

2010 -- S 2272

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STATE OF RHODE ISLAND

IN GENERAL ASSEMBLY

JANUARY SESSION, A.D. 2010

A N A C T

RELATING TO TAXATION – COMBINED REPORTING

Introduced By: Senators C Levesque, Perry, and Pichardo

Date Introduced: February 11, 2010

Referred To: Senate Finance

It is enacted by the General Assembly as follows:

1 SECTION 1. Title 44 of the General Laws entitled "TAXATION" is hereby amended by
2 adding thereto the following chapter:

3 CHAPTER 67

4 COMBINED REPORTING

5 **44-67-1. Definitions.** -- As used in this chapter, the following words and terms shall have
6 the following meanings:

7 (1) "Person" means any individual, firm, partnership, general partner of a partnership,
8 limited liability company, registered limited liability partnership, foreign limited liability
9 partnership, association, corporation (whether or not the corporation is, or would be if doing
10 business in this state, subject to chapter 30 of title 44, company, syndicate, estate, trust, business
11 trust, trustee, trustee in bankruptcy, receiver, executor, administrator, assignee or organization of
12 any kind;

13 (2) "Taxpayer" means and includes any corporation subject to provisions of chapter 44-
14 11;

15 (3) "Corporation" means any corporation as defined by the laws of this state or
16 organization of any kind treated as a corporation for tax purposes under the laws of this state,
17 wherever located, which if it were doing business in this state would be a "taxpayer." The
18 business conducted by a partnership which is directly or indirectly held by a corporation shall be
19 considered the business of the corporation to the extent of the corporation's distributive share of

1 the partnership income, inclusive of guaranteed payments to the extent prescribed by regulation;

2 (4) "Partnership" means a general or limited partnership, or organization of any kind
3 treated as a partnership for tax purposes under the laws of this state;

4 (5) "Internal revenue code" means title 26 of the United States code without regard to
5 application of federal treaties, unless expressly made applicable to states of the United States;

6 (6) "Unitary business" means a single economic enterprise that is made up either of
7 separate parts of a single business entity or of a commonly controlled group of business entities
8 that are sufficiently interdependent, integrated and interrelated through their activities so as to
9 provide a synergy and mutual benefit that produces a sharing or exchange of value among them
10 and a significant flow of value to the separate parts exchange and flow of value between the two
11 parts of the business and the two corporations are members of the same commonly controlled
12 group;

13 (7) "Combined group" means the group of all persons whose income and apportionment
14 factors are required to be taken into account pursuant to subsection 44-67-2(a) or 44-67-2(b) in
15 determining the taxpayer's share of the net business income or loss apportionable to the state of
16 Rhode Island;

17 (8) "United States" means the fifty (50) states of the United States, the District of
18 Columbia, and United States' territories and possessions;

19 (9) "Tax haven" means a jurisdiction that, during the tax year in question:

20 (i) Is identified by the organization for economic co-operation and development (OECD)
21 as a tax haven or as having a harmful preferential tax regime; or

22 (ii) Exhibits the following characteristics established by the OECD in its 1998 report
23 entitled "Harmful Tax Competition: An Emerging Global Issue" as indicative of a tax haven or as
24 a jurisdiction having a harmful preferential tax regime, regardless of whether it is listed by the
25 OECD as an un-cooperative tax:

26 (A) Has no or nominal effective tax on the relevant income; and

27 (B)(I) Has laws or practices that prevent effective exchange of information for tax
28 purposes with other governments on taxpayers benefiting from the tax regime;

29 (II) Has tax regime which lacks transparency. A tax regime lacks transparency if the
30 details of legislative, legal or administrative provisions are not open and apparent or are not
31 consistently applied among similarly situated taxpayers, or if the information needed by tax
32 authorities to determine a taxpayer's correct tax liability, such as accounting records and
33 underlying documentation, is not adequately available;

34 (III) Facilitates the establishment of foreign-owned entities without the need for a local

1 substantive presence or prohibits these entities from having any commercial impact on the local
2 economy;

3 (IV) Explicitly or implicitly excludes the jurisdiction's resident taxpayers from taking
4 advantage of the tax regime's benefits or prohibits enterprises that benefit from the regime from
5 operating in the jurisdiction's domestic market; or

6 (V) Has created a tax regime which is favorable for tax avoidance, based upon an overall
7 assessment of relevant factors, including whether the jurisdiction has a significant untaxed
8 offshore financial/other services sector relative to its overall economy.

9 **44-67-2. Combined reporting required, when -- Discretionary under certain**
10 **circumstances. -- (a) Combined reporting required, when. A taxpayer engaged in a unitary**
11 **business with one or more other corporations shall file a combined report which includes the**
12 **income, determined under subsection 44-67-3(c) of this chapter, and apportionment factors,**
13 **determined under provisions on apportionment factors and subsection 44-67-2(b) of this chapter,**
14 **of all corporations that are members of the unitary business, and such other information as**
15 **required by the director;**

16 (b) Combined reporting at director's discretion, when. The director may, by regulation,
17 require the combined report including the income and associated apportionment factors of any
18 persons that are not included pursuant to subsection 44-67-2(a), but that are members of a unitary
19 business, in order to reflect proper apportionment of income of entire unitary businesses.
20 Authority to require combination by regulation under subsection 44-67-2(b), includes authority to
21 require a combination of persons that are not, or would not be if doing business in this state,
22 subject to chapter 30 of title 44.

23 In addition, if the director determines that the reported income or loss of a taxpayer
24 engaged in a unitary business with any person not included pursuant to subsection 44-67-2(a),
25 represents an avoidance or evasion of tax by such taxpayer, the director may, on a case by case
26 basis, require all or any part of the income and associated apportionment factors of such person
27 be included in the taxpayer's combined report.

28 With respect to inclusion of associated apportionment factors pursuant to subsection 44-
29 67-2(b), the director may require the exclusion of any one or more of the factors, the inclusion of
30 one or more additional factors which will fairly represent the taxpayer's business activity in this
31 state, or the employment of any other method to effectuate a proper reflection of the total amount
32 of income subject to apportionment and an equitable allocation and apportionment of the
33 taxpayer's income.

34 **44-67-3. Determination of taxable income or loss using combined report. – The use**

1 of a combined report does not disregard the separate identities of the taxpayer members of the
2 combined group. Each taxpayer member is responsible for tax based on its taxable income or loss
3 apportioned or allocated to this state, which shall include, in addition to other types of income,
4 the taxpayer member's apportioned share of business income of the combined group, where
5 business income of the combined group. A member's net business income is determined by
6 removing all but business income, expense and loss from that member's total income, as provided
7 in detail below:

8 (A) Components of income subject to tax in this state; application of tax credits and post
9 apportionment deductions:

10 (i) Each taxpayer member is responsible for tax based on its taxable income or loss
11 apportioned or allocated to this state, which shall include:

12 (a) Its share of any business income apportionable to this state of each of combined
13 groups of which it is a member, determined under subsection 44-67-3(b);

14 (b) Its share of any business income apportionable to this state of a distinct business
15 activity conducted within and without the state wholly by the taxpayer member, determined
16 under any applicable taxation statute;

17 (c) Its income from a business conducted wholly by the taxpayer member entirely within
18 the state;

19 (d) Its income sourced to this state from the sale or exchange of capital or assets, and
20 from involuntary conversions, as determined under subparagraph 44-67-3(c)(ii)(G), below;

21 (e) Its nonbusiness income or loss allocable to this state, determined under applicable tax
22 laws;

23 (f) Its income or loss allocated or apportioned in an earlier year, required to be taken into
24 account as state source income during the income year, other than a net operating loss; and

25 (g) Its net operating loss carryover or carryback. If the taxable income computed pursuant
26 to section 44-67-3 results in a loss for a taxpayer member of the combined group, that taxpayer
27 member has a state net operating loss (NOL), subject to the net operating loss limitations,
28 carryforward and carryback provisions of provisions on NOLs. Such NOL is applied as a
29 deduction in a prior or subsequent year only if that taxpayer has state source positive net income,
30 whether or not the taxpayer is or was a member of a combined reporting group in the prior or
31 subsequent year.

32 (ii) Except where otherwise provided, no tax credit or post-apportionment deduction
33 earned by one member of the group, but not fully used by or allowed to that member, may be
34 used in whole or in part by another member of the group or applied in whole or in part against the

1 total income of the combined group; and a post-apportionment deduction carried over into a
2 subsequent year as to the member that incurred it, and available as a deduction to that member in
3 a subsequent year, will be considered in the computation of the income of that member in the
4 subsequent year, regardless of the composition of that income as apportioned, allocated or wholly
5 within the state.

6 (B) Determination of taxpayer's share of the business income of a combined group
7 apportionable to this state. The taxpayer's share of the business income apportionable to this state
8 of each combined group of which it is a member shall be the product of:

9 (i) The business income of the combined group, determined under section 44-67-3(c), and

10 (ii) The taxpayer member's apportionment percentage, determined under applicable
11 apportionment factors, including in the numerators the taxpayer's associated with the combined
12 group's unitary business in this state, and including in the denominator the of all members of the
13 combined group, including the taxpayer, which property, payroll and sales are associated with the
14 combined group's unitary business wherever located. The property, payroll and sales of a
15 partnership shall be included in the determination of the partner's apportionment percentage in
16 proportion to a ratio the numerator of which is the amount of the partner's distributive share of
17 partnership's unitary income included in the income of the combined group in accordance with
18 subparagraph 44-67-(3)(ii)(c) and the denominator of which is the amount of the partnership's
19 total unitary income.

20 (C) Determination of the business income of the combined group.

21 The business income of combined group is determined as follows:

22 (i) From the total income of the combined group determined under 44-67-3(c)(ii),
23 subtract any income, and add any expense or loss, other than the business income, expense or loss
24 of the combined group;

25 (ii) Except as otherwise provided, the total income of the combined group is the sum of
26 the income of each member of the combined group determined under federal income tax laws, as
27 adjusted for state purposes, as if the member were not consolidated for federal purposes. The
28 income of each member of the combined group shall be determined as follows:

29 (a) For any member incorporated in the United States, or included in a consolidated
30 federal corporate income tax return, the income to be included in the total income of the
31 combined group shall be the taxable income for the corporation after making appropriate
32 adjustments under state tax code.

33 (b)(1) For any member not included in section 44-67-3(ii)(a), the income to be included
34 in the total income of the combined group shall be determined as follows:

1 (A) A profit and loss statement shall be prepared for each foreign branch or corporation
2 in the currency in which the books of account of the branch or corporation are regularly
3 maintained.

4 (B) Adjustment shall be made to profit and loss statement to conform it to the accounting
5 principles generally accepted in the United States for the preparation of such statements except as
6 modified by this regulation.

7 (C) Adjustments shall be made to the profit and loss statement to conform it to the tax
8 accounting standards required by the state tax laws.

9 (D) Except as otherwise provided by regulation, the profit and loss statement of each
10 member of the combined group, and the apportionment factors related thereto, whether United
11 States or foreign, shall be translated into the currency in which the parent company maintains its
12 books and records.

13 (E) Income apportioned to this state shall be expressed in United States dollars.

14 (2) In lieu of the procedures set forth in section 44-67-(ii)(b)(1), above, and subject to the
15 determination of the director that reasonably approximates income as determined under the state
16 tax laws, any member not included in section 44-67-(C)(ii)(a) may determine its income on the
17 basis of the consolidated profit and loss statement which includes the member and which is
18 prepared for filing with the securities and exchange commission by related corporations. If the
19 member is not required to file with the securities and exchange commission, the director may
20 allow the use of the consolidated profit and loss statement prepared for reporting to shareholders
21 and subject to review by an independent auditor. If above statements do not reasonably
22 approximate income as determined under the state tax laws the director may accept those
23 statements with appropriate adjustments to approximate that income.

24 (c) If a unitary business includes income from a partnership, the income to be included in
25 the total income of the combined group shall be the member of the combined group's direct and
26 indirect distributive share of the partnership's unitary business income.

27 (d) All dividends paid by one to another of the members of the combined group shall, to
28 the extent those dividends are paid out of the earnings and profits of the unitary business included
29 in the combined report, in the current or an earlier year, be eliminated from the income of the
30 recipient. This provision shall not apply to dividends received from members of the unitary
31 business which are not a part of the combined group.

32 (e) Except as otherwise provided by regulation, business income from an intercompany
33 transaction between members of the same combined group shall be deferred in a manner similarly
34 to 26 CFR 1.1502-13. Upon the occurrence of any of the following events, deferred business

1 income resulting from an intercompany transaction between members of a combined group shall
2 be restored to the income of the seller, and shall be apportioned as business income earned
3 immediately before the event:

4 (1) The object of a deferred intercompany transaction is:

5 (A) Re-sold by the buyer to an entity that is not a member of the combined group

6 (B) Re-sold by the buyer to an entity that is a member of the combined group for use
7 outside the unitary business in which the buyer and seller are engaged, or

8 (C) Converted by the buyer to a use outside the unitary business in which the buyer and
9 seller are engaged; or

10 (2) The buyer and seller are no longer members of the same combined group, regardless
11 of whether the members remain unitary.

12 (f) A charitable expense incurred by a member of a combined group shall, to the extent
13 allowable as a deduction pursuant to Internal Revenue Code Section 170, be subtracted first from
14 the business income of the combined group (subject to the income limitations of the section
15 applied to the entire business income of the group), and any remaining amount shall then be
16 treated as a nonbusiness expense allocable to the member that incurred the expense (subject to the
17 income limitations of that section applied to the nonbusiness income of that specific member).
18 Any charitable deduction disallowed under the foregoing rule, but allowed as a carryover
19 deduction in a subsequent year, shall be treated as originally incurred in the subsequent year by
20 the same member, and the rules of this section shall apply in the subsequent year in determining
21 the allowable deduction in that year.

22 (g) Gain or loss from the sale or exchange of capital assets, property described by Internal
23 Revenue Code Section 1231(a)(3), and property subject to an involuntary conversion, shall be
24 removed from the total separate net income of each member of a combined group and shall be
25 apportioned and allocated as follows:

26 (1) For each class of gain or loss (short term capital, long term capital, Internal Revenue
27 Code Section 1231, and involuntary conversions) all members' business gain and loss for the
28 class shall be combined (without netting between such classes), and each class of net business
29 gain or loss separately apportioned to each member using the member's apportionment
30 percentage determined under section 44-67-3(B) above.

31 (2) Each taxpayer member shall then net its apportioned business gain or loss for all
32 classes, including any such apportioned business gain and loss from other combined groups,
33 against the taxpayer member's nonbusiness gain and loss for all classes allocated to this state,
34 using the rules of Internal Revenue Code Sections 1231 and 1222, without regard to any of the

1 taxpayers member's gains or losses from the sale or exchange of capital assets, Section 1231
2 property, and involuntary conversions which are nonbusiness items allocated to another state.

3 (3) Any resulting state source income (or loss, if the loss is not subject to the limitations
4 of Internal Revenue Code Section 1211) of a taxpayer member produced by the application of the
5 preceding subsections shall then applied to all other state source income or loss of that member.

6 (4) Any resulting state source loss of a member that is subject to the limitations of
7 Section 1211 shall be carried forward or [carried back] by that member, and shall be treated as
8 state source short-term capital loss incurred by that member for the year for which the carryover
9 or [carryback] applies.

10 (h) Any expense of one member of the unitary group which is directly or indirectly
11 attributable to the nonbusiness or exempt income of another member of the unitary group shall be
12 allocated to that other member as corresponding nonbusiness or exempt expense, as appropriate.

13 **44-67-4. Designation of surety.** – As a filing convenience, and without changing the
14 respective liability of the group members, members of a combined reporting group may annually
15 elect to designate one taxpayer member of the combined group to file a single return in the form
16 and manner prescribed by the department, in lieu of filing their own respective returns, provided
17 that the taxpayer designated to file the single return consents to act as surety with respect to the
18 tax liability of all other taxpayers properly include in the combined report, and agrees to act as
19 agent on behalf of those taxpayers for the year of the election for tax matters relating to the
20 combined report for that year. If for any reason the surety in unwilling or unable to perform its
21 responsibilities, tax liability may be assessed against the taxpayer members.

22 **44-67-5. Water's-edge election; initiation and withdrawal.** – (a) Water's-edge
23 election. Taxpayer members of a unitary group that meet the requirements of section 44-67-5(B)
24 may elect to determine each of their apportioned shares of the net business income or loss of the
25 combined group pursuant to a water's-edge election. Under such election, taxpayer members shall
26 take into account all or a portion of the income and apportionment factors of only the following
27 members otherwise included in the combined group pursuant to Section 2, as described below:

28 (i) The entire income and apportionment factors of any member incorporated in the
29 United States or formed under the laws of any state, the District of Columbia, or any territory or
30 possession of the United States;

31 (ii) The entire income and apportionment factors of any member, regardless of the place
32 incorporated or formed, if the average of its property, payroll, and sales factors within the United
33 States is twenty percent (20%) or more;

34 (iii) The entire income and apportionment factors of any member which is a domestic

1 international sales corporation as described in Internal Revenue Code Sections 991 to 994,
2 inclusive; or any member which is an export trade corporation, as described in Internal Revenue
3 Code Sections 970 to 971, inclusive;

4 (iv) Any member not described in Section 44-67-5(A)(i) to Section 44-67-5(A)(iii),
5 inclusive shall include the portion of its income derived from or attributable to sources within the
6 United States, as determined under the Internal Revenue Code without regard to federal treaties,
7 and its apportionment factors related thereto:

8 (v) Any member that is a “controlled foreign corporation,” as defined in Internal Revenue
9 Code Section 957, to the extent of the income of that member that is defined in Section 952 of
10 Subpart F of the Internal Revenue Code (“Subpart F income”) not excluding lower-tier
11 subsidiaries’ distributions of such income which were previously taxed, determined without
12 regard to federal treaties, and the apportionment factors related to that income; any item of
13 income received by a controlled foreign corporation shall be excluded if such income was subject
14 to an effective rate of income tax imposed by a foreign country greater than ninety percent (90%)
15 of the maximum rate of tax specified in Internal Revenue Code Section 11;

16 (vi) Any member that earns more than twenty percent (20%) of its income, directly or
17 indirectly, from intangible property or service related activities that are deductible against the
18 business income of other members of the combined group, to the extent of that income and the
19 apportionment factors related thereto; and

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

26 (B) Initiation and withdrawal of election.

27 (i) A water’s-edge election is effective only if made on a timely-filed, original return for a
28 tax year by every member of the unitary business subject to tax under state income tax code. The
29 director shall develop rules and regulations governing the impact, if any, on the scope or
30 application of a water’s-edge election, including termination or deemed election, resulting from a
31 change in the composition of the unitary group, the combined group, the taxpayer members, and
32 any other similar change.

33 (ii) Such election shall constitute consent to the reasonable production of documents and
34 taking of depositions in accordance with [state statute on discovery].

1 (iii) In the discretion of the director, a water's-edge election may be disregarded in part or
2 in whole, and the income and apportionment factors of any member of the taxpayer's unitary
3 group may be included in the combined report without regard to the provisions of this section, if
4 any member of the unitary group fails to comply with any provision of this act or if a person
5 otherwise not included in the water's-edge combined group was availed of with a substantial
6 objective of avoiding state income tax.

7 (iv) A water's-edge election is binding for and applicable to the tax year it is made and all
8 tax years thereafter for a period ten (10) years. It may be withdrawn or reinstated after
9 withdrawal, prior to the expiration of the ten (10) year period, only upon written request for
10 reasonable cause based on extraordinary hardship due to unforeseen changes in state tax statutes,
11 law, or policy, and only with the written permission of the director. If the director grants a
12 withdrawal of election, he or she shall impose reasonable conditions as necessary to prevent the
13 evasion of tax or to clearly reflect income for the election period prior to or after the withdrawal.
14 Upon the expiration of the ten (10) years, subject to the same conditions as applied to the original
15 election. If no withdrawal is properly made, the water's-edge election shall be in place for an
16 additional ten (10) year period, subject to the same conditions as applied to the original election.

17 SECTION 2. This act shall take effect upon passage.

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EXPLANATION
BY THE LEGISLATIVE COUNCIL
OF
A N A C T
RELATING TO TAXATION – COMBINED REPORTING

- 1 This act would address the factors required to be taken into account in determining the
- 2 taxpayers share of the net business income or loss apportionable to the State of Rhode Island.
- 3 This act would take effect upon passage.

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