



## **Model Statute for Combined Reporting – “Finnigan Method” Adopted August 4, 2021**

### **Section 1. Definitions.**

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

**B.** “Combined return” means a tax return required to be filed for the combined group containing information as provided in [this Act] or required by the [Director].

**C.** “Corporation” means an 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.”

**D.** “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.

**E.** “Partnership” means an organization of any kind treated as a partnership for tax purposes under the laws of this state.

**F.** “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 [reference to state income tax act]), company, syndicate, estate, trust, business trust, trustee, trustee in bankruptcy, receiver, executor, administrator, assignee, or organization of any kind. For purposes of the [reference to state corporate income tax act] “person” also means a combined group. *[DRAFTER’S NOTE: The state may have a definition of “person” that it wishes to reference here. What is important is that the model relies on the inclusion of the combined group in the definition of “person.” See also the definition of “taxpayer” below.]*

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

**i.** has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime;

**ii.** 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;

iii. 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;

iv. 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

v. 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 or other services sector relative to its overall economy.

**H.** “Taxpayer” means a person subject to the tax imposed by [reference to state corporate income tax act].

*[DRAFTER’S NOTE: The tax imposition sections of the state code should be clear that tax is imposed on the combined group or corporations as part of a combined group.]*

**I.** “Unitary business” means a single economic enterprise 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. A unitary business includes that part of the business that meets the definition in this Section 1.I. and is conducted by a taxpayer through the taxpayer’s interest in a partnership, whether the interest in that partnership is held directly or indirectly through a series of partnerships or other pass-through entities.

*[DRAFTER’S NOTE: This definition follows the MTC Model General Allocation and Apportionment Regulations, Sec. IV.1.(b), defining a “unitary business.” Reg. Sec. IV.1.(b). includes a definition of a “commonly controlled group.” A state which treats ownership or control requirements separately from the unitary business requirement will need to make additional amendments to the statutory language. A state that does not wish to define unitary business in this manner should consider alternative language.]*

**J.** “United States” means the 50 states of the United States, the District of Columbia, and United States’ territories and possessions.

**Section 2.** Requirement to file a combined return; joint and several liability.

**A.** Except as provided in Section 4, all the corporations, wherever incorporated or domiciled, that are members of a unitary business shall file a combined return as a combined group. That return must include the income and apportionment factors, determined under Section 3, and other information required by the [Director] for all members of the combined group wherever located or doing business. The combined 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 shall 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. Members of the combined group are jointly and severally liable for the tax liability of the combined group included in the combined return.

**B.** The [Director], by regulation, may require that the combined return 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 the income and associated apportionment factors of persons that are not subject to the [state income tax act], or would not be subject to the [state income tax act] if doing business in this state.

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., or pursuant to an election under Section 4, 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 return.

With respect to inclusion of associated apportionment factors pursuant to this 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.

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

**A.** The combined group calculates its state taxable net income as provided in this Section 3.A.

**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.i.(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

**(b)** 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: The treatment of capital gains and losses in this model conforms generally to the treatment of such attributes under federal consolidated filing rules. 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. If a state declines to follow the provisions of this section, it is recommended that language eliminating the use of capital loss carryforwards for entities joining the combined filing or leaving the combined filing group.]*

**(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 net capital loss carryover], but only to the extent that the amount or use of such capital loss carryover is not subject to limitations under any provision of the Internal Revenue Code or applicable federal regulations, or would not be subject to such limitations applied as if the combined group was the consolidated group.

**(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; then adding any nonapportionable gains and subtracting any losses allocated to the state that were generated by that member.

**(II)** 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.

**(III)** 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 a member of the combined group holds a partnership interest from which it derives apportionable income, the share of the partnership’s apportionment factor[s] to be included in the apportionment factor[s] of the group is determined by multiplying the partnership’s factor[s] by a ratio the numerator of which is the amount of the partnership’s apportionable income properly included in the member’s income, whether received directly or indirectly, and including any guaranteed payments, and the denominator of which is the amount of the partnership’s total apportionable income. If a member of the combined group directly or indirectly receives an allocation of a partnership tax item, such as an item of loss or expense, so that it is not possible to determine the member’s share of apportionable income, the [Director] may provide rules for inclusion of particular partnership factors, or portions of factors, in the combined group’s factors.

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

**A. Water’s-edge election.**

Members of a unitary group that meet the requirements of Section 4.B. may elect to file as a combined group pursuant to a water’s-edge election. Under such election, the combined group takes 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 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;

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

**iii.** the entire income and apportionment factors of a member which is a domestic international sales corporations 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 which is an export trade corporation, as described in Internal Revenue Code Sections 970 to 971, inclusive;

**iv.** for a member not described in Section 4.A.i. to Section 4.A.iii., inclusive, 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.** for a member that is a “controlled foreign corporation,” as defined in Internal Revenue Code Section 957, include income 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; any 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;

**vi.** for 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, include the related income and the apportionment factors; and

**vii.** 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.JI., the activity of the member shall be treated as not having been conducted 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 the members of the unitary business. The Director shall develop rules and regulations governing the impact, if any, on the scope or application of a water’s-edge election, including the procedures for election and termination or deemed election, resulting from a change in the composition of the unitary group, the combined group, the members, and any other similar change.

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

**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 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.

**iv.** 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 reinstated 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, the members of 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 will be in place for an additional 10 year period, subject to the same conditions as applied to the original election.

**C. Effect of water’s edge election on excluded entities.**

The election under this Section 4 has no effect on whether entities that are excluded from the water’s edge combined group may be separately liable for tax under [the state income tax act]. Entities subject to the state tax must separately file and pay tax in the state.

*[DRAFTER’S NOTE: In addition to allowing an election to file a group return on a unitary domestic basis (“water’s edge”), many states offer a group filing election based on inclusion in the taxpayer’s federal consolidated return (“federal consolidated filing”) or based on common ownership and control of domestic corporations (“affiliated group filing”). These filing methods*

*have the advantage of eliminating controversy and uncertainty about the proper make-up of the filing group occasioned by the model’s reliance on the unitary business principle. States must still establish policies and procedures for determining the group’s income tax base, treatment of tax attributes and apportioning the tax base. Because the filing group may include the incomes, losses and apportionment factors of non-unitary entities, states should consider an explicit provision providing for the full apportionment of all of the group’s income. The absence of a consolidated or affiliated group filing election in this model should not be construed as a rejection of either election as a policy matter.]*