

## POLICY BRIEF

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### Combined Reporting Prevents Corporate Tax-Dodging Some Seek to Re-Open “Las Vegas Loophole”

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In 2009, Wisconsin amended its tax policy to require combined reporting of corporate income and expenses, joining 22 other states that already had this policy. Some policymakers are advocating for a repeal of combined reporting.

This change reduced the opportunity for corporations to shift income to subsidiaries in other states in an attempt to avoid corporate income tax. Policymakers from a variety of ideological backgrounds have advocated for combined reporting, with then-Governor Tommy Thompson first proposing the change to the Legislature in 1999.

Re-opening this corporate tax loophole would add roughly \$100 million a year to the state’s revenue shortfall.

#### About Combined Reporting

Combined reporting prevents corporations from setting up a shell company in order to avoid paying income tax. Many large corporations with operations in more than one state are made up of a parent corporation and a number of subsidiary corporations owned by the parent.

Combined reporting treats the parent and subsidiary corporations as one unit for income tax purposes. A corporation’s nationwide profits are combined and the state taxes a share of the combined profit based on a formula that takes into account the corporation’s activity in that state.

Separate accounting, which was Wisconsin’s previous tax filing system, gave corporations

an unintended incentive to avoid paying income taxes. Under separate accounting, each corporation—parent and subsidiaries—reported its own income and expenses separately, without regard to the income and expenses of corporations with which it was affiliated.

Because a parent corporation and each of its subsidiaries filed separate returns under separate accounting – even though they were part of a single, unified business – corporations had an incentive to shift income to subsidiaries outside of Wisconsin in order to avoid the tax.

For example, with separate reporting, Wisconsin banks transferred their investments to subsidiaries in Nevada, which did not have a corporate tax, to try to avoid being taxed on the income from those investments. This is how separate reporting earned the nickname “Las Vegas Loophole.”

#### Why Combined Reporting Matters

Under the old separate accounting system, many national corporations operating in the state avoided paying any corporate income tax in Wisconsin. Companies such as Microsoft, PepsiCo, McDonald’s, General Electric, Merck, and Apple paid *nothing* in Wisconsin income tax, even though a portion of their profit came from Wisconsin sales.

If Wisconsin returns to a separate accounting system, these multistate corporations would likely return to paying no corporate income tax to the state. Because it’s unlikely that the tax savings they enjoy will be invested in

Wisconsin, rolling back combined reporting is not a cost-effective strategy for job creation.

Combined reporting ensures that corporations pay tax to the state they should be paying. Under the old separate accounting system that some would like to bring back, some businesses skirted their responsibilities for paying for public services. That meant that other taxpayers, both corporations and households, had to pay higher taxes, and citizens were deprived of the services they needed because of a lack of revenue.

### **The Bottom Line**

**Wisconsin should ensure the integrity of its corporate income tax by keeping a combined reporting system.**