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Corporations and State Taxes: The Big Ones Get Away

by James Rosapepe

To the average taxpayer, battered for years with reports of tax dodging by the nation's biggest corporations and richest families, new revelations of tax avoidance by the big boys tend to lack shock value. Nelson Rockefeller didn't pay a penny in federal income taxes in 1970. So what else is new?

But even the most cynical of us may be surprised by the estimate by some of the nation's top state tax officials that perhaps half the tax money legally owed state governments by the big corporations goes uncollected every year. "Avoidance of state tax liabilities by America's largest corporations has reached scandalous proportions," says Byron Dorgan, North Dakota's 32-year-old state tax commissioner. Lost revenue totals "hundreds of millions and perhaps billions of dollars," Dorgan estimates, and it is the result not of the legal forms of tax "avoidance" so characteristic of loophole-ridden state corporate tax laws, but of good old-fashioned, illegal, tax evasion. The reason they get away with it is simple: most states can't enforce the tax laws.

When Virginia changed its tax laws in 1972 from "straight line" depreciation to the much more generous "accelerated" depreciation allowed under federal law, state tax officials were surprised to find that most companies were not saving any money as a result of the change. After some inquiries, the officials discovered why: the companies had been using the "accelerated" depreciation schedules for years, in clear violation of Virginia law. But as the state's Deputy Tax Commissioner, Stuart Connock, explains, "The Department never checked, and the companies sure didn't volunteer the information."

A similar situation prevails in Illinois, which collected almost $235 million in corporate taxes in 1972. State Revenue Department official Harry Spellman told the *Chicago Tribune* last year that "if we spent $2 million [to improve the system], we could recover $50 million more." If the scale of evasion prevalent in Illinois is typical of that in the rest of the nation—and there is no reason to think it is not—non-payment of corporate taxes probably cost the 50 states over $700 million in 1972.

Corporate income taxes are not the only state taxes evaded on a large scale by businesses. For example, Albert Stoessel, former president of the Iowa Petroleum Association, esti-

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mates his state loses $50 million a year in uncollected diesel fuel taxes—a particularly hard area to enforce, since diesel fuel is chemically similar to non-taxed home heating fuel. Sales taxes are another area of undoubted abuse. Bill Brown of the Committee on State Taxation, a big-business group known as COST, claims, "There's a lot more sales tax revenue that they are not collecting than they have any idea. I say that on the basis of what the companies tell us in confidence." Illinois officials say they are losing around $25 million in cigarette tax revenue alone, and they won't even guess about total sales tax losses.

According to a 1974 report by New York State Comptroller Arthur Levitt, the state has been losing millions of dollars because the tax department has never collected from some 31,000 employers who have failed to turn over state taxes withheld from their employees' paychecks.

Taking Off the Gloves

Over the last few years several states have toughened up their enforcement efforts. Their experience demonstrates that massive corporate tax evasion is no myth—and that it is surprisingly easy to control.

Until 1973, Virginia had never sent its auditors to out-of-state corporate headquarters to check corporate tax returns. In the first year it started doing so, the state collected more than $1 million from 54 of the 6,000 multistate corporations doing business in Virginia. "In a lot of cases it was just a matter of dropping by the corporate offices to pick up the check," one Virginia tax official said. "They knew they owed us the money, but we'd never asked for it before." Fifty-four down, only 5,946 to go.

In North Dakota, Commissioner Dorgan's aggressive enforcement efforts increased the state's corporate tax receipts by nearly 30 per cent in two years. Since 1969 an average of 20 per cent of this revenue has been collected from audits, and Dorgan thinks he's just scratched the surface. Idaho, too, has collected 20 per cent of its recent corporate tax revenues through auditing, and the state's Chief Corporation Auditor, Frank L. Medlin, says improved enforcement efforts will soon yield even more "sizable tax recoveries."

But the best illustration of what a good auditor's division can do is in California. The state's Franchise Tax Board has 240 corporate auditors who collected an extra $51 million in 1972, including $35.8 million from field audits of 6,026 multistate corporations. To these substantial savings must be added the millions of dollars businesses paid voluntarily, aware that they were likely to be audited. Admitting in a *Wall Street Journal* interview that California has the toughest corporate tax enforcement around, U.S. Steel's Director, Arthur Hauser, said, "If we could get out of there, we would save a lot of money."

The most obvious difference between California's enforcement program and those in other states is its extensive network of trained auditors. In addition to its in-state staff, California has 200 field auditors located throughout the country, including those permanently based in offices in New York and Chicago. Idaho, by way of comparison, has six corporate auditors, all operating out of Boise. Even when the difference in the two states' population is taken into account, California clearly is devoting a greater effort to its program. You don't have to be a Wall Street tax lawyer to figure out which state ITT or GM is more likely to try to bilk at tax time.

Most other states resemble Idaho rather than California. Kentucky has 45 field auditors, who are responsible for auditing sales and personal income as well as corporate taxes. Vermont has 12. The deficiencies in Missouri's auditing operation are so great that U.S. District Court Judge William R. Collinson declared in a recent decision that "the enforcement of the tax laws in this state is notoriously lax and slipshod, apparently because the legislature will not appropriate the money to employ sufficient persons to even begin to adequately police the system."

"One of the facts of life is that most states are limited in resources," confesses Eugene Corrigan, executive director of the Multistate Tax Commission, a joint agency of 21 state governments. "They just can't afford the major operation of auditing a giant corporation." Corrigan points out that it's the multistate, and often multinational, corporations with dozens of subsidiaries that are the source of most state enforcement problems.

"We don't have the resources or personnel to go to New York and audit the tax books of U.S. Steel, for example," admits Missouri's state revenue director, James R. Spradling. "It takes highly knowledgeable, highly trained people to audit giant companies like that," adds Corrigan, "and most states just don't have them."

Closed Books

To solve that problem, the Multistate Tax Commission (MTC) was set up in 1967 to audit firms which operate nationwide. "These big corporations are not above telling different stories to each state—telling Illinois for example that certain income was produced in Indiana and telling Indiana the income came from Illinois," Corrigan explains. "What we are trying to do is joint audits for several states so a company can't do that." In the first nine months of the Commission's joint audit program, it recovered $2.5 million for the states from just ten corporations.

But as the states have closed in on the corporate tax evaders, North Dakota's Dorgan says, "We've run into really vicious resistance." A dozen of the nation's top corporations, including U.S. Steel, Procter and Gamble, General Mills, and Standard Brands, have so far refused to open their books to the MTC's auditors. And a coalition of 82 large corporations, led by these firms and joined by, among others, ITT, Green Giant, IBM, and International Harvester, have sought an injunction from the U.S. District Court in New York to put an end to joint corporate audits and to disband the MTC (the companies claim it is an unconstitutional compact among the states). The case has been pending for two years as lawyers for each side keep exchanging briefs, and no decision is in sight. The leaders of the MTC see the lawsuit as a diversionary tactic aimed at keeping the Commission busy defending its very existence rather than uncovering corporate tax evasion. "I spend days on end answering court papers," Corrigan says.

Meanwhile, the same corporations are prowling the halls of Congress, attempting to short circuit the MTC through federal legislation. Coordinating the fight is the pro-business COST, whose members include a number of the companies that are plaintiffs in the New York suit.

The principle which underlies the companies' various efforts, as explained by Bill Brown of COST, is as follows: "It's not a case of the states versus business, at all. Our view is simply that the commission is not acting within the law." Brown claims that corporate executives in his group do not object to joint audits in principle; rather "our members are concerned about the rules and regulations on auditing adopted by the MTC." While corporate spokesmen prefer to characterize their dispute with the MTC as "technical," Brown admits "the biggest problem is dividend and foreign source income."

This matter of "foreign" income is a complicated question, near the heart of the states' tax problems. Most states determine a multistate corporation's tax liability by calculating the firm's nationwide profits and then applying the state corporate tax rate to the state's proportional share of those profits. The big corporations' major objection to the MTC is that it treats foreign source and dividend income just like any other income and requires conglomerates and multinationals to be taxed as a complete unit, the way the corner drugstore is. The ins and outs of this are too complicated to explain briefly, but enough money is at stake that the companies have mobilized for a real fight in Congress.

Putting California in Its Place

COST's major efforts in this session of Congress have been on behalf of S. 1245 (sponsored by liberal Senators Charles Mathias, Abraham Ribicoff, and Hubert Humphrey). The key provision of S. 1245 would, in most cases, bar the states from taxing profits from foreign sources and dividends from corporate subsidiaries. Thus, by excluding foreign profits and other dividends, S. 1245 limits the taxable income of multinationals, like the oil companies, and of conglomerates with far-flung subsidiaries, like ITT. Brown of COST points out that only two or three states, among them California, now tax these dividends, and he stresses that S. 1245 would guarantee "uniformity" by getting these states, as well as the MTC, in line.

Byron Dorgan denounces S. 1245 as "a massive tax giveaway program for the largest corporations," and so far he and his colleagues at the MTC have managed to keep the bill bottled up in the Senate Finance Committee.

But the fight continues at the state level as the big corporations try to undermine the MTC and its joint audit efforts. Earlier this year, when Missouri Revenue Director James Spradling asked the state legislature for permission to join the Commission's joint audit program, large corporate interests, including the Missouri Oil Council, led the opposition. In Indiana, the State Chamber of Commerce has announced that "efforts to end Indiana's participation in the Multistate Tax Compact" is one of its top lobbying priorities in the 1975 legislative session.

Given the widespread political popularity of taxing giant corporations, it is somewhat surprising that Dorgan is just about the only state official who has attempted to focus public attention on corporate tax evasion. One reason may be that he is the only elected tax commissioner in the nation. While California's corporate tax laws are supervised by the Franchise Tax Board, which is made up of two elected officials and one appointee, its chief administrative officer is appointed. And in the great majority of the other states, the position of tax director is appointive, similar to the Commissioner of the Internal Revenue Service at the federal level.

Like so many appointed officials at any level of government, many state tax directors tend to see as their constituency not the public but the big corporations they are supposed to audit. Or they may develop incestuous personal and professional relationships with the companies. Illinois Revenue Director Robert Allphin is on leave from his regular job as tax manager of Pittsburgh Plate Glass. Paul Dillingham started out with the Kentucky Revenue Department and now manages Coca Cola's tax business as a corporate vice president, while Arizona State Tax Commission Chairman John Hazelett previously handled state tax matters for an aircraft firm. A familiar story, but it helps explain why state tax officials are not beating down the doors of the daily press with exposés about corporate tax evasion.

This particular case of governmental surrender to corporate pressure would be discouraging if the solution were not so obvious: auditors, auditors, and more auditors. Experience in dozens of states shows that when the corporations are audited, they pay more taxes; when they are not audited, they pay less. For example, of the 13,736 corporations that California field audited in 1972, 44 per cent owed the state more money and only five per cent had been overtaxed.

Indeed, for a governor or state legislature trying to balance the state's budget, tax auditing is one of the few areas in which the state can save money by expanding the payroll. State auditing of large, multistate corporations normally returns to the states anywhere from $5 to $10 for each dollar spent on auditing. In its first year of corporate field audits, Virginia was earning a return of 12 to 1. Obviously the ratio will decrease as the state moves from detecting the most obvious evasion to more sophisticated and complex cases. But even California, with its highly developed audit operation, still produces nearly $9 in new revenue for every dollar spent on corporate field audits.

For years the federal government has known that the best way to insure voluntary compliance with income tax laws is to have a staff of auditors ready to catch reluctant taxpayers. It's time for the states to apply the same principle to the corporations. ◘