Department of Revenue
Division of Taxation

Senate Committee on Finance

Combined Reporting Study
March 18, 2014

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Agenda

- Current Corporate Tax System
- Single Entity vs. Combined Filing
- Combined Reporting Study
- Results
- Administrative Challenges
- General Assembly Considerations

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Current Corporate Tax System

- For Rhode Island purposes, a corporation must file its corporate tax return on a separate entity basis
- Corporations pay the higher of the corporate income tax (§44-11) or the franchise tax (§44-12)
- Minimum tax is $500

Current Corporate Tax System

- A corporation that derives all its income from sources within Rhode Island must apportion its entire net income to this state (§44-11-13).
- A corporation that derives income from two or more states must apportion its income to Rhode Island for corporate income tax.
- Generally, corporations use a three-factor apportionment formula taking into account the corporation’s sales, property, and payroll (§44-11-14).

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Current Corporate Tax System

- Sample three-factor apportionment:

Three-factor apportionment formula				
	Rhode Island	State B	**Total**	Factor
Sales	$2,000,000	$2,000,000	**$4,000,000**	$2,000,000/$4,000,000 = 50%
Payroll	$1,500,000	$200,000	**$1,700,000**	$1,500,000/$1,700,000 = 88%
Property	$2,500,000	$200,000	**$2,700,000**	$2,500,000/$2,700,000 = 93%
				Sum of apportionment factors = 231%
				Sum of apportionment factors /3 = 77%

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Current Corporate Tax System

- Sample tax calculation using three-factor apportionment:

Federal Taxable Income	1,000,000
Total Modifications	-
Adjustable Taxable Income	1,000,000
Rhode Island Apportionment Ratio	77.00%
Rhode Island Taxable Income	770,000
Tax Rate	9.0%
Total Tax Due	69,300

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Current Corporate Tax System

- Rhode Island General Law allows for special apportionment for specific industries:

Certified Facility (§44-11-14.1): Allows a corporation to exclude from the numerator of the "payroll" factor the amount by which total qualified payroll expenses for the tax year exceeds the total qualified payroll expenses in the immediately preceding tax year.

Regulated investment companies (§44-11-14.2): (also known as RICs, or mutual fund companies) Single Sales factor

Credit card banks (§44-11-14.3): Apportioned to Rhode Island only to the extent that customers of the taxpayer are domiciled in RI

Retirement and pension plans (§44-11-14.4): Single sales Factor

International investment service (§44-11-14.5): Exclude from its net income any income derived from the sale of international investment management services.

Manufacturers (§44-11-14.6): Double-weighted sales fact

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Current Corporate Tax System

- Sample Single Sales apportionment:

Single sales apportionment formula				
	Rhode Island	State B	**Total**	Factor
Sales	$2,000,000	$2,000,000	**$4,000,000**	$2,000,000/$4,000,000 = 50%
~~Payroll~~	~~$1,500,000~~	~~$200,000~~	~~**$1,700,000**~~	
~~Property~~	~~$2,500,000~~	~~$200,000~~	~~**$2,700,000**~~	
				Apportionment factor = 50%

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Current Corporate Tax System

- Sample tax calculation using single sales factor apportionment:

Federal Taxable Income	1,000,000
Total Modifications	-
Adjustable Taxable Income	1,000,000
Rhode Island Apportionment Ratio	50.00%
Rhode Island Taxable Income	500,000
Tax Rate	9.0%
Total Tax Due	45,000

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Single Entity vs. Combined Filing

- What is combined reporting?
  - Generally, each corporation which is part of a unitary business must file corporate income taxes combined - reporting the entire net income of the combined group.

Single Entity vs. Combined Filing

- **"Unitary business"** means the activities of a group of two (2) or more corporations under common ownership that are sufficiently interdependent, integrated or interrelated through their activities so as to provide mutual benefit and produce a significant sharing or exchange of value among them or a significant flow of value between the separate parts.
- **"Common ownership"** means more than fifty percent (50%) of the voting control of each member of the group is directly or indirectly owned by a common owner or owners, either corporate or non-corporate, whether or not owner or owners are members of the combined group.

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Single Entity vs. Combined Filing

States with combined reporting		
Alaska	Kansas	New York
Arizona	Maine	North Dakota
California	Massachusetts	Oregon
Colorado	Michigan	Texas
District of Columbia	Minnesota	Utah
Hawaii	Montana	Vermont
Idaho	Nebraska	West Virginia
Illinois	New Hampshire	Wisconsin

Note: New Mexico in 2013 approved mandatory unitary combined reporting for certain retailers.
Source: U.S. Public Interest Research Group: U.S. PIRG Education Fund, January 30, 2014

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Combined Reporting Study

- Legislation passed in the 2011 General Assembly required each corporation that is part of a unitary business under common ownership to file a *pro forma* report for the combined group to include the combined income of the combined group (§44-11-45).

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Combined Reporting Study

- The legislation required businesses to calculate their combined income using two different apportionment formulas:
  - Three-factor Apportionment
  - Single Sales Apportionment

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Combined Reporting Study

- In computing tax under the three-factor apportionment formula and under the single sales factor apportionment formula, corporations had to employ two different methods to compute the sales factor:
  - Joyce Method
  - Finnigan Method

Combined Reporting Study

- Joyce Method:
  - “Nexus” determinations are made at the level of each individual entity.
  - Sales by an entity lacking nexus in Rhode Island are excluded from the numerator for Rhode Island tax purposes

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Combined Reporting Study

- Finnigan Method:
  - The entire unitary group as a whole is treated as the taxpayer for apportionment purposes.
  - All sales of members of the unitary group attributable to Rhode Island are included in the sales factor numerator.

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Combined Reporting Study

Joyce vs. Finnigan Example:

Name of entity	Rhode Island receipts	Everywhere receipts	Nexus with Rhode Island
Hotel Corp.	50	100	Yes
India Corp.	100	200	Yes
Juliet Corp.	100	200	No

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Combined Reporting Study

Joyce vs. Finnigan Example:

Name of entity	Rhode Island receipts	Everywhere receipts	Nexus with Rhode Island
Hotel Corp.	50	100	Yes
India Corp.	100	200	Yes
Juliet Corp.	[illegible]	200	No

Joyce Method: 150 / 500 = 30.0%

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Combined Reporting Study

Joyce vs. Finnigan Example:

Name of entity	Rhode Island receipts	Everywhere receipts	Nexus with Rhode Island
Hotel Corp.	50	100	Yes
India Corp.	100	200	Yes
Juliet Corp.	100	200	No

Finnigan Method: 250 / 500 = 50.0%

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Combined Reporting Study

Joyce vs. Finnigan Example:

Name of entity	Rhode Island receipts	Everywhere receipts	Nexus with Rhode Island
Hotel Corp.	50	100	Yes
India Corp.	100	200	Yes
Juliet Corp.	100	200	No

Joyce Method: 150 / 500 = 30.0%

Finnigan Method: 250 / 500 = 50.0%

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Combined Reporting Study

- Process:
  - Promulgated regulation on December 31, 2011.
  - Performed several outreach/training seminars for businesses and practitioners.
  - Created new schedule to be filed with corporate income tax return (CRS form)

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Name	Federal employer identification number

Schedule CRS - Required Data for Combined Reporting Study

Section 1 - Combined Group Information

		Yes	No
A.	Is this company a member of a combined group of companies?	☐	☐
B.	Is another company the designated agent responsible for the combined group?	☐	☐
C.	If yes, provide the federal employer identification number of the designated agent filing the combined report		
D.	Is an election being made to file based on the federal consolidated return?	☐	☐
E.	Is a FAS 109 Deduction Statement attached?	☐	☐
F.	If yes, provide the lump sum FAS 109 deduction amount		

Section 2 - Combined Group Calculations

1.	Combined Federal Taxable Income		
2.	Combined Deductions (Attach detailed schedule)		
3.	Combined Additions (Attach detailed schedule)		
4.	Adjusted Taxable Income. Line 1 minus Line 2 plus Line 3		

		Rhode Island	Everywhere	Ratio
5.	Combined Average Net Book Value of Property			
6.	Combined Receipts using Joyce Method			
7.	Combined Receipts using Finnigan Method			
8.	Combined Salaries, Wages and Compensation			

		Joyce Method	Finnigan Method
9.	Combined Ratios Total Joyce Method - Add Ratios from lines 5, 6 and 8 Finnigan Method - Add Ratios from lines 5, 7 and 8		
10.	Combined Apportionment Ratio - For each method, divide line 9 by 3.0		
11.	Rhode Island Adjusted Taxable Income - For each method, multiply line 4 times line 10		
12.	Combined Rhode Island Tax (If zero or less, enter zero.)		
13.	Credits under Combined Reporting (Attach detailed schedule)		
14.	Tax Due under Combined Reporting - Line 12 minus Line 13 (If zero or less, enter zero.)		
15.	Tax Due using Single Sales Factor (If zero or less, enter zero.)		
16.	Tax Due on actual filing (Including Rhode Island Minimum Tax for all members of the combined group)		
17.	Minimum Tax for the combined group (see instructions)		

		Rhode Island	Worldwide
18.	Combined Sales		
19.	Taxable Income		

Section 3 - Listing of Companies included in this Combined Report (If more space is needed, attach a separate sheet.)

Federal ID#	Name	2012 RI Filing Requirement (Y/N)	Federal ID#	Name	2012 RI Filing Requirement (Y/N)

Total number of companies included in this Combined Report: ☐

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Results

- Results are based solely on the returns as filed.
- Returns were not audited by Division of Taxation.
- Generally tax years 2011 and 2012 were positive years for businesses.

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Results

- Total filers required to file a combined report:

Tax Year	Total Combined Reports Filed
2011	1,370
2012	1,621

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Results

- Legislation required Division of Taxation to report on the financial impacts of combined reporting using three-factor apportionment.
- Division analyzed both the Joyce and Finnigan methods of apportionment.

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Results

- Joyce Method – three-factor apportionment:

Tax Year	Increase in Tax		Decrease in Tax		No Change	Total	
	Count	Amount	Count	Amount	Count	Count	Net Change
2011	401	$31,033,225	137	($7,606,284)	832	1,370	$23,426,941
2012	343	$27,321,476	125	($5,811,556)	1153	1,621	$21,509,920

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Results

- Finnigan Method – three-factor apportionment:

Tax Year	Increase in Tax		Decrease in Tax		No Change	Total	
	Count	Amount	Count	Amount	Count	Count	Net Change
2011	420	$32,828,692	130	($7,543,493)	820	1,370	$25,285,199
2012	359	$28,916,825	122	($5,784,150)	1140	1,621	$23,132,675

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Results

- Legislation also required Division of Taxation to report on the financial impacts of combined reporting using single sales factor apportionment.
- Division analyzed both the Joyce and Finnigan methods of apportionment.

Results

Important Note: The following results include only the corporations required to file on a combined return.

The results do not reflect the overall effect on all corporations of a change to single sales factor apportionment.

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Results

- Joyce Method – single sales factor apportionment:

Tax Year	Increase in Tax		Decrease in Tax		No Change	Total	
	Count	Amount	Count	Amount	Count	Count	Net Change
2011	477	$60,630,244	70	($11,168,989)	823	1,370	$49,461,255
2012	434	$44,742,831	63	($6,113,103)	1124	1,621	$38,629,728

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Results

- Finnigan Method – single sales factor apportionment:

Tax Year	Increase in Tax		Decrease in Tax		No Change	Total	
	Count	Amount	Count	Amount	Count	Count	Net Change
2011	501	$65,814,591	69	($11,154,547)	800	1,370	$54,660,044
2012	455	$50,299,771	59	($5,908,062)	1107	1,621	$44,391,709

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Administrative Challenges

- Combined reporting is complex
- Lack of expertise in the State
- Increased legal challenges

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General Assembly Considerations

- Combined vs. single entity reporting
- Effective date of any change
- Worldwide income vs. Water’s Edge
  - Tax Havens

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General Assembly Considerations

- Apportionment formula
  - Three-factor vs. Single Sales
  - Joyce vs. Finnigan
  - Market-based Sourcing
- How would various benefits impact combined group?

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General Assembly Considerations

- Overall Corporate Tax Rate
- Impact of FAS 109
- Franchise Tax/Minimum Tax?
- Others?

Questions?