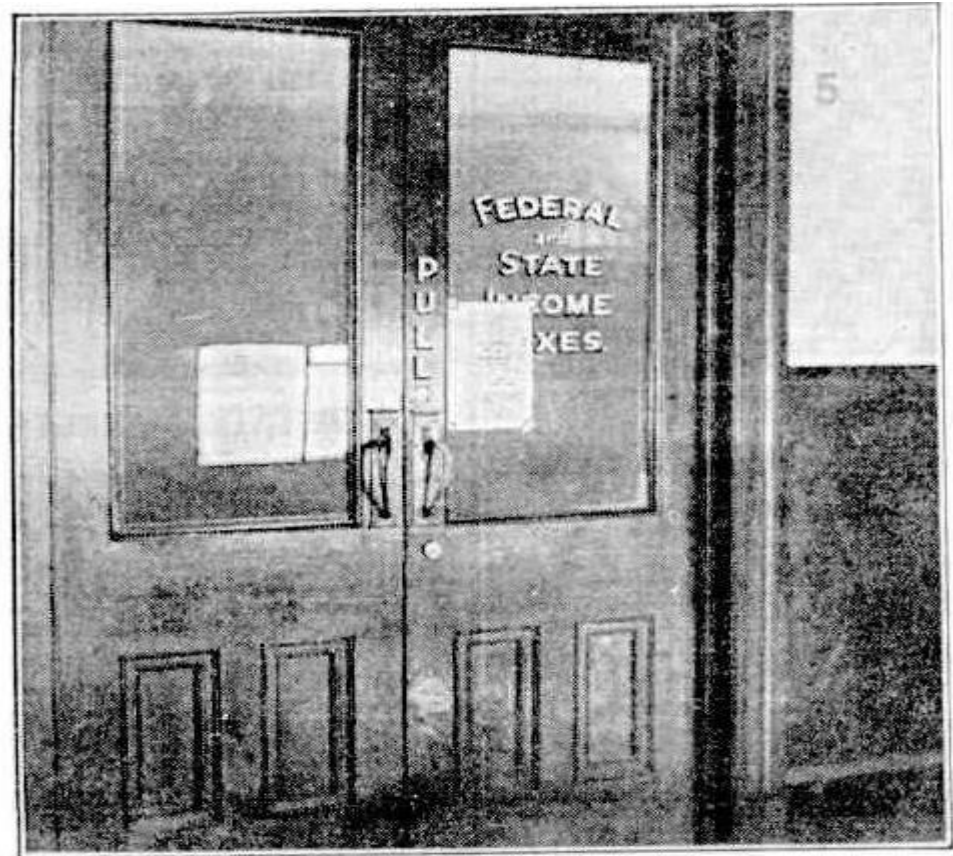


# Income taxation by states in a federation: Allocation of business income

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- *Australia: Federal and State income taxes, 1915-1942*
- *Canada*
- *Germany*
- *United States*
- *European Union, Common Consolidated Corporate Tax Base (CCCTB)*



State Taxation Department, in *Sydney Morning Herald*, 9 April 1932  
(cited in Twomey 2006)

# Structural issues I: Source v residence principles

- *Interjurisdictional equity: Musgrave and Musgrave, 1972*
- *State personal income taxes usually on residence basis*
- *US state corporation taxes: developed on source basis*
- *Australia, 19th-20th centuries: clear focus on source principle*
- *Canada: provincial income tax jurisdiction where permanent establishment in the province; issue of allocation only where also a PE in another province*

## Structural issues II: Common or separate tax bases

- *Common state and federal tax bases often proposed to facilitate joint collection by single tax agency, e.g., Canada*
- *US Multistate Tax Commission maintains suggested uniform model*
- *Australia, 1923-1942: joint collection by the States (except WA, where by Commonwealth, and taxpayers with income in more than one State)*
- *Common bases however also impose democratic cost where substantial government spending programs ('tax expenditures') included in base; 'endowment effects' may also then constrain state autonomy*
- *Common bases may also lock states into federal deficit/surplus stance*

## Structural issues III: Separate accounting v formula apportionment

- *Large literature on relative merits, and sustainability of ALS in globalised economy with large multinationals and intangible property*
- *Commentators have noted formula apportionment will not solve separate issue of deferral of genuine active income of foreign subsidiaries*
- *Early 20th century, US state income taxes favoured separate accounting (still available in some states)*
- *1922: US NTA committee recommends state FA (Burbank, Haig et al) while League of Nations proceeds with ALS internationally (e.g. Mitchell B Carroll 1933)*

## Structural issues IV: Unitary combination or separate entities

- *Unitary combination: California, 1930s due to use of Nevada distribution companies by Hollywood film producers*
- *Unitary business: 'common enterprise'*
- *1983: Container Corp case confirmed combination could extend to foreign affiliated entities – led to protests and threats of retaliation from other countries incl. UK and Australia*
- *1994: Barclays Bank plc case confirmed worldwide unitary combination within state constitutional power subject to federal gov't override*
- *'Water's edge' limitations provided by states, optionally for taxpayers*

# Allocation of business income: Australian historical approaches



*(Treaties IBFD)*

- *Tasmania, 1880 (Feb and Nov): s'holders on Tas register*
- *South Australia, 1884: separate accounting*
- *Queensland, 1890: average capital employed in Queensland - assets*
- *Victoria, 1895: receipts (non-banks), assets and liabilities (banks)*
- *1929: development of 'profit split' methodology, 67:33 m'fering, sales*
- *1935: sales apportionment held valid under s 92 – Aust'Asian Scale*
- *1937: wide test for nexus to States confirmed - BHP South*

# Allocation of business income: US state approaches



- *Traditional ‘three-factor’ formula: sales, assets and payroll, also adopted in Uniform Division of Income for Tax Purposes model, 1957*
- *More recent trend to overweight sales, or use sales only - to encourage manufacturing? Wide latitude from courts: ‘fair apportionment’*
- *Sourcing of receipts from services: place of performance vs ‘market source’ rules (delivery, customer location or use)*

# Allocation of business income: Canadian approach



- *Where PE in one province, 'whole of ... taxable income' deemed attributable to that province – includes non-PE business income in other provinces (residence approach); also foreign branch income of resident corporations? (cf nexus). Taxable income of non-resident corporations limited to Canadian income (reg 413(1)(b))*
- *FA system used where taxpayer has PE in more than one province*
- *General rule, revenue and payroll formula (equal weighting)*
- *Special rules: e.g., banks (1/3 payroll, 2/3 loans and deposits), railways (1/2 track miles, 1/2 gross ton miles)*
- *Quebec: own DTA with France (1987)*



# Allocation of business income: Germany



- *PIT and CIT imposed under federal statutes, but both are shared with the Länder under constitutional rules (PIT, 42.5:42.5:15) (CIT 50:50)*
- *PIT and CIT collected and administered by the Länder*
- *4-stage horizontal fiscal equalisation rules apply*
- *Stage 1: underlying entitlement to tax shares determined according to residence (PIT) and business conducted in state (CIT)*
- *CIT Allocation Law, 1969 (Zerlegungsgesetz): appears to be based on wages*

# Formula apportionment: EU proposals



- *Harmonisation of Member State company taxes entered debate after completion of EU monetary union on 1 January 1999: 'CCCTB'*
- *2011 EC report proposed three-factor formula apportionment: sales, assets and labour (equally divided: wages and number of employees)*
- *2012 amendments, 10:45:45 sales, labour and capital*
- *2016: renewal of proposals?*
- *Institutional issues: EU, OECD, UN*