

Unitary Reporting—All It Provides Is Uncertainty and Cost

Unitary corporate income tax reporting is not a panacea for increasing revenues or compliance. Its impact on revenues, especially in the short term, is highly uncertain. On the compliance side, advocates of unitary reporting allege that it is “a powerful tool for cracking down on common tax avoidance strategies used by multi-state corporations.” What they fail to acknowledge, however, is that (i) Connecticut already has statutes on its books that preclude tax avoidance through such transactions, and (ii) the adoption of unitary reporting will impose significant costs and uncertainty on the State and businesses that provide jobs in Connecticut.

CT HAS ADEQUATE TOOLS TO ADDRESS TAX AVOIDANCE

The existing corporate tax system in Connecticut has evolved to close perceived “loopholes”.

- First, no deduction generally is allowed for intercompany royalties or other amounts paid for the use of intangible property.
- Second, no deduction generally is allowed for intercompany interest.
- Third, no deduction will be allowed for expenses paid to a “captive REIT”.
- Finally, the Department of Revenue Services (“Department”) has long had the authority under C.G.S. Section 12-226a to challenge, adjust or disregard any transactions between related parties that do not fairly reflect income.

The royalty, interest and REIT addbacks are mechanical—they require no judgment or discretion as a predicate to their operation. The applicability of an addback typically is clear, with a high burden on the taxpayer to prove an exception from such addback. In contrast, the determination of a unitary reporting group requires a significantly factual analysis that can be fraught with controversy due to its subjectivity.

Further, if the Department were to conclude that transactions between related companies were not reflective of income, Section 12-226a gives it the authority to adjust the transactions, or in appropriate cases, even to combine the two entities. While that may generate controversy, and possibly litigation over the use of that discretionary authority, there have only been a few such cases (and none since 2001)—which pales in comparison to the number of cases involving unitary reporting that other states have experienced.

UNITARY REPORTING WILL IMPOSE SIGNIFICANT UNCERTAINTY

Proponents of unitary reporting claim that it will prevent the improper shifting of income amongst members of a corporate group by computing the taxable income of the group as if it were “one corporation”. This vastly overstates the breadth of a unitary reporting structure, while understating the complexity involved in applying it.

Under the Constitution, only those companies that are “unitary” with one another can be included in a combined return. It is not correct to assume that all members of the federal consolidated tax return group will be members of a Connecticut unitary group. The federal consolidated group is determined primarily by common ownership, while the unitary group is comprised only of those corporations that meet common ownership and “are sufficiently interdependent, integrated or interrelated through its activities so as to provide mutual benefit and produce a significant sharing or exchange of value.” Accordingly, a federal consolidated

group might be comprised of two or more unitary groups, and a unitary group may be comprised of members of two or more federal consolidated groups.

In addition, it is not correct to assume that companies that file on a unitary basis in other states can simply file the same unitary return in Connecticut. The determination of which members of a corporate group are unitary is quite complex—even among states that use a similar definition of unitary. There has been, and continues to be, litigation in virtually every unitary reporting state over this issue. In addition, the composition of the unitary group can change from year to year based on changes in the business, which also has spawned frequent litigation. Accordingly, simply assuming that all members of a corporate family will end up in a unitary return is overly simplistic.

UNITARY REPORTING – THE ONLY CERTAINTY IS COST

- **Revenue Cost** – There is real potential for a net revenue loss from the adoption of unitary reporting. Some companies will see a reduction in their Connecticut tax through the inclusion of loss companies in their unitary group or by reducing their CT apportionment factor. While it has been suggested that such companies already would have elected under the current tax system to file on a unitary basis, that election is so restrictive that many companies have not made it. (For instance, to make the election companies would have to give up all credits from prior years.)
- **Compliance Cost** - There will be a significant compliance cost to every company doing business in Connecticut in determining how to address the Connecticut unitary system. Every unitary tax system has elements that are unique to that state and Connecticut will be no exception. It will require time and effort on behalf of each company to determine how to address the Connecticut statute.
- **Administrative Cost** - There will be a significant cost for the Department to address the new statute and to prepare to administer it. There will be a significant time lag between the imposition of the new tax and the ability of the Department to construe the tax, promulgate regulations and then begin auditing the tax.
- **Litigation Cost** - It is certain that there will be litigation generated by the tax as controversies arise over who is in and who is out of the unitary group.
- **Business Climate Cost** - There is the intangible cost to Connecticut of dramatically changing its tax structure during one of the worst recessions in history. The long-standing tax policy of the State will be disregarded, which can negatively impact the expectations and investment decisions of many companies considering the maintenance or expansion of operations in Connecticut.

Clearly, the adoption of unitary reporting will come at a tremendous financial, policy and economic development cost to the State of Connecticut. Given this reality, there is no justifiable reason to adopt unitary reporting.