

**NEW WAVE OF TAX SHELTERS AT EXPENSE OF STATES WOULD BE UNLEASHED
BY U.S. HOUSE BILL TO BE HEARD THIS WEEK**

***California Projects Over Half a Billion Dollars in State Revenue Losses Under Bill;
Successful State Tax Crackdown Efforts Would Be Halted.***

WASHINGTON, D.C.//May 11, 2004///The Multistate Tax Commission (MTC) warned today that H.R. 3220 would legalize controversial tax shelter schemes. The bill would allow income-shifting games made notorious by a handful of companies in order to avoid paying taxes to state governments, which are still shaky in the wake of the recent economic recession. Slated to be the subject of a U.S. House Judiciary Subcommittee hearing this Thursday, the bill would severely limit states' authority to impose reasonable taxes on corporations. The bill would free all companies to follow the lead of the most aggressive tax-sheltering corporations in shifting income to low or no-tax jurisdictions.

North Carolina Secretary of Revenue Norris Tolson said: **“The House bill would send the message that the widely criticized style of income shifting associated with WorldCom and Tyco in order to avoid state taxes is just fine with Congress. The inevitable surge in opportunistic tax sheltering would create new state revenue shortfalls in 40 states – and more in New York City and other cities around the U.S. This new epidemic of tax sheltering would put a further crimp on essential services such as education, transportation and infrastructure at a time of already historic state budget shortfalls.”**

In a new estimate, the California Franchise Tax Board calculates that H.R. 3220 would reduce state revenues there by \$525 million when fully in effect. Entitled, “Analysis of H.R. 3220: The Effects on the California Corporation Tax and the Personal Income Tax,” the estimate shows how the legislation could devastate states struggling with still uncertain revenue pictures. The Franchise Tax Board estimates that, if enacted, the House bill would result in revenue losses in the first five years as follows: \$10 million (2005); \$50 million (2006); \$150 million (2007); \$325 million (2008); and \$525 million (2009). The impact of the bill if enacted would increase over time as a growing number of corporations engage in congressionally approved maneuvers to minimize or altogether wipe out their state tax bills.

Billions of dollars would be lost under H.R. 3220 in dozens of other states, including those that for years have been working successfully to combat corporate tax sheltering activity. A total of \$330 million in revenues have been assessed or collected through such efforts in Maryland (\$100 million); North Carolina (\$200 million) and New Mexico (\$30 million). If H.R. 3220 had been in effect in the last ten years, these states would not have been able to assess or collect these revenues from efforts to curtail tax sheltering. H.R. 3220 would prevent these and other states from pursuing similar efforts for future tax years. The MTC currently is researching a detailed, state-by-state revenue loss estimate for H.R. 3220 and expects to release its findings during the summer of 2004.

Maryland Deputy Comptroller Stephen Cordi said: **“The House bill runs roughshod over federalism by imposing from above a substantial number of federally mandated state tax exemptions overriding hundreds of existing state and local laws and rules. This bill would provide for a bonanza of tax avoidance and corporate tax shelter opportunities.”**

The ability of states to independently determine their own tax revenue policy is a basic tenet of federalism. The House bill would impose a disproportionately greater share of business taxes on local family businesses and farms while benefiting out-of-state and foreign businesses that can afford sophisticated tax planning advice or that primarily market and sell to consumers.

The House bill currently under consideration would legitimize corporate tax avoidance schemes already underway by some corporations. According to legal filings by MCI bondholders and the investigation conducted by former U.S. Attorney General Dick Thornburgh, WorldCom may have routed \$24 billion in revenue through one of its units to cut down on as much as \$500 million in state tax bills, as part of a 128-page strategy devised by KPMG and used in the years following WorldCom’s acquisition of MCI. The bondholders said that the scheme kept income away from high-tax states by charging royalties for the use of intangible assets assigned to MCI WorldCom Brands, which is licensed in Delaware and pays no state tax. The Wall Street Journal reported that WorldCom was advised to declare regular income as returns on intellectual property, instead of receipts from sales of phone services. According to a 2003 news report: “Dissenting bondholders say the money was not related to licensing the company's intellectual property, but served as a ‘thinly veiled tax avoidance scheme.’ The royalties were part of a ‘Total Tax Minimization’ strategy devised by KPMG to lower state taxes paid by MCI’s operating units, according to the bondholder’s lawsuit.”

The MTC noted that the attack in certain quarters in Congress on state business activity taxes is founded on a misunderstanding. The U.S. Supreme Court has never ruled that a business must have “physical presence” in a state before it can be subjected to state business activity taxes. The U.S. Supreme Court in *Quill v. North Dakota* held only that a “substantial nexus” under the Commerce Clause requires physical presence for purposes of imposing an obligation to collect use taxes. It made no such finding for income tax. In short, there is nothing inappropriate or unconstitutional in what the states are now doing in the course of collecting business activity tax revenues.

Ironically, even though H.R. 3220 is generally labeled as requiring a corporation to pay income or other business taxes only if it has a physical presence, the bill would allow corporate taxpayers to have a large number of employees and a considerable quantity of tangible personal property – and in some cases real property – in states without incurring an income or franchise tax, despite enjoying substantial benefits and protections of the state with respect to those employees and that property.

Utah State Tax Commissioner Bruce Johnson said: **“This bill is bad public policy because it ties state taxes to an outmoded form of doing business – physical presence – that ultimately will serve to undermine the entire foundation of state business activity taxes. This outmoded approach simply is not in keeping with modern business practices in which significant income can be made with little or no physical presence or contact required. If Congress ‘ropes off’**

all such revenue from the states, the fairness and effectiveness of state corporate and other business taxes as a revenue source would be severely compromised and states would have to increase the burden on small local businesses and individuals just to maintain existing revenues.”

ABOUT THE MULTISTATE TAX COMMISSION

Created in 1967, the Multistate Tax Commission is an agency of state governments established to help make state tax systems fair, effective and efficient as they apply to interstate and international commerce, and to protect state fiscal authority. The Commission encourages states to adopt uniform tax laws and regulations that apply to multistate and multinational enterprises. Greater uniformity in multistate taxation reduces compliance burdens for multistate businesses, helps insure that interstate commerce is neither undertaxed nor overtaxed, and lessens the possibility that Congress will intervene in state taxation.

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