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Be Careful What You Wish For: Minnesota May Be on the Precipice of Enacting Worldwide Combined Reporting at the Worst Possible Time

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It has been widely reported that the Minnesota Legislature has advanced an omnibus tax bill that would require the inclusion of the "entire *worldwide* income" of combined corporate income tax filers engaging in a unitary business. Tax press outlets have made the broad claim that mandatory worldwide combined reporting will "add foreign subsidiaries' *profits*" to Minnesota corporate tax returns. But these claims disregard how such a change in Minnesota's tax regime would also bring worldwide *losses* into a combined filing group's income (or loss) calculation. If Minnesota passes mandatory worldwide combined reporting legislation this year and economic expert predictions of an impending global recession come true, the state could see a significant *decrease* in revenue from its corporate income tax.

Claims that worldwide combined reporting will bring additional profits into the corporate tax base presuppose foreign subsidiaries added to a combined group are always profitable. But if the entities added to a combined group are unprofitable, the opposite would be true. Instead, the foreign entities would either decrease income subject to state corporate income taxation or increase losses that generate net operating loss carryforwards that will decrease state corporate income taxation in future years.

This isn't just a hypothetical concern. Tax specialists who practiced in the wake of the 2008 global recession recall that states with combined reporting regimes often sought to force unitary groups of corporations to "decombine" in order to remove entities generating losses from the state corporate tax base. When attempts to decombine were unsuccessful (as many were), states were often forced to walk away from large assessments or pay large refunds to corporate taxpayers. Such experiences should serve as a reminder that combined reporting often can decrease a state's revenues from a corporate income tax. In Minnesota's case, the potential for lost tax revenues may only balloon if its legislature imposes worldwide combined reporting during a recession.

No state currently has a true mandatory worldwide combined reporting regime (Alaska only imposes it on specific industries), and concerns about bringing foreign loss companies into the combined group is one of many reasons why. If Minnesota were to break state ranks by imposing worldwide combined reporting and a US parent corporation determined the regime could cause its Minnesota taxable income to increase, the corporation would have every incentive to either avoid or decrease connections with the state—potentially causing the state to lose out on capital investments that bring jobs with high wages and benefits.

Further, any attempt to impose mandatory worldwide combined reporting is likely to cause an international backlash, along with potential federal action and litigation challenging Minnesota's regime. In the immediate wake of a 1983 U.S. Supreme Court decision indicating, to a limited degree, that a state mandatory worldwide combined reporting regime could pass constitutional muster, the US Department of the Treasury completed a study outlining state taxing principles supported by "state, business, and federal representatives," including the principle that state corporate tax regimes should use "[w]ater's edge unitary combination for both U.S. and foreign-based companies." The outcome of this study was strongly supported by foreign governments, many of which were threatening retaliatory tax measures if states adopted mandatory worldwide combined reporting regimes. States universally responded to this study by backing away from attempts to impose mandatory worldwide combined reporting. This reversal happened before other theories, based on model US treaty language, could be brought to bear to invalidate mandatory worldwide combined reporting. Since the 1980s, when the issue first arose, there have been significant developments in judicial and scholarly interpretations of the foreign commerce clause jurisprudence that also create an opportunity for a state's law to be challenged on constitutional grounds.

Any attempt by Minnesota to impose such a regime now is likely to reignite foreign government concerns and could instigate an international tax war at a time when the US government is seeking cooperation to reform international tax rules at the Organisation for Economic Co-operation and Development, raising the risk that a federal solution could be introduced to curtail state corporate taxation regimes. Even without federal intervention though, there are a number of legal challenges brewing for Minnesota's proposed regime.

Together, these concerns underline why the Minnesota Legislature's attempt to introduce a mandatory worldwide combined reporting regime is coming at the worst possible time. For the state's own sake, one must hope that the Minnesota Legislature will back away from this precipice of its own creation and put it to rest.

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