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# State Tax Return

## Combined Reporting on the Move: Recent Proposals and Legislation

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As states increasingly seek to meet budgetary shortfalls, many have proposed mandatory unitary combined reporting as a means to compensate for lost revenue. While legislatures differ in their enthusiasm for adopting combined reporting<sup>1</sup> and in the rules they would apply,<sup>2</sup> many states are moving forward with legislation that would implement some form of combined reporting or changes to their existing combined reporting schemes. The Council On State Taxation (COST) has taken a stance against such legislation, arguing that mandatory unitary combined reporting “arbitrarily assigns income to a State, negatively impacts the real economy, has an unpredictable [effect] on State revenue and imposes significant administrative burdens on both the taxpayer and State.”<sup>3</sup> Nevertheless, while mandatory combination remains controversial, it clearly is squarely in state legislators’ sights, especially as they struggle to deal with strained budgets. What follows here is a state-by-state summary of recent and proposed legislation addressing combination.

### California

California AB 1178,<sup>4</sup> now before the California State Senate, would expand California's unitary combined reporting to require any multinational corporation that has made a water's-edge election to include in its California combined report the income and apportionment factors of any affiliated corporation that does business in, or derives income from or attributable

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<sup>1</sup> John Buhl, *Outlook for Combined Reporting Differs in Pennsylvania and Tennessee*, 2010 STT 35-1 (2/13/2010).

<sup>2</sup> For the 2008 Georgetown State Tax Institute, *STR* contributors Charolette Noel and Carolyn Joy Lee examined whether the states might adopt a uniform approach to combination. Thousands of words later, the conclusion was clear: No! The recent legislative proposals reported here continue that tradition of diversity in states' approaches to combination.

<sup>3</sup> COST, *Mandatory Unitary Combined Reporting: Policy Position 1* (2008).

<sup>4</sup> AB 1178, 2009–10 Leg., Reg. Sess. (Cal. 2010).

to, a tax haven.<sup>5</sup> This proposal would be effective for tax years beginning on or after July 1, 2011, and before July 1, 2014. The bill was referred to the Senate Commission on Revenue and Taxation on February 11, 2010.

### **Connecticut**

Connecticut HB 5179<sup>6</sup> calls for the seemingly unconstitutional mandate that “the general statutes be amended to require corporations to report their income together with all other associated corporations and pay their corporate income taxes based on the greater of these ‘unitary’ reports or their liability as separate corporations,” but contains no statutory language beyond this statement. The bill was referred to the Joint Committee on Finance, Revenue and Bonding on February 11, 2010.

### **Delaware**

Delaware HB 297,<sup>7</sup> passed and signed into law on January 26, 2010, reaffirmed and made technical corrections to existing required consolidated reporting on franchise tax. This legislation would be effective retroactive to January 1, 2006.

### **Iowa**

Iowa SSB<sup>8</sup> 3122 requires the net income of affiliated groups of corporations engaged in a unitary business to be computed on a combined return basis for corporate tax purposes. Affiliated groups must meet the requirements for filing a consolidated federal return. All unitary affiliates would be required to combine, unless exempt from tax under Iowa Code § 422.34. Iowa taxable income would be calculated by applying federal consolidated return principles, including those for intercompany transactions. The group would be treated as a single unit, with a single apportionment factor applied to the combined income. The bill would include in the apportionment numerator only sales by companies subject to Iowa corporate tax under Iowa Code § 422.33. Joint and several liability for the group’s tax would be limited to corporations doing business and taxable in Iowa. The bill would apply retroactively to January 1, 2010, for tax years beginning on or after that date. At press time, this bill is currently before the Iowa Senate Ways and Means Committee.

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<sup>5</sup> “Tax haven” is defined as any jurisdiction identified in Table 1 of Appendix I to the December 2008 Report of the U.S. Government Accountability Office on International Taxation (GAO-09-157) for which a U.S. district court order granted leave for the IRS to serve a “John Doe” summons, as that list may be amended from time to time. The Franchise Tax Board would issue annual notices of “tax havens.”

<sup>6</sup> HB 5179, 2010 Leg., Feb. Sess. (Conn. 2010).

<sup>7</sup> 77 Del. Laws, c. 216 (2010).

<sup>8</sup> Study bills are used to determine reception of an issue by the Iowa General Assembly. They are developed under committee sponsorship for committee consideration. Should a study bill attain committee approval, it would be introduced with the committee as its sponsor, receive a Senate or House file number, and be eligible for debate on the floor of the chamber of introduction.

## Maryland

Maryland currently has two substantially identical bills pending, one before its House (HB 584<sup>9</sup>) and one before its Senate (SB 354<sup>10</sup>), to address combined reporting for unitary affiliated corporations. (The bills reference the MTC regulations for the definition of “unitary.”) The proposals would apply to corporations under common ownership and control, as measured by more than 50 percent of voting stock, that engage in a unitary business. The group would include all affiliates that are taxable in Maryland, or that would be taxable if doing business in the state, as well as other unitary affiliates where combination is clearly necessary to reflect income or prevent tax avoidance. Intercompany transactions are to be “disregarded” in calculating group income. Apportionment is a two-step process under these bills. First, the combined property, payroll, and sales factors are determined, again disregarding intercompany transactions. Then each member allocates a portion of the group’s income to that corporation under a formula that compares a single corporation’s Maryland factors to all members’ Maryland factors. The bills also propose a water’s-edge election. In hearings before the Senate Budget and Taxation Committee on February 24, 2010, and the Maryland House Ways and Means Committee on February 25, opponents of the bills urged that a final decision on combined reporting be postponed until after the release of a report by the Maryland Business Tax Reform Commission on the effects of such legislation.<sup>11</sup>

## New Mexico

New Mexico is considering three nearly identical proposals to mandate (rather than allow elections of) combined reporting. New Mexico HB 62,<sup>12</sup> HB 215,<sup>13</sup> and SB 90<sup>14</sup> would require combined returns for “unitary corporations.” The combined return would “include the net income of all the unitary corporations.” HB 62 and SB 90 would provide an exception for unitary corporations whose principal business is manufacturing and which have not previously filed on a combined basis in New Mexico, continuing the current electivity of combination for these corporations. HB 62, HB 215, and SB 90 were introduced in the New Mexico House of Representatives and Senate on January 20, 28, and 25, 2010, respectively. HB 62 and HB 215 are currently before the House Business and Industry Committee; SB 90 is before the Senate Corporations and Transportation Committee.

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<sup>9</sup> HB 584, 2010 Leg., Reg. Sess. (Md. 2010).

<sup>10</sup> SB 354, 2010 Leg., Reg. Sess. (Md. 2010).

<sup>11</sup> Karen Setze, *Maryland House Panel Hears Testimony on Combined Reporting Measure*, 2010 STT 38-6 (2/26/2010); Karen Setze, *Maryland Senate Panel Debates Whether to Act on Combined Reporting*, 2010 STT 37-12 (2/25/2010).

<sup>12</sup> HB 62, 49th Leg., Reg. Sess. (N.M. 2010).

<sup>13</sup> HB 215, 49th Leg., Reg. Sess. (N.M. 2010).

<sup>14</sup> SB 90, 49th Leg., Reg. Sess. (N.M. 2010).

## Pennsylvania

The Pennsylvania Governor has proposed lowering the state's overall corporate income tax rate while implementing unitary combined tax returns and single sales factor apportionment of income.<sup>15</sup>

## Rhode Island

Rhode Island SB 2272<sup>16</sup> is a fairly detailed bill that would require combined reporting for corporations engaged in a unitary business and provide regulatory discretion to require the combination of other unitary "persons" where necessary to reflect apportionment properly or prevent tax avoidance. A 10-year water's-edge election is also proposed, subject to the director's discretion to override the election where an excluded person has been availed of the substantial objective of avoiding state income tax. "Unitary business" is defined in the bill as "a single economic enterprise" consisting of one or more entities "that are sufficiently interdependent, integrated and interrelated" to produce "a significant flow of value" among them. The bill specifies that combined reporting does not disregard the separate existence of the group members, each member is responsible for tax on its own apportioned income, and NOLs are limited to the corporation generating the loss. The bill excludes intercompany dividends to the extent paid out of the earnings and profits of the unitary business and applies the federal deferred intercompany transaction rules, treating any conversion of an asset to use outside the unitary business as an event triggering any deferred-tax incidents. The bill was introduced in the Rhode Island Senate on February 11, 2010, and referred to Senate Finance.

## Virginia

Virginia HB 1122<sup>17</sup> would have revised the apportionment of income for manufacturers by removing language that required manufacturers using a single sales factor apportionment formula to pay additional taxes and penalties if they did not reach certain hiring metrics. This bill would have deleted language that required such manufacturers to pay additional taxes, interest, and penalties if they had fewer jobs on their payrolls than they had during the "baseline year," the year in which they switched to this alternative apportionment formula. The Virginia House of Delegates unanimously passed the bill on February 16, 2010, and on February 17 it was referred to the Virginia Senate Finance Committee, where it was defeated on March 2. Virginia SB 705<sup>18</sup> would also have required combined reporting for corporate income tax purposes, but on February 16 it was likewise defeated in Senate Finance.

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<sup>15</sup> Joseph Henchman, *Pennsylvania Governor Proposes Spending Boost, Broader Sales Tax, Heavier Business Taxes*, 2010 STT 39-23 (2/25/2010).

<sup>16</sup> SB 2272, 2010 Leg., Jan. Sess. (R.I. 2010).

<sup>17</sup> HB 1122, 2010 Sess. (Va. 2010).

<sup>18</sup> SB 705, 2010 Sess. (Va. 2010).

## West Virginia

West Virginia HB 4240 would authorize the State Tax Department to promulgate rules on combined returns pursuant to the Corporation Net Income Tax.<sup>19</sup> HB 4240 was referred to the House Judiciary Committee on February 12, 2010, after amendment by the House Finance Committee.

## Wisconsin

Last but not least, and bucking the trend, Wisconsin AB 478<sup>20</sup> would *repeal* combined reporting in the state for taxable years beginning after June 30, 2011. The bill has been before the Joint Committee on Finance since October 6, 2009.

States clearly are under pressure to raise revenues. Bringing into their jurisdictions new taxpayers, revenue streams, and apportionment factors that, by dint of corporate structures, have not previously been included in the tax base can appear to be a quick and politically palatable means to plug budget holes. As with apportionment, however, combination can produce winners as well as losers. Perhaps more significantly—especially given the rise of FIN 48 and the importance of provisions for state and local tax exposures—clear rules, as well as elections made binding over fixed terms, offer important simplicity, certainty, and efficiency to businesses doing business across state and foreign boundaries. Uniformity may be beyond hoping for, but clarity should be every legislature's responsibility.



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<sup>19</sup> W. Va. Code §§ 11-24-1 to 11-24-24 (2010).

<sup>20</sup> HB 478, 2009–10 Leg. (Wisc. 2009).