

**Multistate Tax Commission**

**Draft Model Statute for Combined Reporting** – **Finnigan Approach**

April 9, 2019 Discussion Draft with Staff Changes

NOTE: The working group met by phone on April 9, 2019 and discussed the draft model as of April 9. Staff then began reviewing the model for a few final issues—including conforming the draft (to a degree) to our current drafting rules. In that process, staff determined that language to clarify could be added in places (with some moving of provisions) and that additional language should be added in light of the work group’s discussion of the sharing of NOLs. There were also a small handful of what are substantive changes.

The following draft includes the conforming changes, which are not redlined. These include, for example, not using “shall be,” proper use of “which” and “that,” being careful with the use of “any,” numbering, etc. The clarifying language and additional language is marked in red line, along with explanatory comments. The substantive changes are redlined, with comments, and highlighted in yellow.

**Section 1. Definitions.**

1. “Person” means an individual, firm, partnership, general partner of a partnership, limited liability company, registered limited liability partnership, foreign limited liability partnership, association, corporation (whether or not the corporation is, or would be if doing business in this state, subject to [state income tax act]), company, syndicate, estate, trust, business trust, trustee, trustee in bankruptcy, receiver, executor, administrator, assignee, or organization of any kind
2. “Taxpayer” means a person subject to the tax imposed by [state corporate income tax act].
3. “Corporation” means a 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 business conducted by a partnership that is directly or indirectly held by a corporation is the business of the corporation to the extent of the corporation’s distributive share of the partnership income, inclusive of guaranteed payments to the extent prescribed by regulation.
4. “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.
5. “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.
6. “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. [Drafter’s note: This portion of the definition is drafted to follow MTC Reg. IV.1.(b)., defining a “unitary business.” A state that does not wish to define unitary business in this manner should consider alternative language. In addition, this MTC Regulation defining unitary business includes a requirement of common ownership or control. A state which treats ownership or control requirements separately from the unitary business requirement will need to make additional amendments to the statutory language.] Business conducted by a partnership is treated as conducted by its partners, whether directly held or indirectly held through a series of partnerships, to the extent of the partner’s distributive share of the partnership’s income, regardless of the percentage of the partner’s ownership interest or the percentage of its distributive or any other share of partnership income.

A business conducted directly or indirectly by one corporation is unitary with that portion of a business conducted by another corporation through its direct or indirect interest in a partnership if the conditions of the first sentence of this section 1.F. are satisfied, to wit: there is a synergy, and exchange and flow of value between the two parts of the business and the two corporations are members of the same commonly controlled group.

1. “” “Combined group” means the group of all persons that must file a combined report as required by Section 2.A. or 2.B, including a group properly making an election under Section 4.
2. “Combined report” means a tax return for the combined group containing information as provided in [this Act] or required by the [Director].
3. “United States” means the 50 states of the United States, the District of Columbia, and United States’ territories and possessions.
4. “Tax haven” means a jurisdiction that, during the tax year in question has no or nominal effective tax on the relevant income and:
	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 regime that lacks 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;
	4. explicitly or implicitly excludes the jurisdiction’s resident taxpayers from taking advantage of the tax regime’s benefits or prohibits enterprises that benefit from the regime from operating in the jurisdiction’s domestic market; or
	5. has created a tax regime that 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. Requirement to File a Combined Report.**

1. A taxpayer engaged in a unitary business with one or more other corporations shall file a combined report that includes the income, apportionment factors, and other information as required by the [Director] for all corporations that are members of the unitary business, or if a proper election is made under Section 4, for all corporations that are part of the water’s-edge group. ’
2. The [Director] may, by regulation, require the combined report to include the income and associated apportionment factors of 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 the entire unitary business. Authority to require combination by regulation under this Section 2.B. includes authority to require combination of persons that are not, or would not be if doing business in this state, subject to the [state income tax act].

In addition, if the [Director] determines that the reported income or loss of a taxpayer engaged in a unitary business with a person not included pursuant to Section 2.A. represents an avoidance or evasion of tax by such taxpayer, the [Director] may, on a case by case basis, require all or part of the income and associated apportionment factors of such person be included in the taxpayer’s combined report.

With respect to inclusion of associated apportionment factors pursuant to Section 2.B., the [Director] may require the exclusion of one or more of the factors, the inclusion of one or more additional factors that will fairly represent the taxpayer’s business activity in this State, or the employment of any other method to effectuate a proper reflection of the total amount of income subject to apportionment and an equitable allocation and apportionment of the taxpayer’s income to this state.

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

The combined group shall compute its taxable income or loss as provided in this Section 3.

**A.** The combined group’s apportionable income or loss shall be the aggregate amount of income or loss of each member of the combined group derived from a unitary business as calculated in this Subsection. A. Except as otherwise provided in this Subsection A, the apportionable net income or loss of each member shall be computed after the elimination of intercompany transactions following applicable principles set forth in the Treasury regulations promulgated under Section 1502 of the Internal Revenue Code, including the principles relating to deferrals, eliminations, and exclusions, to the extent consistent with the [state] combined group membership and the unitary business principle. Upon the occurrence of either of the following events, deferred business income resulting from an intercompany transaction among members of a combined group is restored to the income of the seller and is included in the combined group’s apportionable net income as if the seller had earned the income immediately before the event: (a) The object of a deferred intercompany transaction is: (i) resold by the buyer to an entity that is not a member of the combined group, (ii) resold 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 (iii) 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.

**(1)** For a member incorporated in the United States and included in a consolidated federal corporate income tax return or filing a separate federal corporate income tax return, the member’s income or loss to be included in calculating the combined group’s apportionable net income is determined as follows:

**(a)** Taking the member’s federal taxable income or federal operating loss before special deductions and before any NOL deduction, but after eliminating intercompany transactions;

**(b)** Making adjustments as required by [reference to state statutory provisions requiring adjustments to federal income];

**(c)** Subtracting gains or losses subject to paragraph (4) of this Subsection; and

**(d)** Subtracting any non-apportionable net income or loss. “”.

**(2)** For a member that is either not incorporated in the United States or is not required to file a federal corporate income tax return, the income or loss to be included in the combined group’s apportionable net income or loss is determined from a profit and loss statement prepared in the currency in which the books of account of the member are regularly maintained, adjusted to conform it to the accounting principles generally accepted in the United States for the presentation of such statements and further adjusted to take into account book-tax differences required by federal or [state] law. The profit and loss statement of the member and the apportionment factors related theretomust be translated into or from the currency in which the parent company maintains its books and records on any reasonable basis consistently applied on a year-to-year or entity-by-entity basis. Income must be expressed in United States dollars. In lieu of these procedures and subject to the determination of the [commissioner] that the income to be reported reasonably approximates income as determined under this chapter, income may be determined on a reasonable basis consistently applied on a year-to-year or entity-by-entity basis. The income or loss of a member subject to this Paragraph 3.(A)(2) must also reflect the elimination of intercompany transactions as provided in Subsection 3.(A) and adjustments as provided in [reference to state statutory provisions requiring adjustments to federal income]. The income or loss of the member to be included in the combined group’s apportionable net income or loss must also exclude gains or losses subject to paragraph (4) of this Subsection and must also exclude non-apportionable net income or loss.

**(3)** If the combined group has unitary business income or loss from an entity that is treated as a pass-through entity, the combined group’s apportionable net income or loss includes its member’s direct and indirect distributive share of the pass-through entity’s unitary business income or loss.

 **(4)** All dividends paid by one member of the combined group to another member of the combined group included on the same combined report shall, 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, be are eliminated from the income of the recipient. This provision shall does not apply to dividends received from members of the unitary business which are not included as part of the same combined report, or dividends for which a dividends-paid-deduction has been claimed and allowed.

**(5)** A charitable expense incurred by a member of a combined group, to the extent allowable as a deduction pursuant to Section 170 of the Internal Revenue Code, is subtracted first from the combined group’s apportionable net income, subject to the income limitations of said section applied to the entire business income of the group. All or part of a charitable deduction disallowed under the foregoing rule, but allowed as a carryover deduction in a subsequent year, is treated as originally incurred in the subsequent year by the same member and the rules of this section apply in the subsequent year in determining the allowable deduction for that year.

**(6)** Gain or loss from the sale or exchange of 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 income or loss of each member of a combined group and shall be included in the combined group’s apportionable income or loss to the extent such income or loss is derived from the unitary business as follows: (a) For each class of gain or loss, whether short-term capital, long-term capital, Section 1231 of the Internal Revenue Code gain or loss, or gain or loss from involuntary conversions, all members’ business gain and loss for the class are combined, without netting among such classes, and each class of net business gain or loss is apportioned to each member under subsection (B) of this section; and (b) Any resulting income or loss apportioned to this state, as long as the loss is not subject to the limitations of Section 1211 of the Internal Revenue Code, of a taxable member produced by the application of subparagraph (a) of this subdivision is then be applied to all other income or loss of that member apportioned to this state. Any resulting loss of a member apportioned to this state that is subject to the limitations of Section 1211 is carried forward by that member and is treated as short-term capital loss apportioned to this state and incurred by that member for the year for which the carryover applies.

**(7)** An expense of any member of the combined group that is directly or indirectly attributable to the income of a member of the combined group which is non-apportionable, exempt from taxation by this state, or which income this state is prohibited from taxing pursuant to the laws or Constitution of the United States, is disallowed as a deduction for purposes of determining the combined group’s apportionable income or loss.

**(8)** The combined group’s apportionable net income or loss shall be apportioned to this state using the combined group’s apportionment factor as calculated under Subsection D of this Section.

**B.** The amount of income or loss apportioned to this state by the combined group is adjusted by the total amount of income or loss allocated to this state pursuant to [state allocation and apportionment rules].

**C.** The combined group is allowed a net operating loss deduction from the amount of income apportioned or allocated to this State under Subsections A and B, and is allowed a tax credit against the state tax owed, as provided in this Subsection C.

 **(1)** The combined group must attribute losses apportioned or allocated to this state in any tax year to the members of the group as follows:

**(a)** To each member of the group that had a loss under Subsections A(1) or (2), the portion of the group loss determined by multiplying that loss by a fraction, the numerator of which is the member’s loss, and the denominator of which is the total loss of all the members that had losses; plus

**(b)** To each member of the group that had a nonapportionable loss allocated to this state, but only to the extent that such loss contributed to the total combined group loss reported to the state in that year.

In no case shall members be attributed total losses under this Paragraph (1) in excess of the loss reported to this state by the combined group in the tax year.

**(2)** The combined group available net operating loss carryover in any tax year is:

 **(a)** The total net operating losses of the combined group allocated or apportioned to the state in past years to the extent such losses have not been used to offset income of the group or are not otherwise limited by state law; plus

 **(b)** The net operating losses of a member of the group created before that member became a part of the group, but only to the extent such losses:

**(i)** would not be subject to limitations applicable to those losses under any provision of the Internal Revenue Code or applicable federal regulations if the member were joining a federal consolidated filing group;

**(ii)** were properly allocated or apportioned to this state in the year created;

**(iii)** were properly attributed to the member under Paragraph (1) if the member was part of a separate combined group when the losses were created;

**(iv)** have not been used to offset income of any taxpayer; and

**(v)** are not otherwise limited by state law; minus

 **(c)** The net operating losses of a member of the combined group attributed to that member under Paragraph (1) or brought into the group under Subparagraph (b) above that have not been used to offset income and are not otherwise limited by state law, as of the date that member is no longer part of the combined group.

For purposes of this Paragraph (2), the losses of combined group members are deemed to have been used to offset income through the deduction allowed in Paragraph (3) by applying a pro-rata reduction to the losses of all combined group members in each year, starting with the earliest year.

**(3)** The combined group may take a net operating loss deduction against income allocated or apportioned to this state in a tax year under this Subsection 3 to offset such income, in whole or in part, to the extent the group has an available net operating loss carryover in that year.

(4) Unless otherwise provided, a tax credit granted to a person that is a member of a combined group and that is otherwise available and unlimited may be used to offset the tax liability of that group regardless of whether the credit was granted when the person was a member.

**D**. Calculation of Apportionment Factors for Combined Group

A combined group shall use an apportionment formula that combines the [property, payroll, and receipts] of the members in calculating the factors.

**(1)** The receipts factor is a fraction, the numerator of which is the total sales of the members of the combined group in this State during the tax period, and the denominator of which is the total sales of the members of the combined group everywhere during the tax period.

For purposes of determining whether receipts are in this state and included in the numerator of the receipts factor, all receipts of the combined group properly assigned to this state under this section are included in the receipts factor numerator for this state if any member of the combined group is taxable in this state. In addition, a taxpayer is considered taxable in another state for purposes of calculating the receipts factor if any member of the combined group is taxable in that state.

**(2)** The property factor is a fraction, the numerator of which is the average value of the all the combined group’s real and tangible personal property owned or rented and used in this State during the tax period, and the denominator of which is the average value of the combined groups’ real and tangible personal property owned or rented and used everywhere during the tax period.

**(3)** The payroll factor is a fraction, the numerator of which is the total payroll of the members of the combined group paid in this State during the tax period, and the denominator of which is the total payroll of the members of the combined paid group everywhere during the tax period.

**(4)** Single return. The combined group must file a single return on which the aggregate [state] income tax liability of members of the combined group is reported. The single return must be filed under the name and federal employer identification number of the parent corporation if the parent is a member of the combined group. If there is no parent corporation, or if the parent is not a group member, the members of the combined group must choose a member to file the return. The filing member must remain the same in subsequent years unless the filing member is no longer the parent corporation or is no longer a member of the combined group. The return must be signed by a responsible officer of the filing member on behalf of the combined group members. The [state] combined report of the combined group must be attached to the [state] corporate income tax return. Members of the combined group are jointly and severally liable for the tax liability of the members of the combined group included in the combined return.

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

**A. Water’s-edge election.**

Subject to the requirements of Section 4.B., the combined group may elect to determine its apportioned business income or loss pursuant to a water’s-edge election. Under such election, the combined group 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 Sections 2 and 3, as described below:

**(1)** The entire income and apportionment factors of a 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;

**(2)** The entire income and apportionment factors of a member, regardless of the place where incorporated or formed, if the average of its property, payroll, and sales factors within the United States is 20 percent or more;

**(3)** The entire income and apportionment factors of a member that is a domestic international sales corporation as described in Internal Revenue Code Sections 991 to 994, inclusive; a foreign sales corporation as described in Internal Revenue Code Sections 921 to 927, inclusive; or a member that is an export trade corporation, as described in Internal Revenue Code Sections 970 to 971, inclusive;

**(4)** A member not described in Paragraphs (1)-(3) of this Subsection 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;

**(5)** A member that is a “controlled foreign corporation,” as defined in Internal Revenue Code Section 957, to the extent of the income of that member that is defined in Section 952 of Subpart F of the Internal Revenue Code (“Subpart F income”) not excluding lower-tier subsidiaries’ distributions of such income which were previously taxed, determined without regard to federal treaties, and the apportionment factors related to that income; an item of income received by a controlled foreign corporation is excluded if 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 Internal Revenue Code Section 11;

**(6)** A member that earns more than 20 percent of its income, directly or indirectly, from intangible property or service related activities that are deductible against the apportionable income of other members of the combined group, to the extent of that income and the apportionment factors related thereto; and

**(7)** The entire income and apportionment factors of a member that is doing business in a tax haven, where “doing business in a tax haven” is defined as being engaged in activity sufficient for that tax haven jurisdiction to impose a tax under United States constitutional standards. If the member’s business activity within a tax haven is entirely outside the scope of the laws, provisions and practices that cause the jurisdiction to meet the criteria established in Section 1.I., the activity of the member is treated as not having been conducted in a tax haven.

**B. Initiation and withdrawal of election**

**(1)** A water’s-edge election is effective only if made on a timely-filed, original return for a tax year by the combined group. 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.

**(2)** Such election constitutes consent to the reasonable production of documents and taking of depositions in accordance with [state statute on discovery].

**(3)** 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 a 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 substantial objective of avoiding state income tax.

**(4)** A water’s-edge election is binding for and applicable to the tax year it is made and all tax years thereafter for a period of 10 years. It may be withdrawn or reinstituted after withdrawal, prior to the expiration of the 10-year period, 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. Upon the expiration of the 10-year period, a combined group may withdraw from the water’s-edge election. Such withdrawal must be made in writing within one year of the expiration of the election, and is binding for a period of 10 years, subject to the same conditions as applied to the original election. If no withdrawal is properly made, the water’s edge election remains in place for an additional 10-year period, subject to the same conditions as applied to the original election.