



GOVERNOR GREG GIANFORTE
DIRECTOR BRENDAN BEATTY

MEMORANDUM

TO: Revenue Interim Committee

FROM: Derek Bell, Administrator

DATE: September 15, 2022

SUBJECT: Biennial Tax Haven Recommendation

Every two years, the Department must provide the Revenue Interim Committee “with an update of countries that may be considered a tax haven.” Section 15-31-322(2), MCA. For the reasons contained in this memorandum, we recommend that the tax haven list found at § 15-31-322(1)(f), MCA, be repealed. Before explaining how we reached our conclusion, we offer a very brief explanation of how a multi-state corporate income taxpayer apportions its income to Montana, and how the “water’s edge election” and the tax haven list affect that calculation.

Properly taxing a corporation doing business in Montana and in other states and/or countries is a more complicated process than for those corporations whose only activities are in this state. For a multi-state or multi-national business with sufficient ties to Montana to permit this state to impose a tax upon it, Montana employs what is known as world-wide combined reporting. Montana’s ability to utilize this method of reporting and ultimately tax income earned outside of our borders is based upon the unitary business principle. Section 15-31-301(2), MCA. The unitary business principle, for state corporate tax purposes, is rooted in state property taxation. *See, Adams Express Company v. Ohio State Auditor*, 165 U.S. 194 (1897). Both are firmly established in Montana, with each acknowledging the increased value associated with a multi-state business operating in a synergistic fashion and as an integrated unit without the functional or geographic division of the whole into its component parts.

For example, if a Montana taxpayer (ABC Corp.) is in a unitary business relationship with DEG Corp. (Delaware) and XYZ Corp. (Canada), then ABC will file a combined report with the Department reflecting its activities in Montana, Delaware, and Canada.

The amount of ABC’s business income attributable (or, apportioned) to Montana is calculated after considering the percentage of its property, payroll, and receipts occurring in Montana versus the percentage of its activities occurring everywhere else. The formula

for ABC and other multi-state/multi-national corporations, therefore, looks something like this:

STEP 1: Determine ABC's Montana portion:

$$\frac{\text{ABC's Montana Property}}{\text{ABC's Total Property}} + \frac{\text{ABC's Montana Payroll}}{\text{ABC's Total Payroll}} + (2 \times \frac{\text{ABC's Montana Receipts}}{\text{ABC's Total Receipts})$$

STEP 2: Determine ABC's Montana Apportionment factor:

$$\text{ABC's Montana portion} \div 4 = \text{Montana apportionment factor}$$

STEP 3: Determine business income apportioned to Montana:

$$\text{ABC's Montana apportionment factor} \times \text{ABC's total business income}$$

In 1987, the Legislature amended our corporation license tax statutes to permit multi-national corporations to make a "water's edge" election. Sections 15-31-321 through -326, MCA. Generally speaking, this election serves to exclude from the Montana combined report any income or loss generated outside of the United States. A water's edge election, when properly made, is prospective in nature and lasts for a three-year renewable period. For taxpayers making this election, their respective tax rate increases from 6.75% to 7.00%. Section 15-31-121(2), MCA.

For ABC, a water's edge election would exclude the income/loss generated by XYZ's Canadian activities. Formulaically, the denominator of the formula identified above would not include XYZ's income or loss. ABC's combined return in Montana, therefore, would only apportion the income or loss attributable to the activities occurring in Montana and Delaware.

In 2003, the Legislature added the tax-haven provision (subsection (f)) to § 15-31-322(1), MCA via House Bill 721. Essentially, this provision disregards a water's edge election for corporations incorporated in the countries identified in § 15-31-322(1)(f), MCA. This list of countries was based upon a 2000 list of tax haven jurisdictions published by the Organization for Economic Co-operation and Development ("OECD").¹

In our example, let's assume that LMN Corp. is also a member of ABC's unitary group and that it is incorporated in the Cayman Islands. ABC's water's edge election will continue to exclude from its Montana combined return the activities of XYZ because Canada is not among the countries found in § 15-31-322(1)(f), MCA. But, because the Cayman Islands are among those countries listed in the statute, ABC's combined return will include LMN's income/loss, in addition to its other domestic income/loss.

¹ The only difference between the OECD list and the list of countries found in the final version of HB 721 is that HB 721 includes Bermuda, The Cayman Islands, and Luxemburg whereas the OECD's list did not.

The challenge the Legislature sought to resolve by creating a list of tax haven countries was to address a corporation's use of holding companies in foreign jurisdictions who coupled that with a water's edge election. In that situation, a taxpayer could essentially park its intellectual property in a foreign holding corporation that lacked any legitimate business activity or purpose. The net result of this type of planning was that the domestic prong (the expense side) would be captured on the Montana return while the foreign side (the income side) would not.

Between 2000 and now, the OECD did not modify its original 2000 List. On the contrary, the OECD published lists of countries that fell into an "uncooperative tax haven" category. This different designation originally comprised tax haven jurisdictions that had not committed to improving transparency and the exchange of information practices. By 2009, no country was viewed by the OECD as an uncooperative tax haven. In fact, "The list of unco-operative tax havens was comprised of tax havens identified by the OECD under criteria it established in 1998 and which have not made formal commitments to the OECD, after being requested to do so. Following the removal of Andorra, Liechtenstein and Monaco from the list, no jurisdiction is currently listed as an unco-operative tax haven by OECD." *Countering Offshore Tax Evasion, Some Questions and Answers on the Project*; Sept. 28, 2009.

It is not possible to determine, upon a review of OECD's materials, which of the 35 tax haven countries found on the 2000 List (or in our statute) would continue to be viewed as a tax haven if reevaluated now. Importantly, the OECD previously cautioned, "While these lists are not replaced by the progress report, they should be seen in their historical context and the OECD will have to reassess their relevance in light of current developments." *Id.*, p. 12. Even before that 2009 acknowledgement, the OECD's website also stated:

That list should be seen in its historical context and as an evaluation by OECD member countries at a particular point in time of which countries met the criteria set out in the 1998 Report... The list has not been updated... If a country chooses to use a list of countries derived from the OECD list, it should do so based on the relevant current facts. Thus, progress made in the implementation of the principles of transparency and effective exchange of information in tax matters should be taken into account by such countries and their legislatures. This statement does not reflect any judgment on the tax or other policies underlying country lists.

<https://www.oecd.org/ctp/harmful/2000progressreporttowardsglobaltaxco-operationprogressinidentifyingandeliminatingharmfultaxpractices.htm>

For close to 20 years, Montana has been virtually the only state to enact a "blacklist" of countries which comprise a tax haven. Oregon adopted a similar tax haven list which was modeled on Montana's, but its legislature repealed the list in 2018. As a result, no other state currently utilizes a statutory list of tax havens to combat tax sheltering schemes. Moreover, and in our experience, a very real consequence of a list is some

taxpayers who engage in non-abusive, legitimate business activity in tax haven jurisdictions have been captured, thus unnecessarily increasing its tax burden relative to its peers.

In light of the foregoing, the Department recommends a repeal of the list of tax havens found at § 15-31-322(f), MCA. To the extent that the agency becomes aware of a taxpayer engaging in behavior that results in it apportioning income to this state that is truly not representative of its business activity, we believe that can be addressed on a case-by-case basis through the application of the “relief provision” found at § 15-31-312, MCA.