THE TAXONOMIST

Jim McGreevey: Working Class Hero

By Robert S. McIntyre

Suppose you're a state governor and your staff has just informed you that most of the biggest corporations doing business in your state have cooked their tax books so severely that they pay virtually nothing in state income taxes. Do you holler, "Hallelujah! Hunt 'em up and have 'em over for a campaign fundraiser"? Well, that would be one common reaction. But it's not how newly-elected New Jersey Gov. Jim McGreevey responded this year.

Like just about every state in the country—not to mention the federal government where George Bush's tax cuts have made things much worse—New Jersey has lately been struggling with huge revenue shortfalls. Unlike almost every other state, however, New Jersey has a governor brave enough to successfully take on the corporate tax dodgers to help solve his state's budget woes.

Rampant corporate avoidance of state taxes has been a growing problem for some time. As the economy soared in the second half of the 1990s, most governors and state legislators watched idly—or acted complicitly—as their corporate income taxes were eroded by aggressive tax sheltering schemes promoted by the major accounting firms. State treasuries have been victimized not only by the infamous offshore tax dodges that bedevil the federal government, but also by interstate shenanigans designed to move profits, on paper, into the handful of states that don't tax them.

The full extent of state corporate tax dodging was masked for a while by the fast growth in state personal income taxes, which jumped by 15 percent as a share of the economy from fiscal 1995 to 2000 due to expanding employment and a soaring stock market. But by the same measure, state corporate income taxes *fell* by 14 percent.

Of course, since *Bush v. Gore* was decided, the economy and the stock market have turned sour. As a result, over the past twelve months, state personal income taxes fell some $26 billion, or 12 percent, short of what collections would have been at their fiscal 2000 share of the economy. Meanwhile, state *corporate* taxes fell by $10 billion, a 27 percent drop from their 2000 level.

In New Jersey, the corporate tax decline was more like a collapse. Indeed, without reform, New Jersey tax officials predicted that in the upcoming fiscal year companies would pay lower taxes in nominal dollars (!) than they paid way back in 1982—unadjusted for inflation, economic growth or anything.

Even before the recession, 30 of the 50 companies with the largest payrolls in New Jersey paid only the state's token $200 minimum tax. These tax scofflaws included ten companies with New Jersey profits totaling $2 billion in 1999. At the regular New Jersey corporate tax rate, that should have meant $177 million in taxes, but instead the companies paid only $2,000—that is, $200 each.

Under one of the tax-avoidance schemes, a New Jersey company sets up a shell subsidiary in Delaware, which doesn't tax royalty income, and gives it ownership of the corporate trademark. Then the Delaware subsidiary charges its New Jersey operations a royalty for the use of the trademark, generating a big New Jersey tax deduction. Similar self-dealing ruses were found in which companies make big interest payments to subsidiaries in no-tax states to slash their New Jersey taxable income.

Facing a $6 billion shortfall in his $23 billion budget for fiscal 2003, Gov. McGreevey decided to take on these and similar corporate tax dodges. His plan, just approved by the legislature, disallows the phony, self-dealing deductions, institutes a real minimum tax (unlike the old, silly $200 minimum) that companies must pay no matter how many loopholes they claim, and institutes a number of other reforms.

So how does McGreevey's approach to the fiscal crisis compare to what his fellow governors have done? Well, like most governors, he papered over a big chunk of the problem — covering up a quarter of the $6 billion shortfall by borrowing (against future tobacco settlement revenues) and shifting money from other state funds. He raised some regressive taxes and fees by about $0.4 billion. And he was forced to scale back his spending wish list by about $3 billion.

But on corporate taxes, McGreevey stands almost alone in the tax reform hall of fame. According to the National Conference of State Legislatures, only nine states boosted corporate taxes for 2003, while eight states actually cut them, for a net increase of $1 billion. Of that net corporate tax hike, some $900 million was in New Jersey.

McGreevey promises that his labor-supported corporate reforms will "ensure corporations pay their fair share, just as every New Jersey family must do, . . . by eliminating the loopholes and gimmicks that have allowed companies to shirk their responsibilities." In contrast, anti-reform business lobbyists criticize McGreevey's bill as a "radical departure" that could embolden governors in other cash-strapped states to follow suit.

Let's hope they're both right.