



MULTISTATE TAX COMMISSION

MEMORANDUM

To: Combined Reporting Model – Finnigan Work Group

From: Helen Hecht – MTC General Counsel

Subject: Proposed Simplified Provisions for Computing Income and Loss of Foreign Operations not Included in a Federal Consolidated Return

Date: October 14, 2019

BACKGROUND

The work group has been considering provisions in the original and proposed model (Section 3.C.(ii)), which provide how foreign operations that are not included in a federal consolidated return should compute their income and loss when filing as part of a combined return. This would happen, for instance, when the foreign operation does not meet the model's 80/20 rule, or when the tax haven provisions apply, or when the taxpayer files on a worldwide combined basis.

The provisions included in the original model, and that are being discussed, apparently derived from California regulations. It also appears that those regulations reflect California's need to specify the federal provisions that would otherwise govern the calculation of income in this circumstance (the tax accounting and exchange rate provisions) and to provide more detail about the way in which income and loss—often denominated in foreign currencies and accounted for differently—will be treated.

The work group asked staff to consider whether the provisions in the model might be simplified. To that end, staff reviewed and summarized the existing state rules that are similar, including current California regulations. (See attached chart which compares these state rules to the model language.)

PROPOSAL

Using primarily Massachusetts, Idaho, and Vermont rules—which are similar to but somewhat simpler than the model rules—the following is the proposed revision of the model provisions (with some previously reviewed, minor, non-substantive changes not noted):

(a) 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 total income of the combined group is the taxable income for the corporation after making appropriate adjustments under [state tax code provisions for adjustments to taxable income].

(b) (1) For any member not included in Section 3.C.ii.(a), the income or loss to be included in the total income of the combined group is determined ~~as follows:~~



~~(A) 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.~~

~~(B) The profit and loss statement must be adjusted 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.~~

~~(C) The profit and loss statement must be adjusted to conform it to the tax accounting standards required by the [state tax code]~~

~~(D) 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, must be translated into the currency in which the parent company maintains its books and records.~~

~~(E) Income apportioned to this state must be expressed in United States dollars.~~

from a profit and loss statement prepared for that member in the currency in which its books of account are regularly maintained, provided this profit and loss statement is subject to 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 or [state] tax law. Income 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. The income 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.

~~(2) In lieu of the procedures set forth in Section 3.C.ii.(b)(1), above, and subject to the determination of the Director that it reasonably approximates income as determined under [the State tax code], the combined group may determine the income for any member not included in Section 3.C.ii.(a) on the basis of the consolidated profit and loss statement which includes the member and which is prepared for filing with the Securities and Exchange Commission by related corporations. If the member is not required to file with the Securities and Exchange Commission, the Director may allow the use of the consolidated profit and loss statement prepared for reporting to shareholders and subject to review by an independent auditor. If above statements do not reasonably approximate income as determined under [the State tax code] the Director may accept those statements with appropriate adjustments to approximate that income or in any case where it is necessary to fairly and consistently reflect the income and apportionment factors of foreign operations included in the unitary business, the [Director] may provide for other procedures to reasonably approximate the income and apportionment factors of members with foreign operations.~~

