Rhode Island Division of Taxation

State of Rhode Island and Providence Plantations
Department of Revenue

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Division of Taxation analyzes impact of possible change to combined reporting

PROVIDENCE, R.I. – The Rhode Island Division of Taxation has posted a report on its website analyzing the policy and fiscal ramifications of changing Rhode Island's business corporation tax statute to a combined method of reporting.

Under legislation approved by the General Assembly and signed into law by Governor Lincoln D. Chafee in June 2011, certain businesses organized as C corporations were required to file a schedule with their annual tax returns for 2011 and 2012 calculated as if combined reporting was mandatory in Rhode Island.

The Division of Taxation studied the returns, analyzed the results, and produced a report that addresses the provisions of the law and what impact certain changes would have on businesses and on Rhode Island state tax revenue.

"This report comes at a good time," Governor Chafee said. "Many states, including Rhode Island, are reviewing their corporate tax structures. It is our hope that this report can serve as a helpful point of reference as we move forward in the discussion about any changes to the system of taxation in Rhode Island," the Governor added.

"This report presents a thorough and balanced look at a number of complex corporate tax issues, information that will be of interest to many of our stakeholders," Rhode Island Tax Administrator David M. Sullivan said. "We look forward to providing any additional help for policymakers as they consider whether any changes are needed to our tax statutes."

Current law and background

Under current Rhode Island law, a corporation must file its return as a single entity – a separate entity – taking into account its own income. That is the case even if the corporation is part of a broader group of corporations in other states, under common ownership, that are together engaged in a common business enterprise – a "unitary business."

Under combined reporting, a Rhode Island corporation would include in its Rhode Island return not only its own income, but also the combined income of the other corporations, or affiliates, that are under common ownership and part of a unitary business. In other words, a Rhode Island corporation would treat all of its affiliates in other states as if they were one, single company, and combine all of their taxable income in a single pool. The Rhode Island corporation would then use a formula to apportion the amount of the combined income to Rhode Island for tax purposes.

States levy various forms of business activity taxes. The most common is the corporate net income tax, which is imposed in 44 states and the District of Columbia, according to the Federation of Tax Administrators. Of those, 23 states and the District of Columbia have combined reporting, according to the Division of Taxation study. New England states with combined reporting include Maine, Massachusetts, New Hampshire, and Vermont. New England states that do not have mandatory unitary combined reporting include Connecticut and Rhode Island.

Following is a summary of the results of the Division of Taxation's two-year study, as noted in the report, which looked at two tax years: 2011 and 2012:

■ For tax year 2011, corporations under combined reporting, using three-factor apportionment, would have had to pay, in the aggregate, $23.4 million more in tax (using a calculation known as the Joyce method) or $25.3 million more in tax (using a calculation known as the Finnigan method).

■ For tax year 2011, corporations under combined reporting, using single sales factor apportionment (instead of standard three-factor apportionment), would have had to pay, in the aggregate, $49.5 million more in tax (Joyce method) or $54.7 million more in tax (Finnigan method).

■ For tax year 2012, corporations under combined reporting, using three-factor apportionment, would have had to pay, in the aggregate, $21.5 million more in tax (Joyce method), or $23.1 million more in tax (Finnigan method).

■ For tax year 2012, corporations under combined reporting using single sales factor apportionment would have had to pay, in the aggregate, $38.6 million more in tax (Joyce method) or $44.4 million more in tax (Finnigan method).

Overall, 6.625 percent of groups, on average, would have seen a decrease in tax; 28.75 percent, on average, would have seen an increase in tax; and 64.625 percent of groups, on average, would have seen no change in tax.

Study limitations

Sullivan emphasized that the Division of Taxation's study is based on unaudited corporate tax returns. Due to the nature of the study, the Division of Taxation had to compile data based solely on the returns as filed by the corporations; there was insufficient time to audit those returns to ensure that they were complete and accurate.

Sullivan also noted that the study of *pro forma* combined reporting measures results for only two tax years – years in which businesses in the aggregate were, broadly speaking, recovering from recession. The study did not cover other years, so it does not reflect the impact on tax revenue in years in which there is a general business downturn.

The study also looks at the impact of a potential change in the corporate tax apportionment formula, to single sales factor apportionment from the existing three-factor formula. Sullivan noted that the study's results on this point are solely for those corporations that were subject to *pro forma* combined reporting. The impact of a change to single sales factor apportionment on corporations that were not subject to *pro forma* combined reporting was not required by statute to be included in the report.

Nevertheless, the Division of Taxation recognizes that policymakers may need such information as they continue their overall review. The agency is therefore in the process of analyzing the estimated effect on such corporations of switching to an apportionment formula which focuses solely on sales (in place of the existing law, which requires that apportionment be computed based on a C corporation's sales, property, and payroll), and plans to provide that information in the coming weeks.

Sullivan delivered the study on *pro forma* combined reporting to the chairs of the House and Senate Finance Committees on March 14, 2014. By statute, the report was due on or before March 15, 2014.

The study on *pro forma* combined reporting is available on the Division of Taxation's website. Click here to view.

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