Corporate taxes have declined markedly over the last several decades as a share of total state tax revenues. In 1979, corporations paid 10.2 percent of all tax revenues collected by states. By 2011, they paid just 5.3 percent. A major contributor to this decline is the increasingly sophisticated and aggressive use of loopholes by corporations to minimize the taxes they owe. Use of these loopholes often relies on complex accounting strategies, such as shifting income among related business entities to reduce the amount of taxes owed. Reducing these opportunities for tax avoidance raises new revenue, primarily from large, profitable corporations. This also can help level the playing field for smaller, in-state businesses.

WAYS TO DO IT

ADOPT COMBINED REPORTING
Under combined reporting, a corporation must file a single tax report showing the combined net profit from all of its various related subsidiaries, including those operating in other states. The portion of that net profit that each state will tax is then determined according to the share of the corporation’s total property, payroll and sales occurring in each state. Requiring this single, combined tax return prevents companies with subsidiaries in different states from artificially shifting revenue among their subsidiaries in order to reduce or eliminate the state taxes they would otherwise owe. Of the 45 states with a corporate income tax, 22 do not employ combined reporting. If these states adopted combined reporting, each of them could see gains in annual tax revenue collections of tens of millions to hundreds of millions of dollars.

ADOPT THE THROWBACK RULE
Under U.S. law, corporations may be taxed only by states in which they have a “substantial presence”, meaning property or employees in that state. For states that are owed tax by a given corporation, the amount of tax owed depends on the portion of the corporation’s total property, employees and sales located in each state and how that state formulates its corporate income tax. When sales are made by a company into a state in which the company is not subject to state taxes, this generates “nowhere income,” profit that will not be factored into any state’s tax “apportionment formula” and thus will go entirely untaxed. Adopting a “throwback rule” changes a state’s tax code so that nowhere income is taxed by the state in which a corporation is headquartered. Twenty states either have no throwback rule or an inadequate version of the rule.

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TALKING POINTS: STATE REVENUE STRATEGIES

Taxes are the way we pay for the many important things we do together through our governments. The common goal of the tax reform proposals presented on the Investing in the Future website is to generate revenue sufficient to pay for schools and universities, roads and bridges, subways and buses, police and fire departments, libraries and parks, and so much more.

Any proposal to generate new tax revenue, however, necessarily raises a number of important questions: How will these tax changes affect the state's economy? How will the changes affect family budgets? How can proponents facilitate a thoughtful and constructive public discussion of the proposals at hand? Below is an overview of responses to each of these questions – greater detail can be found on the Background Basics page of the Investing in the Future website.

TAXES & THE ECONOMY

The evidence strongly indicates that when appropriate investments are paid for with well-structured tax increases they result in significant positive net impacts to a state's economy, particularly over the long term.

- Raising taxes on high-income households = substantial net tax revenue gains
- Raising taxes on high-income households does not lead to substantial migration out-of-state
- States with higher tax levels do NOT have weaker economies than low-tax states
- Better educated workforce = higher wage economy

FAIRNESS

In every state in the U.S., low and middle-income households pay more of their income in combined state-and-local taxes than high-income households do. It is reasonable, therefore, that efforts to raise more revenue for education and other public investments would seek to collect that new revenue from high-income households. This would bring the tax levels of high-income households closer to the levels paid by other households.

The goal of tax reform is to generate adequate revenue to pay for essential government functions, and to raise that revenue in a fair way.

TALKING ABOUT TAXES AND GOVERNMENT

Thirty years of determined anti-tax/anti-government messaging has undermined the general public's belief in the essential, positive role that government plays in our daily lives. The fact is, we do many great things – large and small – for our communities, working together through our federal, state and local governments. Telling this positive story is essential, just as it is essential to offer a positive, aspirational vision of the future:

- Help people imagine how their communities can benefit from increased investment in schools, roads, libraries, public safety and more.
- Remind people of the direct connection between these public goods and the taxes we all pay.
- Focus discussion on overall public benefit and revenue gains of a particular tax proposal rather than an extensive debate on the minor details of a given plan.
- Remember to stay positive and inclusive and to focus on the big picture: Tax reform is a tool that will help people realize the aspirational visions they have for their communities.

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