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May 5, 2017

Chair Michael D. Brady
Chair Jay R. Kaufman
The General Court of the Commonwealth of Massachusetts
Joint Committee on Revenue

Via E-mail

Re: COST's Opposition to H.B. 1501, S.B. 1569 ("Corporate Tax Haven")

Dear Chair Brady, Chair Kaufman, Vice Chair Creem, Vice Chair Campbell, and Members of the Committee:

On behalf of the Council On State Taxation (COST),[1] I am writing to oppose legislation (H.B. 1501 and S.B. 1569) that would include entities formed or incorporated in certain listed countries ("tax havens") within the unitary business group subject to Massachusetts corporate excise tax, regardless of where the entity's business activities are conducted. The COST Board of Directors has approved a policy position opposed to such "tax haven" designations by states:

> *State "tax haven" designations are arbitrary and overly broad, reflect a discarded "worldwide" approach to state taxation, and are inappropriate to address income shifting or other tax avoidance concerns. Punitive treatment of multinational businesses with affiliates in countries designated by states as "tax havens" interferes with the U.S. Government's ability to "speak with one voice" on foreign affairs and is constitutionally suspect. States should limit their income tax base to the domestic "water's-edge" and not tax foreign income with little or no connection with the United States.*[2]

To date, only Montana and Oregon have adopted the "blacklisting" approach of foreign nations contemplated under both bills (H.B. 1501 requires the Department of Revenue to establish the tax haven list; S.B. 1569 includes the tax haven list in the statute itself). The blacklisting of foreign countries as "tax havens" and the arbitrary inclusion in the state tax base of income from businesses operating in these countries contravenes the approach taken by the vast majority of states and virtually all of the nations in the world.

[1] COST is a nonprofit trade association consisting of approximately 600 multistate corporations engaged in interstate and international business. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.
[2] COST's policy position on this issue is available on the COST website at: http://cost.org/uploadedFiles/About_COST/Policy_Statement/COST%20State%20Tax%20Haven%20Policy%20Statement%20Final%204%2016%2015.pdf.

Arbitrary and Overly Broad Approach. Branding foreign nations as "tax havens" has been widely rejected as a legitimate means for dealing with tax avoidance. The "tax haven" lists are derived largely from a list created over 15 years ago by the Organization for Economic Cooperation and Development (OECD) to encourage countries to adopt greater transparency and information sharing about tax issues, not to broaden the tax base of member countries. Presently, no countries remain on the OECD's list of uncooperative tax jurisdictions. Moreover, no country, including the United States, has ever adopted the "tax haven" list approach as a means for defining their income tax base. Rather than providing a viable solution to the issue of international income sourcing, the adoption of a tax haven list creates new problems by arbitrarily targeting sovereign nations.

The Slippery Slope to Worldwide Unitary Combination. Tax haven lists impose, on a selective country-by-country basis, the discredited "worldwide" combination method for the state taxation of multinational businesses. State attempts in the 1970s to tax the income of the worldwide unitary group, including entities with no U.S. presence, created considerable apprehension among both foreign governments and foreign and domestic multinational business enterprises, instigating what many thought would be an international tax war. Indeed, in 1985, the United Kingdom took the unprecedented approach of approving legislation that would have allowed the U.K. Treasury to penalize multinational companies with operations in any U.S. state that employed worldwide combination. A Presidential Working Group agreed to forestall federal intervention if states limited mandatory unitary combination to a domestic water's-edge approach. Tax haven legislation undermines the consensus among the states that has prevailed for 30 years to limit mandated income tax bases to the "water's-edge" and to avoid the taxation of income earned outside the United States. The blacklisting of designated "tax haven" countries also interferes with U.S. foreign relations, threatening our nation's ability to "speak with one voice" in its dealings with our key trading partners. This interference in foreign affairs raises constitutional concerns as well, and state tax haven statutes likely will be subject to judicial challenge in the coming years.

Tax Haven Lists Unsuitable to Address Tax Avoidance Concerns. While the international community searches for solutions to the issue of base erosion and profit shifting (called "BEPS"), U.S. states have extensive experience in shoring up the corporate tax base and addressing tax avoidance. These methods include participating in information-sharing with the IRS, adjusting intercompany income (*e.g.*, I.R.C. Section 482 powers), asserting alternative apportionment, and applying common-law doctrines and state statutory standards of business purpose and economic substance. Indeed, the Massachusetts Department of Revenue possesses all these powers to enforce the corporate excise tax. These methods reflect a focus on specific transactions or corporate arrangements, rather than blacklisting entire nations and their international trade.

Tax haven designations invite retaliatory action by other countries and, at a minimum, work to decrease investment in adopting states both by foreign-based businesses and U.S. domestic businesses engaged in multinational operations. While the desire by states to address the complexities of global commerce and instances of tax evasion are understandable, tax haven lists are a clumsy and ineffective method that are detrimental to states' own interests.

Further Research Available for the Committee's Consideration. For a more in-depth look at this issue, COST urges you to review a research paper undertaken by the State Tax Research

Institute (STRI), a 501(c)(3) organization established in 2014 to conduct research designed to enhance public dialogue relating to state and local tax policy. STRI is affiliated with COST. The research paper, "State Tax Haven Legislation: A Misguided Approach to a Global Issue" (February 2016),[3] documents how the "tax haven" listing approach is based on a fundamental misunderstanding of the OECD initiative, with even the Multistate Tax Commission abandoning the blacklist's use.

Please contact me with any questions you may have or for more information regarding COST's research in this area.

Respectfully,

Karl A. Frieden

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

[3] The STRI research paper is available on the COST website at: http://cost.org/WorkArea/DownloadAsset.aspx?id=92483.