Tax haven legislation is growing in popularity

David M. Kall | Friday, April 22, 2016

There has been much news lately about corporate practices that reduce an entity's tax burden. Just last week, we discussed Philadelphia's attempt to stem the use of inversions by way of legislation that would require any firm that wants to enter into a contract with the city to sign a contract stating that it is not a tax inversion company. According to the U.S. Department of Treasury, an inversion occurs when a "U.S.-parented group… acquires a smaller foreign company and then locates the tax residence of the merged group outside the United States, typically in a low-tax country." New federal tax rules, released on April 4, 2016, lead Pfizer and Allergan to abruptly call off their merger on April 6, 2016.

Another tax avoidance method is sheltering income in a foreign jurisdiction, or tax haven. However, as we described last month, a February 2016 report by the State Tax Research Institute (STRI), ***State Tax Haven Legislation: A Misguided Approach to a Global Issue*** (Report), concluded that there is little clear evidence to support the argument that profit shifting to tax havens is eroding the state corporate tax base.

Even so, in November, **MultiState Insider** explained that during 2015, lawmakers introduced 16 bills in 11 states and the District of Columbia. One of the few states that actually passed something last year was Connecticut, by way of **H.B. 7061**, the state's biennial budget bill, and the implementing bill, **S.B. 1502**, which Gov. Dannel Malloy signed on June 30, 2015. SB 1502 defines a tax haven as a jurisdiction that, among other things, lacks transparency, "has created a tax regime which is favorable for tax avoidance," or "has laws or practices that prevent effective exchange of information for tax purposes with other

governments on taxpayers benefiting from the tax regime."

In addition, on May 27, 2015, Washington D.C. passed the **Combined Reporting Clarification Act of 2015**, which identified 39 specific jurisdictions as tax havens, and was intended to enable more effective enforcement of tax laws. This measure was expected to increase business income tax revenues by $3.7 million in fiscal year 2017, and by a total of $10.6 million in the fiscal years 2016 through 2019.

Now, a recent ***Bloomberg*** article reveals that more and more state lawmakers are looking for ways to mitigate the effects of tax haven usage. In Kansas, for instance, **House Bill 2680** establishes that a corporation is subject to state tax laws when it is in a unitary relationship with the taxpayer, and that is incorporated in a tax haven. HB 2680 includes a list of those tax havens, such as Aruba and the Bahamas.

Kentucky's **H.B. 86** requires combined reporting of all business income, disallows tax haven transactions and requires disclosure of all reportable transactions. In H.B. 86, a tax haven means one of the 44 jurisdictions listed.

In Maine, **LD 1634**, which is expected to increase general fund revenue by almost $5 million in fiscal year 2016-17, requires corporations who file unitary income tax returns to include income from certain jurisdictions outside the United States in net income when apportioning income among tax jurisdictions. Like the other legislation, Maine's incorporates a list of the external jurisdictions.

Lastly, **SF No. 3318**, in Minnesota, renders any corporation subject to the state tax laws when, among other things, it is incorporated in a tax haven, or reports that at least 20 percent of its gross income is derived from sources in one or more tax havens. SF No. 3318 names 46 jurisdictions as tax havens.

Bloomberg suggests that as this kind of legislation passes, assuming tax avoidance scandals remain in the news, there will be a domino effect that will spread throughout the country. The article quoted the executive director of the Institute on Taxation and Economic Policy, who speculated that "years after the revelations that Apple and Google and Microsoft have been twisting the international tax system around like a pretzel, I don't think these revelations have lost their capacity to shock." A Colorado lawmaker, who proposed a bill there that has since died, opined that "[i]f we keep pressing forward and these type of scandals keep breaking, like the Panama Papers, and people get more and more information about how blatant this tax evasion has become, then I have to believe people eventually will come around."

The article acknowledged the conflicting evidence that tax haven legislation saves states money. It referenced the STRI report, and others, that show that "[t]he volume of empirical data substantiating or refuting the need for tax haven legislation is vast and often difficult to reconcile. Practitioners particularly stress the difficulty in quantifying the state-specific impact of corporate profit shifting."

Some prefer tax overhauls, not laws, to address the problem of revenue loss. At the federal level, **Morningstar** revealed that a group of bipartisan high-ranking Treasury officials and economists from six presidential administrations have urged current Treasury Secretary Lew to reconsider the anti-inversion rules that caused Pfizer and Allergan to call off their merger. Instead, they suggest, he should address the competitive disadvantages that harm capital investment, employment, and economic growth. "Inversions are a symptom. The disease is America's anomalous international tax code."

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Team member bio

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