US: Tax shelters for the rich starve state budgets

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Tax shelters, loopholes and "aggressive accounting" cost states more than one third of the revenue due from taxes on corporate profits in 2001, according to a study released Tuesday by the Multistate Tax Commission (MTC), a national organization of taxing authorities representing 45 states.

The result, according to the report, is that $12.4 billion was diverted from schools and other public services, a phenomenon that only exacerbates the current fiscal crisis faced by cash-strapped state legislatures across the United States.

The scope of this crisis was described earlier this year in a separate study by the National Conference of State Legislatures. The report indicated that states faced budget deficits of $78 billion as they approached the 2004 fiscal year.

"There are very real and very painful state budget deficits in America today," said South Carolina Department of Revenue Director Burnet R. Maybank, in releasing the MTC report. "It is apparent that the revenue shortfall in many states is significantly larger because of tax sheltering."

The picture outlined in the eight-page report is essentially one of legalized tax evasion by the wealthy. By itself, it represents but a snapshot of a process carried out, over a period of decades, of shifting the tax burden in the United States from corporations to millions of American middle class and working people.

According to the report, state corporate income taxes, as a proportion of profits, dropped by more than a third—from about 9 percent during the 1980s to 5.9 percent in 2001.

State corporate income taxes that year totaled $35.4 billion, but would have been as much as 35 percent higher had corporations not made such extensive use of loopholes and tax shelters, both domestic and foreign. The phenomenon, the report concludes, is "adding to the size of state budget deficits while undermining the equity and integrity of state tax systems."

"It is not enough to say that state corporate tax revenues are declining just because of federal tax changes or state tax-cutting during the 1990s," the executive summary states. "It is apparent that various corporations are increasingly taking advantage of structural weaknesses and loopholes in the state corporate tax systems."

In the Pacific Northwest, the state of Oregon offers a useful perspective. Although that state ranks near the bottom of the list in terms of the percentage of potential tax revenue lost, a recent report in Oregon's largest newspaper on the use of tax loopholes illustrates how even a relatively small bite out of a state's corporate tax revenue assumes a criminal and grotesque character.

The *Oregonian* reported on May 25 that 65 percent of that state's corporations paid no income taxes in 2000. Instead, the companies—including the state's largest utility, Enron subsidiary Portland General Electric—wrote $10 checks, the minimum that is required on zero liability. Although not all businesses are corporations, more than 23,000 of the latter paid the $10 minimum, the newspaper reported.

The same article noted that a report by the Oregon Office of Economic Analysis showed that corporate tax collections for the two-year budget period that ended June 30 dropped to their lowest level in a decade. Corporate taxes as a percentage of the state's general fund revenue shrank to 4 percent in 2001-2003, from 7 percent in 1999-2001.

"At no time since record-keeping began in the late 1970s has the corporate contribution to the state budget been so low," according to the article.

As outrageous as this situation sounds, it is important to understand that in the context of the most recent data reported by the MTC, Oregon is among those states that is affected the least by the so-called “aggressive accounting” practices the national group examined. The study found that Oregon collected $323 million in 2001 but could have received $80 million more, which translates to a 24.8 percent loss. By that measure, Oregon ranks 40th on the list.

At the other end of the scale, 10 states—West Virginia, Ohio, Florida, Mississippi, Vermont, South Carolina, Connecticut, Louisiana, Tennessee and Indiana—each lost more than 41 percent of the corporate tax revenue they were entitled to. West Virginia lost the greatest share. It collected $113 million but was deprived of $65 million more—a whopping 57.8 percent.

The typical state suffered losses of more than 31 percent, the report found. In terms of dollar losses, the hardest hit state was California, which lost about $1.34 billion. Illinois showed a $693 million loss, and Texas lost $607 million.

The majority of the losses identified by the MTC analysis are linked to what the report terms “exotic” tax sheltering techniques, such as: shifting taxable income to other nations through the pricing of goods and services that is involved in transactions between jointly-owned companies; creating separate corporations to house “intangibles” and then “siphoning profits away from taxation in the states in which the companies actually do business”; and relying on tax havens such as Bermuda.

The study does not identify any corporations by name, but newspaper reports out of Wisconsin—which lost about $174 million to tax shelters—provide a glimpse of specific companies and the methods they employ.

According to a series of articles published during the last few months by the *Capital Times*, some corporations have avoided paying taxes in Wisconsin by “aggressive tax management” schemes that include shifting income to states with no corporate income tax, or making “royalty payments” to subsidiaries and then deducting that money from their state income taxes as a business expense.

In one such case, Kohl’s Corp. is fighting the state’s effort to collect $800,000 in taxes and penalties stemming from the company’s use of a trademark subsidiary.

Also, the newspaper has reported that some 80 percent of the banks in Wisconsin have set up subsidiaries in Nevada, which has no corporate income tax. Records cited by the newspaper show than 11 of the 15 largest banks in Wisconsin paid no corporate income tax in 2000 or 2001.

According to one news report Wednesday, California State Comptroller Steve Westly said the pervasive use of tax shelters “is a slap in the face of every taxpayer who plays by the rules.”

Utah tax commissioner R. Bruce Johnson told the *New York Times*: “A third of these resources are dropping off the radar because aggressive companies are availing themselves of tax planning strategies that are not available to smaller companies or to individuals, and the result is unfair to the vast majority of taxpayers.”