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Corporations Are Big Winners in State Tax Shell Game

By **Gerry Bradley**

Research Director, N.M. Voices for Children

Mid-April is the time of year when most of us think about the income taxes we pay. Whether our tax bill is large or small, and whether we grumble about paying it or not, chances are, all of us benefit just about every day from the infrastructure and services our taxes buy.

Taxes pay for the roads we drive on to work each day, for police and fire protection, the criminal justice system, and our schools and universities to say nothing of our libraries, museums, swimming pools and parks. But while we're thinking about what we get for our tax investment, we ought to give some thought to those of our neighbors who are not paying their fair share.

These moneyed, powerful neighbors are engaged in multimillion-dollar shell games where they hide their New Mexico profits from the state's corporate income tax. These corporate neighbors enjoy the same infrastructure and services we all do, but without having to invest their fair share. And we've let them get away with it for years.

New Mexico's corporate income tax laws have a loophole through which some \$80 million disappears every year, according to our own Taxation and Revenue Department. That's because multi-state corporations doing business here can elect to report their profits on a "separate-entity" basis— meaning separate from any out-of-state subsidiaries. So if a separate-entity corporation shifts its New Mexico profits to an out-of-state subsidiary, it doesn't have to pay New Mexico the income tax on those profits.

Here's how some multi-state corporations like to play the shell game: The parent corporation sets up a passive investment company, or PIC, in a state without a corporate income tax (such as Nevada). The parent corporation then transfers its licenses, patents, trademarks and know-how to the PIC. The PIC graciously allows the parent to use the licenses, trademarks, etc., in exchange for royalty payments— which the parent can then deduct from its New Mexico profits as a business expense, even though the money never actually left the business. It just left the state.

To further the game, the PIC can then loan its profit back to the parent

corporation in exchange for an interest payment—which the parent again deducts from its state profits. So essentially, the corporation pays itself for the right to use its own trademarks, etc., and then loans its money back to itself so that it may pay itself interest on its own money.

Watching these corporations bounce their money from place to place is rather like watching a tennis match: after a while it gets painful.

Over the last few years, the state's Taxation and Revenue Department has slapped both Wal-Mart and Kmart with assessments for unpaid corporate income taxes (\$11.6 million and \$1.2 million, respectively). Both Wal-Mart and Kmart were paying an out-of-state PIC for the use of their trademarks.

Kmart appealed its case to the state Supreme Court and lost. Wal-Mart also lost, but then conveniently opened a real estate investment trust, or REIT. Now Wal-Mart pays itself rent for the use of its New Mexico property. It can now deduct the rent from its New Mexico profits as a business expense.

The use of PICs and REITs are only two of the ways multi-state corporations can shelter their profits. There are more. Fortunately, there is one easy way to stop them all. The Legislature could enact a mandatory combined reporting law. Such laws require multi-state corporations to combine the income from all their subsidiaries. A formula is then used to determine how much income tax is owed each state. Combined reporting is now required in 20 of the 46 states that collect a corporate tax for which combined reporting is relevant. And the governors of five more states are recommending that it be adopted.

The Legislature has seen combined reporting bills in each of the last three sessions. All sponsored by Rep. Peter Wirth, D-Santa Fe, these bills have died in the House Business and Industry Committee every year.

Next year when our lawmakers convene again, I hope they will decide that multi-state corporations like Wal-Mart and Kmart should be required to invest in the very communities in which they make their money. Since they expect the same sort of police and fire protection that we all get, they should pay for it, too. This sort of tax fairness makes writing out that check in mid-April a little less painful for the rest of us.