

CHAPTER SIX

CORPORATE INCOME TAXES

A robust corporate income tax is an important tax fairness tool. It ensures that the large and profitable corporations that benefit from public services pay their fair share towards the maintenance of those services, just as working people do. The corporate tax is also one of the few progressive taxes available to state policymakers.

More than forty states currently levy a corporate income tax, but a variety of forces have combined to weaken the tax over the past quarter century. This decline is troubling for at least two reasons. First, rather than arising solely from the conscious design of elected officials, it appears to be at least partially the result of tax avoidance strategies by multi-state corporations. Second, the less that profitable corporations pay in taxes, the more working people must pay to shore up their states' tax systems.

This chapter discusses the rationale for taxing corporations; explains the basic workings of the corporate tax; details the downward trend in the tax over the last thirty years; explores some of the factors that have contributed to that decline; and reviews some of the reforms—at both the federal and the state level—necessary for revitalizing this important revenue source.

Why Tax Corporations?

Corporations are legally considered “persons,” eligible for many of the same rights and protections as ordinary men and women. Corporations are also granted certain privileges—such as limited liability and perpetual life—that everyday people do not enjoy. And just as working families and individuals benefit from the services that state and local governments provide, so too do corporations. Corporations rely on a state's education system to provide a trained workforce, use a state's transportation system to move their

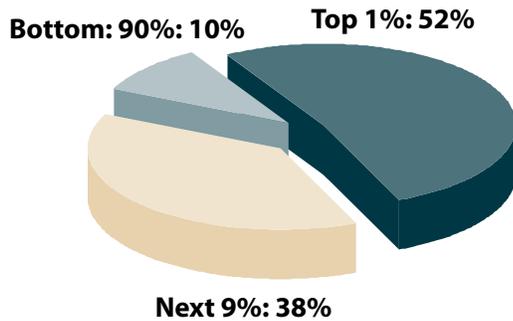
products from one place to another, and depend on the state's court system and police to protect their property and business transactions. Consequently, corporations should contribute to funding these services just as working people do. While corporations—like individuals—may pay taxes on the purchases they make or on the property they own, they should also pay taxes on the profits they realize, much in the way that people earning a living in the state pay taxes on their income.

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Of course, while a corporation may be treated as a single legal person, it exists in reality as a collection of individuals—the shareholders that own it; the executives and staff that work for it; and the consumers that buy its products. As a result, any tax levied on a corporation ultimately falls on one of these groups. Economic research generally indicates that for the most part, it tends to be borne by corporate shareholders.

From a fairness perspective, the corporate tax has three important attributes:

Corporate Stock Ownership, 2007



Source: Kennickell, Arthur B. "Ponds and Streams: Wealth and Income in the US 1989-2007."

- **The corporate income tax is one of the most progressive taxes a state can levy.** Since stock ownership is concentrated among the very wealthiest taxpayers, the corporate income tax falls primarily on the most affluent residents of a state. As the chart on this page shows, the wealthiest one percent of Americans held just over half of all corporate stock in 2007, while the poorest ninety percent of Americans owned just 10 percent of the total.
- **The corporate income tax is, in part, exported to other states.** Because most multi-state corporations have shareholders around the country and around the world, the bulk of a state's corporate income tax will ultimately fall on residents of other states and countries. The ability to export some portion of the corporate income tax may hold great appeal for state policymakers, since it may be their only option for taxing those out-of-state shareholders who benefit indirectly from the services provided to in-state corporations.
- **The corporate income tax serves as an essential backstop to the personal income tax.** Without the corporate tax, much of the income of wealthier Americans would go entirely untaxed, as individuals could easily shelter their personal income by putting it in a corporate form.

How Corporate Income Taxes Work

In its simplest form, the corporate income tax is a tax on corporate profits—that is, receipts minus expenses. Like the personal income tax, the corporate tax is based on the "ability to pay" principle: just as someone who does not have any income in a given year usually does not owe any personal income tax, a corporation that does not realize a profit in any one year generally does not owe any corporate income tax that year.

Here's an overview of how the state corporate income tax is calculated:

- **Determining who can be taxed.** A given company must determine whether it has nexus in a given state—that is, the company must determine whether it engages in a sufficient level of activity in the state to be subject to tax. The amount of in-state activity in which a company must engage before achieving nexus with a state for corporate income tax purposes is defined by a little-known federal law known as Public Law 86-272, which says that a state cannot apply its corporate income tax to companies whose only connection to the state is the solicitation of orders from, or the shipment of goods to, the residents of the state. In recent years, an increasing number of states have determined that physical presence is not necessary to establish substantial nexus. They have successfully argued in court that out of state businesses selling services to state residents (such as banking or accounting) should be subject to the corporate income tax because they have an "economic presence" in the state and are benefitting from state provided public services to conduct their business activities. As will be discussed later in this chapter, companies are well aware of nexus requirements and may structure their operations so that they avoid "crossing the nexus threshold"—and, by extension, the corporate income tax—in some of the states in which they do business.
- **Measuring profits.** Potentially taxable companies must calculate the net income, or profit, that it earned over the course of the year. To do this, most states "piggyback" on the federal corporate income tax, using the federal definition of taxable income as a starting point. While this dependence on federal tax law leaves states vulnerable to potential revenue losses in the event the law changes—as has been the case with accelerated depreciation rules or the deduction for "qualified production activities income" (QPAI) enacted in recent years—it makes tax administration easier both for states and for taxpayers.
- **Splitting income into "business" and "non-business" components.** The next step is to divide a company's taxable income into a "business income" component and a "non-business income" component. Business income is typically considered to be the profits a company earns from its day-to-day business operations (and therefore must be distributed among the states in which it operates). Non-business income arises from certain irregular

transactions such as the sale of an asset no longer used in day to day operations and is allocated in full to the state in which such a sale occurs or to the state in which the part of the company generating such income is situated (usually the state in which a company is headquartered).

- **Apportionment, or determining each state's share of corporate "business" income.** For obvious reasons, a given state is not allowed to simply tax all of the profits of any company that has nexus in the state. If states could do this, the profits of companies that operate in multiple states might be taxed many times over.

Instead, states are required to levy their corporate income taxes in such a way that the whole of a company's profits are subject to tax just once.¹

States conform with this requirement by dividing their business income into an "in-state" portion (which is taxable in a given state) and an "out-of-state" portion (which is not). Each state uses what is known as an apportionment formula to accomplish this step.

In the 1950s, legal reformers worked to set up a fair, uniform way of distributing profits among states, so that the profits of companies operating in multiple states were taxed exactly once. The result was a model piece of legislation—the Uniform Division of Income for Tax Purposes Act or UDITPA—that is today part of about twenty states' tax codes. UDITPA recommends relying on three factors to determine the share of a company's profits that can be taxed by a state. These factors are:

- The percentage of a corporation's nationwide **property** that is located in a state.
- The percentage of a corporation's nationwide **sales** made to residents of a state.
- The percentage of a corporation's nationwide **payroll** paid to residents of a state.

The main rationale for using these three factors is that it is impossible to determine with any accuracy the specific parts of a company that generate a given dollar of profit, let alone the states in which those parts may be located. These three factors are viewed as reasonable approximations of the share of a company's profit that arises from doing business in a state, based on both the demand for company output in the state (the sales factor) and the production activity in which it engages in that state (the property and payroll factors), since profits are a function of both demand and supply.

UDITPA's recommendation was to assign each of these three factors an equal weight in distributing a company's business income among the states in which it operates. In other words, the percentage of a company's business income that can be considered "in-state" is the average of these three percentages. If one supposes that the Acme Corporation operates in three states—each of which uses an equally-weighted three factor apportionment formula, as UDITPA recommends—40 percent of its business income will be apportioned to State A, 25 percent to State B, and 35 percent to State C. In each case, these percentages are the averages of Acme's sales, property, and payroll factors in each state. For instance, Acme has 50 percent of its total sales, 20 percent of its property, and 50 percent of its payroll in State A. The average of these factors is 40 percent; accordingly, 40 percent of Acme's business income will be apportioned to State A.

- **Calculating tax:** Having determined the share of its total taxable income that is attributable to a given state (including the amount of business income that can be apportioned to the state and the amount of non-business income that is allocated to the state), the resulting sum is multiplied by the state's corporate tax rates to yield a tax amount.
- **Subtracting credits.** Many states now allow targeted tax credits (for example, credits for research or investment activities) that companies can subtract directly from their pre-credit liability.
- **Pay the Minimum.** Most states now require that even technically unprofitable corporations must pay some minimal amount of income tax. As is discussed at greater length later in this chapter, states' minimum taxes vary from very modest flat dollar amounts to more substantial sums based on a company's net worth.

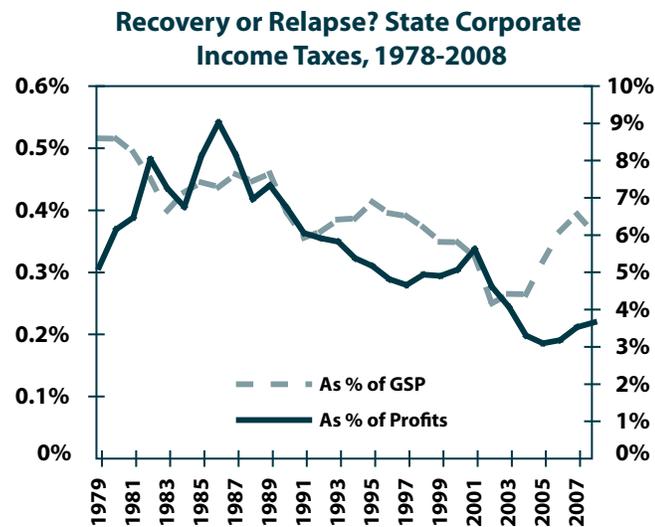
Federal Deductibility

In considering how corporate income taxes are determined, it is worth noting one final similarity between personal and corporate state income taxes – both are deductible in determining federal income tax liability. Thus, since the federal corporate income tax rate is 35 percent, as much as 35 percent of a state's corporate income tax ultimately will be paid, not by the businesses operating in that state, but by the federal government in the form of reduced federal corporate income tax collections. This interaction also means that any state corporate income tax increase is subsidized by the federal

government—and that part of any state corporate income tax cut will never be received by in-state businesses, but will flow instead into the federal treasury. For a more detailed discussion of this “federal offset” effect, see page 9.

Revenue and Stability

Few state tax trends are as striking as the rapid decline of state corporate income tax revenues. As recently as 1986, state corporate income taxes equaled almost 9 percent of nationwide corporate profits, and 0.5 percent of nationwide Gross State Product (a measure of nationwide economic activity). But by each of these measures, the state corporate tax has declined noticeably in the past two decades.



Source: US Census Bureau, Bureau of Economic Analysis

- As a share of nationwide GSP, state corporate taxes reached a low of 0.25 percent of GSP in 2002 before rebounding in the past several years.
- The post-2002 rebound in taxes as a share of the economy conceals a more worrisome trend: nationwide taxes as a share of corporate profits have remained at historical low levels since 2002. Measured this way, state corporate taxes were just over a third of their 1986 level in fiscal year 2008.

Some of the fluctuation in the corporate tax is due to legitimate year-to-year fluctuations in the tax base: the corporate income tax is affected by the state of the economy because the tax is based on corporate profits, which usually fall significantly during economic downturns. State corporate income taxes are also facing downward pressure because they are linked to the federal tax code: the proliferation of tax loopholes at the federal level is being passed through, in many cases, to state governments. Another reason for declining

corporate income tax revenues is that many companies have become better at taking advantage of loopholes that Congress (and state legislatures) never intended to create.

Corporate Income Tax Reform: Issues and Options

The decline of the state corporate income tax has been so dramatic in recent years that a few anti-tax advocates have suggested repealing the tax entirely, arguing that the limited yield of the corporate tax makes it not worth the trouble of collecting. A robust corporate income tax can—and should—be part of each state’s tax system. State policymakers only need understand the sources of this problem and the solutions that are available to them. Indeed, a number of easily administrable, economically sound reforms could help to revitalize this important revenue source.

An Eroding Federal Tax Base

One of the factors that has contributed to the decline of state corporate income taxes is the erosion of the federal corporate income tax. As noted earlier in this chapter, for many companies, the starting point in determining their state corporate income tax liabilities is the income they report for federal tax purposes. Consequently, changes in law that shrink the size of the federal corporate income tax base, in many instances, result in smaller state bases as well. Similarly, both federal corporate income taxes, relative to gross domestic product, and state corporate income taxes, relative to gross state product, have both grown over the last several years, principally because corporate profits have come to comprise a larger share of the economy. Again, whatever affects the federal base—whether due to policy or from fundamental changes in the economy—affects the state base as well.

Two changes in federal tax law are illustrative. In 2002, Congress and the Bush Administration enacted a federal corporate tax break known as “bonus depreciation” that enabled companies to write off capital investments much more rapidly than they had been able to do previously. At the time the change was made, it was expected to lead to a federal revenue loss of \$97 billion; since that break affected federal taxable income, it was also expected to suppress state corporate income tax revenue by as much as \$14 billion².

In 2004, Congress and the President extended another giveaway to profitable multinational corporations. Known as the “qualified production activities income” (QPAI) deduction, this tax cut was originally envisioned as a means to

Tax Credits and the Incentive Illusion

Many states give businesses numerous tax credits that significantly reduce (or even eliminate) their tax liability. These include credits supposedly intended to create jobs or encourage investment. Unfortunately, these credits usually just reward businesses for doing things they would have done anyway—or, even worse, make a state’s economy more inefficient by shifting investment into areas that do not make the most economic sense.

compensate manufacturers for the loss of an export subsidy that violated World Trade Organization rules, but grew well beyond that purpose on its way to enactment. At the time that it became law, this new deduction was projected to reduce federal tax revenue by \$77 billion over 10 years. States were also expected to sustain significant revenue losses from the change.

States are not powerless in the face of such changes, however. They do not have to stand idly by and accept such unwelcome inheritances from the federal government. They can—and have—selectively severed the connections between the federal tax code and their own tax laws that convey such tax cuts from one level of government. This process, known as “decoupling,” allows states to preserve most of the administrative ease of linking to federal rules while also preserving their revenue stream. Indeed, at least twenty states have decoupled from the “bonus depreciation” tax break, while just under half have chosen to decouple from the QPAI deduction.

Manipulating Apportionment Rules in the Name of Economic Development?

In determining what portion of a multistate company’s profit is taxable in a given state, most states use the three-factor, payroll-property-sales apportionment formula method described on page 46. In recent years, however, many states have deviated from this basic three-factor approach by increasing the importance of the “sales factor.” For example, Florida allows companies to count the sales factor twice. (In the example on page 46, this means that instead of taxing 70 percent of a company’s business income (the average of

90, 30 and 90), Florida can only tax 60 percent of that income (the average of 90, 30, 30 and 90). This “double weighting” approach reduces the tax paid by corporations that sell most of their products in other states—for example, manufacturing corporations. Nine states still use the unweighted UDITPA formula.

Many states have gone even further, increasing the weight of the sales factor to one hundred percent—eliminating the payroll and property factors entirely. This is known as the “single sales factor,” or SSF. Under SSF, the sole determinant of a corporation’s state tax is how much of its sales are made to in-state customers. Advocates of increasing the sales factor claim that it encourages exporting businesses to locate in a state, since it favors companies with greater payroll and assets in a state than sales. But claims that an increased sales factor attracts corporate investment are dubious. Indeed, in some cases, it might actually discourage investment in a state.

If a company, for instance, only ships products into a state, it may not have nexus with the state. But in a state with an increased sales factor, if such a company makes even a small investment in a state, it will immediately have much of its income apportioned to the state because the sales factor counts so heavily. And a company with only a small amount of

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property or payroll in a sales factor state can reduce its in-state corporate taxes to zero by moving this property and payroll out of the state. Thus, increasing the sales factor can actually have exactly the opposite effect of what its proponents intend: discouraging in-state investment.

In addition, increasing the sales factor discriminates between companies in a way that is hard to defend. Increasing the sales factor will reduce taxes for some companies, but will increase taxes for others. For each corporation that benefits from SSF because most of its sales take place in other states, there are also corporations that will be punished by SSF rules because their sales are mostly in-state. Smaller corporations that tend to make most or all of their sales within the state in which they are located generally get little if any tax savings

under the SSF approach. In short, adoption of the single sales factor ultimately benefits some corporations while punishing others in an arbitrary way.

These arbitrary distinctions reduce the confidence of the public—and of corporations—in the fairness of state tax administration. When profitable companies benefit from a state's services—as the manufacturing companies that typically benefit from the single sales factor clearly do—they should pay their fair share of the corporate tax. When these corporations are allowed to reduce or eliminate their tax liability, that lost revenue must be made up by other competing companies—and by individual taxpayers.

Separate Accounting & Transfer Pricing

A further inconsistency in state corporate taxes stems from the fact that some states permit companies to determine their in-state taxable income using separate accounting for each of their related subsidiaries. Separate accounting is a bookkeeping procedure that determines each company's taxable income by having companies keep separate accounts for their in-state and out-of-state business segments. Every transaction between the legally distinct subsidiaries of a company is supposed to have a transfer price (that is, the "sales price" at which these companies are essentially selling products to themselves) attached to it, which is supposed to be carefully scrutinized by auditors.

Not surprisingly, separate accounting is subject to abuse by large, multistate companies. In fact, it's an open highway for corporate tax avoidance. A large multistate company can use separate accounting to shift taxable profits to low-tax jurisdictions. Here's how it works:

Consider a multistate company that has two subsidiaries, one in State A that permits separate accounting and one in State B, which has no corporate income tax. To reduce its taxable profits, the subsidiary in State A might say that it "pays" high transfer prices for the items it "buys" from the State B subsidiary. This shifts income out of State A (where it would be taxed) and into State B (where it's not).

For example, a furniture company might machine the metal parts for its furniture (handles, knobs, etc.) in State B, but assemble the furniture in State A. The company will, on paper, charge very high prices to its State A subsidiary for the metal parts. This makes the State B subsidiary look like it has very high profits (which are not taxed) and the State A subsidiary look like it has very low (taxable) profits.

Of course, except for tax considerations it doesn't matter to

ExxonMobil to Maine: Sayonara

Maine is among the states that have recently enacted a "single sales factor" with the hope of improving the state's business climate. But the hit-or-miss nature of SSF became immediately apparent when ExxonMobil announced in July of 2008³ that they planned to stop doing business with Maine airports—and cited likely tax hikes from the new single sales factor as one reason for their decision.

the parent company if its State B subsidiary has 80 percent of the total profits and its State A subsidiary has only 20 percent. Either way, the parent company gets 100 percent of the profits.

Another example of transfer pricing that has gotten more attention in recent years is the passive investment company (PIC) approach. In this variation on the transfer pricing scheme, a multi-state company will set up a subsidiary in a state that does not tax certain types of intangible income like royalties and interest—and make sure that this subsidiary receives all of the company's royalty income. The most infamous example of this practice is the Toys R Us corporation, which created a subsidiary in Delaware called Geoffrey, Inc. The subsidiary owns the Toys R Us trademark, and Toys R Us stores around the nation pay royalty fees to the Delaware subsidiary for their use of the trademark. This reduces the taxable profit of Toys R Us in two ways: stores based in other states get to deduct their royalty payments as a cost of doing business, which reduces their taxable profit, and the Delaware subsidiary pays no tax on their royalty income because Delaware does not tax such income.

Trying to assure accurate transfer pricing under separate accounting creates huge enforcement problems. It is a time-consuming, complicated and often impossible job for state auditors to determine whether separate accounting methods accurately reflect a company's net business income in the state. The federal government, which tries to apply the same approach to multinational corporations, has had the same kinds of difficulties.

States seeking to prevent these income-shifting strategies have two options. They can close down these loopholes one at a time—as some states have done in response to the PIC problem by enacting legislation that prevents the use of PICs—or they can adopt a comprehensive solution known as combined reporting. Combined reporting requires a multi-

Separate accounting is an open highway for corporate tax avoidance by big multi-state companies—but “combined reporting” can help clamp down on tax-avoidance schemes.

state corporation to determine its apportionable income by adding together the profits of all its subsidiaries into one total. Since the income of subsidiaries in the various states is added together in one sum, there is no tax advantage to income shifting between these subsidiaries under a combined reporting regime. While anti-PIC legislation can close down one particular path to tax avoidance, combined reporting is a better, more comprehensive approach to loophole-closing because it simply removes the incentive to shift income from high-tax to low-tax jurisdictions.

Combined reporting is intuitively more fair than separate accounting because it ensures that a company’s tax should not change just because its organizational structure changes. It also creates a level playing field between smaller and larger companies: small companies doing business in only one state can’t use separate accounting to reduce their tax because they have no business units in other states to shift their income to. Large, multi-state corporations will find it easier to avoid paying taxes using separate accounting because they have business units in multiple states. The fact that small businesses can benefit from combined reporting may help explain the growing popularity of this needed reform: seven states and DC have enacted combined reporting since 2004.

“Nowhere Income” and the Throwback Rule

Every state with a corporate income tax uses the location of the corporation’s sales as a factor in apportioning business income between states. The “sales factor” for a given corporation in a given state is calculated by assigning each individual sale a company makes to exactly one state, and then calculating what percentage of total nationwide sales are in each state. In general, the rule states use to decide which states a given sale should be assigned to is the “destination rule,” which says that a sale should be assigned to the state to which the product sold is being sent.

Sometimes, however, sales allocated to other states using the destination rule end up not being taxed at all because the destination state lacks the authority to tax the seller. When

this happens, it’s because the seller doesn’t have nexus in the destination state.

Unless states take action, this “**nowhere income**” will not be taxed anywhere at the state level. The best remedy for the problem of nowhere income is enacting a **throwback rule**, which simply says that any sales to other states that are not taxable will be thrown back into the state in which the sale originated for tax purposes. The throwback rule was among the tax rules adopted by the UDITPA in the 1950s, but many states still have not enacted it. The lack of throwback rules poses a major threat to state corporate income tax revenues in almost twenty states.

Splitting Hairs? Exploiting the Business/Nonbusiness Income Distinction

As previously noted, every company must divide its potentially taxable income into two categories: a “business income” component and a “nonbusiness income” component. Business income is apportioned (divided) between the states in which a company does business, while non-business income generally is taxed entirely by the one state in which the asset generating that income is managed. But each state must set its own legal dividing line between business- and non-business income—and the way in which states do this has important implications for corporate tax fairness.

The appropriate dividing line between these two types of income has been the topic of frequent litigation in the states. In many states, business income is defined as any income that arises from the regular transactions that a company typically engages in—which means that any income that can be characterized as “irregular” may be considered non-business (and therefore non-apportionable) income. Businesses sometimes try to take advantage of this poorly defined distinction between business and non-business income by misleadingly classifying some business income as irregular non-business income, then allocating this non-business income entirely to a low-tax state in which they are nominally headquartered. A 1992 U.S. Supreme Court case, *Allied-Signal v. Director, Division of Taxation, New Jersey*⁴, made it clear that many states currently falling prey to these tax-minimization strategies are not taxing all the corporate income they could legally tax.

States with corporate income taxes have responded to these corporate tax-minimization efforts using two strategies:

- Seven states define business income as everything they can legally apportion under the U.S. Constitution—which

means that non-business income is whatever is left over. This approach is recommended by corporate tax experts as the best way of fairly taxing multi-state corporations' income.⁵

- Eleven states define all income as business income. This approach allows states to tax some of the "irregular" income that companies seek to classify as non-business income, but prevents states from taxing some non-business income that they are entitled to tax. For example, if a company is based in state A, and generates \$100 million of non-business income in state A, the state should be entitled to tax the entire amount as non-business income (since non-business income is not apportioned between states). But when states make no distinction between business and non-business income, all of a company's income is apportioned—which means that state A can only tax a percentage of this income.

Every state with a corporate income tax (except for the six states that currently define business income in accordance with the U.S. Constitution's limits), could enact statutory changes that would allow them to prevent the nonbusiness income loophole from eroding their tax base.

Corporate Minimum Taxes

All states with corporate income taxes use corporate profits to define the tax base. This ensures that the corporate tax reflects a business' ability to pay the tax: if a corporation loses money in any year, they don't pay the tax. But the growing use of tax avoidance strategies means that many profitable corporations are now able to report artificially low (or negative) profits for tax purposes even when they've done quite well financially. These tax avoidance strategies have created the specter of profitable "zero-tax corporations." Federal tax reform legislation in 1986 created an "alternative minimum tax" (AMT) to ensure that all profitable corporations would pay some tax no matter how many tax breaks they might otherwise claim.

States seeking to follow the federal government's lead have taken one of three strategies: imposing an AMT based on the federal tax, imposing a flat-dollar minimum tax, or using a non-profit-based measure of business activity as a backstop to the corporate profits tax.

A few states use an AMT based on the federal tax. Like the regular corporate income tax, the AMT usually is defined as a percentage of corporate profits—but the AMT typically applies a lower tax rate to a much broader definition of corporate

There is a growing consensus among many tax experts that state and local tax breaks for business are being used in a way that is actually unconstitutional, by subverting the regular flow of interstate commerce. Congress can take steps to stop the bleeding.

taxable income. This approach has become much less useful because the federal AMT has been seriously watered-down over time by Congress—but a state AMT based on the older federal AMT rules could still help prevent the excessive use of tax loopholes.

A growing number of states rely on a simpler, lower form of minimum tax: a flat-dollar amount that all corporations must pay. This amount ranges widely, from \$50 in Ohio to a maximum of \$1,500 in New York. As more and more corporations rely on tax avoidance strategies, the fixed-dollar minimum tax has become more important in these states: in New York, for example, more than sixty percent of all C-corporations paid only the fixed-dollar minimum tax in tax year 2006.⁶ More than 70 percent of Utah C-corporations paid only the minimum in tax 2008 including 27 percent of profitable corporations.⁷

About half of the states now levy a "corporate franchise tax" in addition to a corporate income tax. In general, these taxes are based on a company's net worth. Some states also use a tax on gross receipts. Gross receipts taxes are described in Chapter Three.

Should States Repeal Their Corporate Taxes?

A few states, including Ohio and Texas, have recently enacted alternative businesses taxes that are designed not as a backstop to the profits tax, but as a replacement. Learn more about the shortcomings of this approach to "tax reform" in Chapter Three.

Each of these options can help eliminate the “zero-tax corporation” problem—and (in some cases) can also help states to get around the problem of corporate nexus described above. Some nexus rules only apply to taxes that are based on profit. So a company that does business in a state, but doesn't have enough physical presence in the state to satisfy the nexus rule, cannot be reached by a profits-based tax, but can be reached by a fixed-dollar minimum tax.

Corporate Disclosure: An Important Tool for Tax Fairness

Tax fairness is important. The perception that state and local taxes treat individuals and corporations fairly is a cornerstone of public support for the tax system. The fairness of corporate taxes at the federal level can be evaluated on a company-by-company basis, with some difficulty: publicly available Securities and Exchange Commission (SEC) filings allow analysts to determine how much the nation's largest corporations have paid in federal taxes and compare this to their profits. In a series of reports, ITEP has shown that many profitable corporations pay little or no federal income tax. A September 2004 ITEP report surveyed 275 of the most profitable corporations, and found that almost a third of these companies paid zero (or less) in federal taxes in at least one year between 2001 and 2003.⁸

Unfortunately, the fairness of each state's corporate tax cannot be evaluated in the same way, because neither the SEC

nor most state governments require corporations to release detailed information on their state corporate tax payments. A few states have now implemented some form of corporate tax disclosure. For example, Massachusetts now requires very limited anonymous disclosure of basic information about profits, taxes paid and tax credits received. But nearly all states still have no such requirements. Greater state corporate tax disclosure is the best means available to ensure that each corporation is treated fairly—and that corporations as a group pay their fair share of taxes.

Corporate disclosure can also help states to prevent the accounting hijinks described above. For example, some companies will report certain income as “non-business income” in one state and “business income” in another to minimize their tax liability. More open reporting of this information could allow states to check for consistency in income reporting between states.

Conclusion

State corporate profits taxes have been a mainstay of state tax systems for almost a century. And despite the worrisome recent drop in the yield of these taxes, virtually every state now has available a straightforward set of tax reform policies that could not only end the erosion of their corporate tax base, but could help these taxes regain their former health. 

¹ This is required by a patchwork of federal case law – most notably, the Supreme Court's decision in *Container Corporation of America v. California Franchise Tax Board*.

² Johnson, Nicholas, “States Can Avoid Substantial Revenue Loss by Decoupling from New Federal Tax Provision.” Center on Budget and Policy Priorities, April 20, 2002. <http://www.cbpp.org/archiveSite/3-20-02sfp.pdf>. The change was retroactive to September 2001 and was set to expire in September 2004, but has been extended several times, most recently as part of the 2009 American Recovery and Reinvestment Act.

³ Robbins, Toni-Lynn, “Jet fuel supplier cites state taxes for decision to pull out of BIA.” *All Business*. July 3, 2008. <http://www.allbusiness.com/government/government-bodies-offices-regional-local/14685900-1.html>

⁴ *Allied-Signal, Inc. v. Director, Division of Taxation* (91-615), 504 U.S. 768 (1992). <http://www.law.cornell.edu/supct/html/91-615.ZS.html>

⁵ Mazerov, Michael, “Closing Three Common Corporate Tax Loopholes Could Raise Additional Revenue for Many States.” Center on Budget and Policy Priorities, May 23, 2003. <http://www.cbpp.org/cms/index.cfm?fa=view&id=1868>

⁶ New York State Department of Taxation and Finance, “2006 New York State Corporate Tax Statistical Report.” April, 2010. http://www.tax.state.ny.us/pdf/stats/stat_corp/corp_stat/2006_new_york_state_corporate_tax_statistical_report.pdf

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