SENATE TAXATION
EXHIBIT NO. 7
DATE 2-05-2013
BILL NO. SB 208

COST
COUNCIL ON STATE TAXATION

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TO: Chairman Tutvedt and the Senate Taxation Committee

RE: **OPPOSITION TO SENATE BILL 208** – REPEAL OF WATER'S-EDGE ELECTION

The Council On State Taxation respectfully opposes Senate Bill 208, legislation proposing to repeal the water's-edge election for businesses that conduct multinational business operations. Repealing the water's edge election would make Montana an outlier among states utilizing unitary combined reporting. SB 208 not only significantly increases the likelihood that businesses engaged in multinational operations will be subject to double taxation, it sends a signal to our international trading partners that Montana does not value their trade partnership.

About COST

COST is a nonprofit trade association based in Washington, DC and Sacramento, California. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of nearly 600 major corporations engaged in interstate and international business. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

The Water's-Edge Election

Montana's water's-edge election limits the determination of income subject to apportionment in the State to the income and apportionment factors of a group of unitary companies operating within the "water's-edge" of the United States. SB 208 would eliminate the water's-edge election and thus require companies operating both in Montana and abroad to include non-U.S. corporations in their determination of Montana corporate income tax. If SB 208 is enacted, Montana would be the only combined reporting state in the nation to employ mandatory worldwide combination.

Worldwide combination became a matter of national and international attention in the 1980s. While California ultimately prevailed before the United States Supreme Court on the constitutionality of the worldwide combination scheme, it became clear very quickly that worldwide combination was an international liability for the U.S. among its largest and closest global trading partners.

Worldwide combination was thoroughly investigated in the 1980s by the Department of the Treasury's Worldwide Unitary Taxation Working Group,

commissioned by then President Ronald Reagan. The Working Group included representatives of the federal government, the states (both the legislative and executive branches), and the business community.

In the Working Group's final report to the President (July 31, 1984),[1] Treasury Secretary Donald Regan noted that the Working Group agreed on three principles that should guide the state taxation of the income of multinational corporations. The very first principle was that a water's-edge election be provided by states for both U.S. and foreign based companies. Secretary Regan recommended that federal legislation be enacted to that effect if the States failed to resolve the issue on their own. Indeed, such federal legislation was introduced in Congress precluding the states from adopting mandatory worldwide combination.

Worldwide combination was not simply a domestic tax matter. Some of our nation's most important trading partners vociferously objected to its use as well. From the perspective of foreign nations, worldwide combination was seen as attempting to tax activities occurring overseas, and to place on their companies doing business within the U.S. a burden that was not placed on U.S. companies operating abroad. In fact, in 1985, the U.K. approved legislation that would have allowed the U.K. Treasury to penalize multinational groups of companies with operations in any U.S. state that employed worldwide unitary combination. Similarly, many Japanese businesses announced that they would not locate or expand operations in any state that applied worldwide combination.

Fortunately both the need for federal legislation and the potential of retaliation by some of our nation's closest trading partners was averted when the states that employed combined reporting adopted a water's-edge election and have maintained it ever since. Even the Multistate Tax Commission's model combined reporting statute includes a water's-edge election.

Conclusion

The water's-edge election serves not only as a limitation on combined reporting that reduces the incidence of double taxation, it also removes a significant barrier to trade with our nation's leading trading partners. SB 208's proposed repeal of the water's-edge election would not only signal the necessity to revisit federal legislation, but it would also raise an unfortunate warning flag for those foreign investors considering direct investment in Montana. COST respectfully opposes SB 208 and urges the Members of the Committee reject it.

Sincerely,

Wm. Gregory Turner
Vice President, Senior Tax Counsel

cc: COST Board of Directors
Douglas L. Lindholdm, President & Executive Director, COST
Nancy Schlepp, President, Montana Taxpayers Association
Webb Brown, President & CEO, Montana Chamber of Commerce

[1] Available at http://www.cost.org/WorkArea/DownloadAsset.aspx?id=82785