IRET Institute For Research On The Economics Of Taxation

IRET is a non-profit 501(c)(3) economic policy research and educational organization devoted to informing the public about policies that will promote growth and efficient operation of the market economy.

Norman B. Ture sent a letter, dated December 22, 1983, to Treasury Secretary Donald T. Regan. In the letter Ture suggested an approach for dealing with some of the problems that arise when U.S. states tax corporations that generate income in multiple countries.

Tax Notes published the letter shortly thereafter (*Tax Notes*, January 16, 1984, pp. 258).

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Letter from Norman B. Ture to Treasury Secretary Donald T. Regan

SUBJECT: A proposal for dealing with the unitary tax problem.

Advise the state governments that there is no opposition at the federal government level to the states continuing to use world-wide combination with their unitary tax for mulae, pending new regulations for implementing section 482 income allocations.

Enact a federal income tax credit equal to the difference between the tax which a multinational corporation pays to a state(s) under world-wide unitary tax formulae and the amount of state taxes the corporation would pay were there a water's edge limit on such taxes.

Initiate promptly a section 482 regulation project, with Treasury economists taking primary responsibility for formulating income allocation and transfer price rules which reflect good economics and sound business practice and which are readily complied with.

Upon satisfactory completion of the section 482 regulation project, enact federal legislation which would

- o mandate states to conform their income allocation formulae with those prescribed in the new section 482 regulations and
- o repeal the federal income tax credit for the excess of state taxes under existing world-wide combination formulae over such taxes with a water's-edge limitation.

The basic premise for this proposal is that there is no politically feasible near-term resolution of the existing impasse which would simultaneously

- o satisfy the President's "New Federalism" criteria,
- o eliminate the tax irritants for the United Kingdom and other foreign governments, and
- o eliminate the tax distortions for multinational companies resulting from world-wide combination in the states' unitary formulae.

Rather than attempting to solve the problem in the near term, a compromise should be sought to buy time for the President while an effective resolution of the conflict is devised. It seems clear to me that any such compromise will "cost" the federal government something, but the proposed price tag -- the federal tax revenue loss under the proposed temporary tax credit -- would likely be modest. Paying that price should result in a large payoff for the President by

- o eliminating an important sore spot in federal-state relations, and
- o facilitating progress in U.S.-foreign government negotiations over a wide range of existing difficulties.

A compromise of the sort proposed above, for example, might improve the prospects for GATT acceptance of a U.S. Foreign Sales Corporation tax device as a replacement for DISC.

The state governments, I believe, are on solid ground in rejecting the existing section 482 regulations as the basis for determining transfer prices and allocating income among related corporate entities. The present 482 regulations are conceptually inane in terms of the rudimentary economics of transfer pricing. Even worse, they are the source of great uncertainty concerning the ultimate tax liabilities of corporate taxpayers. Requiring states to adhere to existing section 482 regulations for purposes of income allocation would be to aggravate their revenue uncertainties while making them adhere to rules which certainly misrepresent true income allocation.

This is not to endorse the existing world-wide combination formulae relied upon by the states. As devices for measuring income arising within a state's jurisdiction, these formulae are at least as senseless as the existing section 482 rules would be. Sooner or later, the states should be brought around to the use of some practicable, sensible transfer-pricing, income allocation rules. The Treasury should promptly get to work on devising such rules. Until they become available, however, there is no point in exacerbating the present tensions between state governments and the Administration.

The proposed federal income tax credit would not address the problems posed by states' unitary tax for mulae for multistate, rather than multinational, corporations. The resolution of their problems would have to wait until the new section 482 regulations became available and were in use by the states. But the multistate tax issue, though not to be ignored, does not now appear to be on the front burner.