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**In Search of Greener Tax Returns:  
States and Localities Mull Over Combined Reporting and Apportionment Changes**

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In response to ever-widening budget gaps, several state and local legislative bodies have proposed measures that would implement mandatory unitary combined reporting (“MUCR”) or amend their current allocation and apportionment schemes to generate additional tax revenue. We have summarized below some of the states that are considering such changes in their 2011 legislative sessions.

**To MUCR or Not to MUCR?**

While the level of interest shown by state legislatures in adopting MUCR is as diverse as the rules the legislatures would likely apply were they to adopt MUCR, we have noticed a number of states considering adoption of some form of combined reporting (or changes to their existing combined reporting schemes) over the last few years. Taxpayer advocate groups, such as the Council On State Taxation (“COST”), have taken a strong stance against MUCR, arguing that it “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 the State.”<sup>1</sup> While MUCR remains controversial, the current dismal condition of state budgets ensures that MUCR remains front and center of the debate on how to close budget gaps in many states. Summarized below are MUCR proposals in 2011 by jurisdiction.

**Arkansas**

Representative Jim Nickels introduced HB 1495,<sup>2</sup> the so-called “Arkansas Small Business Tax Fairness Act,” on February 22, 2011. The bill would institute MUCR and use the Uniform Division of Income for Tax Purposes Act’s three-factor apportionment method, effective for tax years beginning on or after January 1, 2012. The House Revenue and Taxation Committee amended HB 1495 on March 8, 2011, and conducted a special hearing regarding the engrossed bill on March 10, 2011.

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

<sup>2</sup> H.B. 1495, 88th Gen. Assem., Reg. Sess. (Ark. 2011).

## District of Columbia

In 2009, the D.C. City Council approved enabling legislation for MUCR but has yet to mandate the new reporting method for corporate taxpayers.<sup>3</sup> It is rumored, however, that the City Council may act in the near future.<sup>4</sup>

## Maryland

The Maryland Senate and House of Delegates are each considering identical MUCR proposals, SB 305<sup>5</sup> and HB 731,<sup>6</sup> that would require corporations to compute their Maryland taxable income using MUCR with the current three-factor, double-weighted sales apportionment scheme for tax years beginning after December 31, 2011. The corresponding fiscal and policy note projects revenue gain from the bill to be approximately \$32 million in fiscal year 2012 and \$119–\$134 million in subsequent fiscal years. The Senate Budget and Taxation Committee heard SB 305 on February 23, 2011, but no votes were taken; the House Ways and Means Committee similarly heard HB 731 on March 10, 2011.

## New Mexico

SB 6,<sup>7</sup> pre-filed by Senator Peter Wirth on December 15, 2010, would adopt MUCR by making its current elective unitary combined filing scheme mandatory, effective for tax years beginning on or after January 1, 2012. In a fiscal impact report released on January 28, 2011, the Legislative Finance Committee forecast that, if passed, MUCR “would increase corporate income tax revenues before credits between 5% and 10%.” SB 6 is pending before the Senate Corporations and Transportation Committee, which has yet to act on the proposal. The New Mexico legislature has taken up similar measures in the past several years to no avail and is set to adjourn its regular session on March 19.

## Rhode Island

Rhode Island Governor Lincoln Chafee called for adoption of MUCR in his budget address to the General Assembly on March 8, 2011.<sup>8</sup> Full details of the proposal are forthcoming from the Office of the Governor.

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<sup>3</sup> Sean Craig, *Pending D.C. Combined Reporting Shows the Devil’s in the Details*, Lexis Tax Staff Analysis (Jan. 10, 2011), available at <http://www.lexisnexis.com/Community/taxlaw/blogs/lexistaxstaffanalyses/archive/2011/01/10/pending-d-c-combined-reporting-shows-the-devil-s-in-the-details.aspx> (web sites herein last visited March 11, 2010).

<sup>4</sup> *Id.*

<sup>5</sup> S.B. 305, 2011 Leg., 428th Sess. (Md. 2011).

<sup>6</sup> H.B. 731, 2011 Leg., 428th Sess. (Md. 2011).

<sup>7</sup> S.B. 6, 50th Leg., 1st Sess. (N.M. 2011).

<sup>8</sup> Lincoln D. Chafee, Governor of the State of Rhode Island, *Budget Address: A Path to Prosperity* (Mar. 8, 2011), available at <http://www.governor.ri.gov/budgetaddress>.

## Tennessee

HB 1914<sup>9</sup> and SB 1614,<sup>10</sup> companion bills each titled the “Tennessee Small Business Protection Act,” would mandate MUCR for franchise and excise tax purposes effective January 1, 2012. Specifically, the Act would expand the current combined reporting requirement applicable only to financial institutions by redefining “unitary business” and “unitary group” to mean

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.<sup>11</sup>

The Senate Finance, Ways and Means Committee referred SB 1614 to the Senate Tax Subcommittee on March 8, 2011. Tennessee legislators weighed similar measures last year, but the MUCR bills died in committee.

### Tinkering With Allocation and Apportionment

Much as the momentum seems to have shifted of late towards MUCR, there is a trend in income apportionment towards single-factor apportionment and market-based sourcing. What all these trends appear to have in common is an effort to tax additional revenue streams—largely the sales of multistate companies based outside the state. Summarized below are some of the current proposals with respect to allocation, apportionment, and (in the case of Montana) the water’s-edge election.

## Arizona

Governor Jan Brewer signed HB 2001<sup>12</sup> into law on February 17, 2011. In addition to numerous corporate income tax cuts and a reduction in the corporate income tax rate from 6.968 percent to 4.9 percent by 2018, HB 2001 provides for incrementally increasing the “optional enhanced sales factor formula” available to multistate businesses to 100 percent by 2017.

SB 1552,<sup>13</sup> which has passed in the Senate and been referred to the House, would allow a multistate service provider to elect to apportion service revenues to the location where the customer receives the benefit of the service (as opposed to where the income-producing activity was performed). A “multistate service provider” is a taxpayer that derives more than 85 percent of its sales from services to purchasers who receive the benefit of the service outside Arizona in

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<sup>9</sup> H.B. 1914, 107th Gen. Assem., Reg. Sess. (Tenn. 2011).

<sup>10</sup> S.B. 1614, 107th Gen. Assem., Reg. Sess. (Tenn. 2011).

<sup>11</sup> *Id.*

<sup>12</sup> H.B. 2001, 50th Leg., 2d Spec. Sess. (Ariz. 2011).

<sup>13</sup> S.B. 1552, 50th Leg., Reg. Sess. (Ariz. 2011).

the taxable year of election. Taxpayers would be allowed to terminate their election after five consecutive years but would be required to receive permission from the department to terminate earlier. Taxpayers would make the election and termination on their income tax returns. If passed, SB 1552 would be applicable to tax years beginning on or after December 31, 2010.

## California

Under current law, for taxable years beginning on or after January 1, 2011, most taxpayers may elect to apportion business income to California on the basis of a single-sales-factor formula in lieu of the standard four-factor (with double-weighted sales) formula.<sup>14</sup> SB 116,<sup>15</sup> which has been set for hearing later this month, would eliminate this authorization and instead require these taxpayers to use single-sales-factor apportionment for tax years beginning on or after January 1, 2011. The proposed law change is expected to generate additional tax revenues of \$468 million in 2010-2011 and \$942 million in 2011-2012 for California.<sup>16</sup> Because the bill is expected to result in a tax increase, a two-thirds vote is required for the bill to pass.

## Maryland

SB 800,<sup>17</sup> which has been set for hearing later this month, would require that if the principal place from which a corporation's trade or business is directed or managed is in Maryland, then nonoperational income of the corporation must be allocated to Maryland for income tax purposes to the extent allowed under the United States Constitution. The bill also provides rules for when sales of tangible personal property should be included in the numerator of the sales factor. If passed, SB 800 would be applicable to tax years beginning after December 31, 2010.

## Montana

SB 94,<sup>18</sup> which is currently in committee, would shore up Montana's water's edge provisions by including all domestically incorporated subsidiaries in the water's edge group; including income in the water's edge group that has a federally reportable U.S. source; expanding the list of countries considered tax havens; and preventing income shifting to foreign intangible holding companies. The bill would also allow taxpayers to rescind their water's edge election. If passed, SB 94 would be applicable to tax years beginning after December 31, 2010.

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<sup>14</sup> Certain taxpayers deriving more than 50 percent of their gross receipts from conducting one or more qualified business activities (agricultural, extractive, savings and loan, or banking or financial activities) must apportion business income using a three-factor formula. SB 116 would not affect such taxpayers.

<sup>15</sup> S.B. 116, 2011-12 Leg., Reg. Sess. (Cal. 2011).

<sup>16</sup> See California Governor Brown's Budget Summary for 2011-2012, p. 42.

<sup>17</sup> S.B. 800, 2011 Leg., 428th Sess. (Md. 2011).

<sup>18</sup> S.B. 94, 2011 Leg., 62d Sess. (Mont. 2011).

## Pennsylvania

SB 205<sup>19</sup> would require single-sales-factor apportionment of business income for taxable years beginning after December 31, 2008. The bill is currently in the Senate Finance Committee. The retroactive implications would no doubt be controversial.

## Virginia

SB 1006<sup>20</sup> would amend the manner in which the sales factor is determined, adopting market-based sourcing in place of costs of performance. The fiscal impact statement notes that the change is expected to result in a net revenue gain for Virginia over the long term. While SB 1006 passed the Senate Finance Committee and has been sent to the Joint Legislative Audit and Review Commission, a similar bill in the House, HB 1604,<sup>21</sup> failed to make it out of the House Finance Subcommittee. If ultimately passed, SB 1006 would be effective for taxable years beginning on or after January 1, 2012.

## Conclusion

While for the most part the MUCR proposals outlined above are in their early stages and appear to have garnered little, if any, real traction to date, the general trend towards state adoption of MUCR continues. Although the bills tinkering with allocation and apportionment are less dramatic than the MUCR bills, the allocation and apportionment bills appear to have a greater likelihood of success at this stage. We should expect more of the same to be proposed, and possibly enacted, over the next couple of years—at least until state economies improve.



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<sup>19</sup> S.B. 205, 195th Gen. Assem., Reg. Sess. (Pa. 2011).

<sup>20</sup> S.B. 1006, 2011 Leg., Reg. Sess. (Va. 2011).

<sup>21</sup> H.B. 1604, 2011 Leg., Reg. Sess. (Va. 2011).