

**Multistate Tax Commission
Income & Franchise Tax Uniformity Subcommittee**

**Working Draft
Model Uniform Statute for
Combined Reporting**

*September 17, 2004
Draft – for Discussion Purposes Only*

Section 1. Definitions.

A. “Person” means any individual, firm, partnership, general partner of a partnership, limited liability company, registered limited liability partnership, foreign limited liability partnership, association, corporation, company, syndicate, estate, trust, business trust, trustee, trustee in bankruptcy, receiver, executor, administrator, assignee or organization of any kind.

B. “Taxpayer” means any person subject to the tax imposed by [State Corporate income tax act].

C. “Corporation” means any corporation as defined by the laws of this state or organization of any kind treated as a corporation for tax purposes under the laws of this state, wherever located, which if it were doing business in this state would be a “taxpayer.” The term “corporation” includes the portion of any business conducted by a partnership which is held directly or indirectly by a corporation in proportion to the corporation’s distributive share of the partnership’s income.

D. "Partnership" means a general or limited partnership, or organization of any kind treated as a partnership for tax purposes under the laws of this state.

E. “Internal Revenue Code” means Title 26 of the United States Code of [date] [and amendments thereto] without regard to application of federal treaties unless expressly made applicable to states of the United States.

F. “Unitary business” means a single economic enterprise that is made up either of separate parts of a single business entity or of a commonly controlled group of business entities that are sufficiently interdependent, integrated and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts. Any business conducted by a partnership shall be treated as conducted by its partners, whether directly held or indirectly held through a series of partnerships, in proportion to the partner's distributive share of the partnership's income. A business conducted directly by a corporation and that portion of a business of a partnership treated as conducted by the corporation through its direct or indirect interest in a partnership will be considered a

unitary business if the conditions of the first sentence of this section 1.F. are satisfied, irrespective of the partner's ownership, distributive or any other share of partnership interest.

G. "Combined group" means the group of all persons whose income and apportionment factors are required to be taken into account pursuant to Section 2.A. or 2.B. in determining the taxpayer's share of the net business income or loss apportionable to this State.

H. "United States" means the 50 states of the United States, the District of Columbia, and United State's territories and possessions.

I. "Tax haven" means a jurisdiction that:

- i.** has been identified by the Organization for Economic Co-operation and Development as a tax haven or as having a harmful preferential tax regime, or
- ii.**
 - (a)** has no or nominal tax on the relevant income; and
 - (b)**
 - (1)** has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime;
 - (2)** has tax regimes which lack transparency. A tax regime lacks transparency if the details of legislative, legal or administrative provisions are not open and apparent or are not consistently applied among similarly situated taxpayers, or if the information needed by tax authorities to determine a taxpayer's correct tax liability, such as accounting records and underlying documentation, is not adequately available;
 - (3)** facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy; or
 - (4)** explicitly or implicitly excludes resident taxpayers from taking advantage of the tax regime's benefits; or
- iii.** the director determines has created a tax regime which is favorable for tax avoidance, based upon an overall assessment of relevant factors, including whether the jurisdiction has a significant untaxed offshore financial/other services sector relative to its overall economy.

Section 2. Combined reporting required, when; discretionary under certain circumstances.

A. Combined reporting required, when. A taxpayer engaged in a unitary business with one or more other corporations shall file a combined report which includes the income, determined under Sections 3.C. of this act, and apportionment factors, determined under [provisions on apportionment factors and Section 3.B. of this act], of all corporations that are members of the unitary business, and such other information as required by the Director.

B. Combined reporting at Director's discretion, when. The Director may, by regulation, require the combined report include the income and associated apportionment

factors of any persons that are not included pursuant to Section 2.A., but that are members of a unitary business, in order to reflect proper apportionment of income of an entire unitary business. In addition, if the Director determines that the reported income or loss of a taxpayer or taxpayers engaged in a unitary business with any person not included pursuant to Section 2.A. does not clearly reflect income or loss of such taxpayer or taxpayers, does not properly reflect apportionment of income of the entire unitary business, or represents an evasion of tax by such taxpayer or taxpayers, and the Director determines that the comparable uncontrolled price method prescribed by regulations pursuant to Section 482 of the Internal Revenue Code cannot practically be applied, the Director may, on a case by case basis, permit or require all or any part of the income and associated apportionment factors of such person be included in the taxpayer's or taxpayers' combined report(s).

With respect to inclusion of associated apportionment factors pursuant to Section 2.B., the Director may require the exclusion of any one or more of the factors, the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this State, or the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Section 3. Determination of taxable income or loss using combined report.

A. Components of income subject to tax in this state; application of tax credit and post apportionment deductions.

The use of a combined report does not disregard the separate identities of the taxpayer members of the combined group. Each taxpayer member is responsible for tax based on its taxable income or loss apportioned or allocated to this state, which shall include:

- i.** its share of any business income apportionable to this State of each of the combined groups of which it is a member, determined under Section 3.B.,
- ii.** its share of any business income apportionable to this State of a distinct business activity conducted within and without the state wholly by the taxpayer member, determined under [provisions for apportionment of business income],
- iii.** its business income from a trade or business conducted wholly by the taxpayer member entirely within the state,
- iv.** its income sourced to this state from the sale or exchange of capital or assets, and from involuntary conversions, as determined under Section C.viii., below,
- v.** its nonbusiness income or loss allocable to this State, determined under [provisions for allocation of non-business income],
- vi.** its income or loss allocated or apportioned in an earlier year, required to be taken into account as state source income during the income year, other than a net operating loss, and
- vii.** its net operating loss carryover or carryback. If the income computed pursuant to Section 3 results in a loss for a taxpayer member of the combined group, that taxpayer member has a [state] net operating loss (NOL), subject to the net operation loss limitations and carryforward provisions of [provisions on NOLs]. Such NOL is applied as a deduction in a subsequent year only if that taxpayer has [State] source positive net

income, whether or not the taxpayer is a member of a combined reporting group in the subsequent year. An NOL incurred by one member of a combined reporting group cannot be used to reduce the [State source] income of any other member of the combined group. Whether the NOL resulted from the member's apportioned business loss or an allocated nonbusiness loss, or a combination of both, the NOL is a deduction against the member's positive [State] source income in a subsequent year, regardless of the composition of that income as apportioned, allocated or wholly within [State].

Unless otherwise provided, no tax credit or deduction earned by one member of the group, but not fully used by or allowed to that member, may be used in whole or in part by another member of the group or applied in whole or in part against the total income of the combined group. However, as provided in Section 3.A.vii, and unless otherwise provided, a deduction carried over into a subsequent year as to the member that incurred it, and available as a deduction to that member in a subsequent year, will be considered in the computation of the income of that member in the subsequent year.

B. Determination of taxpayer's share of the business income of a combined group apportionable to this State.

The taxpayer's share of the business income apportionable to this State of each combined group of which it is a member shall be determined as follows:

- i. from the total income of the combined group, determined under [Section 3. C.], subtract any income, and add any loss, other than business income or loss of the combined group; then
- ii. multiply the amounts determined under [Section 3.B.i.] by the taxpayer member's apportionment percentage, determined under [provisions on apportionment factors], including in the numerator the taxpayer's [property, payroll and sales] associated with the combined group's unitary business in this state, and including in the denominator the [property, payroll and sales] of all members of the combined group, including the taxpayer, which property, payroll and sales are associated with the combined group's unitary business wherever located. The [property, payroll, and sales] of a unitary business of a partnership shall be included in the determination of the partner's apportionment percentage in proportion to a ratio the numerator of which is the amount of the partner's share of partnership income included in the income of the combined group in accordance with [Section 3.C.iii.] and the denominator of which is the amount of the partnership's total unitary income.

C. Determination of the total income of the combined group.

The total income of the combined group is the sum of the incomes, separately determined, of each member of the combined group. The income of each member of the combined group shall be determined as follows:

- i. For any member incorporated in the United States, or included in a consolidated federal corporate income tax return, the income to be included in the combined report shall be the taxable income for the corporation after making appropriate adjustments under [state tax code provisions for adjustments to taxable income].

ii. (a) For any member not included in [Section 3.C.i.] the income to be included in the combined report shall be determined as follows:

(1) A profit and loss statement shall be prepared for each foreign branch or corporation in the currency in which the books of account of the branch or corporation are regularly maintained.

(2) Adjustments shall be made to the profit and loss statement to conform it to the accounting principles generally accepted in the United States for the preparation of such statements except as modified by this regulation.

(3) Adjustments shall be made to the profit and loss statement to conform it to the tax accounting standards required by the [state tax code]

(4) Except as otherwise provided by regulation, the profit and loss statement of each member of the combined group, and the apportionment factors related thereto, whether United States or foreign, shall be translated into the currency in which the parent company maintains its books and records.

(5) Income apportioned to this state shall be expressed in United States dollars.

(b) In lieu of the procedures set forth in Section ii.a. above, and subject to the determination of the Director that it reasonably approximates income as determined under [the State tax code], such member may determine its income on the basis of the consolidated profit and loss statement prepared for related unitary corporations for filing with the Securities and Exchange Commission. If the business is not required to file with the Securities and Exchange Commission, the consolidated profit and loss statement prepared for reporting to shareholders and subject to review by an independent auditor may be used.

iii. If a unitary business includes income from a partnership, the income included in the combined report shall be the member of the combined group's proportionate direct and indirect share of the partnership's unitary business income.

iv. All dividends paid by one to another of the members of the combined group shall, to the extent those dividends are paid out of the earnings and profits of the unitary business included in the combined report, be eliminated from the income of the recipient. This provision shall not apply to dividends received from members of the unitary business which are not a part of the combined group.

v. Income from an intercompany transaction between members of the same combined group shall be deferred in a manner consistent with 26 CFR 1.1502-13. Upon the occurrence of any of the following events, deferred income resulting from an intercompany transaction between members of a combined group shall be restored to the income of the seller, and shall be apportioned as business income earned immediately before the event:

(a) the object of a deferred intercompany transaction is

(1) re-sold by the buyer to an entity that is not a member of the combined group,

(2) re-sold by the buyer to an entity that is a member of the combined group for use outside the unitary business in which the buyer and seller are engaged, or

(3) converted by the buyer to a use outside the unitary business in which the buyer and seller are engaged, or

(b) the buyer and seller are no longer members of the same combined group, regardless of whether the members remain unitary.

vii. A charitable expense incurred by a member of a combined group shall, to the extent allowable as a deduction pursuant to Internal Revenue Code §170, be subtracted first from the business income of the combined group, and any remaining amount shall then be treated as a nonbusiness expense allocable to the member that incurred the expense. The income limitations on charitable deductions prescribed in Internal Revenue Code §170 shall first be applied to the business income of the combined group, and such limitation shall then be applied against the member's nonbusiness income. Any charitable deduction disallowed under the foregoing rule, but allowed as a deduction in a subsequent year, shall be treated as originally incurred in the subsequent year by the same member, and the rules of this section shall again apply.

viii. Gain or loss from the sale or exchange of a capital assets, property described by Section 1231(a)(3) of the Internal Revenue Code, and property subject to an involuntary conversion, shall be removed from the total separate net income of each member of a combined group and shall be apportioned and allocated as follows.

(a) For each class of gain or loss (short term capital, long term capital, IRC §1231, and involuntary conversions) all members' business gain and loss for the class shall be combined, and each class of net business gain or loss separately apportioned to each member using the member's apportionment percentage determined under Section B.ii., above.

(b) Each taxpayer member shall then net its apportioned business gain or loss for all classes, including any such apportioned business gain and loss from other combined groups, against the taxpayer member's nonbusiness gain and loss for all classes allocated to this State, using the rules of Sections 1231 and 1222 of the Internal Revenue Code, without regard to any of the taxpayer member's gains or losses from the sale or exchange of capital assets, Section 1231 property, and involuntary conversions which are sourced to another state.

(c) Any resulting state source income (or loss, if the loss is not subject to the limitations of Section 1211 of the Internal Revenue Code) of a taxpayer member produced by the application of the preceding subsections shall then be applied to all other state source income or loss of that member. (d) Any resulting state source loss of a member that is subject to the limitations of section 1211 shall be carried forward [or carried back] by that member, and shall be treated as state source short-term capital loss incurred by that member for the year for which the carryover [or carryback] applies.

(d) Any resulting state source loss of a member that is subject to the limitations of section 1211 shall be carried forward [or carried back] by that member, and shall be treated as state source short-term capital loss incurred by that member for the year for which the carryover [or carryback] applies.

D. Designation of surety.

As a filing convenience, and without changing the respective liability of the group members, members of a combined reporting group may elect to designate one taxpayer member of the combined group to file a single return in the form and manner prescribed

by the department, in lieu of filing their own respective returns, provided that the taxpayer designated to file the single return consents to act as surety with respect to the tax liability of all other taxpayers properly included in the combined report. If for any reason the surety is unwilling or unable to perform its responsibilities, tax liability may be assessed against the taxpayer members.

Section 4. Water's-edge election; initiation and withdrawal.

A. Water's-edge election.

Taxpayer members of a unitary group that meet the requirements of Section 4.B. may elect to determine each of their apportioned shares of the net business income or loss of the combined group pursuant to a water's-edge election. Under such election, taxpayer members shall take into account all or a portion of the income and apportionment factors of only the following members otherwise included in the combined group pursuant to section 2, as described below:

- i.** the entire income and apportionment factors of any member incorporated in the United States or formed under the laws of any state, the District of Columbia, or any territory or possession of the United States;
- ii.** the entire income and apportionment factors of any member, regardless of the place incorporated or formed, if the average of its property, payroll, and sales factors within the United States is 20 percent or more;
- iii.** the entire income and apportionment factors of any member which is a foreign sales corporation as described in §§921 to 927, inclusive, of the Internal Revenue Code; and any member which is an export trade corporation, as described in §§970 to 971, inclusive, of the Internal Revenue Code;
- iv.** any member not described in [Section 4.A.i.] to [Section 4.A.iii.], inclusive, shall include the portion of its income derived from or attributable to sources within the United States, as determined under the Internal Revenue Code without regard to federal treaties, and its apportionment factors related thereto;
- v.** any member that is a "controlled foreign corporation," as defined in Section 957 of the Internal Revenue Code, to the extent the income of that member is defined in Section 952 of Subpart F of the Internal Revenue Code ("Subpart F income"), determined without regard to federal treaties, and the apportionment factors related to that income, excluding any item of income received by a controlled foreign corporation if the taxpayer establishes to the satisfaction of the Director that such income was subject to an effective rate of income tax imposed by a foreign country greater than 90 percent of the maximum rate of tax specified in §11 of the Internal Revenue Code;
- vi.** any member that earns more than 20 percent of its income, directly or indirectly, from activities that are deductible against the business income of other members of the combined group, to the extent of that income and the apportionment factors related thereto; and
- vi.** any member that is doing business in a tax haven.

B. Initiation and withdrawal of election

i. A water's-edge election is effective only if made on a timely-filed, original return for a tax year by every member of the unitary business subject to tax under [state income tax code]. The Director shall develop rules and regulations governing the impact, if any, on the scope or application of a water's-edge election, including termination or deemed election, resulting from a change in the composition of the unitary group, the combined group, the taxpayer members, and any other similar change.

ii. Such election shall constitute consent to the reasonable production of documents and taking of depositions.

iii. In the discretion of the Director, a water's-edge election may be disregarded in part or in whole, and the income and apportionment factors of any member of the taxpayer's unitary group may be included in the combined report without regard to the provisions of this section, if any member of the unitary group fails to comply with any provision of [this act] or if a person otherwise not included in the water's-edge combined group was availed of with a principal objective of avoiding state income tax.

iv. A water's-edge election is binding for and applicable to the tax year it is made and all tax years thereafter. It may be withdrawn or reinstated after withdrawal, only upon written request for reasonable cause based on extraordinary hardship due to unforeseen changes in state tax statutes, law, or policy, and only with the written permission of the Director. If the Director grants a withdrawal of election, he or she shall impose reasonable conditions as necessary to prevent the evasion of tax or to clearly reflect income for the election period prior to or after the withdrawal.