The following draft incorporates and substantially revises language that has been discussed by the work group that generally implements a “single-entity” approach to calculating the state-sourced income of the combined group. The draft attempts to take a “step-by-step” approach to this calculation.

Section 3. Determination of combined group income subject to tax.

A. Calculation of combined group state taxable net income.

i. Determine the total combined group income or loss, before net operating loss deduction, as follows:

(a) Each member of the combined group determines its separate income or loss, before net operating loss deduction, as follows:

(1) For a member incorporated in the United States, or included in a consolidated federal corporate income tax return, the member’s income or loss is the taxable income for the member under the Internal Revenue Code, on a separate entity basis, after making appropriate adjustments under [state tax code provisions for adjustments to taxable income].

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

(I) The member’s income or loss is determined from a profit and loss statement prepared for that member on a separate entity basis in the currency in which its books of account are regularly maintained, provided this profit and loss statement is subject to an independent audit, adjusted to conform it to the accounting principles generally accepted in the United States for the preparation of such statements and further modified to take into account any book-tax adjustments necessary to reflect federal and [state] tax law. Income or loss so computed includes all income wherever derived and is not limited to items of U.S. source income or effectively connected income within the meaning of the Internal Revenue Code. Items of income, expense, gain or
loss and related apportionment factors that are denominated in a foreign

currency must also be translated into U.S. dollars on a reasonable basis

consistently applied year-to-year and entity-by-entity. Unrealized foreign
currency gains and losses are not recognized. Income apportioned to this
state is to be expressed in U.S. dollars.

(II) In lieu of the procedures set forth in Section 3.A.i.(a)(2)(I) or in
any case where it is necessary to fairly and consistently reflect the
income or loss and apportionment factors of foreign operations included
in the unitary business, the [Director] may provide for other procedures
to reasonably approximate the income or loss and apportionment factors
of members with foreign operations.

(b) Unless otherwise provided by this Act, or by regulation, income or loss of the
members as determined under Section 3.A.i.(a) are combined, eliminating items of
income, expense, gain and loss from transactions between members of the combined
group, applying the consolidated filing rules under Internal Revenue Code and agency
regulations as if the combined group was a consolidated filing group.

(1) Dividends paid by one member of the combined group to another
member are excluded from that member’s income to the extent those dividends
are paid out of the earnings and profits of the unitary business included in the
combined report in the current or an earlier year.

(2) A charitable expense incurred by a member of a combined group, to
the extent allowable as a deduction pursuant to Internal Revenue Code Section
170, is subtracted first from the apportionable income of the combined group
subject to the income limitations of that section applied to the entire
apportionable income of the group, and any excess may be carried over as
provided in Section 170, subject to limitations in that section.

ii. Determine combined group ordinary apportionable income or loss by eliminating
from the amount determined in Section 3.A.i:
(a) The amount of any net capital gain resulting from application of the Internal Revenue Code, Subchapter P; and

(c) Any other income or loss, or item of income, expense, gain or loss, that is nonapportionable.

iii. Determine state share of combined group ordinary apportionable income or loss by multiplying the amount determined under Section 3.A.ii. times the combined group apportionment factor as determined under Section 3.B.

iv. Determine the combined group state net capital gain or loss from the application of the Internal Revenue Code, Subchapter P, and the amount of any state net capital loss carryover, as follows:

[DRAFTER’S NOTE: If the state decouples from federal treatment of depreciation and tax basis and requires taxpayers to compute separate state amounts for capital gains, losses and/or loss carryovers, then insert language here referring to the section that instructs taxpayers how to report state-adjusted capital gains and losses.]

(a) Each separate item of capital gain or loss for the combined group is determined [following Internal Revenue Code, Subchapter P or state provisions requiring the computation of state-adjusted capital gains and losses].

(b) Each separate item of apportionable capital gain or loss is then apportioned using the combined group’s apportionment factor determined under Section 3.B., and each separate item of nonapportionable capital gain or loss is allocated under [reference to state allocation and apportionment statute].

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

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

(e) If the amount determined in Section 3.A.iv.(c) is a net capital loss, that loss may not be deducted from other income but may be carried over by the combined group and used to offset combined group capital gains, subject to [state law allowing a
(f) If the combined group capital loss carryover must be attributed to particular members of the group for purposes of determining limitations applicable to the amount or use of the capital loss under Section 3.A.iv(e) above, then this will be done by multiplying the combined group net capital loss generated for any applicable year times a fraction the numerator of which is the separate entity net capital loss of the member for that year, if any, and the denominator of which is the total separate entity net capital losses for all the members of the combined group that had net capital losses for that year. A member’s separate entity net capital loss carryover will be determined as follows:

(I) For each year in which the combined group recognized a net capital loss, multiply the combined group net apportionable gains and losses times the member’s separate entity apportionment factor determined under Section 3.B, netting the resulting apportioned gains and losses as provided in this Section 3.A.iv; and then add or subtract

(II) Any nonapportionable gains or losses allocated to the state that were generated by that member.

(III) In no case may members of the combined group be attributed total capital losses under this Section 3.A.iv(f) in excess of the combined group net capital loss properly reported to this state in the tax year.

(IV) In computing the net capital loss carryover for the member of the combined group, the separate entity capital losses for all members computed under this Section 3.A.iv.(f) will be deemed to be used to offset combined group capital gains in other years, as allowed under [federal or separate state law], on a pro-rata basis, starting with the earliest year.
v. Determine the amount of any combined group nonapportionable items of income, expense, gain or loss not allocated under Section 3.A.iv(b) that are allocable to the state under [reference to state allocation and apportionment statute].

vi. Determine the combined group state net income or loss before net operating loss deduction by combining and netting the results from Section 3.A.iii, iv(d), and v.

vii. Determine the combined group state taxable net income after any net operating loss deduction, by deducting from the amount of combined group state net income computed under Section 3.A.vi an allowable amount of the combined group’s net operating loss carryover, determined under this Section 3.A.vii, as follows:

(a) The allowable amount of the combined group net operating loss carryover in any tax year is:

(1) The total of the combined group state losses determined under Section 3.A.vi for prior years to the extent such losses have not been used to offset the combined group’s state net income and to the extent those losses are not otherwise limited by state law or this Section 3.A.vii; plus

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

   (I) represents net operating losses that were properly attributed to the member under Section 3.A.vii(b) below if the member was part of a separate combined group when the losses were created;

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

   (III) has not been used to offset income of any taxpayer;

   (IV) would not be subject to limitations as to the amount or use applicable under any provision of the Internal Revenue Code or federal regulations, or would not be subject to such limitations applied as if the combined group was the consolidated group; and

   (V) is not otherwise not limited by state law; minus
(3) The net operating loss carryover of a member of the combined group attributed to that member under Section 3.A.vii.(c) below, that has not been used to offset income and is not otherwise limited by state law as of the date that member is no longer part of the combined group.

(b) If the combined group net operating loss carryover must be attributed to particular members of the group for purposes of determining limitations applicable to the amount or use of the net operating loss carryover under this Section 3.A.vii, then this will be done by multiplying the combined group net loss generated for any applicable year times a fraction the numerator of which is the separate entity net loss of the member for that year, if any, and the denominator of which is the total separate entity net losses for all the members of the combined group that had net losses for that year. A member’s separate entity net loss will be determined as follows:

(1) The amount of combined group ordinary apportionable income determined under Section 3.A.ii multiplied times the member’s separate entity apportionment factor as determined under Section 3.B; plus

(2) The amount of any combined group net gain determined under Section 3.A.iv. multiplied times the member’s separate entity apportionment factor as determined under Section 3.B; plus or minus

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

(4) Any adjustments to properly reflect the member’s separate entity loss.

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

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

viii. Application of state tax credits.

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

(1) The amount of combined group ordinary apportionable income
determined under Section 3.A.ii multiplied times the member’s separate entity
apportionment factor as determined under Section 3.B; plus

(2) The amount of any combined group net gain determined under
Section 3.A.iv. multiplied times the member’s separate entity apportionment
factor as determined under Section 3.B; plus or minus

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

(4) Any adjustments to properly reflect the member’s separate entity
loss; multiplied by

(5) The applicable tax rate.

B. Allocation and apportionment.

i. Allocation and apportionment.

Unless otherwise provided in this Act, [reference to state allocation and apportionment
statute] determines how income or loss, or items making up income or loss, are allocated and
apportioned to this state.

ii. Combined group apportionment factor.

The combined group apportionment factor is a percentage determined under [reference
to state allocation and apportionment statute] where the numerator of the factor[s] includes
amounts sourced to the state for the combined group’s unitary business, regardless of the
separate entity to which those factors may be attributed, and the denominator of the factor[s]
includes amounts associated with the combined group’s unitary business wherever located.
iii. Separate entity apportionment factor.

The separate entity apportionment factor for a member of the combined group is a percentage determined under [reference to state allocation and apportionment statute] where the numerator of the factor[s] includes amounts sourced to the state for the member, and the denominator of the factor[s] includes amounts associated with the combined group’s unitary business wherever located.

iv. If the combined group or a member of the group holds a partnership interest from which it derives apportionable income, the share of partnership apportionment factor[s] to be included in the apportionment factor[s] of the group or member is determined by multiplying the partnership’s factor[s] by a ratio the numerator of which is the amount of the distributive share of the partnership’s apportionable income included in the income of the combined group or member, and the denominator of which is the amount of the partnership’s total apportionable income.