Testimony in Support of LD 403, “An Act to Prevent Tax Haven Abuse”

February 13, 2020

Senator Chipman, Representative Tipping, and members of the Taxation Committee,

My name's Sarah Austin. I'm a policy analyst at the Maine Center for Economic Policy. I'm here to testify in favor of LD 403. Use of tax havens by the largest companies is well documented, and Maine should take steps to close loopholes in its own tax system that reward this behavior.

Corporations depend on things like an educated workforce, consumers with enough income to pay for services and products, and infrastructure that facilitates commerce. As a state and a nation, we fund the investments that help businesses succeed and create a strong economy that allows them to profit.

In return, corporations are supposed to pay taxes — just like families do — to help sustain and improve strong economic conditions for future generations.

But every year, large US-based companies such as Apple, Pfizer, Exxon Mobil, Google, and others use a complex system of international accounting loopholes to move their domestic profits in foreign countries with lower tax rates. Instead of contributing what they should at home, these corporations exploit “offshore tax havens” to move their US-based profits — including those generated here in Maine — to a more favorable tax environment.

This international tax avoidance scheme reduces revenue right here in Maine. National and international businesses owe taxes in Maine on a share of their US-based profits equal to the share of US-based sales that occur in Maine. For example, a company that made 50 percent of its US sales in Maine would owe Maine income taxes on 50 percent of their US-based profits.

When businesses exploit the tax haven loophole to lower their US profits on paper, Maine loses out on revenue that should go to our state. Nationally, Fortune 500 companies have moved $2.6 trillion of profit to offshore tax havens. As a result, Maine loses up to $52 million/year in lost revenues.

The state could reform its system of international business taxation to bring tax haven profits out of hiding and into the Maine tax base. You could extend Maine's current method of combined reporting to include profits booked to known tax havens — as the initial draft of this bill proposes. Alternatively, you could extend combined reporting to incorporate worldwide profits, creating a more complete profit base from which to apportion Maine
income taxes. Both of those solutions would still require businesses to pay taxes on the share of their profits that equaled the share of their sales that happened in Maine.

The committee also could clean up the state’s international tax laws this year by decoupling our state tax code from a flawed and costly international provision of the federal 2017 Tax Cuts and Jobs Act.

The TCJA created a “foreign-derived intangible income deduction,” or “FDII”, to encourage corporations to keep high-return intangible properties such as brands and patents in the US, rather than registering them in offshore tax havens. These assets are central elements in offshore tax haven abuse and ensuring that US-based companies register their brands and patents in the United States is a crucial element of closing the tax haven loophole.iii

But the deduction is so poorly designed that it has done nothing to sway decisions about how companies account for intangible properties. In fact, it has created a new opportunity for corporations to game the tax system by rewarding companies for investing more tangible capital, such as factories, overseas. Multiple papers from lead researchers on international taxation have outlined the ways the FDII deduction is rife with opportunities for tax avoidance and laid bare the reality that the deduction is ineffective at stemming tax haven abuse.iv

For example, companies can export and then reimport their products through another subsidiary to take advantage of the deduction without ever bringing their intangible property back home. This maneuver is out of reach for a small, medium, or even large business. But for multinational corporations with armies of accountants and mazes of subsidiaries across the world, the payoffs can be large.

While FDII was passed with the intent of slowing international tax avoidance, the deduction does the opposite. It is a costly tax giveaway that gives more to companies that are locating their capital assets overseas than it does to companies that keep their large productions operations here at home. Because the tax break is larger for companies that have assets overseas, the main economic incentive of this deduction is to encourage investment overseas. Early evidence shows that is exactly what’s happening.v

The tax conformity package approved by the Legislature in 2018 brough FDII to Maine. Decoupling from this provision would improve Maine’s tax code. It would ensure large corporations aren’t able to benefit from this latest tax gaming opportunity and divert resources away from the investments that make Maine a good place to live and do business. While instituting a system of combined worldwide reporting would be the most comprehensive solution to ending tax haven abuse in Maine, decoupling from FDII is a good first step that addresses a specific defect in the TCJA.
I urge the committee to pass LD 403 with language that improves fairness in Maine's business tax system by closing loopholes and ending giveaways for the largest and most profitable international corporations.

Thank you for your time and I welcome any questions.

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3 Ibid
