

## DRAFT – FOR DISCUSSION PURPOSES ONLY

The following draft model statute is intended to implement a single-entity style, Finnigan approach to combined corporate tax filing and incorporates provisions discussed by the work group to date and makes other changes including:

- Listing definitions in order alphabetically (to conform to drafting rules).
- Capitalizing defined terms for ease of review.
- Highlighting (in yellow) internal cross-references for ease of review.
- Simplifying or clarifying certain provisions—redlined with or without comments.
- Adding a provision in the water’s edge election making clear that entities excluded from the group may nevertheless have a separate filing obligation.
- Adding drafters notes in certain provisions.

1 **Section 1. Definitions.**

2           A. “Combined Group” means the group of all Persons that must file a Combined  
3 Return as required by **Section 2.A. or 2.B**, including a group properly making an water’s  
4 edge election under **Section 4**.

5           B. “Combined Return” means a tax return required to be filed for the Combined  
6 Group containing information as provided in [this Act] or required by the [Director].

7           C. “Corporation” means ~~a corporation as defined by the laws of this state, or an~~  
8 organization of any kind treated as a corporation for tax purposes under the laws of this  
9 state, wherever located, which if it were doing business in this state would be a “Tax-  
10 payer.” ~~The business conducted by a Partnership that is directly or indirectly held by a~~  
11 ~~Corporation is the business of the Corporation to the extent of the Corporation’s distrib-~~  
12 ~~utive share of the Partnership income, inclusive of guaranteed payments to the extent~~

1 ~~prescribed by regulation.~~ COMMENT – This concept, deleted here, is adequately and  
2 appropriately addressed as part of the definition of a Unitary Business below and in  
3 other provisions of this model. Note that it is unnecessary to specify that the corporate  
4 partner’s income will include the partnership income since that is simply how pass-  
5 through taxation works. States that follow federal law (Subchapter K) will include this  
6 partnership income in the corporate partner’s income automatically. What is generally  
7 necessary is to specify: (1) that the business conducted by the partnership may be part  
8 of the unitary business of the partner, and (2) how to determine the share of the factors  
9 of the partnership that will “roll up” and be included in the factors of the corporation or  
10 the combined group. (See Section 3.B.iv.).

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

14 **E.** “Partnership” means ~~an general or limited Partnership, or~~ organization of any  
15 kind treated as a partnership for tax purposes under the laws of this state.

16 **F.** “Person” means an individual, firm, Partnership, general partner of a Partner-  
17 ship, limited liability company, registered limited liability Partnership, foreign limited  
18 liability Partnership, association, Corporation (whether or not the Corporation is, or  
19 would be if doing business in this state, subject to [reference to state income tax act]),  
20 company, syndicate, estate, trust, business trust, trustee, trustee in bankruptcy, receiver,  
21 executor, administrator, assignee, or organization of any kind. For purposes of the [ref-  
22 erence to state corporate income tax act] “Person” also means a Combined Group.  
23 *[DRAFTER’S NOTE: The state may have a definition of “person” that it wishes to reference*  
24 *here. What is important is that the model relies on the inclusion of the Combined Group in*  
25 *the definition of “Person.”]*

1           **G.** “Tax Haven” means a jurisdiction that, during the tax year in question has no  
2 or nominal effective tax on the relevant income and:

3                   **i.** has laws or practices that prevent effective exchange of information for  
4 tax purposes with other governments on Taxpayers benefiting from the tax re-  
5 gime;

6                   **ii.** has tax regime that lacks transparency. A tax regime lacks transparency  
7 if the details of legislative, legal or administrative provisions are not open and  
8 apparent or are not consistently applied among similarly situated Taxpayers, or  
9 if the information needed by tax authorities to determine a Taxpayer’s correct tax  
10 liability, such as accounting records and underlying documentation, is not ade-  
11 quately available;

12                   **iii.** facilitates the establishment of foreign-owned entities without the need  
13 for a local substantive presence or prohibits these entities from having any com-  
14 mercial impact on the local economy;

15                   **iv.** explicitly or implicitly excludes the jurisdiction’s resident Taxpayers  
16 from taking advantage of the tax regime’s benefits or prohibits enterprises that  
17 benefit from the regime from operating in the jurisdiction’s domestic market; or

18                   **v.** has created a tax regime that is favorable for tax avoidance, based upon  
19 an overall assessment of relevant factors, including whether the jurisdiction has  
20 a significant untaxed offshore financial or other services sector relative to its  
21 overall economy.

22           **H.** “Taxpayer” means a Person subject to the tax imposed by [reference to state  
23 corporate income tax act]. *[DRAFTER’S NOTE: The tax imposition sections of the state*  
24 *code should be clear that tax is imposed on the Combined Group or Corporations as part of*  
25 *a Combined Group.]*

1 I. "Unitary Business" means a single economic enterprise ~~that is~~ made up either  
2 of separate parts of a single business entity or of a commonly controlled group of busi-  
3 ness entities that are sufficiently interdependent, integrated, and interrelated through  
4 their activities so as to provide a synergy and mutual benefit that produces a sharing or  
5 exchange of value among them and a significant flow of value to the separate parts. ~~Busi-~~  
6 ~~ness conducted by a Partnership is treated as conducted by its partners, whether di-~~  
7 ~~rectly held or indirectly held through a series of Partnerships, to the extent of the part-~~  
8 ~~ner's distributive share of the Partnership's income, inclusive of guaranteed payments,~~  
9 ~~regardless of the percentage of the partner's ownership interest or the percentage of its~~  
10 ~~distributive or any other share of Partnership income. A business conducted directly or~~  
11 ~~indirectly by one Corporation is unitary with that portion of a business conducted by~~  
12 ~~another Corporation through its direct or indirect interest in a Partnership if the condi-~~  
13 ~~tions of the first sentence of this Section 1.I. are satisfied, to wit: there is a synergy, and~~  
14 ~~exchange and flow of value between the two parts of the business and the two Corpora-~~  
15 ~~tions are members of the same commonly controlled group. A Unitary Business includes~~  
16 ~~that part of the business that meets the definition in this Section 1.I. and is conducted by~~  
17 ~~a Taxpayer through the Taxpayer's interest in a Partnership, whether the interest in that~~  
18 ~~Partnership is held directly or indirectly through a series of Partnerships or other pass-~~  
19 ~~through entities.~~

20 COMMENT – Similar to the change above under the definition of "Corporation",  
21 this concept can be simplified as shown here. As noted above, the income of the partner-  
22 ship will flow through under federal law. The only question is whether that income (or  
23 loss) is part of the unitary business.

24 *[DRAFTER'S NOTE: This definition follows the MTC Model General Allocation and*  
25 *Apportionment Regulations, Sec. IV.1.(b)., defining a "Unitary Business." Reg. Sec. IV.1.(b).*

1 *includes a definition of a “commonly controlled group.” A state which treats ownership or*  
2 *control requirements separately from the Unitary Business requirement will need to make*  
3 *additional amendments to the statutory language. A state that does not wish to define Uni-*  
4 *tary Business in this manner should consider alternative language.]*

5 J. “United States” means the 50 states of the United States, the District of Colum-  
6 bia, and United States’ territories and possessions.

7

8 **Section 2.** Requirement to file a Combined Return; joint and several liability.

9 A. Except as provided in **Section 4**, all the Corporations, wherever incorporated  
10 or domiciled, that are members of a Unitary Business shall file a Combined Return as a  
11 Combined Group. That return must include the income and apportionment factors, de-  
12 termined under **Section 3**, and other information required by the [Director] for all mem-  
13 bers of the Combined Group wherever located or doing business. The Combined Return  
14 must be filed under the name and federal employer identification number of the parent  
15 Corporation if the parent is a member of the Combined Group. If there is no parent Cor-  
16 poration, or if the parent is not a group member, the members of the Combined Group  
17 shall choose a member to file the return. The filing member must remain the same in  
18 subsequent years unless the filing member is no longer the parent Corporation or is no  
19 longer a member of the Combined Group. The return must be signed by a responsible  
20 officer of the filing member on behalf of the Combined Group members. Members of the  
21 Combined Group are jointly and severally liable for the tax liability of the Combined  
22 Group included in the Combined Return.

23 B. The [Director], by regulation, may, ~~by regulation~~, require that the Combined  
24 Return include the income and associated apportionment factors of Persons that are not  
25 included pursuant to **Section 2.A.**, but that are members of a Unitary Business, in order

1 to reflect proper apportionment of income of the entire Unitary Business. Authority to  
2 require combination by regulation under this **Section 2.B.** includes authority to require  
3 combination of the income and associated apportionment factors of Persons that are  
4 ~~not, or would not be if doing business in this state,~~ subject to the [state income tax act].  
5 or would not be subject to the [state income tax act] if doing business in this state.

6 In addition, if the [Director] determines that the reported income or loss of a Tax-  
7 payer engaged in a Unitary Business with a Person not included pursuant to **Section 2.A.**,  
8 or pursuant to an election under Section 4, represents an avoidance or evasion of tax by  
9 such Taxpayer, the [Director] may, on a case by case basis, require all or part of the in-  
10 come and associated apportionment factors of such Person be included in the Tax-  
11 payer's Combined Return.

12 COMMENT – It appears that this section could be read to apply this anti-abuse  
13 provision only to combined groups that file on a worldwide basis and not to groups that  
14 file on a water's edge basis under Section 4.

15 With respect to inclusion of associated apportionment factors pursuant to this  
16 **Section 2.B.**, the [Director] may require the exclusion of one or more of the factors, the  
17 inclusion of one or more additional factors that will fairly represent the Taxpayer's busi-  
18 ness activity in this State, or the employment of any other method to effectuate a proper  
19 reflection of the total amount of income subject to apportionment and an equitable allo-  
20 cation and apportionment of the Taxpayer's income.

21  
22 **Section 3.** Determination of Combined Group income subject to tax.

23 A. ~~The Calculation of~~ Combined Group calculates its state taxable net income as  
24 provided in this Section 3.A.

1           i. Determine the total Combined Group income or loss, before net operating  
2 loss deduction, as follows:

3                   **(a)** Each member of the Combined Group determines its separate  
4 income or loss, before net operating loss deduction, as follows:

5                           **(1)** For a member incorporated in the United States, or in-  
6 cluded in a consolidated federal corporate income tax return, the  
7 member's income or loss is the taxable income for the member un-  
8 der the Internal Revenue Code, on a separate entity basis, after mak-  
9 ing appropriate adjustments under [state tax code provisions for ad-  
10 justments to taxable income].

11                           **(2)** For any member not included in **Section 3.A.ii.(a)(1)**:

12                                   **(I)** The member's income or loss is determined from a  
13 profit and loss statement prepared for that member on a sep-  
14 arate entity basis in the currency in which its books of account  
15 are regularly maintained, provided this profit and loss state-  
16 ment is subject to an independent audit, adjusted to conform  
17 it to the accounting principles generally accepted in the  
18 United States for the preparation of such statements and fur-  
19 ther modified to take into account any book-tax adjustments  
20 necessary to reflect federal and [state] tax law. Income or loss  
21 so computed includes all income wherever derived and is not  
22 limited to items of U.S. source income or effectively connected  
23 income within the meaning of the Internal Revenue Code.  
24 Items of income, expense, gain or loss and related apportion-  
25 ment factors that are denominated in a foreign currency must

1 also be translated into U.S. dollars on a reasonable basis con-  
2 sistently applied year-to-year and entity-by-entity. Unreal-  
3 ized foreign currency gains and losses are not recognized. In-  
4 come apportioned to this state is to be expressed in U.S. dol-  
5 lars.

6 **(II)** In lieu of the procedures set forth in **Section**  
7 **3.A.i.(a)(2)(I)** or in any case where it is necessary to fairly and  
8 consistently reflect the income or loss and apportionment fac-  
9 tors of foreign operations included in the Unitary Business,  
10 the [Director] may provide for other procedures to reasona-  
11 bly approximate the income or loss and apportionment fac-  
12 tors of members with foreign operations.

13 **(b)** Unless otherwise provided by this Act, or by regulation, income  
14 or loss of the members as determined under **Section 3.A.i.(a)** are combined,  
15 eliminating items of income, expense, gain and loss from transactions be-  
16 tween members of the Combined Group, applying the consolidated filing  
17 rules under Internal Revenue Code and agency regulations as if the Com-  
18 bined Group was a consolidated filing group.

19 **(1)** Dividends paid by one member of the Combined Group to  
20 another member are excluded from that member's income to the ex-  
21 tent those dividends are paid out of the earnings and profits of the  
22 Unitary Business included in the combined report in the current or  
23 an earlier year.

24 **(2)** A charitable expense incurred by a member of a Combined  
25 Group, to the extent allowable as a deduction pursuant to Internal

1 Revenue Code Section 170, is subtracted first from the apportiona-  
2 ble income of the Combined Group subject to the income limitations  
3 of that section applied to the entire apportionable income of the  
4 group, and any excess may be carried over as provided in Section  
5 170, subject to limitations in that section.

6 **ii.** Determine Combined Group ordinary apportionable income or loss by  
7 eliminating from the amount determined in **Section 3.A.i**:

8 **(a)** The amount of any net capital gain resulting from application of  
9 the Internal Revenue Code, Subchapter P; and

10 **(b)** Any other income or loss, or item of income, expense, gain or  
11 loss, that is nonapportionable.

12 **iii.** Determine state share of Combined Group ordinary apportionable in-  
13 come or loss by multiplying the amount determined under **Section 3.A.ii** times  
14 the Combined Group apportionment factor as determined under **Section 3.B**.

15 **iv.** Determine the Combined Group state net capital gain or loss from the  
16 application of the Internal Revenue Code, Subchapter P, and the amount of any  
17 state net capital loss carryover, as follows:

18 *[DRAFTER'S NOTE: If the state decouples from federal treatment of depreci-*  
19 *ation and tax basis and requires Taxpayers to compute separate state amounts for*  
20 *capital gains, losses and/or loss carryovers, then insert language here referring to*  
21 *the section that instructs Taxpayers how to report state-adjusted capital gains and*  
22 *losses.]*

23 **(a)** Each separate item of capital gain or loss for the Combined Group  
24 is determined [following Internal Revenue Code, Subchapter P or state

1 provisions requiring the computation of state-adjusted capital gains and  
2 losses].

3 **(b)** Each separate item of apportionable capital gain or loss is then  
4 apportioned using the Combined Group’s apportionment factor deter-  
5 mined under **Section 3.B.**, and each separate item of nonapportionable cap-  
6 ital gain or loss is allocated under [reference to state allocation and appor-  
7 tionment statute].

8 **(c)** The capital gains or losses allocated or apportioned to this state  
9 are then netted consistent with the provisions of the Internal Revenue  
10 Code, Subchapter P.

11 **(d)** If the amount determined in **Section 3.A.iv.(c)** is a net capital  
12 gain, that gain is included in Combined Group taxable net income or loss  
13 before net operating loss deduction as computed under Section 3.A.vi.

14 **(e)** If the amount determined in **Section 3.A.iv.(c)** is a net capital loss,  
15 that loss may not be deducted from other income but may be carried over  
16 by the Combined Group and used to offset Combined Group capital gains,  
17 subject to [state law allowing a net capital loss carryover], but only to the  
18 extent that the amount or use of such capital loss carryover is not subject  
19 to limitations under any provision of the Internal Revenue Code or appli-  
20 cable federal regulations, or would not be subject to such limitations ap-  
21 plied as if the Combined Group was the consolidated group.

22 **(f)** If the Combined Group capital loss carryover must be attributed  
23 to particular members of the group for purposes of determining limitations  
24 applicable to the amount or use of the capital loss under **Section 3.A.iv(e)**  
25 above, then this will be done by multiplying the Combined Group net

1 capital loss generated for any applicable year times a fraction the numerator  
2 of which is the separate entity net capital loss of the member for that year,  
3 if any, and the denominator of which is the total separate entity net capital  
4 losses for all the members of the Combined Group that had net capital  
5 losses for that year. A member's separate entity net capital loss carryover  
6 will be determined as follows:

7 **(I)** For each year in which the Combined Group recognized a  
8 net capital loss, multiply the Combined Group net apportionable  
9 gains and losses times the member's separate entity apportionment  
10 factor determined under **Section 3.B**, netting the resulting appor-  
11 tioned gains and losses as provided in this **Section 3.A.iv**; ~~and then~~  
12 ~~add or subtract~~

13 ~~(II) adding Any any~~ nonapportionable gains ~~or and subtract-~~  
14 ~~ing any~~ losses allocated to the state that were generated by that  
15 member.

16 ~~(III)~~**(II)** In no case may members of the Combined Group be  
17 attributed total capital losses under this Section 3.A.iv(f) in excess of  
18 the Combined Group net capital loss properly reported to this state  
19 in the tax year.

20 **(IIIV)** In computing the net capital loss carryover for the  
21 member of the Combined Group, the separate entity capital losses  
22 for all members computed under this **Section 3.A.iv.(f)** will be  
23 deemed to be used to offset Combined Group capital gains in other  
24 years, as allowed under [federal or separate state law], on a pro-rata  
25 basis, starting with the earliest year.

1           v. Determine the amount of any Combined Group nonapportionable items  
2 of income, expense, gain or loss not allocated under **Section 3.A.iv.(b)** that are al-  
3 locable to the state under [reference to state allocation and apportionment stat-  
4 ute].

5           vi. Determine the Combined Group state net income or loss before net op-  
6 erating loss deduction by combining and netting the results from **Section 3.A.iii,**  
7 **iv.(d), and v.**

8           vii. Determine the Combined Group state taxable net income after any net  
9 operating loss deduction, by deducting from the amount of Combined Group state  
10 net income computed under **Section 3.A.vi** an allowable amount of the Combined  
11 Group's net operating loss carryover, determined under this **Section 3.A.vii**, as fol-  
12 lows:

13                   **(a)** The allowable amount of the Combined Group net operating loss  
14 carryover in any tax year is:

15                           **(1)** The total of the Combined Group state losses determined  
16 under **Section 3.A.vi** for prior years to the extent such losses have  
17 not been used to offset the Combined Group's state net income and  
18 to the extent those losses are not otherwise limited by state law or  
19 this **Section 3.A.vii**; plus

20                           **(2)** The net operating loss carryover of any members of the  
21 group created before the member became a part of the group, but  
22 only to the extent that the net operating loss carryover:

23                                   **(I)** represents net operating losses that were properly  
24 attributed to the member under **Section 3.A.vii(b)** below if the

1 member was part of a separate Combined Group when the  
2 losses were created;

3 **(II)** represents net operating losses properly allocated  
4 or apportioned to this state in the year created;

5 **(III)** has not been used to offset income of any Tax-  
6 payer;

7 **(IV)** would not be subject to limitations as to the  
8 amount or use applicable under any provision of the Internal  
9 Revenue Code or federal regulations, or would not be subject  
10 to such limitations applied as if the Combined Group was the  
11 consolidated group; and

12 **(V)** is not otherwise not limited by state law; minus

13 **(3)** The net operating loss carryover of a member of the Com-  
14 bined Group attributed to that member under **Section 3.A.vii.(c)** be-  
15 low, that has not been used to offset income and is not otherwise  
16 limited by state law as of the date that member is no longer part of  
17 the Combined Group.

18 **(b)** If the Combined Group net operating loss carryover must be at-  
19 tributed to particular members of the group for purposes of determining  
20 limitations applicable to the amount or use of the net operating loss car-  
21 ryover under this **Section 3.A.vii**, then this will be done by multiplying the  
22 Combined Group net loss generated for any applicable year times a fraction  
23 the numerator of which is the separate entity net loss of the member for  
24 that year, if any, and the denominator of which is the total separate entity  
25 net losses for all the members of the Combined Group that had net losses

1 for that year. A member's separate entity net loss will be determined as  
2 follows:

3 (1) The amount of Combined Group ordinary apportionable  
4 income determined under Section 3.A.ii multiplied times the mem-  
5 ber's separate entity apportionment factor as determined under  
6 Section 3.B; plus

7 (2) The amount of any Combined Group net gain determined  
8 under Section 3.A.iv. multiplied times the member's separate entity  
9 apportionment factor as determined under Section 3.B; plus or mi-  
10 nus

11 (3) The amount of any nonapportionable items of income, ex-  
12 pense, gain or loss allocated to the state under Section 3.A.v. that  
13 were generated by the member; plus or minus

14 (4) Any adjustments to properly reflect the member's sepa-  
15 rate entity loss.

16 (5) In no case shall members be attributed total losses under  
17 this Section 3.A.vii.(b) in excess of the Combined Group loss properly  
18 reported to this state in the tax year.

19 (6) In computing the net operating loss carryover for the  
20 member of the Combined Group, the separate entity net operating  
21 losses for all members computed under this Section 3.A.iv.(f) will be  
22 deemed to be used to offset Combined Group net income in other  
23 years, as allowed under [federal or separate state law], on a pro-rata  
24 basis, starting with the earliest year.

25 **viii.** Application of state tax credits.

1                   If the use of a tax credit provided in any other section of [this act] is  
2 limited to the [state] tax attributed to a member of a Combined Group, then  
3 the tax that may be offset by the credit is calculated as follows:

4                   **(1)** The amount of Combined Group ordinary apportionable  
5 income determined under **Section 3.A.ii** multiplied times the mem-  
6 ber’s separate entity apportionment factor as determined under  
7 **Section 3.B**; plus

8                   **(2)** The amount of any Combined Group net gain determined  
9 under **Section 3.A.iv.** multiplied times the member’s separate entity  
10 apportionment factor as determined under **Section 3.B**; plus or mi-  
11 nus

12                   **(3)** The amount of any nonapportionable items of income, ex-  
13 pense, gain or loss allocated to the state under **Section 3.A.v.** that  
14 were generated by the member; plus or minus

15                   **(4)** Any adjustments to properly reflect the member’s sepa-  
16 rate entity loss; multiplied by

17                   **(5)** The applicable tax rate.

18 **B. Allocation and apportionment.**

19                   **i. Allocation and apportionment.**

20                   Unless otherwise provided in this Act, [reference to state allocation and ap-  
21 portionment statute] determines how income or loss, or items making up income  
22 or loss, are allocated and apportioned to this state.

23                   **ii. Combined Group apportionment factor.**

24                   The Combined Group apportionment factor is a percentage determined un-  
25 der [reference to state allocation and apportionment statute] where the

1 numerator of the factor[s] includes amounts sourced to the state for the Com-  
2 bined Group's Unitary Business, regardless of the separate entity to which those  
3 factors may be attributed, and the denominator of the factor[s] includes amounts  
4 associated with the Combined Group's Unitary Business wherever located.

5 **iii.** Separate entity apportionment factor.

6 The separate entity apportionment factor for a member of the Combined  
7 Group is a percentage determined under [reference to state allocation and appor-  
8 tionment statute] where the numerator of the factor[s] includes amounts sourced  
9 to the state for the member, and the denominator of the factor[s] includes  
10 amounts associated with the Combined Group's Unitary Business wherever lo-  
11 cated.

12 **iv.** If ~~the a member of the~~ Combined Group ~~or a member of the group~~ holds  
13 a Partnership interest from which it derives apportionable income, the share of  
14 ~~the~~ Partnership's apportionment factor[s] to be included in the apportionment  
15 factor[s] of the group ~~or member~~ is determined by multiplying the Partnership's  
16 factor[s] by a ratio the numerator of which is the amount of ~~the distributive share~~  
17 ~~of the Partnership's apportionable income included in the income of the Com-~~  
18 ~~bined Group or member, the Partnership's apportionable income properly in-~~  
19 ~~cluded in the member's income, whether received directly or indirectly, and in-~~  
20 ~~cluding any guaranteed payments,~~ and the denominator of which is the amount  
21 of the Partnership's total apportionable income.- If a member of the Combined  
22 Group directly or indirectly receives an allocation of a Partnership tax item, such  
23 as an item of loss or expense, so that it is not possible to determine the member's  
24 share of apportionable income, the [Director] may provide rules for inclusion of

1 [particular Partnership factors, or portions of factors, in the Combine Group's fac-](#)  
2 [tors.](#)

3 COMMENT – This is necessary because partners may not receive a distrib-  
4 utive share of the net income of a partnership but may, instead, receive special  
5 allocations of particular items of partnership income, expense, gain or loss that  
6 will not relate to the partnership apportionment factors generally.

7  
8 **Section 4.** Water's -edge election; initiation and withdrawal.

9 **A.** Water's-edge election.

10 Members of a unitary group that meet the requirements of **Section 4.B.** may elect  
11 to file as a Combined Group pursuant to a water's-edge election. Under such election,  
12 the Combined Group takes into account all or a portion of the income and apportionment  
13 factors of only the following members, otherwise included in the Combined Group pur-  
14 suant to **Section 2**, as described below:

15 **i.** the entire income and apportionment factors of a member incorporated  
16 in the United States or formed under the laws of any state, the District of Colum-  
17 bia, or any territory or possession of the United States;

18 **ii.** the entire income and apportionment factors of a member, regardless of  
19 the place incorporated or formed, if the average of its property, payroll, and re-  
20 ceipts factors within the United States is 20 percent or more;

21 **iii.** the entire income and apportionment factors of a member which is a  
22 domestic international sales Corporations as described in Internal Revenue Code  
23 Sections 991 to 994, inclusive; a foreign sales Corporation as described in Internal  
24 Revenue Code Sections 921 to 927, inclusive; or a member which is an export

1 trade Corporation, as described in Internal Revenue Code Sections 970 to 971,  
2 inclusive;

3 **iv.** for a member not described in Section 4.A.i. to Section 4.A.iii., inclusive,  
4 include the portion of its income derived from or attributable to sources within  
5 the United States, as determined under the Internal Revenue Code without regard  
6 to federal treaties, and its apportionment factors related thereto;

7 **v.** for a member that is a “controlled foreign Corporation,” as defined in  
8 Internal Revenue Code Section 957, include income to the extent of the income of  
9 that member that is defined in Section 952 of Subpart F of the Internal Revenue  
10 Code (“Subpart F income”) not excluding lower-tier subsidiaries’ distributions of  
11 such income which were previously taxed, determined without regard to federal  
12 treaties, and the apportionment factors related to that income; any item of income  
13 received by a controlled foreign Corporation is excluded if such income was sub-  
14 ject to an effective rate of income tax imposed by a foreign country greater than  
15 90 percent of the maximum rate of tax specified in Internal Revenue Code Section  
16 11;

17 **vi.** for a member that earns more than 20 percent of its income, directly or  
18 indirectly, from intangible property or service related activities that are deducti-  
19 ble against the apportionable income of other members of the Combined Group,  
20 include the related income and the apportionment factors; and

21 **vii.** the entire income and apportionment factors of a member that is doing  
22 business in a Tax Haven, where “doing business in a Tax Haven” is defined as be-  
23 ing engaged in activity sufficient for that Tax Haven jurisdiction to impose a tax  
24 under United States constitutional standards. If the member’s business activity  
25 within a Tax Haven is entirely outside the scope of the laws, provisions and

1 practices that cause the jurisdiction to meet the criteria established in Section  
2 1.JI., the activity of the member shall be treated as not having been conducted in  
3 a Tax Haven.

4 **B. Initiation and withdrawal of election**

5 **i.** A water's-edge election is effective only if made on a timely-filed, original  
6 return for a tax year by the members of the Unitary Business. The Director shall  
7 develop rules and regulations governing the impact, if any, on the scope or appli-  
8 cation of a water's-edge election, including the procedures for election and termi-  
9 nation or deemed election, resulting from a change in the composition of the uni-  
10 tary group, the Combined Group, the members, and any other similar change.

11 **ii.** Such election constitutes consent to the reasonable production of docu-  
12 ments and taking of depositions in accordance with [state statute on discovery].

13 **iii.** In the discretion of the Director, a water's-edge election may be disre-  
14 garded in part or in whole, and the income and apportionment factors of any  
15 member of the unitary group may be included in the combined report without  
16 regard to the provisions of this section, if any member of the unitary group fails  
17 to comply with any provision of [this act] or if a Person otherwise not included in  
18 the water's-edge Combined Group was availed of with a substantial objective of  
19 avoiding state income tax.

20 **iv.** A water's-edge election is binding for and applicable to the tax year it is  
21 made and all tax years thereafter for a period of 10 years. It may be withdrawn or  
22 reinstated after withdrawal, prior to the expiration of the 10 year period, only  
23 upon written request for reasonable cause based on extraordinary hardship due  
24 to unforeseen changes in state tax statutes, law, or policy, and only with the writ-  
25 ten permission of the Director. If the Director grants a withdrawal of election, he

1 or she shall impose reasonable conditions as necessary to prevent the evasion of  
2 tax or to clearly reflect income for the election period prior to or after the with-  
3 drawal. Upon the expiration of the 10 year period, the members of a Combined  
4 Group may withdraw from the water's edge election. Such withdrawal must be  
5 made in writing within one year of the expiration of the election, and is binding  
6 for a period of 10 years, subject to the same conditions as applied to the original  
7 election. If no withdrawal is properly made, the water's edge election will be in  
8 place for an additional 10 year period, subject to the same conditions as applied  
9 to the original election.

10 C. Effect of water's edge election on excluded entities.

11 The election under this Section 4 has no affect on whether entities that are  
12 excluded from the water's edge Combined Group may be separately liable for tax  
13 under [the state income tax act]. Entities subject to the state tax must separately  
14 file and pay tax in the state.