Happy New Year, Multi-State Corporations!

DC Council Inaction Could Give You A $22 Million Gift at The Expense of DC Taxpayers

by Jenny Reed and Elissa Silverman

Mayor Vincent Gray has made it abundantly clear that dealing with the District's looming $400 million budget shortfall next year will be his biggest immediate challenge. However, you may not have heard that Gray and the DC Council could be making the gap even bigger by failing to follow through on an important corporate tax reform they adopted last year. If they don't take action soon, the city could lose $22 million in needed tax revenue by allowing big multi-state corporations to continue to avoid paying taxes to the District.

Right now, corporations like CVS and Starbucks are taking advantage of weaknesses in our tax system by shifting profits they make in DC to other states that have lower — or no — businesses taxes. The result? They avoid paying their fair share of DC taxes while local businesses and residents pick up the slack in tax revenue.

This doesn't sound like good tax policy. And the DC Council seemed to agree, when it passed an important tax reform in 2009 to prevent this abuse of corporate tax shelters called "combined reporting."

So everything has been fixed, right?

Not yet. The problem is that the Mayor and Council haven't spelled out the rules and details so that corporations can actually start abiding by combined reporting this month as planned. The result of this inaction? A $22 million larger hole in our budget next year. This comes despite the fact that a majority of states with a corporate income tax use combined reporting, and DC's Chief Financial Officer Natwar Gandhi endorses it. In fact, Gandhi has made it easy for the Council to take action because his office has drafted the legislation needed to implement this important reform.

So is it too late?

No. If the Mayor and Council act soon, combined reporting can go into effect and the District can collect the taxes it needs from Macy's, Home Depot, and others. At a time when funding for libraries, parks, and assistance to poor families has been cut, and more cuts will be coming soon, our leaders should be doing everything they can to keep DC's revenue base healthy and strong.

The Tax Evasion Game That Big Corporations Play

Should a locally-owned hardware store be taxed more than a branch of a national retailer? Of course the answer is no. Yet right now, national retailers and other corporations often have a distinct tax advantage over local DC businesses. These companies engage in complicated tax-avoidance strategies that artificially shift profits out from states where they are earned and into states where the business tax rate is lower— or where a corporate income tax doesn't exist at all.

This happens because most large, multistate corporations are composed of a "parent" corporation and a number of "subsidiary" corporations owned by the parent. Some major retailers shift profits earned by subsidiaries to reduce their taxes. For example, Toys R Us has its corporate logo registered in Delaware. Each store pays a royalty to this Delaware subsidiary, which takes profits earned across the country and moves them to Delaware, which just happens to not have a corporate income tax.

DC doesn't have a Toys R Us, but there are many other multi-state corporations in the city that use practices like this to deny the District needed revenues to help fund schools, libraries, health care and roads. The result is that individual taxpayers and small businesses have a heavier tax burden.

The DC Council passed legislation to stop this abuse last year, and combined reporting was supposed to take effect Jan. 1, 2011. At the time the Council adopted combined reporting, CFO Gandhi estimated this tax reform would add $20 million to DC coffers in FY 2012, and this was used to balance the FY 2012 budget. Gandhi has recently upped the revenue from combined reporting to $22 million.

However, the Mayor and DC Council have not moved on legislation to implement the law, even though the CFO's prepared draft legislation. If nothing happens, then the budget for 2012 will fall $22 million further into the hole. That means $22 million more in cuts while multi-state corporations continue to pocket money that should be coming to the city.

Gandhi has also expressed his support for the law, telling the Washington Examiner: "This legislation is a fair and equitable revenue source for the District…It is being adopted by many states." In fact, combined reporting is recognized by economists and tax experts as the most comprehensive way for states to stop corporations from abusing tax shelters. Twenty-three states of the 45 with a corporate income tax use combined reporting.

Combined Reporting Poses No Harm to DC's Business Climate

Multi-state corporations lobby against combined reporting, but here's an important fact to keep in mind: Many of the corporations that would be impacted by combined reporting in DC are already subject to it in other states. Companies such as CVS and Marriott already follow the combined reporting law in these states, and it has not proven to be a disincentive to do business there.

In fact, most states with combined reporting have had it in effect for decades, and they include some of the most economically-successful states in the country. Studies suggest that combined reporting has not affected their economic competiveness.

At a time when cuts are being made to libraries, parks and poor families with children — and when DC government employees are being asked to forgo pay, lack of action on this important tax reform will mean deeper cuts next year while multi-state corporations continue to avoid paying DC taxes.

Mayor Gray has said we need to make tough choices to tackle our budget shortfall. And Council Chairman Kwame Brown has argued that DC should be fighting to collect taxes owed to us before we talk about raising taxes.

Combined reporting shouldn't even be a tough choice. It's a no-brainer. The DC Council should take the final steps needed to implement combined reporting and pass the necessary legislation as soon as possible.

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