



Combined Reporting

Leveling the Playing Field to Help Louisiana's Home-Grown Businesses

A Loophole for the Big Boys

Louisiana's home-grown companies often compete for business against large, multistate, and multinational corporations whose size and wealth give them significant advantages. One is their ability to capitalize on the way Louisiana law is written to avoid paying millions of dollars in taxes.

Local firms pay corporate income taxes to the state on all their business profits. Multi-state firms, on the other hand, can hide much of their profits by creatively claiming, for tax purposes, that these profits were made outside Louisiana.

Because of this loophole, other Louisiana taxpayers – companies and families – have to pay more taxes to pick up the slack for profitable multi-state corporations, or make do with less revenue and have a weaker system of public services – poorer schools, under-resourced universities, fewer supports for elderly residents, and the like.

How it Works

For businesses that operate only in Louisiana, calculating the state corporate income taxes they owe is straightforward – all of their profits are taxable in Louisiana. But multi-state corporations get to take a different approach. They are allowed to shift profits to subsidiaries set up in states with little or no corporate income tax, for no other purpose but to avoid paying taxes they otherwise would owe.

This leads to all sorts of shenanigans. Walmart, for instance, transferred ownership of all its stores to a real estate investment trust (REIT) subsidiary. Then, the company paid rent to the REIT subsidiary for use of each of the stores – in effect paying itself rent on its own stores. This rent payment allowed Walmart to reduce its taxable profits. And, because most states effectively exempt REITs from taxation, only the state where the rent-collecting subsidiary was located could tax the profits when they were passed on as dividends to the REIT's owner – which was Walmart. But, in fact, that state in which the dividends were received didn't tax them, either — so Walmart completely escaped taxes on "rent" diverted to the REIT.

Toys-R-Us and other companies have used a similar scheme. They transfer ownership of their trademarks or patents to a subsidiary holding company created for that purpose in a state such as Delaware or Nevada that does not tax royalties, interest, or similar types of "intangible income." The holding company then charges the parent company a royalty for use of the trademarks or patents. The parent company deducts these royalty payments from its taxable profits, reducing the taxes it owes. And, because the holding company is located in a state that exempts that kind of profit from tax, the subsidiary owes no tax on the royalty profits it collects. Thus, profits are shifted from the state such as Louisiana in which they are earned and could be taxed to a state in which they were not earned but are exempt from tax. It's a win-win for the company – but a loser for everyone else.

Trying to stay on top of each of these tax avoidance schemes is hard for any state. Big firms like Walmart and Toys-R-Us employ armies of highly paid tax attorneys and accountants to figure out new ways to exploit tax loopholes.

How to Make it Right

What some states have been able to do successfully, though, is change their corporate tax laws to a system called “combined reporting.” It’s a comprehensive and – above all -- fair policy approach that ends the inefficient and costly practices companies engage in to avoid taxes.

Here’s how combined reporting works. The profits of the “parent” company and its subsidiaries that make up the typical multi-state corporation are added together. Once their total national profits are determined, corporations calculate how much of their total U.S. profits are attributable to Louisiana using a formula that is based on objective measures of the amount of economic activity they have in the state. Because they included all their profits in the basic calculation, they can’t artificially shift income to subsidiaries or otherwise hide any profits from being properly taxed. This method helps level the playing field between multi-state companies and local businesses. It eliminates the unfair competitive advantage enjoyed by multi-state corporations operating in Louisiana – and provides the state with revenues to pay for necessary services (including those used by the big companies).

Twenty-three states, including Texas, have switched to combined reporting; 16 of those states have required combined reporting for at least two decades, whereas seven more have put it into effect since 2004. A majority of states that have corporate income or similar business taxes now use the procedure. It is under consideration in several other states as well.

If Louisiana required combined reporting, the state would have collected between \$31 million and \$61 million more in corporate income taxes in the current fiscal year from multi-state corporations who now can use the loophole to hide profits from taxation. When economic activity returns to its pre-recession level, the state’s take would be \$60-120 million. Every year we wait to make this reform costs Louisiana families and businesses more.