

An Explanation of Sales Factor Apportionment

Our tax system should benefit U.S. domestic companies. Or at the very least, it should never put our companies at a competitive disadvantage in world markets. In the last eight years, Congress finally recognized there was a problem. American Multinational Enterprises (MNEs) were using tax planning on a massive never-seen-before scale to keep up with foreign corporations. Domestic Corporations had few mechanisms to stay competitive. The Tax Cuts and Jobs Act (TCJA) reform of international taxation rules ended up being limited and complicated. But it set the opportunity for a better follow-up reform.

Sales Factor Apportionment is the method used by many states to tax the income of multi-state corporations. This same method should be part of a Destination-Based taxation model to streamline and simplify international taxation. The TCJA attempted but failed to significantly reduce tax avoidance. Income shifting to tax havens and other complicated loopholes remain tax strategies under the tax code. Destination-Based Sales Factor Apportionment (DBSFA) virtually eliminates unfair tax advantages harming domestic companies, achieves actual territorial tax and encourages U.S. investment, employment and exports.

How It Works

- American Corporation sells \$10 billion of its products to customers around the world.
- \$6 billion of those sales (60% of total sales) are made to U.S. customers.
- American's worldwide profit is \$1 billion, therefore, \$600 million of that profit would be taxed as U.S. profits.
- Where the company claims it earns its income would be irrelevant. U.S. taxable income would be determined solely by the percent of that company's worldwide sales made to U.S. customers. Foreign MNEs would be taxed the same way on U.S. income, leveling the playing field between domestic firms and foreign and domestic MNEs.

Why It's Better

Experts agree the TCJA international aspects are overwhelmingly problematic. DBSFA is a fundamental improvement because it would:

- Simplify the amount of corporate profit the U.S. taxes with a simple formula. Individual states would similarly benefit from this simplification and would stop crafting complicated legislation which achieves poorer results.
- Level the playing field between purely domestic businesses and multinational enterprises. Inversions would be pointless because the company would pay the same tax on profits regardless of tax planning. All other proposals allow the accounting method known as transfer pricing. Most practitioners view minimizing the taxes paid by the MNE as the goal of transfer pricing.
- This territorial system eliminates the tax incentives to locate jobs, factories, and corporate headquarters offshore, boosting employment, exports, and U.S. tax revenue.
- Estimated to increase revenue by \$600 billion over ten years at the 21% rate. It would reduce the estimated increased deficit from about \$1.1 trillion to perhaps as little as \$500 million. Shifting to a sales-based single-factor formula apportionment will raise revenue without raising rates because it will stop U.S. and foreign MNEs from being able to place their profits offshore to avoid U.S. taxes.

Eliminates Corporate Tax Base Erosion

Currently, MNEs can still manipulate loopholes in our tax system to avoid paying U.S. taxes. This plan would provide a straightforward solution to this problem. Adopting SFA would make MNE avoidance of U.S. corporate tax nearly impossible because a company's U.S. taxable income would be determined by the percent of its sales made in the U.S.

Conclusion

Destination-Based Sales Factor Apportionment is more straightforward and more effective than our new system which attempts — and fails — to tax the worldwide business activities of U.S. corporations with a quasi-territorial exemption. Companies can easily move certain business operations and assets out of the U.S., but few, if any, would be willing to give up sales to the world's largest market. This system is not perfect, but it is far more equitable and efficient than the old system and greatly improves on the TCJA.