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News Analysis: Massachusetts Lawmakers' Broken Promise on FAS 109

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Summary by taxanalysts

When Massachusetts enacted mandatory combined reporting, it also promised to lower rates and permit a deduction under Financial Accounting Standard No. 109 for affected companies; this analysis asks why combined reporting and the rate reduction proceeded as planned, while the legislature has continually delayed enactment of the deduction.

Full Text Published by taxanalysts

It was part of the deal, part of a Massachusetts legislative package, and it went like this:

When the state enacted mandatory unitary combined reporting in 2008 to help raise revenue, it would help make the medicine go down easier by lowering corporate income tax rates and adding a sweetener: a special deduction -- under Financial Accounting Standard No. 109, "Accounting for Income Taxes" -- for publicly traded corporations whose balance sheets would be adversely affected by combined reporting.

The package (H 4904) was approved by the Democrat-controlled legislature and signed into law by Gov. Deval Patrick (D). Mandatory unitary combined reporting took effect as scheduled for tax years beginning on or after January 2, 2009. (Prior coverage.)

The reductions in the 9.5 percent corporate income tax rate also took effect in stages, as planned; the current rate is 8 percent.

But the FAS 109 deduction? Still waiting.

Year after year, budget after budget, the legislature has postponed the effective date of the deduction. And now, six years after the law was enacted, it appears almost certain that the deduction will be delayed once again.

Often cited but never seen, "some folks are beginning to think of this as a unicorn," said Senate Minority Leader Bruce Tarr (R).

Delaying a Revenue Drop

At issue is a requirement under FAS 109 that corporations report the effect of some tax law changes -- including accounting for deferred tax liabilities -- on their financial statements.

The Massachusetts combined reporting law enacted in 2008 generally said that if combined reporting resulted in an increase to a corporation's net deferred tax liability, the combined group generally would be allowed an FAS 109 deduction on its Massachusetts tax return.

In other words, the deduction would reduce an eligible corporation's Massachusetts tax liability to fully or partially offset its increased deferred tax liability due to combined reporting, according to a Department of Revenue summary.

Under the 2008 law, the deduction was to be prorated over seven years beginning with the combined group's tax year that began in 2012. But the seven-year clock has never been allowed to start; the state has repeatedly delayed it.

Why? The answer, in short, is money -- as spelled out in a little-publicized letter in September 2009 from Navjeet Bal, then the state's revenue commissioner, to legislative leaders.

Information that the DOR gathered from 128 public corporations indicated that they intended to claim FAS 109 deductions totaling $178.1 billion. That, in turn, would result in corporate tax savings of $535 million, the DOR estimated. And that didn't count five other filers that the DOR estimated would be likely to claim FAS 109 deductions of between $1 billion and $1.5 billion, resulting in additional corporate tax savings of $10 million to $20 million.

In other words, the deduction would save businesses and cost the state tens of millions of dollars each year. That, in turn, would reduce the revenue the state hoped to gain each year from combined reporting by as much as 37 percent, Bal estimated.

Another Delay on the Way?

Each year, since before the FAS 109 deduction was to have taken effect in 2012, Massachusetts has used the delay to help balance its budget.

And this year, long after the combined reporting law was enacted, Patrick proposed in his fiscal 2015 budget that the deduction be delayed yet another year; the House and Senate have included the delay in their versions of the fiscal 2015 budget, which is now in conference. (Prior coverage.)

If the FAS 109 postponement is included in the enacted budget, it would represent the fourth consecutive year that the deduction has been delayed.

This year's proposal, to delay the effective start to 2016, would save the state an estimated $45.8 million, according to a fiscal note. Tarr said the figure is closer to $79 million, toward the high end of the range that Bal referenced in her 2009 letter.

"It is simply a matter of revenue, but the delay goes against an agreement that was made at the time combined reporting was adopted," said Michael Widmer, president of the Massachusetts Taxpayers Foundation, a business-backed public policy group.

Joseph Donovan, counsel at Sullivan & Worcester, said that postponing implementation of the deduction "would not really be fair" because it was part of the trading process involved in crafting the combined reporting legislation in 2008.

Donovan said he understands the potential budget impact. "The state government is watching the cash; that's what they're looking at for a given year," he said.

And the deduction can be postponed without immediate detriment to the corporations "because it's all about the financial statement treatment, which doesn't change," Donovan said.

Still, Donovan said, "it's going to be a little ridiculous" if the deduction is postponed a fourth consecutive time. He said the situation is comparable in some ways to the federal research and development credit, which Congress has repeatedly allowed to expire -- mainly to avoid counting the credit's impact in budget projections -- only to later renew it temporarily and usually retroactively.

Is the delay about more than money? "Not really," and legislators may be especially "troubled" by the magnitude of the benefit of the deduction concentrated on a small subset of corporations, Donovan said.

'A One-Sided Abacus'

To Tarr, it is high time that the state honors the commitment that it made to employers in 2008 when combined reporting was adopted. "We said we were going to limit the impact of that grab" to provide "a little bit of relief" to those affected, Tarr said during recent legislative debate.

Tarr asserted that the state is using "a one-sided abacus" in its tax treatment of corporations, collecting taxes on the one hand through combined reporting but refusing to allow the deduction on the other.

"Businesses are told they're going to have to wait to receive this offset that we agreed to honor six years ago," Tarr said. "We didn't tell them we were going to put on hold combined reporting . . . I'm hoping that we can rectify that injustice."

Associated Industries of Massachusetts (AIM), which represents 4,500 employers, has called on the legislature to allow the deduction to take effect as planned, according to Brad MacDougall, AIM's vice president of government affairs.

"AIM views any effort to eliminate FAS 109 as a reversal of the agreement reached as part of the 2008 combined reporting tax policy change," MacDougall said, adding, "Such a reversal would send a signal to the business community that prior agreements on major tax policy may be changed on a whim and add to the negative reputation of Massachusetts for tax predictability and fairness."

Part of the reason that implementation of the FAS 109 deduction has been repeatedly postponed is that when it was initially passed, the deduction "was not clearly understood" and its cost was unknown, said Noah Berger, president of the Massachusetts Budget and Policy Center.

"To this day, there has never been a compelling rationale as to whether this was good tax policy or good economic policy," Berger said. And as Bal's letter in 2009 made clear, about $281 million of the projected $535 million in corporate tax savings -- or 52 percent of the total -- would benefit just three corporations, he added.

When the Senate recently debated the FAS 109 deduction, Senate Ways and Means Committee Chair Stephen Brewer (D) said that "95 percent" of the benefit from the deduction would go to non-Massachusetts companies. "It benefits 128 companies. Fifty-two percent of the benefit is claimed by only three companies," he said.

Brewer also said that recent tax collections for May have showed a slowdown compared with the same period last year. "We need to have the deduction delayed," Brewer said. "The revenues are not as abundant as they are thought to be."

"It is about choices, and sometimes they are difficult choices," Brewer said, adding that he hopes that an improving economy will allow the deduction to proceed. Speaking of the corporations that would seek to claim the deduction, Brewer said there is "no ill will toward them; it's about choices."

When Tarr proposed an amendment to restore the FAS 109 deduction, it was rejected on a roll call vote: Four voted in favor of the amendment, 35 voted against.

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