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Members of the Oregon House Committee on Revenue

Via E-mail

Re: COST Supports Repeal of Oregon's Tax Haven Law – S.B. 1529-A; Opposes -A9 Amendment to S.B. 1529-A

Dear Chairman Barnhart and Committee Members:

COST is submitting these comments in support of S.B. 1529-A, as passed unanimously by the Senate, and opposing the -A9 amendment to S.B. 1529-A. As many of the Committee members are aware, COST has a long-standing policy position in opposition to tax haven legislation.[1] Not only is the tax haven blacklist approach arbitrary and misleading, but it is fraught with Constitutional infirmities that are on the brink of being litigated. Although the Legislature's initial policy sought to address the issue of income shifting of concern to many policymakers, the tax haven blacklist approach has been rejected by all developed nations, including the United States in its recent tax reform legislation. Further, this is not an efficient tax policy, as the Department of Revenue is required to not only spend numerous hours every other year updating Oregon's list of tax haven jurisdictions, but it has been entangled in a significant number of audits that have yet to be resolved. For all of these reasons, COST respectfully opposes the -A9 amendments, which would delete from S.B. 1529-A the repeal of the tax haven provisions.

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 approximately 550 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.

[1] http://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/cost-state-tax-haven-policy-statement-final-4-16-15.pdf

Tax Haven Lists Are a Misguided Tax Policy Being Rejected

As COST has previously pointed out, the branding of specific nations as "tax havens," thereby penalizing companies merely incorporated there, is a counterproductive tax policy. "Blacklisting" specific countries is overly broad, and it may result in double taxation of legitimate business activities. Further, this approach has been rejected by all other developed nations[2] including the United States. One of the goals of the 2017 federal tax reform efforts was to move the U.S. from its antiquated worldwide international tax system to a territorial system. The U.S. was one of the last developed nations to maintain a worldwide system. The U.S., like other nations that have moved to a territorial system, included provisions to curb profit shifting and base erosion as part of the federal tax reform efforts. Thus, it is clear that the U.S. has considered the issue of profit shifting, and it is also clear that the U.S. did not include as part of its anti-abuse or anti-profit shifting provisions any type of tax haven approach. Thus, like all other developed nations, the U.S. has rejected the tax haven approach.

Tax haven provisions have also fallen out of favor with the states. Montana was the first state to adopt tax haven legislation back in 2003, and it took 10 years for another state (Oregon) to adopt similar provisions. While this type legislation gained a bit of popularity during 2013 and 2014, only Oregon has adopted the blacklist approach, and only four other states have adopted some type of tax haven legislation. Since 2015, however, while several other states, including California, have considered tax haven legislation, they have all ultimately rejected it as bad tax policy because it puts the states' economic development or foreign direct investment at risk. It should also be noted that the states that have tax haven provisions make up less than four percent of the total U.S. population; therefore, this is a policy that has been rejected by the overwhelming majority of the states as well as the federal government. Moving forward with its tax haven provisions would put Oregon out of step with the vast majority of other states, the U.S., and other developed nations.

Oregon's Tax Haven Law is an Inefficient Policy and a Drain on State Resources

Oregon's tax haven law, while it may appear simple on its face, is anything but simple in its application. ORS § 317.716 requires "the taxable income or loss" of a unitary member that is incorporated in one of the enumerated jurisdictions to be added back for purposes of determining Oregon taxable income. For federal corporate income tax purposes, however, a taxpayer is not required to compute the taxable income or loss of its foreign affiliates that might be subject to Oregon's tax haven provisions. Thus, taxpayers are required to compute the taxable income or loss of any such entities solely for the purposes of determining its Oregon taxable income. Again, not only is the policy out of step with the computation of tax for other jurisdictions, but it requires taxpayers to expend additional time and resources to file an Oregon excise tax returns.

The amount of the addback (*i.e.*, what is the member taxable income or loss) is also at issue in numerous audits that have been pending with the Department of Revenue for the last year and a half or more. In fact, on March 15, 2017, during hearings before the House Revenue and Senate Finance Committees, Paul Warner of the Legislative Revenue Office testified that the Department had 115 active audits on this issue. These audits began in 2015, and through

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[2] The OECD abandoned its blacklisting of jurisdictions in 2006.

conversations with several taxpayers and practitioners, the main issue on audit has been what is the proper number to be added back for Oregon purposes. The source of this issue is based on a Department of Revenue regulation that instructs taxpayers to add back a book accounting number, as opposed to taxable income. The issues are not caused by the Department of Revenue, however, but rather by a policy that is not grounded in basic conformity principles, which inevitably creates additional complexity. Sound tax policy instructs us that any law that requires a taxpayer and taxing agency to go through a lengthy and adversarial audit process to determine a proper amount of tax is clearly inefficient. Thus, any illusion that Oregon's tax haven laws are easy to comply with or administer are severely misguided, and I encourage you as policymakers to inquire as to the amount of state resources being utilized to administer this policy.

The Committee should also consider the time and resources required by the Department of Revenue to keep the tax haven jurisdiction list updated. According to a report of the Legislative Revenue Office, the cost to Oregon to update its list was $250,000 in 2017 alone,[3] and the state will be required to spend this amount going forward, as the Department of Revenue is required to update the tax haven jurisdiction list every other year pursuant to ORS §317.717. In addition to the monetary expense to the state, the Department has to spend numerous hours looking into the tax laws of at least 45 other nations as to whether they may meet the criteria provided in ORS § 317.717. These resources could be better utilized by the state. The staff of the Oregon Department of Revenue should be experts in and spend their time and resources on Oregon tax law—not international tax law. It is unfair to expect the staff of the Department of Revenue to take on a role for which no state tax administrator is properly equipped. Moving forward into tax years 2017 and beyond, the Department will also need to expend resources to determine how the tax haven provisions will intersect with the new international corporate tax laws under federal tax reform. Section ORS § 317.716(3)(b) requires the Department of Revenue to draft rules to preclude double taxation resulting from the tax imposed under the tax haven provisions. Going forward it is almost certain that the Department of Revenue would be required to provide guidance on, audit for, and adhere to two international tax regimes—one for tax haven provisions and one related to other international provisions with which Oregon may conform. This is an inefficient and misdirected use of state resources, which must be considered as part of this debate.

Tax Haven Legislation Will be Subject to a Constitutional Challenge

Finally, all of the prior arguments assume that this policy is constitutionally sound—which it is not. The Foreign Commerce Clause disallows states from discriminating against foreign commerce. Although a worldwide filing methodology has been found to pass constitutional muster, a selective tax haven blacklist has yet to be considered by the U.S. Supreme Court. By including only certain nations on a blacklist and requiring taxpayers to add back taxable income only from those nations, Oregon's tax haven provisions discriminate against commerce involving entities located in certain foreign nations. Thus, there is a significant risk that Oregon's law is in violation of the Foreign Commerce Clause.

The Foreign Commerce Clause also requires that the states not interfere with the federal government's ability to speak with one voice on foreign affairs. With federal tax reform, the

[3] Legislative Revenue Office. "An Assessment of Oregon's Listed Jurisdiction Policy and Its Cost Effectiveness." March 2017. Report #4-17.

federal government has spoken with respect to how it wants to tax multinational corporations going forward. As noted above, the federal government has clearly rejected the tax haven approach. The continuation of Oregon's tax haven provisions flies in the face of the federal government's policies on international taxation. If tax haven provisions are preserved in Oregon's corporate conformity bill, as intended by the -A9 amendment, is almost certain that a taxpayer or taxpayers will file a lawsuit challenging Oregon's tax haven provisions. A challenge has not yet been filed, because the audits pending have yet to be resolved. The fact the current audits are generally focused on the proper amount to be included as an addback is also not an indicator that taxpayers have conceded that the tax haven provisions are constitutional. Rather, this goes back to the inefficiency of these provisions—taxpayers, and the Department of Revenue, are required to fight about what must be added back to close an audit. And, only once an audit has been closed may a taxpayer challenge the constitutionality of these provisions. Tax haven laws may also run afoul of the foreign affairs power doctrine, and there could be other constitutional infirmities raised by taxpayers.

Again, I urge this Committee to think about the time and resources required to administer this law and the significant risk that it may very well be overturned in a lengthy court battle, which will also require additional state resources to defend. Is this really the best approach for Oregon moving forward? Especially, when the federal government has addressed through federal tax reform the very issue—potential income shifting—that Oregon sought to correct with its tax haven laws.

For the reasons discussed above, COST urges the Committee to reject the -A9 amendment, and should recommend instead that it move S.B. 1529-A as passed unanimously by the Senate. Oregon now has other tools to combat profit shifting, and it should reject tax haven provisions as so many other states and countries have done.

Sincerely,

Nikki Dobay

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director