

Using Combined Reporting for Corporations in Order to Raise Revenue in PA

For years, Pennsylvania has seen large corporations reduce or eliminate their state corporate net income tax bills by shifting profits from Pennsylvania-based subsidiaries to those outside the state. Because some of those subsidiaries outside Pennsylvania were located in Delaware, this strategy became known as the “**Delaware loophole.**” But today the subsidiaries can be located anywhere, including abroad in the Cayman Islands, the Bahamas, and elsewhere.

Wherever they are, the basic tax avoidance strategy uses creative accounting to reduce profits earned by Pennsylvania subsidiaries. External affiliates charge Pennsylvania subsidiaries for things, such as the use of intellectual property, national advertising, business services or even the use of corporate logos. **As a result, profits are moved around on paper, leaving little in the Pennsylvania subsidiary, even when the real activity and sales happen here.**

Such profit-shifting strategies **weaken Pennsylvania’s revenue base and force Pennsylvania-based corporations, as well as PA’s small businesses and families, to pick up the tab through higher local taxes, higher fees, or cuts to public services.**

But this doesn’t have to be the case. Twenty-six states and the District of Columbia have adopted a policy called “combined reporting” to curb income shifting and protect their corporate tax bases. Pennsylvania can do the same.

PA House Bill 1610

A combined reporting bill is already moving in the current session. House Bill 1610, introduced by Rep. Elizabeth Fiedler and others, would shift Pennsylvania to water’s-edge combined reporting for the Corporate Net Income Tax. Representative Fiedler intends to propose a world-wide combined reporting bill soon.

How It Works

Combined reporting requires corporations that operate through multiple, related entities to file their taxes as a group, that is, as if they were a unitary organization. Then the state taxes the share of profits earned by the entire group equal to the share of sales they make in a particular state.

Under water's edge reporting, the combined group is limited to U.S.-based entities, while under worldwide reporting there is no geographic restriction.

"Water's-edge" combined reporting would tax corporations on the Pennsylvania share of U.S. profits equal to their Pennsylvania share of U.S. sales. It closes the Delaware loophole.

The broader worldwide combined reporting approach would tax corporations based on the Pennsylvania state share of worldwide profits equal to the Pennsylvania share of worldwide sales. It closes the Cayman Islands loophole, too.

Depending on the tax rate, moving to worldwide combined reporting would generate between \$500 million and \$1.2 billion in state revenues.

The Bottom Line

Combined reporting is a practical, proven reform that would protect Pennsylvania's corporate tax base and increase recurring revenue to support schools, health care, and infrastructure without shifting more costs onto working and middle-class families.

Call your state representative and senator and urge them to support HB 1610 and other sustainable revenue solutions that keep Pennsylvania's communities strong.