'Reshoring' Should Inspire Favorable State Tax Policy

by Brian Strahle

"Made In America." We haven't seen that slogan much in the last decade; in fact, it seems like every piece of clothing or tangible good we purchase is made in China. However, according to several recent articles and surveys, the trend of offshoring or sourcing jobs overseas may be reversing, partly because the business benefits of offshoring have decreased.

The "reshoring" of American manufacturing business is not a new topic of discussion, but the trend is gaining steam for several reasons: labor rate differences are shrinking, oil prices are escalating, and U.S. productivity is improving.[1] Those factors reflect manufacturers' focus on keeping costs low and productivity high. Manufacturers have adopted several new technologies for increasing production that have eliminated manual activities. Thus, the reshoring of manufacturing jobs will require the U.S. workforce to be highly trained and skilled in technology.

One technology that has been growing and having an effect on manufacturing is cloud technology. Cloud-delivered solutions are being used to manage production, quality, and other areas. According to Jim Shepherd of Plex Systems, cloud technology improves overall productivity through better shop floor controls, production visibility, streamlined processes, ease of reporting, and more flexibility. Customers cannot get those benefits from their low-cost offshore suppliers.

According to Henry Moser, founder of the Reshoring Initiative, reshoring is not moving rapidly, with only 50,000 jobs returned to the United States from 2009 to 2012. However, five years ago, the number of jobs coming back was close to zero.

According to a Grant Thornton LLP survey of 278 executives, more than one-third of U.S. businesses will move goods and services work back to the United States in the next 12 months.[2] Forty-two percent of executives are likely to bring IT services back to the United States, and 35 percent of executives are likely to bring back services such as customer service and call centers, Grant Thornton found.

Overall, as much as 5 percent of U.S. procurement may come home. While some companies may simply bring work back to existing facilities, some companies will invest in new facilities. For example, in 2012 General Electric Co. brought production of hot water heaters and refrigerators back to two new assembly lines in Kentucky. Apple Inc. is investing $100 million to build a Mac product line in the United States and Wal-Mart has pledged to buy an additional $50 billion in U.S.-made goods over the next 10 years.

A recent survey by the Boston Consulting Group focused on more than 200 manufacturers from a variety of industries and companies with annual sales of at least $1 billion. According to the survey, 54 percent of the respondents said they are planning to reshore or are seriously considering it. In response to the same question in February 2012, 37 percent of respondents said they were considering reshoring.[3] According to the survey and Harold L. Sirkin, senior partner of the Boston Consulting Group, the main factors driving the reshoring decision are labor costs, proximity to customers, and quality. Other factors include access to skilled labor, transportation costs, and supply-chain efficiencies.

During the past decade or two, the U.S. economy has become service-**based**. That is a result not only of the departure of jobs to other countries, but also the replacement of jobs with automation or technology. Manufacturers have also become multidimensional, meaning they are not only manufacturers, but may also be service providers and retailers. For example, each tangible product generally requires a warranty with maintenance, so companies have

[1]Jim Shepherd, "The Truth About Reshoring, Productivity, and Today's Manufacturer," Manufacturing.net (Oct. 2013).

[2]Grant Thornton LLP, "The Realities of Reshoring" (Aug. and Sept. 2013).

[3]Harold L. Sirkin, "Reshoring Grows From Trickle to Trend," *Taunton Daily Gazette* (Nov. 7, 2013).

created new subsidiaries, departments, or have even acquired companies to provide those services. Thus, even though the reshoring of manufacturing may not equate directly to jobs, it may provide a ripple effect in the creation of jobs for service providers.

The Role of State Taxation

If reshoring is a real phenomenon, what can states do to facilitate and encourage companies to reshore in a particular place? Are states already positioned to assist the reshoring initiative?

States are constantly competing against each other for businesses to locate or invest with them. They often enact taxpayer-friendly legislation and provide incentives and exemptions to specific industries or taxpayers. As a result, state taxation can play an integral part in encouraging the move of jobs and facilities back to the United States.

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As the U.S. economy switched to a more service-based economy, states enacted policies to obtain more tax revenue from market activities instead of production activities. For example, policies such as single-sales-factor apportionment and market-based sourcing shift the tax burden from in-state manufacturers with large amounts of property and payroll to out-of-state manufacturers with only sales into the state. Also, out-of-state manufacturers of tangible property may escape nexus and taxation altogether if they meet all the requirements of P.L. 86-272. Hence, single-sales-factor apportionment provides incentives for manufacturers to locate their operations in a state without the fear that the increase in property or payroll will increase their apportionment factor and tax in that state.

A single sales factor is an incentive for service providers to locate their main base of operations — customer service, call centers, etc. — in a particular state, because the increase in payroll will have no effect. Market-based sourcing is an additional incentive for service providers to locate in a state if the majority of their services performed in the state relate to out-of-state sales. As states have made the switch to a single sales factor or double-weighted sales factor, they have already provided the foundation for a favorable income tax environment.

States seeking to make themselves even more attractive may want to consider additional changes such as repealing any sales apportionment factor throwback rule to encourage domestic production and sales origination. Also, I wrote in a previous article that the use of offshore tax havens by U.S. companies may push states to adopt worldwide combined reporting.[4] However, states may want to think twice before implementing worldwide combined reporting if they want to incentivize companies to reshore their operations to their state. Water's-edge combined reporting is generally more appealing to multinational corporations with overseas operations.

In addition to broad-based legislation that applies to all taxpayers, states continually provide exemptions and credits to specific industries or taxpayers and they should continue to do so when appropriate. For example, companies have said that a shortage of trained workers is a reason why reshoring has not occurred more rapidly. Because technology plays a large role in manufacturing, states with a highly skilled workforce that can handle the demands of modern manufacturing will be more appealing to companies. Hence, states that provide training programs and incentives for companies to equip employees with the appropriate skill set will have an advantage. Other incentives, such as sales tax and property tax exemptions along with job creation or expansion credits, should also be considered.

It's Not State vs. State

Reshoring is not only an opportunity to obtain more tax revenue, but an opportunity to rebuild America. Therefore, states should look not only at the revenue base a company's increased operations can provide, but also at the overall economic impact created by a company employing and training a community's workforce. The departure of blue-collar jobs in the 1980s and 1990s resulted in many U.S. cities experiencing a rapid decline in their economies. Reshoring is an opportunity to rebuild those communities.

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Credits and incentives have received some negative attention lately, with some critics asking whether states are getting the expected return on their investment. Opponents of credits and incentives complain there is no way to measure whether a state has received the tax and economic benefits from providing incentives to companies to locate or

[4]Strahle, "Are Tax Havens Pushing States to Worldwide Combined Reporting?" *State Tax Notes*, Nov. 25, 2013, p. 489.

build there. As a result, opponents are hesitant to recommend that incentives should be provided to companies.

However, reshoring should not be viewed in the same light. Reshoring is an opportunity to rebuild America, to rebuild the pride of "Made in America." Reshoring is not state versus state — it's states versus foreign countries.

Conclusion

The United States appears to have become a nation of distribution centers, customer service call centers, and service businesses. The reshoring of jobs and company operations (whether manufacturing or otherwise) is an opportunity to diversify the economy and increase the tax base of each state. Although companies will make the decision to reshore operations based on their own cost-benefit analysis, including better control of the manufacturing process, the ability to respond swiftly to customers, or lower energy and shipping costs, state taxes can be a differentiator. Therefore, states should seek opportunities to help facilitate reshoring by continuing to compete for businesses to locate in their state using broad-based, favorable tax legislation and incentives. ✰

The SALT Effect is written by Brian Strahle, owner of LEVERAGE SALT LLC. He provides state and local tax technical services to accounting firms, law firms, and tax research/news organizations and is the author of the state tax blog, LEVERAGE SALT (www.leveragestateandlocaltax.com). He welcomes comments at Strahle@leveragesalt.com.