

Mandatory Combined Reporting Trend: Do You Have a Choice?

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As many states review their budget shortfalls this year, the option to move toward mandatory combined reporting continues to appear on several legislative agendas. This move is generally seen by states to increase revenue, although some studies seem to indicate the opposite effect.

Since 2004, seven states have passed combined reporting legislation. Keeping apprised of the requirements of combined unitary filing, as well as which states allow freedom of choice, will improve your tax forecasting and potentially identify savings strategies.

Freedom of Choice

As corporate taxpayers, it is to your advantage to weigh all the options when deciding whether to file as a combined unitary group or separately in the handful of states where the option still exists (see chart below for a state breakout).

- **Impact:** For those states not mandating separate filing, run a multi-year scenario for your business reflecting the impact on net operating losses, capital losses, dividends, charitable contributions, and basis in subsidiaries, among other things. Some years may result in a spiked increase or decrease in tax when choosing one scenario over another, but perhaps over the long run, the trend goes in the opposite direction. In most states which allow a choice in filing method, once you choose you are locked in, so be sure your choice is well researched. Research each state to determine whether the combination is mandatory or optional.

Exhibit 1 – Jurisdictional Filing Requirements

Combined = Unitary group income is combined, intercompany transactions are eliminated, and combined business income is apportioned among the states based on group-level apportionment.

Combined Return Required / Allowed

| | | | |
|----------------------|---------------|---------------|---------------|
| Alaska | Illinois | New Hampshire | Vermont |
| Arizona | Kansas | Nebraska | Virginia |
| California | Maine | New Mexico | West Virginia |
| Colorado | Massachusetts | New York** | Wisconsin |
| Connecticut | Michigan | North Dakota | Idaho |
| District of Columbia | Minnesota | Oklahoma** | Montana |
| Hawaii | Mississippi | Texas | Utah |

Combined Return Not Allowed

| | | |
|-----------|------------|------------------|
| Alabama | Iowa | North Carolina** |
| Arkansas | Kentucky | Oregon |
| Delaware | Louisiana | Pennsylvania |
| Florida | Maryland | Rhode Island |
| Georgia | Missouri | South Carolina |
| Indiana** | New Jersey | Tennessee** |
| | | |

Consolidated = Affiliated corporations (typically a parent owning 80% of each member) consolidate income and apportion (Typically only allowed if file federal consolidated return).

Consolidated Return Required / Allowed

| | | | |
|----------------------|---------|--------------|----------------|
| Alabama | Florida | Kentucky | Oregon |
| Alaska | Georgia | Maine | Rhode Island |
| Arizona | Hawaii | Missouri | South Carolina |
| Arkansas | Indiana | Montana | Vermont |
| Colorado | Iowa | New Mexico | Virginia |
| District of Columbia | Kansas | North Dakota | Wisconsin |

Consolidated Return Not Allowed

| | | | |
|---------------|-------------|--------------|------------------|
| California | Michigan | Oklahoma | Maryland |
| Connecticut | Minnesota | Pennsylvania | New York |
| Delaware | Mississippi | Tennessee | Massachusetts |
| Idaho | Nebraska | Texas | North Carolina** |
| Illinois | Utah | Louisiana** | West Virginia |
| New Hampshire | | | New Jersey |

** Review carefully. Certain conditions may change this

Advantages of Combining: Combining your separate business return with that of your unitary businesses can serve to dilute your apportionment factor in high tax states, eliminate intercompany dividends, and allow utilization of tax attributes of the unitary group such as net operating losses, credits, and capital losses, that may otherwise be in a carry forward “holding pattern” waiting to be used.

Disadvantages of Combining: On the flip side, combining many businesses into one return could result in pulling income into a higher tax state where your business may not previously have had nexus. In addition, once you choose to combine, you are generally locked into that choice for several years depending on the state. This reduces your ability to employ tax strategies to shift income away from higher tax states.

Trend toward Combined Reporting Continues

Several states have introduced bills in 2010 to adopt mandatory combined reporting. Connecticut, Florida, Maryland, New Mexico, and Rhode Island are among these states. Taxpayers are urged to carefully review the definition of “unitary” for each state, as this can differ. You may be considered a unitary group in one state, but not in another. In addition, your sales factor can be dramatically affected depending on whether the state is *Joyce* or *Finnigan* (*Joyce* states require only specific members making the sale to be included in the sales factor numerator whereas *Finnigan* states count all group members as the taxpayer making the sale). As more states move toward a single sales factor apportionment system, this could significantly impact your tax provision.

For More Information

If you are interested in learning more about this topic or our Tax Services, please contact: tax@allynintl.com.

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