					X												X	
Packerland Packing		X					X											X		
Patrick Cudahy							X							X						
Phillips Plastics			X																	
Pierce Manufacturing																				
Plexus			X	X		X	X													
Procter & Gamble			X					X	X		X			X						
Quad/Graphics																X				
Rexnord Industries			X				X							X		X		X		
Rockwell Automation																				
S C Johnson & Son			X				X			X	X					X		X		
Sargento Food																				
Trane			X	X						X	X			X		X		X		
Waupaca Foundry																				
Wausau Paper			X						X		X				X			X		
Weather Shield Manufacturing																			X	

2. Of the 10 big banks, 9 operate in combined-reporting states. Three of them operate in at least ten states with combined reporting.

Table 2: Most of the largest banks are already subject to combined reporting in other states
States marked with an X are where the company or its corporate family already has significant operations

Employer	AK	AZ	CA	CO	HI	ID	IL	KS	ME	MI	MN	MT	ND	NE	NH	NY	OR	TX	UT	VT
AnchorBank																				
Associated Bank							X				X									
Bank Mutual											X									
Johnson Bank		X																		
JP Morgan Chase		X	X	X		X	X			X						X	X	X	X	
M&I Marshall & Ilsley		X									X									
National City							X			X										
North Shore							X													
U.S. Bank		X	X	X		X	X	X			X	X	X	X			X	X	X	
Wells Fargo	X	X	X	X		X	X			X	X	X	X	X			X	X	X	

3. Every single one of the 15 big retailers operates in states with combined reporting. Two-thirds of the retailers have operations in at least a dozen such states.

Table 3: Most of the largest retailing employers are already subject to combined reporting in other states
States marked with an X are where the company or its corporate family already has significant operations

Employer	AK	AZ	CA	CO	HI	ID	IL	KS	ME	MI	MN	MT	ND	NE	NH	NY	OR	TX	UT	VT
Cabela's						X	X	X	X		X			X				X	X	
J.C. Penney	X	X	X	X		X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Kohl's		X	X	X		X	X	X	X	X	X		X	X	X	X	X	X	X	X
Kwik Trip											X									
Mc Donald's	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Menards				X			X			X	X		X	X						
Roundy's							X				X									
Sears (including Lands' End & Kmart)	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
ShopKo						X	X			X	X	X		X			X		X	
Target	X	X	X	X		X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
The Home Depot	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Time Warner Cable		X	X	X	X	X	X	X	X	X				X	X	X		X		
United Parcel Service	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Walgreen's		X	X	X	x	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Wal-Mart	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X

The point is that most of Wisconsin's largest employers are now operating in a combined-reporting tax environment. If enacted here, it will not be a radically new venture. It is something the firms are familiar with and already have to deal with. It is something that has not driven these firms away from states with combined reporting.

As previous studies by Mazerov point out, 16 of the 22 combined reporting states have had such tax laws in effect for more than 20 years.[7] Its presence in California clearly did not prevent that state's extraordinary growth, including the creation of whole new industries in areas such as Silicon Valley. It is plausible to assume that many of the firms studied here located in combined reporting states after the state adopted combined reporting. Corporations expanded and/or modernized facilities knowing that combined reporting was already in place.

Most of the concern about possible job loss applies to manufacturing, not the banking or retail sectors. But the latter two kinds of businesses were included in this report to emphasize the fact that for large corporations with operations in many states—the kind of firms that combined reporting is intended to impact—combined reporting is something familiar and accepted as an ordinary price of doing business in a location which is desirable for a variety of reasons. This data indicates that Wisconsin's economy would not be affected by adopting combined reporting.

States with combined reporting hold manufacturing jobs better

There is additional data showing that combined reporting could serve Wisconsin's economy well. In recent decades, states with combined reporting expanded or maintained their manufacturing jobs base far more successfully than did states without this tax reform.

This is clear from reviewing manufacturing job statistics from the 45 states with a corporate income tax, and comparing the results over time for states with and states without combined reporting. Six of the 22 combined reporting states were eliminated from the analysis, because they have adopted combined reporting only in the past few years. The remaining 16 combined reporting states, however, have had it in effect for at least 20 years, so it is meaningful to see how they have performed in terms of retaining manufacturing jobs.

As shown in Table 4, since 1990 only eight states in all have increased their total number of manufacturing jobs.[8] Seven of these eight states are long-time combined reporting states: Arizona, Idaho, Kansas, Montana, Nebraska, North Dakota and Utah. The only state without combined reporting with an increased manufacturing job base was Iowa, and Iowa has come close in recent years to implementing combined reporting.

The situation was reversed at the bottom of the performance scale. Of the eight states which lost the highest percentage of their manufacturing jobs, seven did not have combined reporting during this period: Connecticut, Maryland, Massachusetts, New Jersey, New York, North Carolina and Rhode Island. The only long-time combined reporting state among the eight worst performers was Alaska.

Manufacturing employment has declined in the United States as a whole over the past 20 years. For the states without combined reporting during that period, the median change was a loss of 27.3%. However, for the 16 states which did have combined reporting for at least 20 years, the median loss in manufacturing employment from 1990 to the present was only 5.7%. When it came to retaining manufacturing jobs, states with combined reporting far outperformed states without combined reporting.

Table 4: Manufacturing jobs fared better in states with combined reporting

States ranked by net change in manufacturing employment, 1990-2008

Shaded states had combined reporting during the entire period

State	Change
North Dakota	53%
Utah	17%
Idaho	11%
Montana	3%
Iowa	3%
Kansas	2%
Arizona	1%
Nebraska	0%
Texas	-3%
Oklahoma	-3%
Minnesota	-5%
Oregon	-7%
Wisconsin	-9%
Kentucky	-13%
New Mexico	-13%
Louisiana	-14%
Indiana	-15%
Colorado	-18%
Vermont	-18%
Arkansas	-20%
New Hampshire	-22%
Alabama	-23%
Georgia	-24%
Illinois	-27%
Hawaii	-27%
Delaware	-27%
Florida	-27%
Missouri	-27%
California	-27%
Tennessee	-28%
Virginia	-30%
Ohio	-30%
West Virginia	-30%
South Carolina	-31%
Mississippi	-31%
Pennsylvania	-34%
Maine	-36%
Maryland	-36%
Connecticut	-37%
North Carolina	-39%
Massachusetts	-39%
Alaska	-41%
New Jersey	-42%
New York	-45%
Rhode Island	-51%

source: U.S. Bureau of Labor Statistics

Similar results are evident when comparing manufacturing job change between 2001—when the last recession began to take effect—and December 2008, the latest month for which data are available. See Table 5.

During this more recent period, all three states with manufacturing job gains were long-time combined reporting states: Alaska, North Dakota and Utah. All twelve states that lost more than 20% of their manufacturing jobs were states without combined reporting. The median change for combined reporting states was a loss of 9.1%. The median for states without combined reporting was a loss of 18.5%. Again, combined reporting states fared far better.

It should be no surprise that combined reporting has no negative impact on employment. As Mazerov notes, there is clear evidence that tax policies have minimal impact on company decisions to locate or stay in a given state: "All state and local taxes paid by corporations represent less than two and one-half percent of their total expenses on average, and the state corporate income tax represents on average less than ten percent of that amount—or less than one-quarter of one percent of total costs. A state's decision to adopt combined reporting increases that small corporate tax load only slightly."[9]

In short, states that have had severe losses in manufacturing employment have lost those jobs for a variety of economic reasons, but the corporate income tax climate was not one of them.

Conclusion

Combined reporting is an important tax reform aimed at ensuring that all those who conduct profitable businesses in Wisconsin contribute to the cost of necessary public systems by paying income tax. Contrary to "the sky will fall" claims of some corporate lobbyists, almost all of the state's large employers are already doing business in states that have had combined reporting for decades. In fact, not only do companies remain in combined reporting states, but states with combined reporting have more success in retaining their manufacturing job base than do states without combined reporting. Although more than two-thirds of the state's corporations would not be affected by combined reporting requirements, the added state revenue and increased tax equity for businesses more than justify this change in state tax laws.

Table 5: Manufacturing jobs fared better in states with combined reporting

States ranked by net change in manufacturing employment, 2001-2008
Shaded states had combined reporting during the entire period

State	Change
Alaska	8%
North Dakota	5%
Utah	5%
Montana	-2%
Iowa	-3%
Kansas	-5%
Louisiana	-7%
Texas	-7%
Hawaii	-7%
Arizona	-8%
Oklahoma	-9%
Nebraska	-9%
Oregon	-9%
Minnesota	-12%
Alabama	-12%
Idaho	-12%
Wisconsin	-13%
Connecticut	-15%
Indiana	-15%
New Mexico	-16%
Delaware	-16%
Illinois	-16%
Missouri	-16%
New Hampshire	-16%
Kentucky	-17%
California	-17%
Colorado	-18%
Florida	-18%
Mississippi	-18%
Maine	-18%
Tennessee	-18%
Virginia	-18%
Georgia	-19%
Arkansas	-20%
West Virginia	-20%
Ohio	-20%
Pennsylvania	-21%
South Carolina	-21%
Vermont	-21%
New York	-22%
Maryland	-23%
Massachusetts	-23%
New Jersey	-23%
North Carolina	-26%
Rhode Island	-29%

source: U.S. Bureau of Labor Statistics

Appendix

To determine largest employers among manufacturers and retailers, data were obtained from the Wisconsin Department of Workforce Development. Their list, Largest employers: Private-sector establishments only [see footnote 6] puts employers in categories such as 1000+, 500-999, 250-499 and so on, rather than a more specific number. So while it was possible to examine all employers with 1000 or more employees, it was not possible to put together a definitive ranking of firms. The Department does provide an overall ranking of the 50 largest employers in the state, but most of those firms were in such fields as health care, insurance and utilities, which generally are taxed on a different basis and were not considered for this report. The employment data, the latest available, are from the quarter ending March 2007.

The list of largest banks was based on the ten banks with the largest market share for deposits in Wisconsin, as reported by the Federal Deposit Insurance Corp. [see footnote 6] These are the ten banks in the state that have a market share of 1% or greater. Together, they account for 55% of all bank deposits in the state. The data are from June 30, 2008.

To determine where a company has factories or other major facilities outside Wisconsin, the starting point was the firm's home page on the Web. Companies generally give information about themselves, sometimes including a list of major facilities. Often, a search of the web site showed that the firm is part of a larger firm, in which case the parent firm's facilities were searched. For some companies that sell stock to the public, their annual 10-K reports to the Securities and Exchange Commission list the company's properties. These reports are available through the Investors' tab on a company's web site. Some firms don't list all their sites, even in the 10-K, and they must be found elsewhere. In some cases, information on factory locations was found only by searching through jobs that were posted on a company's web site. Mazerov's methodology was a guide.

Notes

[1] Letter from Gov. Jim Doyle to Sens. Russell Decker and Mark Miller and Reps. Michael Sheridan and Marc Pocan, Feb. 11, 2009, accessed at: www.wisgov.state.wi.us/docview.asp?docid=15919.

[2] Michael J. McIntyre, Paull Mines and Richard D. Pomp, "Designing a Combined Reporting Regime for a State Corporate Income Tax: A Case Study of Louisiana," Louisiana Law Review, Vol. 61, pp. 699-761, 2001.
Accessed at: papers.ssrn.com/sol3/papers.cfm?abstract_id=314801.

[3] Michael Mazerov and Katherine Lira, Almost All Large Iowa Manufacturers Are Already Subject to 'Combined Reporting' in Other States, April 3, 2008, Center on Budget and Policy Priorities, p. 5. Accessed at: www.cbpp.org/4-3-08sfp.htm.

[4] Memo to Wisconsin legislators from the Coalition to Save Wisconsin Jobs, Feb. 2, 2009. Accessed at Wisconsin Manufacturers & Commerce, www.wmc.org/PDFfiles/Coalition_2-02_09ltr.pdf.

[5] For the Iowa study, see Note 3. Also, Michael Mazerov, Most Large North Carolina Manufacturers Are Already Subject to 'Combined Reporting' in Other States, Jan. 15, 2009, Center on Budget and Policy Priorities. Accessed at: www.cbpp.org/1-15-09sfp.htm.

[6] Data from Wisconsin Department of Workforce Development, Largest employers: Private-sector establishments only. Accessed at: dwd.wisconsin.gov/oea/largest_employers/largest_employers.htm. Bank data from Deposit Market Share Report, June 2008, by the Federal Deposit Insurance Corp. Accessed at: www2.fdic.gov/sod/sodMarketBank.asp?barItem=2.

[7] Mazerov and Lira on Iowa, p. 4.

[8] U.S. Bureau of Labor Statistics, State and Metro Area Employment, Hours, & Earnings. The figures used are for December 1990, December 2001, and December 2008 (preliminary). Accessed at: www.bls.gov/sae/data.htm.

[9] Mazerov on North Carolina, p. 5.

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