Mandatory Unitary Combined Reporting

Policy Position

Position: *Mandatory unitary combined reporting ("MUCR") is not a panacea for the problem of how to accurately determine multistate business income attributable to economic activity in a State. For business taxpayers, there is a significant risk that MUCR will arbitrarily attribute more income to a State than is justified by the level of a corporation's real economic activity in the State. A switch to MUCR may have significant and unintended impacts on both taxpayers and States. Further, MUCR is an unpredictable and burdensome tax system. COST opposes MUCR.*

Explanation: One of the most controversial business tax policy issues currently debated by state legislators, tax administrators, and corporate taxpayers is how a State should determine the corporate income tax base for multistate corporations with multiple businesses and entities. One possible system—MUCR—arbitrarily assigns income to a State, negatively impacts the real economy, has an unpredictable affect on State revenue and imposes significant administrative burdens on both the taxpayer and State.[1]

- Arbitrarily Assigns Income – Although proponents of MUCR argue that it helps to overcome distortions in the reporting of income among related companies in separate filing systems, the mechanics used under MUCR create new distortions in assigning income to different States. The MUCR assumption that all corporations in an affiliated unitary group have the same level of profitability is not consistent with either economic theory or business experience. Consequently, MUCR may reduce the link between income tax liabilities and where income is actually earned. Many corporate taxpayers may conclude that there is a significant risk that MUCR will arbitrarily attribute more income to a State than is justified by the level of a corporation's real economic activity in the State.

- Negatively Impacts the Real Economy – Proponents of MUCR have focused on the benefits in terms of reducing tax planning opportunities, but they fail to acknowledge that adopting MUCR may actually increase effective corporate income tax rates. Even if MUCR results in a relatively small increase in net corporate tax revenue, there will be significant increases and decreases in tax liabilities for specific businesses. Depending upon the industry distribution of winners and losers, adopting MUCR may have a negative impact on a state's overall economy. Moreover, economic theory suggests that any tax increase resulting from adopting MUCR will ultimately be borne by labor in the State through fewer jobs (or lower wages over time) or by in-state consumers through higher prices for goods and services.

- Unpredictable Effect on State Revenue – MUCR has uncertain effects on a state's revenues, making it very difficult to predict the revenue effect of adopting MUCR. Switching from separate filing to MUCR can decrease, increase or leave state tax collections unchanged depending upon the complex economic relationships among corporations included in a unitary group and the apportionment methodology selected by the state. Because of this complexity, the overall revenue impact of adopting MUCR cannot be predicted reliably.

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[1] A thorough discussion of the problems associated with MUCR can be found in the study prepared for COST by Ernst & Young LLP, *"Understanding the Revenue and Competitive Effects of Mandatory Unitary Combined Reporting"* (www.cost.org).

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- Significant Administrative Burden

    - *Determining the Unitary Group:* The concept of a "unitary business" is uniquely factual and universally poorly defined. It is a constitutional (Due Process) concept that looks at the business as a whole rather than individual separate entities or separate geographic locations. In order to evaluate the taxpayer's determination of a unitary relationship, state auditors must look beyond accounting and tax return information. Auditors must annually determine how a taxpayer and its affiliates operate at a fairly detailed level to determine which affiliates are unitary. Auditors must interact with a corporation's operational and tax staff to gather this operational information. In practice, however, auditors routinely refuse to make a determination regarding a unitary relationship on operational information and instead wait to determine unitary relationships until after they have performed tax computations. In other words, the tax result of the finding that a unitary relationship exists (or does not exist) often significantly influences, or in fact controls the auditor's finding. Determining the scope of the unitary group is a complicated, subjective, and costly process that is not required in separate filing states and often results in expensive, time-consuming litigation.

    - *Calculating Combined Income* **–** Calculating combined income is considerably more complicated than simply basing the calculations on consolidated federal taxable income. In most MUCR states, the group of corporations included in a federal consolidated return differs from the members of the unitary group. In addition to variations in apportionment formulas among the States that apply to all corporate taxpayers, further compliance costs related to MUCR result from variations across States in the methods used to calculate the apportionment factors.