Shifting the Burden for Vital Public Services: Walmart's Tax Avoidance Schemes

by

Philip Mattera

Good Jobs First

1616 P Street NW Suite 210
Washington, DC 20036
202-232-1616
www.goodjobsfirst.org

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Executive Summary

When Walmart seeks to add to its portfolio of more than 3,000 big-box outlets in the United States, it invariably argues that the project will be a major economic benefit, generating a vast new stream of tax revenue. Actually, research shows the company will go to great lengths to limit the size of that revenue stream. Walmart is obsessed with cutting costs, and tax payments are one of its favorite targets. The company doesn't just reduce its tax outlays; in hundreds of places it has sought taxpayer funds to finance its expansion and thus expand its market share.

For every kind of tax that a retail company would normally pay or remit to support public services, Walmart has engineered an aggressive scheme to pay less and keep more.

- It has extracted more than $1.2 billion in property tax abatements, sales tax rebates, infrastructure and site improvements, and other economic development subsidies from state and local governments around the country. In recent years the subsidies amounted to roughly $70 million annually.

- Using gimmicks such as deducting rent payments made to itself (through a captive real estate investment trust), it avoids an estimated $300 million a year in state corporate income tax payments.

- Using an army of lawyers and consultants, it systematically challenges property tax assessments to chip away at its property tax bills, costing local governments several million dollars a year in lost revenues and legal expenses.

- And it takes advantage – to the tune of about $60 million a year – of those states that fail to cap the “vendor discounts” they provide to large retailers for collecting sales taxes from their customers.

These practices are not illegal, but taken together they apparently cost state and local governments more than $400 million a year in lost revenue. Walmart may be more of a fiscal burden than a benefit to many of the communities in which it operates.

Introduction

When Walmart[1] seeks to add to its portfolio of more than 3,000 big-box outlets in the United States, it invariably argues that the project will be a major economic benefit to the community in which the store will be built. Local officials are led to believe that business activity will boom, and as a result a vast new stream of tax revenue will flow into government coffers.

What the company does not say is that it will actually go to great lengths to limit the size of that revenue stream. Walmart is obsessed with cutting costs, and tax payments are one of its favorite targets. Indeed, Walmart has sought to game every major kind of tax that a retail company would normally pay or remit to support public services—property tax, income tax and sales tax.

The company doesn't just reduce its tax outlays; in hundreds of places it has sought taxpayer funds to finance its expansion and grow its market share, often at the expense of small and locally owned businesses. Walmart doesn't get huge one-shot packages like those granted to firms such as foreign auto makers, but it makes up the difference in volume.

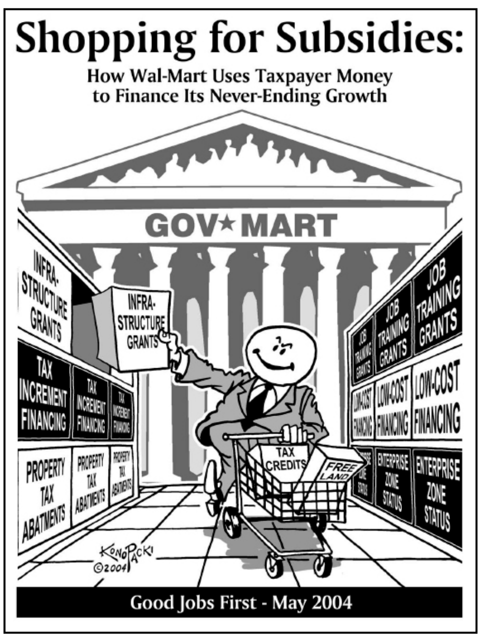
Of course, when Walmart pays less, everyone else has to pay more; there is no such thing as free growth. When Walmart avoids paying its fair share of state and local taxes, only two things can happen: either working families and small businesses pay higher taxes or the quality of schools and other public services goes down, or some of both. This paper summarizes how Walmart quietly engineers such a giant burden shift.

The fiscal burden imposed by Walmart is not limited to its tax policies. The company's low wage rates and inadequate health benefits force many of its employees to turn to taxpayer-funded programs such as Medicaid. Compilations of employers with the most workers and their dependents participating in these programs usually show Walmart at or near the top of the list.[2]

Walmart and Economic Development Subsidies: More than $1.2 Billion

Despite enjoying more than $400 billion in annual revenues and $13 billion in profits, Walmart has repeatedly turned to U.S. taxpayers to help fund its expansion. The company is one of the most frequent recipients of economic development subsidies from state and local governments across the country—in the form of tax breaks, cash grants, infrastructure assistance, etc.

In 2004 Good Jobs First issued the first detailed study of Walmart's use of these subsidies.[3] While comprehensive information was not available, we gathered data showing that the company had received a cumulative total of more than $1 billion in such public assistance.



Given the data limitations, we were unable to determine what portion of Walmart's roughly 3,000 stores had benefited from subsidies, but we found examples from around the country. We were able to reach a more precise conclusion about the company's large network of distribution centers. We contacted local officials in every one of the nearly 100 communities in which one of those centers had been built or was planned. We found that 92 percent of those facilities had been given economic development subsidies, with individual packages ranging as high as $46 million.

In 2007, we updated our research, documenting an additional 39 subsidy deals worth more than $200 million, roughly $70 million a year. We then assembled both the old and the new data on a new searchable website called Walmart Subsidy Watch.[4]

The Walmart Subsidy Watch website can display state summaries as well as details of individual subsidy deals. It has extensive rankings of both older and recent subsidy deals, including a list of the largest nationwide, the largest in each state and the largest in each category. It also has rankings of the states by the number of deals and value of deals.

In our 2007 update we found subsidy deals benefiting 30 stores and nine distribution centers in 15 states. The stores (all but one of which were Supercenters combining groceries and general merchandise) accounted for about $190 million of the $220 million total, an average of about $6 million per store. The distribution centers accounted for about $30 million, an average of about $3 million per facility. The distribution center amount was understated, because several warehouses received enterprise zone benefits, the value of which could not be estimated before the centers opened and began hiring.

The most common type of subsidy we found among the new deals was infrastructure assistance, which occurred in 21 facilities and accounted for $124 million of the total subsidies (with the money usually raised through tax increment financing, or TIF). The second most significant type, by value, was sales tax rebates, which went to 10 stores and totaled $55 million.

Walmart Subsidy Watch:
www.walmartsubsidywatch.org

These rebates occur when a locality allows a development project with a Walmart to keep a significant portion of the sales taxes it collects from customers that would normally go to local government. We saw few such rebates in our previous work. This new trend suggests that Walmart increasingly seeks to be subsidized directly by its customers, even though it often brags about how much money it saves them.

As with our findings in 2004, the updated totals had to be regarded as incomplete, given that the disclosure of development subsidies remains quite limited in many states. In most cases, we learned of deals first through articles in local newspapers. We then interviewed local officials and obtained documents to confirm the facts and get additional details. Although it was not practical to contact local officials in each of the hundreds of communities in which Walmart opened new stores each year, Good Jobs First contacted officials in all the communities in which new distribution centers had been announced over the previous three years. Subsidies were found for 9 of the 10 (the exception being Storey County, Nevada). The 90 percent figure was consistent with what we had found for distribution centers in the 2004 report.

While all of the distribution center subsidies directly benefited Walmart or its affiliates and subsidiaries, some of the deals for retail projects went through the developers of shopping centers in which Walmart stores serve as anchors. Good Jobs First regards these as, in effect, subsidies to Walmart, since they help make possible the company's expansion. Moreover, by reducing land acquisition and site preparation costs for developers, the subsidies presumably lead to lower rents for Walmart.

In the past few years, it appears that Walmart has become more cautious about seeking economic development subsidies, especially in its efforts to expand in urban centers. The company is apparently not seeking discretionary subsidies in two of its highest profile initiatives: in New York City and in Washington, DC. To the extent that low-wage workers in these cities end up seeking taxpayer-funded health coverage, the stores will still create a fiscal burden.

This is not to say that Walmart and its developers are turning down taxpayer dollars everywhere. For instance, officials in Elgin, Illinois agreed in 2010 to give the company $8 million in sales tax rebates over ten years for a new store.[5] In February 2011 city officials in El Monte, California awarded a $7.7 million grant to a developer planning to bring a Walmart store to a long-vacant property.[6]

Yet these deals remain controversial and are sometimes shot down. In August 2010 the city council of Florissant, Missouri rejected a request from THF Realty, a developer with close ties to Walmart, for $9 million in tax increment financing for a Supercenter project.[7]

The Walmart subsidy problem has not disappeared, but these days the big giveaways are less likely to sail through state and local approval processes.

How Walmart Avoids Paying Its Fair Share of State Income Taxes

In February 2007 the *Wall Street Journal* published a front-page story revealing that Walmart was using a real estate gimmick to avoid paying many millions of dollars in state corporate income taxes each year.[8]

It was doing this by putting many of its stores under the ownership of a real estate investment trust (REIT) controlled by the company. The stores would pay rent to the captive REIT and deduct those payments as a business expense. This trick, essentially paying rent to itself, reduced the company's taxable income and thus lowered its state tax bill (the REIT is structured so its income isn't taxed by any state). An April 2007 report by Citizens for Tax Justice estimated that Walmart had thereby avoided some $2.3 billion in state income tax payments between 1999 and 2005 – an average of more than $300 million a year.[9]

FRIENDLY LANDLORD

Wal-Mart Cuts Taxes By Paying Rent to Itself

Other Retailers, Banks Use Loophole in Rules To Lower States' Levies

By JESSE DRUCKER

As the world's biggest retailer, Wal-Mart Stores Inc. pays billions of dollars a year in rent for its stores. Luckily for Wal-Mart, in about 25 states it has been paying most of that rent to itself—and then deducting that amount from its state taxes.

The strategy is complex, but the bottom line is simple: It has saved Wal-Mart from paying several hundred million dollars in taxes, according to court records and a person familiar with the matter. And Wal-Mart is far from alone.

The arrangement takes advantage of a tax loophole that the federal government plugged decades ago, but which many states have been slower to catch. Here's how it works: One Wal-Mart subsidiary pays the rent to a real-

Shifting Burden

As tax-saving strategies such as Wal-Mart's have helped lower the share of state taxes paid by companies, the percentage paid by individuals has risen:

Source: Rockefeller Institute of Government

deduct the rent from state taxes as a business expense, even though the money has stayed within the company.

Partly thanks to sophisticated financial strategies like these, states' tax collections from companies have been plummeting. On average, Wal-

Wall Street Journal, February 1, 2007

The REIT gimmick was devised for Walmart in the 1990s by the accounting firm Ernst & Young, which also sold the strategy to other companies, especially banks. For Walmart it served as a substitute for a prior tax trick that states were challenging—the transfer of intellectual property such as trademarks to a captive entity in Delaware which charged the parent company for its use. Those payments were not taxable in Delaware.

Even before the *Wall Street Journal* article appeared, Walmart's captive REIT strategy was being challenged by the North Carolina Department of Revenue.[10] The state required the company to pay an additional $33 million in taxes for a four-year period, prompting Walmart to bring a lawsuit. In December 2007, Superior Court Judge Clarence E. Horton Jr. resoundingly rejected the company's claims, declaring that "there is no evidence that the rent transaction, taken as a whole, has any real economic substance apart from its beneficial effect on plaintiffs' North Carolina tax liability."[11] In May 2009 the state court of appeals upheld the lower court ruling.

While pursuing the North Carolina case, Walmart ended up disclosing documents that provided a wealth of details on the company's obsession with minimizing its state tax bills. According to an October 2007 review of those documents in the *Wall Street Journal*, Walmart had held meetings with Ernst & Young in what was called the "Tax Shelter Room" at its headquarters in Arkansas.[12] The company unsuccessfully sought to have the court documents sealed.[13]

North Carolina was not the only state that challenged Walmart's captive

REIT scheme. States such as Wisconsin and Illinois disallowed many of the deductions and required the company to pay millions in additional taxes.

Other states approached the issue through the legislative process. The most popular remedy is a practice known as combined reporting. Rather than allowing a company to report the profits of only the subsidiary that operates in that state, combined reporting requires it to disclose the earnings of all of its subsidiaries as a unified whole. The state then taxes it on the portion of its total business activity that took place within its borders.

By 2009 a majority of states that tax corporate income had embraced this reform.[14] Yet until it is the practice nationwide, Walmart and other large companies will enjoy “nowhere income”—profits that are taxed by no state.

How Walmart Rolls Back Its Property Tax Payments

When Walmart proposes to build a new store, local residents often raise concerns about increased traffic, loss of open space, higher crime rates and other negative impacts that depress property values. The company responds by claiming that its stores provide substantial benefits to communities.

What Walmart does not disclose during these “site fights” is the extent to which the company later in effect concedes the point about reduced property values. Once a store has been in operation for a while, Walmart frequently challenges the assessed value that local officials assign to it for tax purposes. In an effort to cut the property tax it pays—thereby reducing revenue needed for services such as public education—Walmart routinely tries to belittle the value of its own facilities.

Good Jobs First discovered this behavior in an intensive investigation of Walmart’s property tax behavior at more than 500 U.S. stores and distribution centers.[15] We researched property tax records, looking at assessment appeals on both real property (buildings and land) and business personal property (fixtures and equipment), and found what appears to be a company policy of *systematically* challenging assessments.

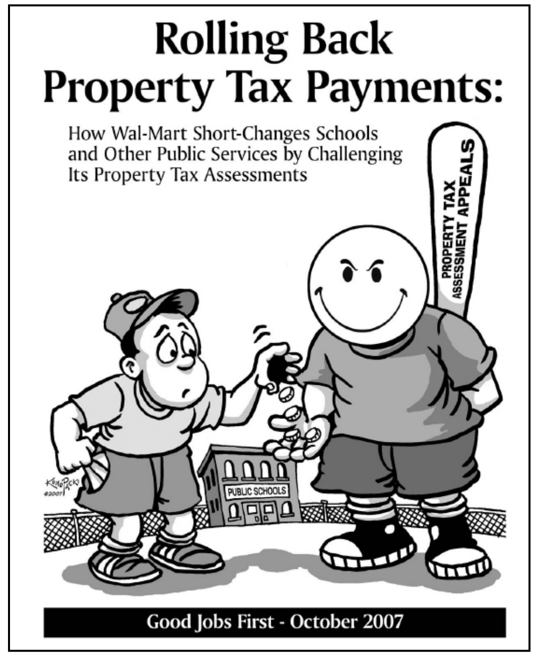
Our key findings:

- An examination of a 10 percent random sample of Walmart’s 2,833 Supercenters and discount stores in operation as of the beginning of 2005 found that at least one assessment challenge had been filed at 35 percent of the stores. Applying that rate to all Walmart stores, we estimated that the company had brought challenges at more than 1,000 of its retail outlets nationwide.

- An examination of all of Walmart's giant distribution centers in operation as of the same date showed that 40 percent have had an assessment challenge—this despite the fact that many of the warehouses had previously been granted property tax abatements when they were first built.

- At many locations, Walmart had filed challenges in multiple years—either because it was not initially successful or because it wanted an even bigger tax reduction. We estimated that the company had filed a total of more than 2,100 appeals at its stores and distribution centers nationwide.

As aggressive and persistent Walmart is in these challenges, the company frequently loses. In fact, when it comes to Supercenters and discount stores, we found that Walmart was denied more assessment reductions than it was granted. Walmart's win rate in appeals at these stores was only 45 percent. The rate at distribution centers was higher (64 percent), but the company still lost more than one-third of those cases.



Walmart's mixed record can be attributed to the efforts of assessors such as those in Johnson County, Arkansas, the company's home state. When Good Jobs First phoned in 2007 and said we were calling about Walmart, a county official responded: "We just kicked their butt." The company had tried to get the valuation of its distribution center in Clarksville reduced from $33 million to $23 million. The county refused, so Walmart sued. When we contacted the county, a circuit court had just ruled in its favor. "Walmart pushes, pushes and pushes," a county official said, "but I'm not bowing down to them."

Thanks to such perseverance by local officials, the total dollar value of tax savings that Walmart has achieved in its appeals has apparently been kept to a moderate level. In 2007 we estimated the company's *cumulative* tax savings nationwide for all Supercenters and discount stores at about $23 million; for all distribution centers the amount was about $6 million. This put Walmart's total cumulative tax savings in the neighborhood of $30 million, or roughly $3 million a year over the prior decade. The amounts it *sought* through its challenges was much higher.

Although Walmart's overall campaign to downsize its property tax payments has often been blunted, the company has enjoyed substantial gains in many individual communities. For example, in 2004 Walmart proposed that the assessment of its distribution center in Tomah, Wisconsin be lowered from $43.6 million to $23 million. The city resisted, but Walmart kept up the pressure. In 2007 the matter was finally settled, with the city agreeing to drop the assessment to $31.4 million and refund the company more than $300,000 for each of three years—a total of $949,000.

Reports of Walmart property tax appeals appear in the press less frequently these days, but the company has not abandoned this practice. For example, in 2010 it challenged its assessments in two cities in New Hampshire: Lebanon and Claremont.[16] This move came not long after the state's Board of Tax and Land Appeals had agreed to lower the valuation of a Walmart store in Conway by 18 percent (the company had wanted a 32 percent decrease).[17]

How Walmart (Legally) Skims the Sales Tax

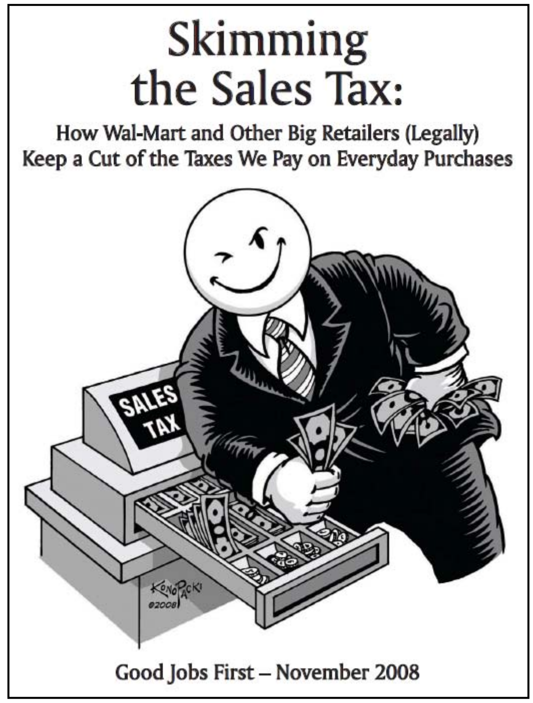
No shopper enjoys seeing sales tax added to the bill at the checkout. We tolerate the expense because the funds pay for vital public services. Yet most of us don't realize that in a majority of states with a sales tax, a portion of the money actually goes into the pocket of the retailer.

In a 2008 report entitled *Skimming the Sales Tax*, the first-ever comprehensive national analysis of the subject, Good Jobs First found that the public sector was losing more than $1 billion a year through these sales-tax diversions—much of it to giant retailers such as Walmart.[18]

The main way sales tax collections are "skimmed" from public coffers is through policies that allow all retailers to keep a portion of what they collect on behalf of state and local governments. The legal practice, known by terms such as "vendor discount" and "dealer collection allowance," is essentially a service fee meant to compensate store owners for the time and trouble of recording sales tax collections and remitting them to revenue agencies. States first adopted retailer compensation policies when shopkeepers kept records by hand, but they remained in place even after the advent of electronic cash registers and computers.

At the time we did our report, about half the states provided such compensation, which is typically calculated as a percentage of the sales tax collected and is limited to retailers who make their tax payments in a timely fashion. Of the 26 states that provided compensation, 13 also put a ceiling on the amount any individual store or chain can receive.

The 13 states *without* a ceiling ended up giving away substantial amounts of sales tax revenue in retailer compensation. Illinois led the list with an annual revenue loss of $126 million. Texas was second at $89 million, followed by Pennsylvania at $72 million and Colorado at $68 million.



The absence of ceilings in these states means that as retailers such as Walmart grow larger and larger, they collect correspondingly bigger amounts in vendor compensation—even though whatever costs they incur in collecting and remitting sales taxes has little relationship to their overall sales volume. Once a computerized system to track sale tax collections is in place, it works just as efficiently with revenues of $10 million as with $100 million.

As a result, mega-retailers receive a windfall with these payments. We estimated in our 2008 report that Walmart alone was collecting about $60 million a year in vendor compensation in the 13 states without ceilings. The highest amounts were in Missouri ($10 million), Colorado ($9 million), Illinois ($8.5 million) and Texas ($7.5 million). In a few states where Walmart has especially large market share, we estimated that Walmart by itself accounted for more than 10 percent of the total amount paid out in retailer compensation. In Missouri, Walmart's estimated share was 25 percent.

Retailer compensation is not the only cause of leakage in sales tax collections. Local governments, as allowed by some states' laws, also use sales tax revenue to finance economic development projects involving big-box stores and malls. This occurs in two main forms. Some localities sign deals that allow big retailers to keep a substantial portion of the local share of the sales tax generated by a new store. In some cases, the locality advances money to the company before the store even opens. Such subsidies are known as sales tax rebates or refunds.

In other cases, localities divert a portion of the sales tax generated by a new retail project to finance tax-free, low-interest bonds that directly subsidize the retailer or pay for infrastructure improvements at the site of the new store or shopping center. This is known as sales tax increment financing or STIF.

Sales tax rebates and STIF deals are subsets of the various categories of economic development subsidies discussed above. In our 2008 *Skimming* report, we estimated that Walmart had received about $130 million in sales-tax-based subsidies during the prior decade, or an average of about $13 million a year. Combining retailer compensation and subsidies, we concluded that Walmart accounted for the diversion of about $73 million in state or local sales tax revenue each year.

Walmart lost about $4 million in annual vendor discount payments in Virginia when the state decided in 2010 to reform its vendor discount by suspending payments to larger retailers, thus saving taxpayers $49 million a year. In 2009, Colorado responded to our findings by reducing the value of its vendor discount.

Conclusion

For every kind of tax that a retail company would normally pay or remit to support public services, Walmart has engineered an aggressive scheme to pay less and keep more.

- It has extracted more than $1.2 billion in property tax abatements, sales tax rebates, infrastructure and site improvements, and other economic development subsidies from state and local governments around the country. In recent years the subsidies amounted to roughly $70 million annually.

- Using gimmicks such as such as deducting rent payments made to itself (through a captive real estate investment trust), it avoids an estimated $300 million a year in corporate income tax payments.

- Using an army of lawyers and consultants, it systematically challenges property tax assessments to chip away at its property tax bills, costing local governments several million dollars a year in lost revenues and legal expenses.

- And it takes advantage – to the tune of about $60 million a year – of those states that fail to cap the "vendor discounts" they provide to large retailers for collecting sales taxes from their customers.

These practices are not illegal, but taken together they apparently cost state and local governments more than $400 million a year in lost revenue. Walmart may be more of a fiscal burden than a benefit to many of the communities in which it operates.

That burden is exacerbated by the sizeable number of low-wage Walmart workers who are forced to seek healthcare coverage from taxpayer-funded programs such as Medicaid.

Notes

[1] The formal company name is Wal-Mart Stores Inc., but it now uses Walmart (without the hyphen) in referring to its stores and in its advertising. For simplicity's sake, this report uses "Walmart" throughout.

[2] For an overview of these compilations, see http://www.goodjobsfirst.org/corporate-subsidy-watch/hidden-taxpayer-costs

[3] Philip Mattera and Anna Purinton, *Shopping for Subsidies: How Wal-Mart Uses Taxpayer Money to Finance Its Never-Ending Growth* (Washington, DC: Good Jobs First, May 2004); online at http://www.goodjobsfirst.org/sites/default/files/docs/pdf/wmtstudy.pdf

[4] http://www.walmartsubsidywatch.org

[5] Harry Hitzeman, "Walmart Set to Start Moving Dirt Piles on Randall Road," *Chicago Daily Herald*, July 17, 2010 (via Nexis).

[6] Rebecca Kimitch, "Path Cleared for Wal-Mart in El Monte, With Union Support," *San Gabriel Valley Tribune*, February 2, 2011 (via Nexis).

[7] Margaret Gillerman, "Florissant Opposes Tax Break," *St. Louis Post-Dispatch*, August 4, 2010 (via Nexis).

[8] Jesse Drucker, "Wal-Mart Cuts Taxes by Paying Rent to Itself," *Wall Street Journal*, February 1, 2007, p.1.

[9] Citizens for Tax Justice, *New Research Shows Wal-Mart Rigs the System to Skip Out on $2.3 Billion in State Taxes* (Washington, DC: Citizens for Tax Justice, April 16, 2007); available online at http://www.ctj.org/pdf/walmart041607.pdf

[10] *One Company's Plan to Save Money, Live Better: Wal-Mart's State Tax Avoidance Schemes*, (Washington, DC: Walmart Watch, June 2008).

[11] *Wal-Mart Stores East Inc. v. Reginald S. Hinton, Secretary of Revenue of the State of North Carolina*, Attachment to Order on Summary Judgment, p.23, December 31, 2007 (North Carolina Superior Court Case No. 06-CVS-3929).

[12] Jesse Drucker, "Inside Wal-Mart's Bid to Slash State Taxes," *Wall Street Journal*, October 23, 2007.

[13] Jesse Drucker, "Wal-Mart Loses Bid to Seal Court Papers in State Tax Dispute," *Wall Street Journal*, November 23, 2007.

[14] Michael Mazerov, *A Majority of States have Now Adopted a Key Corporate Tax Reform—"Combined Reporting,"* (Washington, DC: Center on Budget and Policy Priorities, April 2009); online at http://www.cbpp.org/files/4-5-07sfp.pdf

[15] Philip Mattera et al., *Rolling Back Property Tax Payments: How Wal-Mart Short-Changes Schools and Other Public Services by Challenging Its Property Tax Assessments* (Washington, DC: Good Jobs First, October 2007); online at http://www.goodjobsfirst.org/sites/default/files/docs/pdf/walmartproptax.pdf

[16] Bret Yager, "Wal-Mart Appeals City Taxes," White River Junction *Valley News*, July 17, 2010 (via Nexis).

[17] Amounts calculated from figures relating to 2004 in the New Hampshire Board of Tax and Land Appeals decision in *Wal-Mart Real Estate Business Trust v. Conway*, December 17, 2009; online at http://www.nh.gov/btla/decisions/documents/20892.doc

[18] Philip Mattera and Leigh McIlvaine, *Skimming the Sales-Tax: How Wal-Mart and other Big Retailers (Legally) Keep a Cut of the Taxes We Pay on Everyday Purchases* (Washington, DC: Good Jobs First, November 2008); online at http://www.goodjobsfirst.org/sites/default/files/docs/pdf/skimming.pdf