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**Testimony to the
Pennsylvania General Assembly
Senate Committee on Finance**

**Public Hearing Re:
Mandatory Unitary Combined Reporting**

Joseph R. Crosby
COO & Senior Director, Policy
May 26, 2010

Chairman Browne, and Members of the Committee, thank you for the opportunity to provide testimony today on behalf of the Council On State Taxation (COST) regarding mandatory unitary combined reporting (MUCR). MUCR arbitrarily assigns income to a State, negatively impacts the real economy, has an unpredictable effect on State revenue and imposes significant administrative burden on both the taxpayer and the State.

About COST

COST is a nonprofit 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 nearly 600 major corporations engaged in interstate and international business. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

Mandatory Unitary Combined Reporting

The COST Board of Directors has adopted a formal policy statement on MUCR. COST's policy position is:

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.

Mandatory Unitary Combined Reporting

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 effect 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.
- 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

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).

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.

Conclusion

Pennsylvania, like nearly every state, is grappling with severe fiscal problems. Those problems result from the significant downturn in the real economy that began in 2008. Most economic indicators suggest that the economy is beginning to improve; the General Assembly must ensure that any tax policies it adopts to address the State's short-term fiscal problems do not hinder the economic recovery. Studies show that MUCR is the most costly way for the State to raise revenue because of its negative impact on job creation. MUCR will not help Pennsylvania attract jobs or investment.