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June 3, 2021

VIA EMAIL
Colorado Senate
Senator Leroy Garcia, Senate President
Senator Stephen Fenberg, Senate Majority Leader
Senator Chris Holbert, Senate Minority Leader
Senator Chris Hansen, Chair, Senate Appropriations Committee
Senator Dominick Moreno, Vice Chair, Senate Appropriations Committee

Re: House Bill 21-1311 – Opposition to Tax Haven List
House Bill 21-1312 – Comments on Digital Goods Treatment

Dear President Garcia, Majority Leader Fenberg, Minority Leader Holbert, Chair Hansen, Vice-Chair Moreno and Members of the Senate:

On behalf of the Council On State Taxation (COST), I am writing to oppose the provisions of House Bill 21-1311 (H.B. 1311), which would require corporate taxpayers to include affiliates incorporated in certain foreign jurisdictions in their combined group income. The listed jurisdiction approach is punitive towards our global trading partners, will make Colorado an outlier in the taxation of foreign source income, and is unnecessary given Colorado's current taxation of foreign income. Further, this proposal fails to consider the impact of the proposed federal changes to taxing foreign source income under the Biden administration. In addition, I am also providing comments to improve the administration of House Bill 21-1312 (H.B. 1312), which would include digital goods in the statutory definition of tangible personal property for purposes of the Colorado sales tax. Changes should be made to the provisions of H.B. 1312 to recognize that taxpayers operate in a national economy and Colorado's definition should align with definitions adopted by other states.

About COST

COST is a non-profit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of over 500 major corporations engaged in interstate and international business, many of which directly do business in Colorado. COST's objective is to preserve and promote the equitable and non-discriminatory state and local taxation of multijurisdictional business entities.

The Listed Jurisdictions in H.B. 1311 Reflect Misguided Tax Policy

House Bill 1311 would include taxpayer affiliates incorporated in certain foreign jurisdictions (labelled as "tax havens") in their combined group income. COST has a long-standing policy position in opposition to state tax haven legislation. The tax haven "blacklist" approach is arbitrary and misleading and fraught with Constitutional infirmities. Further, in light of Colorado's current conformity with the federal provision under the Tax Cuts and Jobs Act of 2017 (TCJA) to include 50% of global intangible low taxed income (GILTI) in the Colorado tax base adopting a tax haven list leads to double taxation and is severely out-of-step with federal and state tax policy.

The COST Board of Directors has approved a policy position opposed to all state tax haven provisions which provides in part:

> *State "tax haven" designations are arbitrary and overly broad, reflect a discarded "worldwide" approach to state taxation, and are inappropriate to address income shifting or other tax avoidance concerns. Punitive treatment of multinational businesses with affiliates in countries designated by states as "tax havens" interferes with the U.S. Government's ability to "speak with one voice" on foreign affairs and is constitutionally suspect. States should limit their income tax base to the domestic "water's-edge" and not tax foreign income with little or no connection with the United States.*[1]

In addition to the policy position, the State Tax Research Institute (STRI), a 501(c)(3) research organization founded by COST, undertook a significant research project relating to state tax haven legislation. In 2016, STRI published its report, entitled "State Tax Haven Legislation: A Misguided Approach to a Global Issue," that provides a detailed analysis of why states should not adopt tax haven legislation.[2]

Detrimental Impact on the State's Economy

The blacklisting of foreign countries as tax havens and inclusion in the state tax base of income from businesses operating in these countries contravenes the approach taken by virtually all other U.S. states and nations in the world.[3] Branding foreign nations as tax havens is widely rejected as an arbitrary and illegitimate means for dealing with tax avoidance. The U.S. federal government has never adopted the tax haven list approach as a means for defining its income tax base. Neither state legislatures nor state revenue departments are equipped to make determinations the

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[1] COST's policy position on this issue is available at: https://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/cost-state-tax-haven-policy-statement-final-4-16-15.pdf

[2] Karl Frieden and Ferdinand Hogroian, State Tax Haven Legislation: A Misguided Approach to a Global Issue, State Tax Research Inst. (Feb. 2016), https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/coststudies-articles-reports/state-tax-haven-legislation--a-misguided-approach-to-a-global-issue.pdf.

[3] COST recognizes that six states (Alaska, Connecticut, Kentucky, Montana, Rhode Island and West Virginia) continue to maintain tax haven provisions in their state tax laws. With the exception of Montana, all of these states reject the blacklist approach and instead utilize a criteria approach.

U.S. federal government has declined to exercise. A tax haven provision will clearly deter international businesses from operating in Colorado, undermining the State's ability to attract jobs and capital investment that improve the State's overall economy. To date, only Montana maintains a blacklist approach to the inclusion of foreign income in the corporate income tax base.

Further, when a state arbitrarily penalizes taxpayers for doing business in specific countries - that state also violates the foreign Commerce Clause. The constitutional standard set forth in *Japan Line, LTD v. County of Los Angeles*, 441 U.S. 434 (1979), is clear: state tax measures may not impose a risk of multiple taxation at the international level and may not prevent the federal government from "speaking with one voice" on international policy matters.

Arbitrary and Overly Broad Approach

Branding foreign nations as tax havens has been widely rejected as a legitimate means for dealing with tax avoidance. The tax haven lists (such as that proposed in H.B. 1311) are derived largely from a list created over 15 years ago by the Organization for Economic Cooperation and Development (OECD) to encourage countries to adopt greater transparency and information sharing about tax issues, not to broaden the tax base of member countries. No country, including the United States, has ever adopted the tax haven list approach as a means for defining their income tax base. Rather than providing a viable solution to the issue of foreign income sourcing, the adoption of a tax haven list creates new problems by arbitrarily targeting sovereign nations.

Out-of-Step with the State Trends for Taxing Foreign Source Income

Prior to 2018, Oregon imposed a blacklist approach similar to the bill's proposal for determining foreign income included in its corporate income tax base. During its 2018 legislative session, however, Oregon repealed its tax haven blacklist provision and created a credit for taxpayers previously subject to tax haven provisions.[4] Oregon realized that the passage of the TCJA provided an opportunity to abandon its tax haven provisions and align itself more closely with the approach taken by the federal government. The TCJA forced the Oregon Legislature to deal with the potential of double taxation of income previously taxed under its tax haven provisions that would now be included in Oregon taxable income pursuant to the TCJA, including both the repatriation transition tax (for tax years prior to 2018) and GILTI (for tax years 2018 and forward). To avoid double taxation, the Legislature opted to fully repeal its tax haven provisions in light of the complexities and potential litigation that would result from retaining the provisions. The Oregon legislature required a report by the Department of Revenue to compare the efficacy of the listed jurisdiction provisions previously in place in Oregon to the GILTI provisions adopted by Oregon. Among other things, the most recent Oregon report found that "On early analysis, it appears that GILTI would generally be easier for the department to administer than the listed jurisdiction law. All other things being equal, a law that is easier to administer and enforce is more likely to accomplish the goals of the law in question".[5]

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[4] Oregon S.B. 1529 (2018), https://olis.leg.state.or.us/liz/2018R1/Downloads/MeasureDocument/SB1529/Enrolled.
[5] Oregon Department of Revenue 2020 Executive Summary, GILTI Report, Global intangible low-taxed income, or GILTI, Report (oregon.gov).

Colorado is in a similar position to Oregon. Colorado has also conformed to the provision in the TCJA that includes 50% of GILTI in the Colorado corporate tax base. While COST does not endorse a state conforming to GILTI, if it does, it should definitely not also adopt the arbitrary, and constitutionally infirm blacklist approach that is utilized by Montana alone.

Out-of-Step with the Proposed Federal Tax Plan for Taxing Foreign Source Income

On March 31, President Biden released the American Jobs Plan—a more than $2 trillion infrastructure spending plan and on May 28, 2021 the U.S. Treasury released the General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals (The Green Book).[6] Although still in flux, the current proposal raises revenue through a tax reform plan, the Made in America tax plan, that would significantly increase corporate income taxes, in part by expanding the GILTI tax base. This is accomplished partly by applying GILTI on a country-by-country basis, and partly by eliminating the qualified business asset investment (QBAI) deduction.[7] The Biden administration proposals, if enacted, would significantly impact Colorado's corporate income tax system, increasing the portion of foreign source income (GILTI) included in the Colorado tax base and exacerbating concerns over double taxation and protracted litigation should Colorado adopt a tax haven list approach.

Inclusion of "Digital Goods" as Tangible Personal Property Subject to Sales Tax

The provisions in H.B. 1312 that would include digital goods within the definition of tangible personal property to include services not previously subject to tax creates ambiguities related to taxation of goods and services, including how those digital goods which are not physically delivered to a customer are sourced. Additionally, the inclusion of digital goods within the tangible personal property definition raises concerns with the legislation attempting to avoid the application of Colorado's Taxpayer Bill of Rights (TABOR).

Further, COST has long advocated for simplification and uniformity in state sales and use tax systems. Uniformity is essential to substantially reducing the burden of tax compliance and improving sales and use tax administration. To that end, to the extent the General Assembly intends to impose sales and use tax on new products, we encourage using the Streamlined Sales and Use Tax Agreement (SSUTA) definitions and sourcing rules which have been adopted by other states and multiple Colorado cities.[8]

If Colorado wishes to tax digital products, it should do so by adopting the "specified digital products" definition and general sourcing rules will create more certainty over sales and use tax imposition and alleviate some of the risks of multiple taxation. There should also be clear prospective effective date (at least 90 days at the beginning of a calendar month) before this goes into effect to give sellers time to set up their systems to collect the tax.

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[6] The "Green Book" is available at: https://home.treasury.gov/system/files/131/General-Explanations-FY2022.pdf.
[7] The plan also proposes to increase the tax rate on GILTI to 21%.
[8] The Agreement is available at: http://www.streamlinedsalestax.org/index.php?page=modules. See sections 332 and 333 of the SSUTA.

Conclusion

COST strongly urges Colorado to reject the tax haven provisions in H.B. 1311 because they are punitive and unnecessary. With respect to H.B. 1312, we urge the Colorado legislature to consider utilizing the SSUTA definitions applicable to the taxation of digital goods if it decides to tax these items. Please let us know if we can provide additional information or assistance.

Respectfully,

Erica S. Kenney
West Coast Tax Counsel

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director