



March 19, 2013

Senator Rod Skoe, Chair of the Senate Taxes Committee,  
Senator Ann Rest, Chair of the Senate Tax Reform Division,  
Representative Ann Lenczewski, Chair of the House Taxes Committee,

Thank you for the opportunity to submit this testimony to the tax committees. We are submitting testimony in support of Minnesota legislation (S.F. 1237/H.F. 1440) to decouple from the federal tax code so as to prevent companies that abuse offshore tax havens from shifting their tax burden onto ordinary Minnesotans.

This testimony covers four basic points:

- (1) According to best estimates, the state of Minnesota loses over \$1.3 billion in annual revenue as a result of corporate abuse of offshore tax havens.
- (2) Legislation for Minnesota to consider companies' profits listed in recognized tax havens as "domestic" for tax purposes would prevent the revenue loss of almost a quarter billion dollars annually.
- (3) The harm caused by multinational corporations abusing offshore tax havens is borne especially by small businesses, which overwhelmingly want to close offshore tax loopholes.
- (4) Decoupling from the federal tax code, as this legislation would do, is a common occurrence in state tax law.

First, the latest academic research shows that legal and illegal abuse of offshore tax havens by multinational corporations leads to approximately \$90 billion in lost federal tax revenues each year. Since state income taxes are closely tethered to federal determinations of taxable income, our recent research report, "The Hidden Cost of Offshore Tax Havens: State Budgets Under Pressure From Tax Loophole Abuse," was able to estimate that almost \$40 billion in state income tax is lost annually as a result of offshore tax haven abuse, with corporations accounting for \$26 billion of that total.<sup>i</sup> The analysis was based on IRS data on the distribution of income tax filings across the fifty states, with data then applied to the prevailing corporate tax rates in each state. A review of this research by Pulitzer Prize winning tax journalist David Cay Johnson in the well-respected tax-industry publication *Tax Notes*, noted that while at first the amounts seemed high, under greater scrutiny, "the fundamental findings seem sound," and the analysis was "done well enough that state agency officials should be ensuring that legislative committees and their staffs see it and that voters know about it."<sup>iii</sup>

The research report estimates that Minnesota's state budget loses \$1.324 billion in annual revenue as a result of corporations dodging taxes through abuse of offshore tax havens.

Secondly, in light of that finding, let us consider the effects of S.F. 1237/H.F. 1440 which would include as taxable domestic income, profits from substantial business activity that companies' list in recognized tax havens. The bill can only prevent a portion of the annual \$1.3 billion in lost Minnesota revenue to tax havens. Offshore tax dodgers deploy a variety of legal and illegal tricks for deferring or avoiding taxes. The state of Montana, which enacted a similar law over three years ago, estimates that their bill generated \$8 million in additional revenue last year, up from \$6 million the first year. This sum is about 18 percent of the \$44 million in annual revenue our report estimates Montana would be losing from corporate abuse of offshore tax havens. Thus, based on prevent the same fraction of Minnesota's \$1.3 billion in lost tax haven revenue, the tax haven legislation can be expected to save \$241 million annually – almost a quarter billion dollars a year.

Third, this substantial volume of revenue hurts small business and ordinary taxpayers. Legislators should be under no delusion that that the loss of this revenue is not borne by other Minnesotans. Every dollar in Minnesota that multinational companies dodge through use of offshore tax havens is a dollar that others must pay for.

Minnesota small businesses are hurt twice by multinationals that use offshore tax loopholes to dodge taxes. First, small businesses must pick up the tab in the form of cuts to public investments that help them thrive, or pay higher taxes. On top of that, multinationals gain an artificial competitive advantage over responsible small businesses that don't use offshore tax havens. Small businesses don't typically have large accounting and legal departments, foreign subsidiaries, or large quantities of extra cash to shift around for tax advantages. Small businesses realize this is a problem. An independent scientific poll found that 90 percent of small business owners believe big corporations use loopholes to avoid taxes that small businesses have to pay, and 92 percent agree it's a problem when "U.S. multinational corporations use accounting loopholes to shift their U.S. profits to their offshore subsidiaries to avoid taxes."<sup>iii</sup>

Fourth, like other states, Minnesota uses federal taxable income as its starting point in calculating its tax base. This means that income which federal tax loopholes allow to be shifted offshore will also be invisible to Minnesota tax authorities. In federal law the income of corporations registered offshore is generally excluded from the taxable income of a unitary business group. The income would similarly not be subject to Minnesota tax unless the offshore registered corporation – perhaps just a mailbox in the Cayman Islands – also does taxable business in Minnesota. Minnesotans need not accept this federal loophole. They can, as the state of Montana does and H.F. 3044/S.F. 1237 would do, treat corporations incorporated in a list of tax haven countries as domestic corporations for tax purposes.

Untethering or "decoupling" from the federal tax code this way is not unusual. For example, many states set their own rules on itemized deductions or estate taxes. More than 30 states decoupled from a federal measure in 2002 to grant bonus depreciation. Many states similarly decouple from the federal code by forbidding companies from carrying back losses against earlier years' taxable income. We know from Montana that

states can decouple their definition of domestic income as the present tax havens bill would do. Those in support of states' rights or of state independence from the federal government should be particularly supportive of these measures.

In sum, enacting the tax haven bill (H.F. 3044/S.F. 1237) will help ensure that businesses in Minnesota will thrive based on their productivity and capacity for innovation, rather than the aggressiveness of armies of tax lawyers and accountants. The bill protects ordinary Minnesotans from shouldering a quarter-billion-dollar burden from multinational corporations' abuse of offshore tax havens. The tax havens bill is also a small but significant step separating Minnesota from the dysfunction and special-interest provisions of federal tax law.

We respectfully urge members of the tax committees to support this legislation.

Sincerely,

Phineas Baxandall, Ph.D.  
Senior Analyst for Tax and Budget Policy  
U.S. Public Interest Research Group (U.S. PIRG)

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<sup>i</sup> “The Hidden Cost of Offshore Tax Havens: State Budgets Under Pressure From Tax Loophole Abuse,” U.S. PIRG Education Fund (January 2013), available at <http://www.uspirgedfund.org/reports/usf/hidden-cost-offshore-tax-havens>

<sup>ii</sup> David Cay Johnston, “Bermuda Robs Sacramento and Albany — Who Knew?” Tax Analysts, *State Tax Notes*, February 11, 2013.

<sup>iii</sup> American Sustainable Business Council, Main Street Alliance, and Small Business Majority. “Poll: Small Business Owners Say Big Businesses, Millionaires Not Paying Fair Share of Taxes” February 6, 2012, <http://businessforsharedprosperity.org/content/poll-small-business-owners-saybig-businesses-millionaires-not-paying-fair-share-taxes>