Half of US Fortune 500 companies pay next to nothing in state taxes

By John Marion
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As the Trump administration and Congress prepare to cut federal taxes on corporations by trillions of dollars, a new report by the Institute on Taxation and Economic Policy (ITEP) documents that, among the 258 Fortune 500 companies which were profitable in 2014, the average effective tax rate levied by all 50 states was only three percent of profits.

ITEP was able to analyze state and local tax payments for 240 of the 258 companies in question. If these companies had paid the average state corporate tax rate—which was only 6.25 percent—on the $3.7 trillion in US profits that they reported to their shareholders between 2008 and 2015, they would have paid $126 billion more in taxes than they actually did.

Just a few examples give the lie to claims that there is not enough money to fund public education, infrastructure repair, public transportation, Medicaid, and other social needs.

In the eight years between 2008 and 2015, according to the ITEP analysis, International Paper and Levi Strauss had negative effective tax rates (-2 percent and -1.7 percent, respectively). Facebook and Intel had effective rates of 0.3 percent during the same period. United Technologies and Honeywell International, which profit from US military contracts, had rates of 1.3 percent and 1.5 percent, respectively.

In some cases, states have lowered their tax rates on corporate profits in recent years. Massachusetts, for example, had a rate of 10.5 percent until January 1, 2010, but has since stepped it down to 8 percent. The state has also set an absurdly low minimum excise tax amount of $456 for any corporation that cries poor.

According to the ITEP report, North Carolina has a rate of 3 percent this year, Mississippi between 3 percent and 5 percent, Colorado 4.63 percent, Utah and South Dakota 5 percent, and Florida 5.5 percent.

Individual corporations which threaten to move their operations from one state to another are often mollified with special tax breaks. Tax breaks are also given by states to large corporations in order to entice them to move. In just one example, Massachusetts and the city of Boston agreed in January 2016 to give General Electric nearly $150 million of tax breaks and other incentives when it committed to moving its headquarters from Connecticut to Boston. Given that GE promised to bring 800 jobs in the move, the cost per job of the government incentives was $180,000.

In addition to these two factors—low base rates and giveaways that are essentially extortion payments—are a variety of tricks used by corporations to shuffle assets and profits between states. According to the ITEP report, 27 states have enacted or partially enacted combined reporting rules in an attempt to quell the use of bogus subsidiaries in other states that have lower tax rates.

Some of the tricks commonly used in states without combined reporting are just a boardroom version of Three-card Monte. A June 2007 study by the Economic Policy Institute and the Massachusetts Budget and Policy Center described some:

• Captive REITs (Real Estate Investment Trusts) pay dividends to their shareholders and can then deduct the dividends paid from the trust's taxable income. The dividend recipient can then take a dividends received deduction. A "captive" REIT is a shell company for the parent, which owns a controlling share even though REITs are legally required to have at least 100 shareholders. By this means, the parent company avoids paying taxes on its real estate profits.

• Income Shifting: Not only is income moved to shell companies in states with lower (or no) tax rates, but intangible assets can be assigned. "In a recent case, a

Massachusetts company had royalty income from third parties. The company simply contributed the intangible asset (a trademark) to a Delaware subsidiary. The subsidiary receives the income and pays no state tax. It then pays dividends to the Massachusetts parent, which qualifies for the 95% dividends received deduction."

• Factoring of Accounts Receivable: A distributor or wholesaler sells its accounts receivable to an out-of-state affiliate at an artificially low price and says that the affiliate will collect from its customers. Because the price at which it "sold" the receivables is much lower than what the customer owes, the parent company takes a loss on its taxable income. The affiliate then sells the receivables to a third party at a higher price and claims that the resulting revenue is not taxable in Massachusetts.

• Captive Employee Leasing Companies: In one example, "a major publicly-traded corporation paid most of the employees through a separate affiliated corporation that 'leased' the employees to the operating entity. The employees then … were not included in the operating company's payroll for apportionment purposes."

These practices result not only in low effective tax rates on corporate profits, but also in low corporate tax revenues for states. In Massachusetts, for example, revenues from the individual income tax were $12.1 billion between July 2016 and April 2017, and the regressive sales tax added $5.1 billion to the state treasury. During the same period, corporate taxes contributed only $1.7 billion.

A January 25 report by Kim Rueben and Richard Auxier of the Urban Institute, titled "State Budgets in the Trump Era," found that in all but 13 states corporate taxes make up less than three percent of revenues.

From National Association of State Budget Officers (NASBO) data, the authors report that in 2016 half of US states took in less revenue than they budgeted, and 31 states are struggling with shortfalls in their fiscal year 2017 budgets even though states are legally required to have balanced books at the end of each fiscal year. Moreover, "after adjusting for inflation, 32 states spent less in fiscal year 2016 than at their prerecession peak in fiscal year 2008."

One other practice, codified in law, deprives state governments of billions of dollars in potential revenue. Hospitals, universities, and other large "not-for-profits" are not taxed, despite the size of their revenues or endowments. Partners Healthcare, for example is one of the largest employers in Massachusetts and owns some of its most renowned hospitals. Its yearly revenues are more than $12.1 billion, and according to its 2014 Form 990, $2.7 million was paid to CEO David Torchiana.

Harvard University, with an endowment of $35.7 billion, paid its chief executive $14.9 million in fiscal year 2015. Nonetheless, it is not satisfied with the growth of its endowment. The *Boston Globe* recently interviewed a recruiter of university investment executives who said, "Harvard was paying their people top Wall Street money for performance that would've gotten them fired on Wall Street." From these commanding heights, Harvard pays the city of Cambridge a small "payment in lieu of taxes" and pays the state nothing.

Many states tie their individual income tax calculations to the federal Adjusted Gross Income, and federal tax expenditures like the deduction for state or local taxes are designed as indirect ways to increase state tax revenues. Federal tax changes under Trump, therefore, will have a cascading effect on individual income taxes in each state. It is too soon to predict the effects on state revenues, but it is certain that workers will be made to pay more taxes.