EXPOSURE DRAFT

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State of Rhode Island and Providence Plantations

Rhode Island Division of Taxation
(Department of Revenue)

Corporate Income Tax:

Combined Reporting

Regulation CT 15-xx

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Please submit comments on this Exposure Draft on or before December 8, 2014, to:

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Preamble

I. Background

Legislation approved by the Rhode Island General Assembly and signed into law by Rhode Island Governor Lincoln D. Chafee on June 30, 2011, directed the Rhode Island Division of Taxation to gather certain corporate income tax returns for two successive years, analyze the data, and use it to help determine the policy and fiscal ramifications of changing the business corporation tax statute from separate entity reporting to a combined method of reporting.[1]

To assist the Division of Taxation in its study, C corporations that were part of a combined group and engaged in a unitary business were required to file *pro forma* Rhode Island combined reports -- as if combined reporting were the law. *Pro forma* combined reporting applied to tax years 2011 and 2012.

Data from the *pro forma* filings for tax years 2011 and 2012 was used by the Division of Taxation to compile a detailed study of combined reporting and related issues; the study was presented to the chairs of the House and Senate Finance Committees by the statutory deadline of March 15, 2014.

Subsequently, legislation was introduced in the General Assembly to make comprehensive changes to Rhode Island's corporate tax structure. The legislation -- contained in the budget bill for the 2015 fiscal year -- was approved by the General Assembly and signed into law by Governor Chafee on June 19, 2014.[2]

As a consequence, mandatory unitary combined reporting for Rhode Island corporate income tax purposes is effective for tax years beginning on or after January 1, 2015.[3] [4]

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[1] Rhode Island Public Law 2011, ch. 151, art. 19, § 4.
[2] Rhode Island Public Law 2014, ch. 145, art. 12, § 13 *et seq.*
[3] See, *inter alia*, RIGL § 44-11-4.1.
[4] The preamble is a summary of the Rhode Island General Laws and related regulations as they relate to Rhode Island mandatory unitary combined reporting. The preamble is not a substitute for the statutes or for Rhode Island Division of Taxation regulations, including the body of this regulation.

Key regulatory carryforwards

To assist C corporations and their advisers in complying with the requirements of *pro forma* combined reporting, the Division of Taxation in 2011 issued Regulation CT 12-15, "Combined Reporting (*pro forma*)."[5]

The Division of Taxation has carried forward a number of elements of Regulation CT 12-15 into this proposed regulation involving mandatory unitary combined reporting – in keeping with provisions of Rhode Island General Laws (RIGL), for the convenience of corporations and their advisers, and to help foster compliance.

For example:

- Definitions of certain key terms – including "combined group" and "common ownership" – remain the same or substantially the same as in the prior regulation.

- The basic approach to determining the composition of a combined group is largely the same.

- "Water's edge" treatment is mandatory.

- The basic approach to determining the unitary business remains the same – relying largely on tests set forth in certain U.S. Supreme Court cases.

- For Rhode Island combined reporting purposes, a taxpayer will still be able to elect to use the same members that the taxpayer includes in filing its federal consolidated return.

- A tracing protocol will apply to net operating losses (NOLs).

- A tracing protocol will apply to tax credits.

- The combined group still must appoint a designated agent. The agent is generally required to act on behalf of the combined group in its own name in all matters related to the combined report.

[5] Rhode Island Division of Taxation Regulation CT 12-15, "Combined Reporting (*pro forma*)," was repealed effective November 4, 2014.

Key regulatory differences

The proposed regulation differs from the *pro forma* regulation in a number of ways, partly due to changes in statute. For example:

- While "water's edge" treatment continues to be mandatory, and the basic approach to determining the composition of a combined group is largely the same, the proposed regulation incorporates a definition of the term "tax haven" to reflect the definition in statute. As a result, certain corporations may or may not have to be included in the combined group.

- Under the regulation for *pro forma* combined reporting, corporations had to apportion income using two methods that are named for seminal California court cases: the Joyce[6] and Finnigan[7] methods. As the proposed regulation spells out, only the Finnigan method will be used for apportionment.

- When the prior regulation was promulgated, three-factor apportionment applied, using sales (total receipts), property, and payroll. However, when the proposed regulation takes effect, for tax years beginning on or after January 1, 2015, a single factor – sales (total receipts) – will be used for apportionment purposes.[8]

- When the prior regulation was promulgated, the sales factor for apportionment purposes was determined using the cost-of-performance method. However, when the proposed regulation takes effect, for tax years beginning on or after January 1, 2015, market-based sourcing will be used in place of the cost-of-performance method.

- For Rhode Island combined reporting purposes, an affiliated group of corporations will be able to elect to use the same members that the taxpayer includes in filing its federal consolidated return. However, effective for tax years beginning on or after January 1, 2015, once the election is made, it must continue for five years, including the year the election is made. (For purposes of *pro forma* combined reporting, the election was binding for two years.)

- The prior regulation asked affected taxpayers to calculate a deduction, related to their balance sheets, in accordance with Financial Accounting Standard 109 (FAS 109).[9] However, the deduction is not prescribed by statute for purposes of Rhode Island mandatory unitary combined reporting.

- When the prior regulation was promulgated, a corporation's Rhode Island tax was the greater of the franchise tax or the corporate income tax, and the corporate income tax rate was nine percent (9%). For tax years beginning on or after January 1, 2015, the

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[6] *Appeal of Joyce, Inc.*, California State Board of Equalization, 66-SBE-070, November 23, 1966.
[7] *Appeal of Finnigan Corp*., California State Board of Equalization, 88-SBE-022, August 25, 1988.
[8] Under RIGL § 44-11-14(b)(1), the factor represents total receipts from sales or other sources.
[9] "FAS 109" is also known as FASB Accounting Standards Codification 740, or "ASC 740".

franchise tax is repealed. Also, for tax year 2015, the corporate income tax rate is seven percent (7%).

- Because combined reporting was new to Rhode Island when the *pro forma* combined reporting regulation was promulgated in 2011, the Tax Administrator allowed for an additional one-month filing extension – beyond the six-month extension allowed by statute.[10] Thus, the extended due date for filing a Form RI-1120C with the attached schedule for *pro forma* combined reporting was seven months after the normal filing deadline. However, because taxpayers are now generally accustomed to combined reporting – if not on a *pro forma* basis for Rhode Island purposes, then for actual filing purposes in many other jurisdictions[11] – the Tax Administrator has determined, pursuant to the authority granted in RIGL § 44-11-5, that the extended due date for corporate returns filed on Form RI-1120C shall be six months after the normal due date.[12]

II. Explanation of provisions

Following is a summary of the chief elements of Rhode Island's statute on mandatory unitary combined reporting. The regulation provides additional details and examples.

COMBINED REPORTING OVERVIEW

For tax years beginning on or after January 1, 2015, a business which is organized as a C corporation, and which is part of a combined group engaged in a common business enterprise – a "unitary" business, must file a combined report with Rhode Island.

Under former law, for purposes of Rhode Island's corporate income tax, a corporation had to file its return as a single entity – a separate entity – taking into account its own income, no matter if the corporation was part of a broader group of corporations, under common ownership, engaged in a unitary business.

Under mandatory unitary combined reporting for tax years beginning on or after January 1, 2015, a C corporation will have to report on its Rhode Island return not only its own income, but also the combined income of the other corporations, or affiliates, that are part of a combined group under common ownership and part of a unitary business.

Thus, a corporation will generally have to treat all of its affiliates as if they were a single company, and combine all of their taxable income in a single pool. A formula will then

[10] The normal due dates for calendar-year and fiscal-year filers is prescribed in RIGL § 44-11-3.
[11] As of early 2014, combined reporting in some fashion was the law in 23 states and the District of Columbia. New England states with combined reporting included Maine, Massachusetts, New Hampshire, and Vermont.
[12] Ibid.

be used to apportion the amount of the combined income to Rhode Island for tax purposes. (Apportionment is done at the group level.)

Rhode Island has not adopted the Uniform Division of Income for Tax Purposes Act, known as UDIPTA, which was approved by the Uniform Law Commission in 1957 and which deals with the division of the tax base among the multiple states in which a taxpayer does business.[13] As a consequence, Rhode Island does not distinguish between business income and non-business income for formulary apportionment purposes. For Rhode Island corporate income tax purposes – including combined reporting, all of a taxpayer's income must be apportioned.

For purposes of mandatory unitary combined reporting under Rhode Island General Laws, a C corporation which is subject to tax under RIGL Chapter 44-11 -- or which would be subject to tax under RIGL Chapter 44-11 if doing business in Rhode Island -- is subject to combined reporting.

The following entities are not subject to combined reporting:[14]

- state banks;
- mutual savings banks;
- federal savings banks;
- trust companies;
- national banking associations;
- building and loan associations;
- credit unions;
- loan and investment companies;
- public service corporations;
- insurance companies.
- S corporations;
- partnerships treated as pass-through entities for federal tax purposes;
- limited liability companies treated as pass-through entities for federal tax purposes;
- sole proprietorships and similar entities that are disregarded as separate from their owners ("disregarded entities"[15]); and
- in general, any corporation incorporated in a foreign jurisdiction if its sales factor for total receipts outside the United States is eighty percent (80%) or more.

The combined group shall exclude any entity listed above that is organized as a C corporation. However, if such an entity is included as an affiliate in the group's federal consolidated return, such an entity must be included in the group's Rhode Island

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[13] "The Project to Revise UDIPTA," Joe Huddleston, Executive Director, Multistate Tax Commission, and Shirley Sicilian, General Counsel, Multistate Tax Commission (from the Proceedings of the New York University Institute on State and Local Taxation, 2009).

[14] The entities on this list may still have a separate filing requirement for Rhode Island tax purposes if they do business in Rhode Island. For example, Form RI-1065 is filed by partnerships, limited liability companies (LLCs), limited liability partnerships (LLPs), limited partnerships, general partnerships, and single-member limited liability companies (SMLLCs); and Form RI-1120S for S corporations.

[15] See U.S. Treas. Reg. § 301.7701-2.

consolidated return. Income from pass-through entities may have to be included in a combined report depending on ownership and other factors. The combined group's share of the pass-through entity's income, normally reported on federal Schedule K-1, should be reported as part of the combined group's income.[16]

The legislation as enacted represented the most sweeping changes to Rhode Island's corporate tax structure in nearly 70 years. Consequently, the Division of Taxation is promulgating this regulation on mandatory unitary combined reporting to provide guidance that will assist corporations and preparers in complying.

THRESHOLD ISSUES

For combined reporting purposes, corporations and their advisers face two threshold issues: the determination of the combined group, and the determination of a unitary business. Consequently, the two issues – and some related matters – are summarized in this preamble and detailed in the body of this proposed regulation.

COMBINED GROUP

The term "combined group" means a group of two or more corporations in which more than 50 percent of the voting stock of each member corporation is directly or indirectly owned by a common owner or owners, either corporate or non-corporate, or by one or more of the member corporations, and that are engaged in a unitary business.

Combined reporting is limited to those entities that are organized as C corporations under subchapter C of the Internal Revenue Code.

For combined reporting to apply, a C corporation must be part of a combined group, and the combined group must be engaged in a single business enterprise -- a unitary business.

Thus, a C corporation that stands alone – i.e., a C corporation with no affiliates or related companies -- is not subject to combined reporting.

However, a C corporation that does business in Rhode Island and is part of a combined group – a group whose members are commonly owned and controlled and which is engaged in a unitary business – is subject to combined reporting, whether the group does business only in Rhode Island or in multiple states. In such a situation, the C corporation must, for Rhode Island tax purposes, count the income of all of its affiliated corporations

[16] "Pass-through entities" for this purpose include, but are not limited to, partnerships, limited liability companies that are taxed as partnerships (not as corporations) or treated as disregarded entities under federal law, and S corporations that are not themselves members of the combined group. Such entities ay have their own filing requirement for Rhode Island tax purposes.

-- no matter where they are situated in the United States and no matter if the affiliates have nexus in Rhode Island.

The use of a combined report does not disregard the separate identities of the taxpayer members of the combined group. Therefore, each taxpayer member is responsible for tax based on its taxable income or loss apportioned to Rhode Island.[17]

WATER'S EDGE

For purposes of Rhode Island's combined reporting statutes, the "water's edge" method is mandatory.

Thus, a combined group must include the entire income and apportionment factors of any member, regardless of the place incorporated or formed, if its sales factors in the United States equal more than twenty percent (20%).

Members of a combined group shall exclude as a member and disregard the income and apportionment factors of any corporation not incorporated in the United States (a "non-U.S. corporation") if its sales factor for total receipts outside the United States is eighty percent (80%) or more.

This regulation provides additional guidance on how to determine which corporations are included in, and excluded from, a combined group, including a flow chart with details involving non-U.S. corporations, tax treaty countries, and tax havens.

UNITARY BUSINESS

A group of C corporations is not subject to combined reporting unless it is engaged in a unitary business. The following excerpt, adapted from the Multistate Tax Commission, helps to explain Rhode Island's position on this matter:

> A unitary business is 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.
>
> This flow of value to a business entity located in this state that comes from being part of a unitary business conducted both within and without this state is what provides the constitutional due process "definite link and minimum

[17] Although each taxpayer member is responsible for tax, the combined group must appoint a designated agent, which is generally required to act on behalf of the combined group in its own name in all matters relating to the combined report. Please see Rule xx.

> connection" necessary for this state to apportion income of the unitary business, even if that income arises in part from activities conducted outside the state. The income of the unitary business is then apportioned to Rhode Island using Rhode Island formulary apportionment.
>
> This sharing or exchange of value may also be described as requiring that the operation of one part of the business be dependent upon, or contribute to, the operation of another part of the business. Phrased in the disjunctive, the foregoing means that if the activities of one business either contributes to the activities of another business <u>*or*</u> are dependent upon the activities of another business, those businesses are part of a unitary business.[18]

For Rhode Island corporate income tax purposes, the term "unitary business" means the activities of a group of two 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.

Rhode Island construes the term "unitary business" to the broadest extent permitted under the United States Constitution.

To help determine whether a group of affiliated corporations is engaged in a unitary business, corporations and their advisers should refer to the tests for, and the principles of, unity as set forth in the following cases:

- *Butler Brothers v. McColgan*, 315 U.S. 501 (1942).
- *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425 (1980)
- *Container Corp. of America v. Franchise Tax Board*, 463 US 159 (1983)
- *Edison California Stores v. McColgan*, 30 Cal.2d 472 (1947)

The Division of Taxation will rely chiefly, though not exclusively, on two tests to determine if a corporation is part of a unitary business. If the corporation meets either of two tests, the corporation shall be deemed to be part of a unitary business. The two tests are summarized below; further details are provided in the regulation.

Interdependence of Functions Test

Under this test, a group is engaged in a unitary business if there exists interdependence in their functions. In general, a unitary relationship requires contribution or dependency between entities, substantial mutual interdependency or flow of value, functional integration, centralized management, or economy of scale.

[18] Multistate Tax Commission Allocation and Apportionment Regulations as adopted February 21, 1973, and revised through July 29, 2010.

THREE UNITIES TEST

> Under this test, adapted from the *Butler Brothers* case, a group is engaged in a unitary business if there is (a) unity of ownership (when the 50 percent ownership threshold is met); (b) unity of operation (through common or centralized accounting, purchasing, marketing, and the like); and (c) unity of use (through centralized executive force, systems of operation, and other such functions). A group must meet all of the three unities to be deemed a unitary business.

In general, if a group meets either the "interdependence of functions" test or the "three unities test" as described above, the group will be considered engaged in a unitary business.

The Division of Taxation also will consider factors such as those described in *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, including functional integration, centralization of management, and economies of scale.

Also for purposes of determining whether a group is in a unitary business, the Division of Taxation will rely on definitions and other guidance in the Multistate Tax Commission (MTC) allocation and apportionment regulations.[19]

CONSOLIDATED RETURN

For tax years beginning on or after January 1, 2015, in determining the members of the unitary group, the taxpayer may elect to use the same members that the taxpayer includes in filing the taxpayer's federal consolidated return.[20]

Put another way, an affiliated group of C corporations, filing a federal consolidated return, may elect to be treated as a combined group with respect to Rhode Island's combined reporting requirement.

Certain taxpayers may find that such an election eases the administrative and compliance burden of identifying which members to include in the combined group for Rhode Island combined reporting purposes.

The election shall be upon the condition that all C corporations which at any time during the taxable year have been members of the affiliated group consent to be included in the group. The filing of a consolidated return for the combined group shall be considered as such consent.

Also, the election cannot be revoked in less than five (5) years – unless otherwise authorized by the Tax Administrator. Thus, effective for tax years beginning on or after

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[19] Reg.IV.1.(b). Principles for Determining the Existence of a Unitary Business.

[20] IRC § 1501 *et seq.*

January 1, 2015, once the election is made, it must continue for five years, including the year the election is made.

APPORTIONMENT – SINGLE SALES FACTOR

For tax year 2014, Rhode Island's formulary apportionment generally takes into account three factors, each weighted equally: sales (gross receipts), property, and payroll.[21] Effective for tax years beginning on or after January 1, 2015, all entities that are organized as C corporations and that are subject to tax under the Rhode Island business corporation tax (RIGL Chapter 44-11) must use single factor – sales (gross receipts) – for apportionment purposes. (See "Finnigan method" and "market-based sourcing" further in this preamble.)

Single sales factor apportionment applies whether or not a C corporation is part of a combined group. There shall be no alternative apportionment method.

Other business entities – in other words, those not organized as C corporations, including subchapter S corporations, partnerships, and limited liability companies (LLCs) that are taxed as pass-through entities or treated as disregarded entities – will continue to use the traditional three-factor apportionment formula (which includes sales, payroll, and property.

APPORTIONMENT -- FINNIGAN METHOD

Rhode Island has adopted the Finnigan method for C corporation apportionment purposes for tax years beginning on or after January 1, 2015.[22]

Under the 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 – regardless of whether an individual member of the combined group has nexus with Rhode Island.

Thus, for purposes of determining whether sales are in Rhode Island and included in the numerator of the sales factor, all sales of the combined group properly assigned to Rhode Island shall be included in the sales factor numerator for Rhode Island no matter if the member of the combined reporting group making the sale is subject to Rhode Island corporate income tax.

Under a "throwback" provision, all sales not assigned to Rhode Island shall not be included in the sales factor numerator for this state if a member of the combined reporting group of the taxpayer is taxable in the state of the purchaser.

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[21] RIGL § 44-11-14, but see also RIGL § 44-11-14.1 through § 44-11-14.6.
[22] *Appeal of Finnigan Corp.*, California State Board of Equalization, 88-SBE-022, August 25, 1988.

The denominator shall include the taxpayer's gross receipts from sales everywhere during the taxable year.

APPORTIONMENT – MARKET-BASED SOURCING

To calculate the sales factor in Rhode Island corporate income tax apportionment, Rhode Island will use market-based sourcing for tax years beginning on or after January 1, 2015. Market-based sourcing will apply only to business entities that are organized as C corporations – and will apply whether or not a C corporation is part of a combined group.

Cost-of-performance sourcing, which is in effect for tax year 2014, will not apply to C corporations for tax years beginning on or after January 1, 2015 – but will continue to apply to other entities.

Under market-based sourcing, receipts from transactions (other than sales of tangible personal property) are sourced to the market state – that is, the state where the recipient of the service receives benefit from the service.[23]

NET OPERATING LOSS DEDUCTIONS (NOLS)

A tracing protocol shall apply to net operating losses (NOLs): For purposes of Rhode Island combined reporting, the treatment of net operating losses (NOLs) depends upon when the NOL was created.

NOLs created before January 1, 2015, are allowed to offset the income only of the corporation that created the NOL; the NOL cannot be shared with other members of the combined group. Furthermore, no deduction is allowable for a net operating loss sustained during any taxable year in which a taxpayer was not subject to Rhode Island business corporation tax.

NOLs created in tax years beginning on or after January 1, 2015, shall generally receive the same treatment by Rhode Island for purposes of combined reporting and the Rhode Island corporate tax as they do under IRC § 172, and can generally be shared within the group.

FAS 109 DEDUCTION

Financial Accounting Standard 109 (FAS 109), "Accounting for Income Taxes," requires that corporations report the effect of certain changes in tax statutes -- including accounting for deferred tax liabilities -- on their financial statements. As noted earlier in this preamble, Rhode Island General Laws do not allow for a FAS 109 deduction for

[23] Under the cost-of-performance method, receipts from transactions (other than sales of tangible personal property) are assigned to the state in which the income-producing activity was actually performed.

combined reporting purposes, so the deduction is not included in this regulation – and cannot be claimed in the computation of a combined group's income.

INTANGIBLES ADD-BACKS, CAPTIVE REITS

For tax year 2014, corporations are required to add back otherwise deductible interest expenses and costs and intangible expenses and costs accrued through transactions with related companies over which they have control. Also for 2014, the net income of captive real estate investment trusts (also known as captive REITs) is taxed.

For tax years beginning on or after January 1, 2015, the intangibles add-back provision and the captive REIT provision are repealed. However, payments to combined group members are eliminated through combined reporting.

TAX CREDITS

A tracing protocol shall apply to all Rhode Island tax credits for purposes of Rhode Island combined reporting:

- Those tax credits generated for tax years beginning prior to January 1, 2015, shall be allowed to offset only the tax liability of the corporation that earned the credits; the Rhode Island tax credits cannot be shared with other members of the combined group.

- Rhode Island tax credits earned in tax years beginning on or after January 1, 2015, may be applied to other members of the group.

Also, two rate reduction programs – the life sciences and Jobs Development Act rate reductions – shall be allowed against the net income of the entire combined group.

ESTIMATED TAX

For tax years beginning on or after January 1, 2015, special rules apply regarding payments of estimated tax for any taxpayer required to file a combined report. To meet "safe harbor" provisions:

(a) The installments must equal 100 percent of the tax due for the prior year plus any additional tax that is due to the combined reporting provisions; or

(b) The installments must equal 100 percent of the current year tax liability.

TAX ADMINISTRATOR AUTHORITY

The Tax Administrator has been granted statutory authority to prescribe and amend rules and regulations so that the tax liability of any combined group – and each corporation in the combined group – may be determined, computed, assessed, collected, and adjusted in a manner so as to clearly reflect the combined income of the combined group and the individual income of each member of the combined group.

Special appeals

For tax years beginning on or after January 1, 2015, the Division of Taxation must establish an independent appeals process to attempt to resolve disputes between the Tax Administrator and the taxpayer with respect to the method of apportionment applied regarding the corporate income tax under RIGL Chapter 44-11, including combined reporting.

Tax Administrator's report

On or before March 15, 2018, the Tax Administrator must file a report analyzing the policy and fiscal ramifications of the changes enacted to the Rhode Island business corporation tax statutes (RIGL Chapter 44-11), as enacted in Article 12 of the fiscal year 2015 budget bill.[24]

[24] Rhode Island Public Law 2014, ch. 145, art. 12.

Rule 1. Purpose

These rules and regulations implement Rhode Island General Laws (RIGL) § 44-11-4.1 *et seq.*, as well as other provisions of Rhode Island Public Law 2014, ch. 145, art. 12, which changed the Rhode Island corporate income tax structure to one of mandatory unitary combined reporting in lieu of separate entity reporting for tax years beginning on or after January 1, 2015.

Rule 2. Authority

These rules and regulations are promulgated pursuant to RIGL § 44-1-4, § 44-11-4, § 44-11-4.1, and other provisions of the Rhode Island General Laws. These rules and regulations have been prepared in accordance with the requirements of RIGL § 42-35-1 *et seq.* of the Rhode Island Administrative Procedures Act.

Rule 3. Application

These rules and regulations shall be liberally construed so as to permit the Division of Taxation to effectuate the purpose of RIGL Title 44 and other applicable State laws and regulations.

Rule 4. Severability

If any provision of these rules and regulations, or the application thereof to any person or circumstance, is held invalid by a court of competent jurisdiction, the validity of the remainder of the rules and regulations shall not be affected thereby.

Rule 5. Definitions

"Affiliated group" means the same as it does in Internal Revenue Code § 1504.

"Appeals" means that, for tax years beginning on or after January 1, 2015, the Division of Taxation must establish an independent appeals process to attempt to resolve disputes between the Tax Administrator and the taxpayer with respect to the method of apportionment applied regarding the corporate income tax under RIGL Chapter 44-11.[25] The decision resulting from the independent appeals process shall not prohibit either party from pursuing any legal remedy otherwise available if the issue is not resolved as a result of the appeal process. The decision resulting from the independent appeals process can be used as evidence, but shall not be given undue weight.

[25] RIGL § 44-11-15.

“Apportionment” means, for purposes of Rhode Island’s combined reporting requirements, the formula used to approximate the amount of a combined group’s income that is subject to Rhode Island corporate income tax. (For Rhode Island corporate income tax purposes, no distinction is made between business and non-business income.) For tax years beginning on or after January 1, 2015, a corporation subject to Rhode Island mandatory unitary combined reporting must apportion income to Rhode Island using a single factor: sales (gross receipts). In calculating the sales factor, a corporation subject to Rhode Island mandatory unitary combined reporting must use the “Finnigan” method. Also, for purposes of sales other than the sale of tangible personal property, a corporation subject to Rhode Island mandatory unitary combined reporting must use the market-based sourcing method.[26] Entities other than C corporations continue to use three-factor apportionment – in which all income of each trade or business of the taxpayer is apportioned to Rhode Island by use of the apportionment formula set forth in RIGL § 44-11-14, which takes into account the property factor, the payroll factor, and the sales factor of the trade or business of the taxpayer.

“Captive REIT” refers to legislation enacted in 2007 to impose a tax on the net income of captive real estate investment trusts (also known as captive REITs). Captive REITs are those not regularly traded on established securities markets where more than 50 percent of the voting power or value is owned or controlled by a single C corporation. Dividends paid by captive trusts are allowable deductions for federal tax purposes, but would be treated as net income for Rhode Island purposes. Under Rhode Island’s mandatory unitary combined reporting regime, the 2007 legislation involving captive REITs is repealed[27] for tax years beginning on or after January 1, 2015; under combined reporting, payments to combined group members are eliminated.[28]

“Combined group” means a group of two or more corporations in which more than 50 percent (50%) of the voting stock of each member corporation is directly or indirectly owned by a common owner or owners, either corporate or non-corporate, or by one or more of the member corporations, and that are engaged in a unitary business.[29] The use of a combined report does not disregard the separate identities of the taxpayer members of the combined group; each taxpayer member is responsible for tax based on its taxable income or loss apportioned to Rhode Island. (See also “Designated Agent” definition and rule.)

“Combined reporting” generally means that a corporation must report on its Rhode Island corporate income tax 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. The corporation thus must treat all of its affiliates as if they were one,

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[26] Subchapter S corporations, partnerships, limited liability companies (LLCs) that are taxed as pass-through entities, and all other entities that are not C corporations will continue to use the traditional equal-weighted, three-factor apportionment formula (which includes sales, payroll, and property), and the cost-of-performance method.
[27] RIGL § 44-11-11(a).
[28] Rhode Island Public Law 2014, ch. 145, art. 12, § 13 *et seq.*
[29] RIGL § 44-11-1(2).

single company, and combine all of their taxable income into a single pool. The corporation must then use a formula to apportion the amount of the combined income to Rhode Island for tax purposes. The use of a combined report does not disregard the separate identities of the taxpayer members of the combined group; each taxpayer member is responsible for tax based on its taxable income or loss apportioned to Rhode Island. (But see also "Designated Agent" rule in this regulation.) Members of a combined group shall exclude as a member and disregard the income and apportionment factors of any corporation not incorporated in the United States (a "non-U.S. corporation") if its sales factor for total receipts outside the United States is eighty percent (80%) or more. If a non-U.S. corporation is includible as a member in the combined group, to the extent that such non-U.S. corporation's income is subject to the provisions of a federal income tax treaty, such income is not includible in the combined group net income. Such member shall also not include in the combined report any expenses or apportionment factors attributable to income that is subject to the provisions of a federal income tax treaty. (See also Rule xx.)

"Common ownership" means that 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 the owner or owners are members of the combined group.[30]

"Consolidated return" means a return filed with the Internal Revenue Service on a consolidated basis by an affiliated group of corporations under terms of IRC § 1501 *et seq*. An affiliated group may file on a consolidated basis for Rhode Island corporate income tax purposes – and use the federal consolidated group to fulfill its obligations under Rhode Island's mandatory unitary combined reporting provisions – provided that the affiliated group meets certain conditions and the election is not revoked in less than five (5) years unless approved by the Tax Administrator.

"Corporate income tax rate" means the Rhode Island corporate income tax rate that applies to a corporation's taxable income apportioned to Rhode Island. For tax years beginning before January 1, 2015, the rate is nine percent (9%); a corporation pays either the corporate income tax, or the franchise tax,[31] whichever is greater: the minimum is $500 a year. For tax year 2015, the rate is seven percent (7%); the franchise tax has been repealed; the annual minimum remains $500.

"Corporation" means, for purposes of mandatory unitary combined reporting under Rhode Island General Laws, an entity wherever located (other than a "foreign corporation") which is subject to tax under RIGL Chapter 44-11 or which would be subject to tax under RIGL Chapter 44-11 if doing business in Rhode Island. Furthermore, the term "Corporation" means any corporation as defined by the laws of this state or organization of any kind treated as a corporation for tax purposes under the laws of this

[30] RIGL § 44-11-1(3).

[31] Under RIGL § 44-12-1 *et seq.*, the franchise tax is equal to $2.50 per $10,000 of a corporation's authorized capital stock. For corporations that have capital stock listing no par value, the deemed value by statute is $100 per share. The annual minimum tax is $500.

state, wherever located, which if it were doing business in this state would be a taxpayer. The business conducted by a partnership which is directly or indirectly held by a corporation shall be considered the business of the corporation to the extent of the corporation's distributive share of the partnership income, inclusive of guaranteed payments to the extent prescribed by regulation. Similarly, the business conducted by another type of pass-through entity which is directly or indirectly held by a corporation shall be considered the business of the corporation to the extent of the corporation's distributive share of the pass-through entity's income. An LLC electing to be taxed as a corporation for federal tax purposes shall be treated as a corporation for purposes of this definition. The term "corporation" can also mean every corporation, joint-stock company, or association, wherever incorporated, a real estate investment trust, a regulated investment company, a personal holding company registered under the federal Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq*., and also a trustee or trustees conducting a business where interest or ownership is evidenced by certificates or other written instruments, deriving any income from sources within this state or engaging in any activities or transactions within this state for the purpose of profit or gain, whether or not an office or place of business is maintained in this state, or whether or not the income, activities, or transactions are connected with intrastate, interstate, or foreign commerce, except those specifically excluded under RIGL § 44-11-1(2)(i) through 44-11-1(2) (vii).[32]

"Cost of performance" – means direct costs determined in a manner consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the trade or business of the taxpayer to perform the income producing activity which gives rise to the particular item of income. Gross receipts are attributed to this state if, with respect to a particular item of income, the income-producing activity is performed within and without this state but the greater proportion of the income producing activity is performed in this state, based on costs of performance. Included in the taxpayer's cost of performance are the taxpayer's payments to an agent or independent contractor for the performance of personal services and utilization of tangible and intangible property which give rise to the particular item of income. (See also "market-based sourcing" below.)

"Designated Agent" means the member of the combined group – or the member's designee – which represents the combined group and whose myriad responsibilities include filing the combined report. (See Rule xx.)

"Division of Taxation" means the Rhode Island Department of Revenue, Division of Taxation, One Capitol Hill, Providence, R.I. 02908. The Division may also be referred to in this regulation as the "Division of Taxation" or "Tax Division."

"Estimated tax" means that any taxpayer required to file a combined report in accordance with RIGL § 44-11-4.1 in a tax year beginning on or after January 1, 2015, shall compute estimated payments for that tax year as follows:

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[32] Such exceptions include banks, public service corporations, insurance companies, and fraternal benefit societies.

(a) The installments must equal one hundred percent (100%) of the tax due for the prior year plus any additional tax due to the combined report provisions under § 44-1-4.1; or

(b) The installments must equal one hundred percent (100%) of the current year tax liability.

"FAS 109" means Financial Accounting Standard 109, "Accounting for Income Taxes."[33]

"Federal income tax treaty"[34] means a comprehensive income tax treaty between the United States and a foreign jurisdiction, other than a foreign jurisdiction which is defined as a tax haven; provided, however, that if the Tax Administrator determines that a combined group member non-U.S. corporation is organized in a tax haven that has a federal income treaty with the United States, its income subject to a federal income tax treaty, and any expenses or apportionment factors attributable to such income, shall not be included in the combined group net income or combined report if:

(a) the transactions conducted between such non-U.S. corporation and other members of the combined group are done on an arm's length basis and not with the principal purpose to avoid the payment of taxes due to Rhode Island; or

(b) the member establishes that the inclusion of such net income in combined group net income is unreasonable.

"Finnigan" means that, for apportionment purposes under Rhode Island's mandatory unitary combined reporting regime, the unitary group as a whole is treated as the taxpayer; all sales of members of the unitary group attributable to Rhode Island are included in the sales factor numerator, regardless of whether the member has Rhode Island nexus.[35] [36] The denominator consists of everywhere sales for all members of the combined group.

"Foreign corporation" means, for purposes of combined reporting, a corporation incorporated in or organized under the laws of a jurisdiction other than the United States. (See also "non-U.S. corporation" below.)

"Foreign jurisdiction" means, for purposes of combined reporting, a jurisdiction other than the United States.

"Finnigan" means the unitary group as a whole is treated as the taxpayer for apportionment purposes; all sales of members of the unitary group attributable to Rhode

[33] Also known as FASB Accounting Standards Codification 740, or "ASC 740".
[34] RIGL § 44-11-4.1(d).
[35] *Appeal of Finnigan Corp.*, California State Board of Equalization, 88-SBE-022, August 25, 1988.
[36] RIGL § 44-11-14(b)(1)(vii).

Island are included in the sales factor numerator – even for the member or members of a combined group that have no nexus in Rhode Island.[37]

"Intangible property" includes, but is not limited to, patents, copyrights, trademarks, trade names, service names, franchises, licenses, plans, specifications, blueprints, processes, techniques, formulas, designs, layouts, patterns, drawings, manuals, technical know-how, contracts, and customer lists. ("Intangible property" does not include stocks, bonds, certificates of deposit, or other securities.)

"Intangibles add-back" means related-party interest and intangibles which a corporation must add back to Rhode Island income for purposes of determining its Rhode Island corporate income tax liability. For tax years beginning on or after January 1, 2015, the provision involving the add-back of related-party interest and intangibles is repealed;[38] under combined reporting, payments to combined group members are eliminated.

"Internal Revenue Code" means the most current edition of Title 26 of the United States Code without regard to application of federal treaties unless expressly made applicable to states of the United States. (It is abbreviated in this regulation as IRC.)

"Jobs Development Act" refers to the Rhode Island corporate income tax rate reduction enacted in 1994[39] and available to eligible entities under RIGL § 42-64.5-1 *et seq*.

"Life sciences tax rate reduction" refers to the Rhode Island corporate income tax rate reduction enacted as "The I-195 Redevelopment Act of 2011"[40] and available to eligible entities under RIGL § 42-64.14-1 *et seq*.

"Market-based sourcing" means, for apportionment purposes for tax years beginning on or after January 1, 2015, the method that all taxpayers organized under subchapter C of the Internal Revenue Code must use to determine how to treat a corporation's sales of services.[41] Market-based sourcing generally means that receipts from transactions are sourced to the market state – that is, to the state where the recipient of the service receives benefit from the service. All gross receipts from the performance of services are included in the numerator of the apportionment factor if the recipient of the service receives all of the benefit of the service in Rhode Island. If the recipient of the service receives some of the benefit of the service in Rhode Island, the gross receipts are included in the numerator of the apportionment factor in proportion to the extent the recipient receives benefit of the service in Rhode Island.

"Member" means a corporation included in a unitary business.[42]

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[37] *Appeal of Finnigan Corp.*, supra.
[38] Rhode Island Public Law 2014, ch. 145, art. 12, § 13 *et seq.*
[39] Public Law 1994, ch. 84, § 1.
[40] Public Law 2011, ch. 245, § 3, and Public Law 2011, ch. 267, § 3.
[41] RIGL § 44-11-14.
[42] RIGL § 44-11-1(6).

"Non-U.S. corporation" means any corporation not incorporated in the United States of America. (See also "foreign corporation" above.)

"Partnership" means an association of two or more persons to carry on as co-owners a business for profit,[43] and which is treated as a partnership for Rhode Island tax purposes, or which would be treated as a partnership for Rhode Island tax purposes if doing business in Rhode Island. The term "Partnership" may include a general or limited partnership, or organization of any kind treated as a partnership for tax purposes under the laws of this state.

"Person" means any individual, firm, partnership, general partner of a partnership, limited liability company, registered limited liability partnership,[44] foreign limited liability partnership, association, corporation (whether or not the corporation is, or would be if doing business in this state, subject to RIGL § 44-11-1 *et seq.*), company, syndicate, estate, trust, business trust, trustee, trustee in bankruptcy, receiver, executor, administrator, assignee or organization of any kind.

"Receipts factor" – See "sales factor" below.

"Rhode Island General Laws" means the General Laws of Rhode Island of 1956, as amended. For purposes of this regulation, the term "Rhode Island General Laws" is abbreviated "RIGL".

"Sales factor" means, effective for apportionment purposes for tax years beginning on or after January 1, 2015, the sole factor that must be used by all entities organized as C corporations and subject to tax under the Rhode Island business corporation tax (RIGL Chapter 44-11) – whether or not they are part of a combined group.[45] Each unitary business group member must include all receipts – i.e., total receipts or gross receipts – from sales or other sources, without regard to whether the member has nexus in this state. Receipts between members included in a unitary business group must be eliminated in calculating the sales factor. (See Rule xx.) The sales factor may also be referred to as the "receipts factor" or "gross receipts factor." The denominator of the sales factor shall include the total gross receipts derived by all members of the combined group from transactions and activity in the regular course of trade or business everywhere.

"Sourcing" – See "market-based sourcing" above.

"Tax Administrator" means the person within the Rhode Island Department of Revenue, Division of Taxation, as described in RIGL § 44-1-1 *et seq.*

"Tax Division" – See "Division of Taxation" above.

"Taxpayer" means any person subject to the tax imposed by Rhode Island General Laws.

[43] RIGL § 7-12-17.

[44] RIGL § 7-12-13.

[45] RIGL § 44-11-14(b).

"Tax haven"[46] means a jurisdiction that, during the tax year in question has no, or nominal effective tax on the relevant income and:

(a) has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime;

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

(c) facilitates the establishment of foreign-owned entities without the need for a local substantive presence, or prohibits these entities from having any commercial impact on the local economy;

(d) explicitly or implicitly excludes the jurisdiction's resident taxpayers from taking advantage of the tax regime's benefits, or prohibits enterprises that benefit from the regime from operating in the jurisdiction's domestic market; or

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

"Tax treaty" – see "Federal income tax treaty" above.

"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. The term "unitary business" shall be construed by the Rhode Island Division of Taxation to the broadest extent permitted under the United States Constitution.[47]

"United States" means the fifty (50) states of the United States, the District of Columbia, and the United States' territories and possessions.[48]

"Water's edge rules" means the rules, described elsewhere in this regulation, under which some or all of a taxpayer's items attributable to a unitary business are not subject to combination because of the degree of the taxpayer's activities outside the United States.[49] ("Water's edge" is a term used in tax discussions regarding to what extent a combined

[46] RIGL § 44-11-1(8).
[47] RIGL § 44-11-1(11).
[48] RIGL § 44-11-1(12).
[49] RIGL § 44-11-4.1(d).

group should include overseas members for purposes of combined reporting. Some states require all of a group’s members worldwide to be included in the combined group. Some states allow the combined group to adopt a “water’s edge” election – which, if adopted, generally limits a combined group’s membership to members within the United States – up to the “water’s edge”. For purposes of Rhode Island combined reporting, water’s edge treatment is mandatory. See also Rule xx.)

“Worldwide” – See “water’s edge rules” above.

Rule 6. Combined Reporting – Overview

(a) For tax years beginning on or after January 1, 2015, each C corporation which is part of a combined group, under common ownership, and engaged in a unitary business with one or more other C corporations must file a return, in a manner prescribed by the Tax Administrator, for the combined group containing the combined income of the combined group.[50]

(b) Where a taxpayer is subject to tax under RIGL Chapter 44-11 or which would be subject to tax under RIGL Chapter 44-11 if doing business in Rhode Island, the taxpayer must determine its Rhode Island tax liability based upon the income and apportionment information of all corporations included in the combined group using a combined report (unless it is an excluded entity as further described in this regulation). The use of a combined report does not disregard the separate identities of the members of the combined group; each taxpayer member is responsible for tax based on its taxable income or loss apportioned to Rhode Island.[51] (See also "Designated Agent" rule.)

(c) A "combined report" is not, in and of itself, a tax return; it is, in fact, a computational schedule or schedules – as required by Rhode Island General Laws and regulations – which are to be attached to a taxpayer member's tax return and which report the income and apportionment information of all entities that are members of the taxpayer member's combined group, as well as any supporting information required by the Tax Administrator.

The return shall include, for each taxable year, the following:

(1) Listing of companies included in the combined report, along with each company's federal Employer Identification Number (EIN) and North American Industry Classification System (NAICS) code;[52]

(2) Combined federal taxable income;

(3) Combined Rhode Island deductions;

(4) Combined Rhode Island additions;

(5) Adjusted taxable income;

(6) Combined receipts for Rhode Island using Finnigan method;

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[50] RIGL § 44-11-4.1(a). For purposes of this regulation, a taxpayer with a 52/53-week year shall be treated as having a tax year beginning date of January 1 and a tax year end date of December 31.
[51] RIGL § 44-11-4.1(c).
[52] The Division of Taxation shall work with tax software providers to ensure that computerized tax preparation software programs require the inclusion of an NAICS code for each member of a combined group.

(7) Combined receipts for everywhere using Finnigan method;

(8) Combined Rhode Island tax;

(9) Information on credits, NOLs, and other items on such forms or schedules that the Tax Administrator may prescribe.

The following example shows how related entities might be affected by combined reporting:[53] For purposes of apportionment calculations, the denominators reflect worldwide, payroll and sales for businesses that are included in the combined group.

Example:

The example below compares combined reporting to separate- entity reporting for three related entities – Echo Corp., Foxtrot Corp., and Golf Corp. – that are U.S. companies, part of a unitary business, and have common ownership.[54] Echo Corp. is a Rhode Island retailer. Foxtrot Corp. is a Rhode Island retailer. Golf Corp. is a Missouri retailer with no Rhode Island nexus and, therefore, no Rhode Island filing requirement but for combined reporting. Most sales are in the U.S., but some are to customers in foreign jurisdictions.

Apportionment:	Echo Corp. (separate)	Foxtrot Corp. (separate)	Golf Corp. (separate)	Combined report
Sales Factor:				
In-state sales……………………	$400	$7,700	$ 0	$ 8,100
Everywhere sales………………	625	15,000	50,000	65,625
Sales percentage……………….	64.0000%	51.3333%	0.0%	12.3429%
Taxable income total	750	9,000	75,000	84,750
In-state taxable income	480	4,620	0	10,461
Total taxable income to Rhode Island	5,100			10,461

[53] Some of the examples in this section are adapted from “Combined Reporting with the Corporate Income Tax: Issues for State Legislatures,” William F. Fox and LeAnn Luna, Center for Business and Economic Research, University of Tennessee, November 2010. (Report commissioned by the NCSL Task Force on State & Local Taxation of Communications and Interstate Commerce.).
[54] The names of corporations or other entities used in examples in this regulation are not intended to represent the names of actual corporations.

Rule 7. Combined Group – Composition; Water's Edge; Tax Havens

(a) "Combined group" means a group of two or more corporations in which more than 50 percent (50%) of the voting stock of each member corporation is directly or indirectly owned by a common owner or owners, either corporate or non-corporate, or by one or more of the member corporations, and that are engaged in a unitary business.

(b) The use of a combined report does not disregard the separate identities of the taxpayer members of the combined group; each taxpayer member is responsible for tax based on its taxable income or loss apportioned to Rhode Island.

(c) A group may be deemed a combined group even if the group is not eligible to apportion its income because all corporations in the group do business solely in Rhode Island.

(d) A combined group remains in existence for as long as two or more C corporations are under common ownership or control and are engaged in the same unitary business.

(e) The mere addition of new members or departure of existing members does not create a new combined group.

(f) In some cases, a taxpayer may make an election to treat, as its combined group for Rhode Island corporate income tax purposes, all of the members of its federal consolidated group. For an explanation of the election and the related requirements and limitations, please see Rule xx in this regulation.

(g) For additional information about non-U.S. corporations, please see the flow chart in the example at the end of this Rule.

(h) *Included corporations.*

(1) All of the income and apportionment factors must be included for the following members. The list includes, but is not limited to, the following:

(i) U.S. corporations;

(ii) Any member, regardless of where it is incorporated or formed, if the average of its sales factors within the United States is twenty percent (20%) or more; and

(iii) Domestic international sales corporations (DISC) described in IRC §§ 991-994, foreign sales corporations (FSC) described in IRC §§ 921-927, and export trade corporations (ETC) described in IRC §§ 970-972.

(2) The following members that are not described above are included only to the extent of any U.S. source income and factors:

(i) Controlled foreign corporation (CFC) defined in IRC § 957, if they have Subpart F income defined in IRC § 952.

(ii) Any member that is a resident of a country that does not have a comprehensive income tax treaty with the United States and earns more than twenty percent (20%) of its income, directly or indirectly, from intangible property or service-related activities that are deductible against the business income of the other members of the water's-edge group, to the extent of that income and the apportionment factors related thereto.

(i) *Excluded corporations.* Members of a combined group shall exclude as a member and disregard the income and apportionment factors of any corporation not incorporated in the United States (a "non-U.S. corporation") if its sales factors for total receipts outside the United States is eighty percent (80%) or more.[55]

Example:

Bristol Biz Corp., Kent Biz Corp., Newport Biz Corp., Providence Biz Corp., and Washington Biz Corp. are all C corporations under common ownership engaged in a unitary business and subject to Rhode Island combined reporting. Bristol, Kent, and Newport are all non-U.S. corporations; Providence and Washington are both U.S. corporations.

Composition of the combined group		
Entity:	*Sales factor for receipts in U.S.*	*Part of combined group?*
Bristol Biz Corp.	10%	No
Kent Biz Corp.	10%	No
Newport Biz Corp.	25%	Yes
Providence Biz Corp.	100%	Yes
Washington Biz Corp.	100%	Yes

In this example, Bristol and Kent are not part of the combined group because they are non-U.S. corporations *and* their sales factors for total receipts outside U.S. are 80% or more. Newport is a non-U.S. corporation, but its sales factor for total receipts outside the U.S. is only 75%, so it is part of the combined group. Providence and Washington are part of the combined group because they are U.S. corporations; a U.S. corporation is subject to combined reporting no matter its sales factor for receipts outside the U.S.

Note, also, that the sales factor – also known as the receipts factor – takes into account total receipts and includes rents, royalties, licensing fees, and other

[55] RIGL § 44-11-4.1(d).

revenue.[56] In this example, Newport Biz Corp. is organized and located in the Republic of Ireland, licensing intangibles to the U.S. – so revenue from such licensing represents a U.S. sale for combined reporting purposes.

For further information about excluding and including non-U.S. corporations, please see the flow chart in the example at the end of this Rule.

(j) A water's edge election is not allowed for purposes of Rhode Island combined reporting. Water's edge treatment is mandatory. Thus, members of the combined group must exclude as a member and disregard the income and apportionment factors of any corporation incorporated in a foreign jurisdiction – a foreign corporation – if its sales factor for total receipts outside the United States is eighty percent (80%) or more.

(k) Entities or persons that engage in activities enumerated under RIGL §§ 44-13-4 (Public Service Corporation Tax), 44-14-3 (Tax on State Banks), 44-14-4 (Tax on National Banks), or 44-17-1 (Taxation of Insurance Companies), whether within or outside Rhode Island, shall be excluded from the combined group. Furthermore, neither the income or loss nor the apportionment factors of such a person or entity shall be included – directly or indirectly – in the combined report. (However, if a combined group makes a consolidated return election, and such an entity is included in the consolidated return for federal corporate income tax purposes, such an entity shall be included in the Rhode Island consolidated return.)

(l) Corporations that are not taxable under the Internal Revenue Code shall not be included in the combined group.

(m) Pass-through entities, including but not limited to partnerships, limited liability companies not taxed as corporations under federal law, and S corporations are not themselves members of the combined group. However, the combined group's share of the pass-through entity's income, normally reported on federal Schedule K-1, should be reported as part of the combined group's income.

(n) In summary, the following entities are not subject to combined reporting:[57]

- state banks;
- mutual savings banks;
- federal savings banks;
- trust companies;

[56] For purposes of Rhode Island combined reporting, receipts include -- but are not limited to -- gross sales of tangible personal property, gross income from services, gross income from rentals, net income from the sale of real and personal property, and net income from the sale or other disposition of securities or financial obligations. See RIGL § 44-11-14.

[57] The entities on this list may still have a separate filing requirement for Rhode Island tax purposes if they do business in Rhode Island. For example, Form RI-1065 is filed by partnerships, limited liability companies (LLCs), limited liability partnerships (LLPs), limited partnerships, general partnerships, and single-member limited liability companies (SMLLCs); and Form RI-1120S for S corporations.

- national banking associations;
- building and loan associations;
- credit unions;
- loan and investment companies;
- public service corporations;
- insurance companies.
- S corporations;
- partnerships treated as pass-through entities for federal tax purposes;
- limited liability companies treated as pass-through entities for federal tax purposes;
- sole proprietorships and similar entities that are disregarded as separate from their owners ("disregarded entities"[58]); and
- in general, any corporation incorporated in a foreign jurisdiction if its sales factor for total receipts outside the United States is eighty percent (80%) or more.

Any entity listed above that is organized as a C corporation shall be excluded from the combined group. However, if such an entity is included as an affiliate in the group's federal consolidated return, such an entity must be included in the group's Rhode Island consolidated return.

Income from pass-through entities may have to be included in a combined report depending on ownership and other factors. The combined group's share of the pass-through entity's income, normally reported on federal Schedule K-1, should be reported as part of the combined group's income.[59]

(o) *Fifty percent test.*

The fifty percent ownership test is satisfied in the following circumstances:

> (1) A parent corporation and one or more corporations or chains of corporations which are connected through voting stock ownership with the parent, whether such ownership is direct or indirect, but only if –
>
> > (A) the parent owns more than 50 percent of the outstanding voting stock of at least one corporation, and,
> >
> > (B) more than 50 percent of the outstanding voting stock of each of the corporations, other than the parent, is owned directly or indirectly by one or more of the other corporations.
>
> (2) Any two or more corporations, if more than 50 percent of the outstanding voting stock of each of the corporations is owned, or indirectly owned, by the same person.

[58] See U.S. Treas. Reg. § 301.7701-2.

[59] "Pass-through entities" for this purpose include, but are not limited to, partnerships, limited liability companies that are taxed as partnerships (not as corporations) or treated as disregarded entities under federal law, and S corporations that are not themselves members of the combined group. Such entities ay have their own filing requirement for Rhode Island tax purposes.

(3) Any two or more corporations, more than 50 percent of whose voting stock is cumulatively owned (without regard to indirect ownership rules), or for the benefit of, members of the same family.

Members of the same family include an individual, his or her spouse, a party to a civil union, ancestors, brothers or sisters, lineal descendants, and their respective spouses.

(p) Except as otherwise provided, voting stock is “owned” when title to the stock is directly held or if the voting stock is indirectly owned.

(1) An individual indirectly owns voting stock that is owned by any of the following:

(A) his or her spouse (other than a spouse who is legally separated from the individual);

(B) party to a civil union;

(C) his or her children, grandchildren, and parents;

(D) an estate or trust, of which the individual is an executor, trustee, or grantor, to the extent that the estate or trust is for the benefit of that individual’s spouse, party to a civil union, children, grandchildren or parents.

(2) voting stock owned by a partnership, other than a limited partnership, is indirectly owned by a partner in proportion to the partner's capital interest in the partnership. For this purpose, a partnership other than a limited partnership is treated as owning proportionately the stock owned by any other partnership or limited partnership in which it has a tiered interest. Voting stock owned by a limited partnership is indirectly owned by the general partner who has authority to determine how the stock is voted. (This section shall also apply to LLCs.)

(3) voting stock owned by a corporation, or a member of a controlled group of which the corporation is the parent corporation, is indirectly owned by any shareholder owning more than 50 percent of the voting stock of the corporation.

(q) In determining ownership, effective control over election of the board of directors will be considered. For example, a group of shareholders acting in concert who collectively own over 50 percent of the voting stock of each of two or more corporations will be considered to be common owners of more than 50 percent of the voting stock of each of those corporations. “Voting stock” refers only to those shares of voting stock having the power to elect the corporation’s board of directors. If the power otherwise held in corporate stock to vote the membership of the board is transferred to another, other than a transfer of proxy only, the holder of that power will be considered to be the owner of that stock to the exclusion of the transferor of such power.

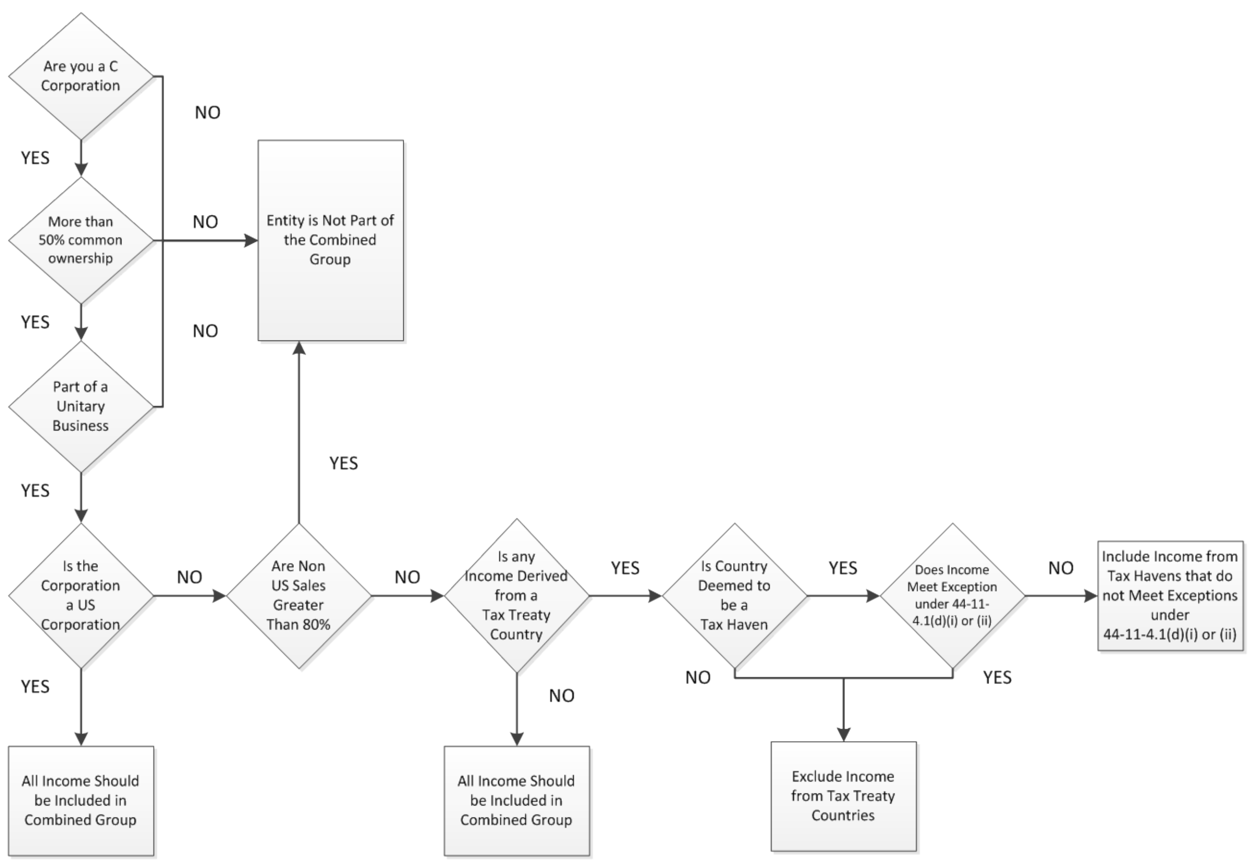
(r) In addition to the tests enumerated above, the Tax Administrator may consider any other circumstance that tends to demonstrate that the 50 percent direct or indirect common ownership test was met or was not met.

(s) The following example illustrates certain principles outlined in this rule:

Example:

Corporation D owns stock representing ten percent (10%) of the voting power of Corporation E and has a seventy-five percent (75%) interest in Partnership F. Partnership F owns stock representing forty-five percent (45%) of the voting power of Corporation E. Corporation D is considered to constructively own stock representing fifty-five percent (55%) (10% + 45%) of the voting power of Corporation E. This is because Corporation D owns more than fifty percent (50%) of Partnership F and is therefore considered to own all of the Corporation E stock owned by Partnership F.

(t) The following flow chart is intended to assist corporations and their tax advisers in determining the composition of a combined group – and whether to include or exclude a member's gross receipts – for purposes of Rhode Island's mandatory unitary combined reporting regime.



Additional information on flow chart.

(u) The following provides further information for interpreting the flow chart above.

(1) As noted elsewhere in this regulation, members of a combined group shall exclude as a member and disregard the income and apportionment factors of any corporation not incorporated in the United States (a "non-U.S. corporation") if its sales factor for total receipts outside the United States is eighty percent (80%) or more.

(2) If a non-U.S. corporation is includible as a member in the combined group, to the extent that such non-U.S. corporation's income is subject to the provisions of a federal income tax treaty, such income is not includible in the combined group's net income. Such member shall also not include in the combined report any expenses or apportionment factors attributable to income that is subject to the provisions of a federal income tax treaty.

(3) For purposes of this Rule, the term "federal income tax treaty" means a comprehensive income tax treaty between the United States and a foreign jurisdiction, other than a foreign jurisdiction which is defined as a tax haven; provided, however, that if the Tax Administrator determines that a combined group member non-U.S. corporation is organized in a tax haven that has a federal income tax treaty with the United States, its income subject to a federal income tax treaty, and any expenses or apportionment factors attributable to such income, shall not be included in the combined group net income or combined report if:

(i) the transactions conducted between such non-U.S. corporation and other members of the combined group are done on an arm's length basis and not with the principal purpose to avoid the payment of taxes due under this chapter; or

(ii) the member establishes that the inclusion of such net income in combined group net income is unreasonable.

(4) The term "tax haven' means a jurisdiction that, during the tax year in question has no or nominal effective tax on the relevant income and:

(i) has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime;

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

(iii) facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy;

(iv) explicitly or implicitly excluded the jurisdictions resident taxpayers form taking advantage of the tax regime benefits or prohibits enterprisers that benefit from the regime from operating in the jurisdiction's domestic market; or

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

Rule 8. Unitary Business – Further Defined

(a) A "unitary business," as defined in Rule 5, 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. The term "unitary business" also refers to a single business entity or a commonly owned or controlled group of business entities that are sufficiently interdependent, integrated, and interrelated through their activities so as to provide synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts.

(b) A determination under this regulation of whether an entity forms part of a unitary business with another is determined based on the facts and circumstances of each case. To the extent compatible with Rhode Island law, any legal or factual determination relevant to the existence or nonexistence of a unitary business will favor consistency with legal and factual determinations of other unitary states. Combined reporting in Rhode Island is required only in those instances in which a unitary business exists.

(c) Under Rhode Island General Laws, the term "unitary business" shall be construed "to the broadest extent permitted under the United States Constitution." Therefore, if the corporation meets *either* of the tests set forth in this rule, the corporation is deemed to be part of the unitary business.

(d) *Interdependence of functions test.*

One or more related business organizations engaged in business activity – entirely within this state, or both within and without this state – are unitary if there exists interdependence in their functions. This test adopts the decisional law of the United States Supreme Court with respect to the constitutional prerequisites for requiring unitary combination. The Court has variously expressed the constitutional test, holding that a finding of unitary relationship requires "contribution or dependency" between businesses; "substantial mutual interdependency" or "flow of value"; functional integration, centralized management or economy of scale.[60]

These concepts collectively express the Court's view of the constitutional parameters of required combination. Rhode Island's "interdependence of functions test" extends as far as, but no further than, the constitutional limits found by the Court.

(e) Any of the following circumstances indicates that an interdependence of functions exists:

> (1) *Same Line of Business.* The principal activities of the entities are in the same general line of business. Examples of the same line of business are manufacturing, wholesaling, and retailing of tangible personal property; transportation or finance.

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[60] *Edison California Stores v. McColgan*, 30 Cal.2d 472 (1947); Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980).

(A) In determining whether two entities are in the same general line of business, consideration shall be given to the nature and character of the basic operations of each entity, including, but not limited to, sources of supply, goods or services produced or sold, labor force, and market.

(B) Two entities are in the same general line of business when their operations are sufficiently similar to reasonably conclude that the entities are likely to depend upon or contribute to one another.

(2) *Vertically Structured Business.* The principal activities of the entities are different steps of a vertically structured business. Illustrations of such different steps are exploration, mining and drilling, production, refining, marketing, and transportation of natural resources.

(3) *Strong Centralized Management.* Centralized management may be evidenced by executive level policy made by a central person, board or committee and not by each entity in areas such as, but not limited to, purchasing, accounting, finance, tax compliance, legal services, human resources, health and retirement plans, product lines, capital investment and marketing.

(4) *Non-Arm's-Length Prices.* Goods or services or both are supplied at non-arm's length prices between or among entities. Existence of arm's-length pricing between entities, however, does not indicate lack of unity.

(5) *Existence of Benefits from Joint, Shared or Common Activity.* A discount, cost-saving or other benefit can be shown to result from joint purchases, leaseholds, or other forms of joint, shared or common activities between or among entities.

(6) *Relationship of Joint, Shared or Common Activity to Income-Producing Operations.* In determining whether or not the fact that there exists a joint, shared, or common activity is indicative of a unitary relationship, consideration shall be given to the nature and character of the basic operations of each entity. Such consideration shall include, but not be limited to, the entity's sources of supply, its goods or services produced or sold, its labor force and market to determine whether the joint, shared or common activity is directly beneficial to, related to or reasonably necessary to the income-producing activities of the unitary business.

(7) *Exercise of Control.* The exercise of control by one entity over another entity.

(f) The "three unities test". This test adopts the state law test for unity followed in Butler Brothers.[61]

(1) *Unity of ownership.* "Unity of ownership" exists with respect to corporations when the fifty percent ownership test is met.

[61] *Butler Brothers v. McColgan*, 315 U.S. 501 (1942).

(2) *Unity of operations and unity of use.* These unities exist if each entity that is to be included in the unitary business benefits or receives goods, services, support, guidance or direction arising from the actions of common staff resources or common executive resources, personnel, third-party providers, or operations under the direction of such common resources. The tests are overlapping and the indicators of each test also indicate the existence of interdependence of functions. The existence or non-existence of the following factors will assist in the determination of whether unity of operations and use exist with respect to a combined group. The existence or non-existence of any one factor, by itself, is normally not determinative of whether there is a unity of operations and use. Nor is this list a limitation on the factors that may be considered in determining this:

(A) Common purchasing;

(B) Common advertising;

(C) Common employees, including sales force;

(D) Common accounting;

(E) Common legal support;

(F) Common retirement plan;

(G) Common insurance coverage;

(H) Common marketing;

(I) Common cash management;

(J) Common research and development;

(K) Common offices;

(L) Common manufacturing facilities;

(M) Common warehousing facilities;

(N) Common transportation facilities;

(O) Common computer systems and support;

(P) Financing support;

(Q) Common management, meaning that one or more officers or directors of the parent are also officers or directors of the subsidiary;

(R) Control of major policies. For example, the parent's board of directors requires that it approve any acquisition by either the parent or subsidiary of any interest in any other company, or the parent's board of directors requires that it approve any lending in excess of a minimum set amount to any one or more of either the parent or subsidiary's suppliers;

(S) Inter-entity transactions. For example, the subsidiary has licensed to parent the use of personal property developed by the subsidiary. The parent uses the property for its production;

(T) Common policy or training manuals. For example, the parent's employee handbook has been expanded to apply to all of a subsidiary's employees, or the subsidiary's employees are required to attend parent's employee training courses, or disciplinary procedures are the same for both the parent and subsidiary's employees, even if the appeal is only through their respective entities;

(U) Required budgetary approval. For example, the parent's board of directors requires that it approve the budget and expenditure plans of the subsidiary on an annual basis; and

(V) Required capital asset purchases approval. For example, the parent's board of directors requires that it approve any capital expenditures by the subsidiary in excess of a minimum set amount.

The factors listed above refer to the relationship between a parent and subsidiary. For purposes of this regulation, the factors also refer to the relationship between a brother and sister entity.

(g) *Holding Companies.* The test for a unitary business established by this rule applies in determining whether a holding company is included or excluded from a unitary business. If a holding company is organizationally between two unitary entities, such holding company does not negate unity of ownership.

(1) Passive holding companies. A passive holding company that is in a commonly controlled economic enterprise and holds intangible assets that are used by the enterprise in a unitary business shall be deemed to be engaged in the unitary business, even if the holding company's activities are primarily passive.

(2) A passive parent holding company that directly or indirectly controls one (1) or more operating company subsidiaries engaged in a unitary business shall be deemed to be engaged in a unitary business with the subsidiary or subsidiaries, even if the holding company's activities are primarily passive.

(h) A commonly controlled group may be engaged in one or more unitary businesses. Therefore, a commonly controlled group may contain more than one combined group.

(i) *Newly formed entities.*

When a corporation forms another corporation, a presumption exists in favor of finding unity between the two corporations as of the date of formation. Any party may rebut such presumption by proving that the entities are not unitary or became unitary at a later date.

For purposes of this rule, a newly formed entity includes – but is not limited to – the following:

(1) A corporation that is formed through a corporate reorganization, a corporate divestiture, split-up, or split-off;

(2) One (1) or more new subsidiaries is acquired and substantially all of the assets and operations of an existing division or operation are placed into or under the administrative or operational responsibility of the acquired corporation;

(3) A partnership is created or formed; or

(4) An existing corporation changes its form of doing business from one (1) organizational structure to a new organizational structure or merges into an existing or newly formed entity.

(j) *Newly acquired entities.*

When an entity acquires another entity so that the acquired entity is a member of a commonly controlled group for the first time, it shall be presumed that the acquiring and acquired entities are engaged in a unitary business for the purchaser's taxable year that includes the acquisition. If the purchaser is already a combined group member, the taxable year that includes the acquisition is the taxable year of the combined group.

(1) The presumption may be rebutted by proving that the entities are not unitary. If the presumption is rebutted, then the entities shall not be considered unitary as of the date of acquisition, unless the evidence shows that unity was established as of another date.

(2) In the succeeding reporting period after the first reporting period subsequent to an acquisition whereby an entity that is a member of a unitary group acquires another entity, and for all reporting periods thereafter, a presumption of a unitary relationship exists. The presumption may be rebutted by proving that the entities are not unitary.

(k) *Pre-existing relationship.*

The presumption against unity shall not apply if, immediately preceding the acquisition, the acquiring and acquired entities were engaged in a unitary business apart from being in the same commonly controlled group.

(l) *Examples.*

The following examples illustrate some of the principles set forth in this rule:

Example:

Kilo Corp., which has its headquarters in Delaware, engages in the United States – directly and indirectly, through subsidiaries and affiliates – in the petroleum business, ranging from exploration for petroleum reserves to production, refining, transportation, and distribution and sale of petroleum and petroleum products. Its business activities in Rhode Island include the retail sale of gasoline, oil and other such products. Its business is deemed to be unitary under Rhode Island statute. Combined reporting is therefore required.

Example:

Lima Corp. is located in Rhode Island and manufactures tin cans. A separate but related corporation is located in California and operates a sheep farm. The two corporations are under common ownership, but do not meet the "Interdependence of Functions" or the "Three Unities" tests described elsewhere in this Rule – and are not part of a unitary business. Thus, a Rhode Island combined report need not be filed.

Example:

Mike Corp. is an Illinois corporation. Its home office is in Chicago, Illinois. It is engaged in the wholesale dry goods and general merchandise business, buying from manufacturers and others and selling to retailers only. There are separate wholesale distribution operations in seven states, including Rhode Island. Each wholesale distribution operation maintains its own stock of goods, serves a separate territory, has its own sales force, handles its own sales as well as solicitation, credit and collection arrangements, and keeps its own books of account. Each wholesale distribution operation is a separate corporation, and shares common ownership with Mike Corp. Thus, the business is deemed to be unitary under Rhode Island statute mainly because they are in the same line of business, and combined reporting is therefore required.

Example:

Alpha Conglomerate owns hundreds of businesses worldwide. Nearly all of the businesses are engaged in life insurance, commercial insurance, retirement services, asset management, and/or financial services. A wholly owned subsidiary, Beta Lake Corp., owns, operates, and conducts a holiday resort with year-round attractions, lodgings, and a conference business. Alpha does not own any other business similar to this year-round holiday resort. The year-round holiday resort is a discrete business enterprise; it is unrelated to Alpha's financial services insurance and related business lines; it is not sufficiently interdependent, integrated or interrelated through its activities so as to provide mutual benefit and produce a significant sharing or exchange of value among other Alpha units; and it does not send taxable value out of state in any appreciable way. Alpha has no significant managerial control over Beta, and has not provided any expertise to it. Thus, there is no unitary relationship between Beta and the other Alpha entities, and it is not part of Alpha's combined group engaged in a unitary business enterprise under Rhode Island statutes for purposes of Rhode Island mandatory unitary combined reporting.

Rule 9. Election to Use Federal Consolidated Group

(a) In determining the members of the unitary group for Rhode Island corporate income tax purposes, the taxpayer may elect to use the same members that the taxpayer includes in filing the taxpayer's federal consolidated return.[62]

(b) For purposes of this Rule, an affiliated group is one or more chains of includible corporations connected through stock ownership with a common parent corporation – as further defined in IRC §§ 1504 (a) and (b). The common parent must be an includible corporation and the following requirements must be met:

> (1) The common parent must own directly stock that represents at least 80% of the total voting power and at least 80% of the total value of the stock of at least one of the other includible corporations;
>
> (2) Stock that represents at least 80% of the total voting power, and at least 80% of the total value of the stock of each of the other corporations (except for the common parent), must be owned directly by one or more of the other includible corporations.
>
> For this purpose, the term "stock" generally does not include any stock that:
>
> > (i) is nonvoting;
> >
> > (ii) is nonconvertible;
> >
> > (iii) is limited and preferred as to dividends and does not participate significantly in corporate growth; and
> >
> > (iv) has redemption and liquidation rights that do not exceed the issue price of the stock (except for a reasonable redemption or liquidation premium).

(c) Thus, in place of the steps listed in this regulation for determining members of the unitary group for purposes of filing a combined report for Rhode Island, the taxpayer may instead use all of the members of its federal affiliated group, as defined in IRC § 1504, as shown on or reflected in the taxpayer's federal consolidated return. Taxpayers should refer to Rhode Island Division of Taxation Regulation xx-xx.

(d) Certain taxpayers may find that such an election eases the administrative and compliance burden of identifying which members to include in the combined group for Rhode Island combined reporting purposes.

[62] IRC § 1501 *et seq.*

(e) Should the taxpayer make this election, it shall be binding for purposes of Rhode Island combined reporting for five consecutive tax years beginning with the first tax year to which the election applies.[63]

Example:

X-Ray Corp., acting as designated agent for its affiliated group of C corporations, as defined in IRC § 1504, elects to have the affiliated group treated as a combined group with respect to Rhode Island's mandatory unitary combined reporting regime. The election is made for tax year 2015. Thus, the election applies for tax years 2015, 2016, 2017, 2018, and 2019. The first time the election may be revoked is for tax year 2020.[64]

(f) Should the affiliated group seek to revoke the election before the five-year period ends, the group's designated agent may petition the Tax Administrator in writing, citing reasonable cause.

(g) Any entity entering the unitary combined group after the year of the election shall be deemed to have consented to the application of the election.

(h) To make the election, the taxpayer shall check the appropriate box on the appropriate schedule accompanying the Form RI-1120C and submit a letter of explanation to the Tax Administrator.

(i) The taxpayer making the election shall file, for the year concurrent with the filing of its Rhode Island combined report, a copy of the following:

1.) its federal consolidated return;

2.) any and all supporting documents, forms, schedules and statements filed with the federal consolidated return, including U.S. Form 851 ("Affiliations Schedule), and all U.S. Forms 1122 ("Authorization and Consent of Subsidiary Corporation To Be Included in a Consolidated Income Tax Return"); and

3.) supporting statements for each corporation included on the federal consolidated return, including, for each such corporation, columns showing items of gross income and deduction, as well as a computation of taxable income.

(j) A taxpayer shall be allowed to make the election described in this rule provided that those entities with which it has an ownership stake of between 50 percent and 80 percent would not materially impact the result of the combined report were they to be included in the combined report. To help ensure that reports and returns are prepared in such a way

[63] RIGL § 44-11-4.1(b).

[64] Assuming that the affiliated group has not petitioned the Tax Administrator for permission for earlier revocation, and the Tax Administrator has not approved said revocation.

so as to clearly reflect income, the Tax Administrator reserves the right to require the taxpayer to include in its Rhode Island combined report certain entities that are not included in the taxpayer's federal consolidated return, and to determine members of its combined report in accordance with the terms set forth in this regulation.

RULE 10. Apportionment; Single Sales Factor; Market-Based Sourcing

(a) For tax years beginning on or after January 1, 2015, all taxpayers organized under subchapter C of the Internal Revenue Code shall apportion net income to this state by means of a single factor representing total receipts – gross receipts – from sales and other applicable sources during the taxable year which are attributable to the taxpayer's activities or transactions.[65]

(b) The sales factor is the ratio of the taxpayer's receipts in this state to the taxpayer's total receipts everywhere during the taxable year. Thus, the numerator shall reflect total receipts from sales and other applicable sources during the taxable year which are attributable to the taxpayer's activities or transactions in this state – whether or not an entity has nexus with this state. The denominator shall reflect everywhere receipts.

(c) Each member's share of the combined unitary income is the product of the combined unitary income and the member's modified sales factor ratio.

(d) The numerator shall reflect total receipts from sales or other sources during the taxable year which is attributable to the taxpayer's activities or transactions in this state – whether or not an entity has nexus with this state. The denominator shall reflect everywhere receipts.

(e) A corporation subject to combined reporting shall include in its receipts the following:

(1) Gross sales of its tangible personal property (inventory sold in the ordinary course of business) where:

(i) Shipments are made to points within this state; or

(ii) Shipments are made from an office, store, warehouse, factory or other place of storage in this state and the taxpayer is not taxable in the state of the purchase.

(2) Gross income from the performance of services where the recipient of the service receives all of the benefit of the service in this state. If the recipient of the service receives some of the benefit of the service in this state, gross income which shall be included in the numerator of the apportionment factor in proportion to the extent the recipient receives benefit of the service in this state;

(3) Gross income from rentals from property situated within the state;

[65] In general, for tax years beginning before January 1, 2015, a C corporation subject to Rhode Island corporate income tax employed three-factor apportionment, using sales (receipts), property, and payroll. In certain cases, a corporation may use a special apportionment formula available under RIGL §§ 44-11-14.1 through 44-11-14.6.

(4) Net income from the sale of real and personal property, other than inventory sold in the ordinary course of business, or other capital assets located in the state;

(5) Net income from the sale or other disposition of securities or financial obligations; and

(6) Gross income from all other receipts within the state.

(f) In summary, a taxpayer subject to Rhode Island mandatory unitary combined reporting shall use the Finnigan method (as described more fully below), single sales factor apportionment, and market-based sourcing in its calculations. Additional information about apportionment is included in Rhode Island Division of Taxation Regulation xx.

(g) Under a "throwback" provision, all sales of tangible personal property not assigned to Rhode Island shall not be included in the sales factor numerator for this state if a member of the combined reporting group of the taxpayer is taxable in the state of the purchaser. (Put another way, with respect to receipts from sales of tangible personal property, such receipts must be included in the origin state's sales factor numerator if the taxpayer is not taxable in the destination state. Thus, if a taxpayer is not doing business in the destination state of the shipment, then those sales of tangible personal property are considered to have a situs in Rhode Island if the property is shipped from an office, warehouse, factory or other place of storage in Rhode Island.)

(h) *Finnigan Method.*

Rhode Island applies the Finnigan[66] method for purposes of calculating the sales factor. Thus, each unitary business group member must include all receipts in this state without regard to whether the member has nexus in this state.

(i) *Example.* The following example illustrates the application of the Finnigan method for apportioning the combined income of a unitary group.

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
Factor total:	250	500	
Finnigan apportionment includes all Rhode Island factor attributes whether entities do or do not have nexus with Rhode Island.			

[66] *Appeal of Finnigan Corp.*, supra.

(j) The Division of Taxation may prescribe additional regulations as necessary or appropriate to carry out the purposes of this Rule.

(k) *Additional Information*

The following information should assist the taxpayer in calculating the sales factor for apportionment purposes:

(1) "Gross receipts" shall mean the gross amount of the sale of inventory sold in the ordinary course of business less any appropriate returns and allowances for such sales as recorded by the taxpayer for federal income tax purposes.

(2) Dividends less exclusions for Rhode Island purposes, such as dividends received from shares of stock of any payee liable for taxes as outlined in RIGL Chapters 11, 13 and 14, and dividends excluded for federal tax purposes.

(3) Interest less exclusions for Rhode Island purposes, such as interest on certain obligations of the United States and its possessions or interest on obligations of Rhode Island Public Service Corporations.

(4) Rent.

(5) Royalties.

(6) Net capital gain as reported for federal tax purposes.

(7) Net ordinary gain as reported for federal tax purposes.

(8) Income exempt for federal taxation but taxable for Rhode Island purposes, such as income from obligations from other states.

(9) The gross receipts factor cannot be less than zero percent (0%).

(10) Each unitary business group member must include all receipts in Rhode Island without regard to whether the member has nexus in Rhode Island.

(11) Receipts between members included in a unitary business group must be eliminated in calculating the receipts factor.

(l) *No apportionment.*

For purposes of Rhode Island's combined reporting regime, it is possible that all corporations comprising a combined group, which is engaged in a unitary business, derive all of their income from within Rhode Island. In other words, in such a case, none of the member corporations of the combined group has income that is taxable in another state. In such a situation, none of the corporations can apportion income because none of the corporations has income from activities that are taxable in another state. As a consequence, a combined group in such circumstances cannot apportion income. Therefore, one hundred percent (100%) of the combined group's taxable income is taxable in Rhode Island.

(m) For additional information about single sales factor apportionment and the market-based sourcing method, please see Rhode Island Division of Taxation Regulation xx-xx.

Rule 11. Combined Net Income of Group

(a) In this rule, “group” refers to the collective members of a combined group that are engaged in a unitary business and at least one of which is doing business in Rhode Island.

(b) *Determination of taxable income or loss of the group using a group report.*

Except as otherwise provided in this regulation, the taxable income of the combined group shall be determined under the provisions of RIGL Chapter 44-11. The use of a group report does not disregard the separate identities of the taxpayer members of the group.

(c) *Components of income subject to tax in this state.*

Each taxpayer member is responsible for tax based on its taxable income or loss apportioned to this state, which shall include a pro-rata share of a pass-through entity’s income.

(d) *Determination of taxpayer’s share of the taxable income of a combined group apportionable to this state.*

The taxpayer’s share of the taxable income apportionable to Rhode Island of each combined group of which it is a member shall be the product of:

> (1) the adjusted taxable income of the combined group, determined under this regulation, and
>
> (2) the taxpayer member’s apportionment percentage, including in the numerator the taxpayer’s total sales (receipts) associated with the combined group’s unitary business in Rhode Island, and including in the denominator the total sales (receipts) of all members of the combined group, including the taxpayer, which total sales (receipts) are associated with the combined group’s unitary business wherever located.

(e) *Pass-through entities.*

A combined group member’s numerator and denominator for purposes of the sales factor generally includes the apportionment factors of pass‑through entities owned directly or indirectly by the member, in proportion to the combined group member’s distributive share of the pass‑through entity’s net income or loss included in the combined unitary income. However, a combined group member’s sales factor may not include apportionment factors of a real estate investment trust, regulated investment company, real estate mortgage investment conduit, or financial asset securitization investment trust.

(f) *FAS 109 Deduction.*

Under Financial Accounting Standard 109 ("FAS 109"), a corporation that is required to issue financial statements must create a liability or an asset for estimated taxes payable or refundable for the current year. For purposes of computing taxable income under Rhode Island's combined reporting statute, the taxpayer shall not claim a FAS 109 deduction.

(g) *Taxable year of the combined group.*

(1)The group's taxable year is determined as follows:

(i) if two or more members of a group file a federal consolidated return, the group's taxable year is the taxable year of the federal consolidated group;

(ii) in all other cases, the taxable year is the taxable year of the designated agent.

(2) Taxpayers with a 52/53-week year ending (for example, a year ending on the Saturday closest to December 31) shall be treated for purposes of this regulation as having a tax year beginning date of January 1. For example, suppose that a corporation is a 52/53-week corporation. Its 2015 tax year ends December 30, 2015. Its 2016 tax year begins December 31, 2015. However, for purposes of this regulation, its 2016 tax year will be deemed to begin January 1, 2016, and end December 31, 2016.

(h) *Members with different accounting periods.*

If the taxable year of a member differs from the taxable year of the group, the principal Rhode Island corporation may elect to determine the portion of that member's income to be included in one of the following ways:[67]

(1) a separate income statement prepared from the books and records for the months included in the group's taxable year; or

(2) including all of the income for the year that ends during the group's taxable year.

Example:

The following example illustrates certain principles outlined in this regulation, including the determination of a combined group, the determination of a unitary business, the calculation of a combined group's income, and apportionment. (The

[67] The same method must be used for each member with a different accounting period. Once an election is made under this section, it is the only method that may be used with respect to members of the group except upon prior approval by the Tax Administrator.

example assumes ownership of a fictitious entity, Al’s Bakery, which is located in Providence, R.I.)

• Al’s Bakery is owned and operated as a sole proprietorship.

A sole proprietorship is not subject to combined reporting.

• Al’s Bakery is treated as a pass-through entity for federal tax purposes – an S corporation, limited liability company (LLC), or partnership.

Pass-through entities are not, in and of themselves, subject to combined reporting.

• Al’s Bakery is a C Corporation, a stand-alone operation with no affiliates.

It is not subject to combined reporting. For combined reporting to apply, there must be two or more C corporations under common ownership engaged in a unitary business.

• Al’s Bakery is a C corporation which makes baked goods and has nexus in Rhode Island but in no other state. Betty’s Distribution, of New Haven, Conn., a C corporation, distributes baked goods in Rhode Island and Connecticut, and has no nexus in Rhode Island but does have nexus in Connecticut. Catrina LLC, of Providence, is a pass-through entity which owns the real estate on which Al’s Bakery is located and passes through income to Al’s Bakery. Al’s Bakery and Betty’s Distribution have common ownership and share management and other services.

For 2015 and later tax years, Al’s Bakery and Betty’s Distribution are subject to Rhode Island combined reporting. They comprise a combined group and are engaged in a single business enterprise, a unitary business. They must therefore combine their income for Rhode Island corporate income tax purposes. In the computation, Al’s Bakery must include in its income the pass-through income that it receives from Catrina LLC. The pooled income of the combined group must be apportioned to Rhode Island using single sales factor apportionment and the market-based sourcing method. For apportionment purposes, the combined group uses as the numerator all sales in Rhode Island – including any sales in Rhode Island by Betty’s Distribution, even though Betty’s Distribution does not have nexus in Rhode Island. The denominator must include everywhere sales.

RULE 12. Corporate minimum tax

(a) The annual corporate minimum tax payable is the amount provided under RIGL § 44-11-2(e). For tax year 2015, that amount is $500. The combined group pays either the tax due based on the amount of its net income apportioned to Rhode Island, using the applicable rate – which is seven percent (7%) for tax year 2015 – or the minimum tax, whichever amount is higher.

(b) To compute the minimum tax, the combined group must determine the number of its members that have nexus in Rhode Island and multiply that number by the amount of the minimum tax as listed in RIGL § 44-11-2(e). (For tax year 2015, that amount is $500.) The sum must be compared to the actual tax due for the entire combined group. The combined group shall pay whichever amount is higher.

(c) The following examples illustrate the application of this rule. The examples are for tax year 2015, when Rhode Island's mandatory unitary combined reporting regime took effect, and when the annual corporate minimum tax was $500.

Example:

Bryant Corp., Bentley Corp., Brandeis Corp., and Babson Corp. are all C corporations that together comprise a combined group subject to Rhode Island combined reporting. Each has a current-year net operating loss.

Application of Corporate Minimum Tax

Name	*Rhode Island nexus*	*NOL*	*Tax*
Bryant Corp.	Yes	($5,000)	$500
Bentley Corp.	Yes	($10,000)	$500
Brandeis Corp.	Yes	($15,000)	$500
Babson Corp.	No	($20,000)	n/a
		Total tax:	**$1,500**

The combined group determines that three of its members have Rhode Island nexus and multiples that number by the $500 minimum tax, for a total of $1,500. The group compares that sum to its tax liability calculated under the standard formula (7% times income apportioned to Rhode Island). Because the group has a current-year NOL of $50,000, it owes no tax under the standard formula, so it must pay the minimum tax of $1,500. (The NOL is carried forward.)

Example:

Bryant Corp., Bentley Corp., Brandeis Corp., and Babson Corp. are all C corporations that together comprise a combined group subject to Rhode Island combined reporting.

Application of Corporate Minimum Tax

Name	*R.I. nexus*	*R.I. apportioned income*	*Tax*
Bryant Corp.	Yes	$10,000	$500
Bentley Corp.	Yes	$5,000	$500
Brandeis Corp.	Yes	$0	$500
Babson Corp.	No	$5,000	n/a
	Totals:	$20,000	$1,500
	Total tax:	$1,400	$1,500

Note: Because minimum tax of $1,500 is greater than tax of $1,400 determined under standard formula, group pays $1,500 in minimum tax.

The combined group determines that three of its members have Rhode Island nexus and multiples that number by the $500 minimum tax, for a total of $1,500. The group compares that sum to the $1,400 in tax it owes using the standard formula (7% of $20,000 in income apportioned to Rhode Island). Because the minimum tax is higher, the group pays the minimum tax.

Example:

Bryant Corp., Bentley Corp., Brandeis Corp., Babson Corp., and Tuck Corp. are all C corporations that together comprise a combined group subject to Rhode Island combined reporting.

Application of Corporate Minimum Tax

Name	*R.I. nexus*	*R.I. apportioned income*	*Tax*
Bryant Corp.	Yes	$10,000	$500
Bentley Corp.	Yes	$10,000	$500
Brandeis Corp.	Yes	$10,000	$500
Babson Corp.	No	$0	n/a
Tuck Corp.	No	$3,000	n/a
	Totals:	$23,000	$1,500
	Total tax:	$1,610	$1,500

Note: Group pays $1,610 in tax because it is higher than minimum tax of $1,500.

The combined group determines that three of its members have Rhode Island nexus and multiples that number by the $500 minimum tax, for a total of $1,500. The group compares that sum to the $1,610 in tax it owes using the standard formula (7% of $23,000 in income apportioned to Rhode Island). The group's has $1,610 in Rhode Island tax liability.

RULE 13. Net operating losses

(a). For purposes of this regulation, a tracing protocol shall apply to net operating losses (NOLs).[68]

1.) No deduction is allowable for an NOL sustained during any taxable year in which a taxpayer was not subject to Rhode Island business corporation tax.

2.) For the year in which the loss is allowed, such loss is limited by the amount of that corporation's federal taxable income for that year.[69]

3.) NOLs created before January 1, 2015, are allowed to offset the income only of the corporation that created the NOL; the NOL cannot be shared with other members of the combined group.

4.) NOLs created in tax years beginning on or after January 1, 2015, shall generally receive the same treatment by Rhode Island for purposes of combined reporting and the Rhode Island corporate tax as they do under IRC § 172, except that:

A.) Any net operating loss included in determining the deduction shall be adjusted to reflect the inclusions and exclusions from entire net income required by §44-11-11(a) – "*Net income" defined* -- and § 44-11-11.1 – *Amortization of air or water pollution prevention or hazardous solid waste control facilities*;

B) The deduction shall not include any net operating loss sustained during any taxable year in which the member was not subject to the tax imposed by RIGL Chapter 44-11; and

C) The deduction shall not exceed the deduction for the taxable year allowable under IRC § 172 – provided that the deduction for a taxable year may not be carried back to any other taxable year for Rhode Island purposes but shall only be allowable on a carryforward basis for the five (5) succeeding taxable years.[70]

(b) *Departing member of combined group.*

(1) NOLs shall be carried forward from year to year separately by the individual taxpayer that originally incurred the underlying loss. Therefore, such NOLs remain the tax attribute of that member, although such carryforwards may be shared in some cases with the other taxable members of a combined group, as described in this Rule.

[68] RIGL § 44-11-4.1(e).
[69] See Rhode Island Reg. CT 94-06 or, if amended, the subsequent version(s).
[70] The term "carryover" is sometimes used in this Regulation in place of the term "carryforward."

(2) In any case in which a taxable member of a combined group ceases to be a member of the combined group, any NOL carryforward owned by such taxpayer is no longer available for use by the other taxable members of the combined group with which the taxpayer was previously affiliated.

(3) If the taxpayer becomes a member of a new combined group, the taxpayer may not share the NOL carryforward with the taxable members of its new combined group unless one of the taxable members of the new combined group was also a member of the taxpayer's combined group during the year the loss was incurred and all the other requirements described in this Rule are met.

(4) In the event that a taxpayer that has a NOL carryforward becomes a member of a new combined group, change of ownership rules may apply, although any amount of NOL carryforward that cannot be applied because of such limitations may be carried forward consistent with the rules and limitations described in this Rule.

(5) In the event that a member of a combined group has an NOL carryforward and subsequently takes part in a merger or consolidation, the NOL carryforward will not be lost if the member liquidates or terminates as a result of the merger or consolidation. In such a situation, the NOL would follow into the surviving entity.

(c) *Examples*. The following examples help to illustrate some of the principles contained in this rule.

Example:

November Corp., Oscar Corp., and Papa Corp. have common ownership, are involved in a unitary business, and are members of a combined group. For Tax Year 2014, November Corp. was required to file a Rhode Island corporate income tax return, and did so. Oscar Corp. and Papa Corp. were not required to file.

November Corp. has a $200,000 NOL carryover from prior year(s). November has no other Rhode Island modifications. For Tax Year 2015, $100,000 of the NOL can be utilized to offset November's current year income of $100,000; the remaining $100,000 may be carried forward to subsequent years. Such treatment is allowed because November Corp. has been a Rhode Island filer for those prior years in which the losses were incurred.

Oscar Corp., prior to combined reporting, had no Rhode Island filing requirement. Oscar has an NOL carryover from prior years of $50,000. For Tax Year 2015, and for future tax years, Oscar's NOL is not allowed to be applied against the federal taxable income of the combined group because the loss was incurred in prior years when Oscar did not have a Rhode Island filing requirement. Papa Corp. has no NOL.

Under the Rhode Island combined reporting regime, the unitary group must combine its income, but is allowed to use NOL carryovers only from those members that had a Rhode Island filing requirement in the year in which they incurred the loss.

Furthermore, the allowable loss that the combined group's Rhode Island member generated through Tax Year 2015 is limited by the amount of income of the Rhode Island member for tax year 2015.

Net operating loss – Tax Year 2015				
	November Corp.	Oscar Corp.	Papa Corp.	Combined Group
Federal taxable income	$100,000	$100,000	$100,000	$300,000
NOL carryover (from TY 2014)	(200,000)	(50,000)	0	
NOL carryover - allowable	(100,000)	0	0	(100,000)
Adjusted taxable income	0	100,000	100,000	200,000

In Tax Year 2016, assume that November, Oscar and Papa each has $50,000 in federal taxable income.

Of November's $100,000 NOL carryover, only $50,000 can be used to offset its income; the remainder of the NOL is carried to future years and applied to the extent allowable by law. Oscar's $50,000 NOL still cannot be used for Rhode Island purposes because the loss was incurred in a year prior to Oscar's being required to file with Rhode Island.

Net operating loss – Tax Year 2016				
	November Corp.	Oscar Corp.	Papa Corp.	Combined Group
Federal taxable income	$50,000	$50,000	$50,000	$150,000
NOL carryover	(100,000)	(50,000)	0	
NOL carryover allowable	(50,000)	0	0	(50,000)
Adjusted taxable income	0	50,000	50,000	100,000

Example:

Quebec Corp., Romeo Corp., Sierra Corp., and Tango Corp. have common ownership, are involved in a unitary business, and are members of a combined group. Before Tax Year 2015, only Quebec Corp. was required to file a Rhode Island corporate income tax return, and did so. In Tax Year 2015 (please see table below), Quebec, Romeo and Sierra Corp. each has $100 million in federal taxable income; Tango Corp. has a current year net loss of $800 million.

As a result, the combined group shows a net operating loss of $500 million for Tax Year 2015. As the example illustrates, Rhode Island law allows a combined group, for purposes of Rhode Island combined reporting, to use current year losses from the combined group's members – even from members that would not otherwise have a Rhode Island filing requirement if it were not for the filing requirement.

Net operating loss – Tax Year 2015

	Quebec Corp.	Romeo Corp.	Sierra Corp.	Tango Corp.	Combined group
Federal taxable income	$100	$100	$100	($800)	($500)

In Tax Year 2016 (please see table below), the four member corporations of the combined group each has $100 million in federal taxable income, for a total of $400 million. But because the combined group had a $500 million net operating loss carryover incurred in Tax Year 2015, the first year in which mandatory unitary combined reporting applied in Rhode Island, the group's Tax Year 2016 federal taxable income of $400 million is offset for Rhode Island tax purposes, and the group carries forward the remaining $100 million NOL.

Net operating loss – Tax Year 2016

	Quebec Corp.	Romeo Corp.	Sierra Corp.	Tango Corp.	Combined group
Federal taxable income	$100	$100	$100	$100	$400
				Allowable NOL:	($400)
				Adjusted taxable income:	$0

Example:

Uniform Corp., Victor Corp., and Whiskey Corp. have common ownership, are involved in a unitary business, and are a combined group under RIGL § 44-11-45.

In Tax Year 2015, Uniform and Victor Corporations have a combined federal taxable income of $200 million, which is offset by Whiskey Corp.'s current year net operating loss of $400 million. Consequently, the combined group has a $200 million net loss for 2015. The combined group carries forward a $200 million NOL – because the NOL was generated in a year in which combined reporting was mandatory.

Net operating loss – Tax Year 2015

	Uniform Corp.	Victor Corp.	Whiskey Corp.	Combined group
Federal taxable income	$100	$100	($400)	($200) current year net loss

In Tax Year 2016, each corporation posts federal taxable income of $100 million. The group deducts its $200 million NOL carryover, generated in 2015, from its Tax Year 2015 federal taxable income of $300 million. That leaves $100 million in adjusted taxable income for 2016.

Net operating loss – Tax Year 2016

	Uniform Corp.	Victor Corp.	Whiskey Corp.	Combined group
Federal taxable income	$100	$100	$100	$300
			NOL carryover from 2015:	(200)
			NOL carryover allowable deduction:	(200)
			Combined group's adjusted taxable income:	100

Example:

January Corp. and February Corp. are Rhode Island C corporations under common ownership engaged in a unitary business and are subject to Rhode Island combined reporting for tax year 2015 and 2016. Due to a reorganization, the corporations are no longer part of a combined group under common ownership for 2017; they file as separate entities in Rhode Island for 2017. As the following table shows, only February Corp. may use the NOL carryforward for 2017 because February Corp. generated the loss in the first place.

Split up **(dollars in thousands)**

	2015	2016	2017
January Corp.	$100	$50	$50 (files as separate entity)
February Corp.	(500)	50	50 (300) (250)
Tentative totals:	(400)	100 (400) (300)	
	Note: Carry $400 NOL to 2016.	Note: Apply $400 NOL from 2015 to TY2016, leaving $300 NOL to carry to 2017.	Note: January has $50 in income for 2017 and files as separate entity. $300 NOL from 2016 applies only to February, reducing February's income to $0; NOL of $250 carries forward to 2018 for February only.

Example:

March Corp., April Corp., and May Corp. are Rhode Island C corporations under common ownership engaged in a unitary business and are subject to Rhode Island combined reporting for tax year 2015 and 2016. For 2017, March Corp. drops out of the group and June Corp. (a C corporation under common ownership) joins the group. As the following table shows, only $100 of the NOL carryforward can be used in 2017, against the income of April Corp. and May Corp.; the NOL carryforward cannot be applied in 2017 against June Corp. in 2017 because June Corp. is new to the group that year – and June's income cannot be offset by a loss to which it was not a party.

New member of group (dollars in thousands)

	2015	2016	2017	
March Corp.	$100	50	n/a	
April Corp.	(500)	50	50	
May Corp.	100	50	50	
June Corp.	n/a	n/a	50	
Total:	(300)	150 (300) (150)	100 (150) (50)	50

Note: For 2015, $500 NOL wipes out group's income, leaving $300 NOL carryforward to 2016. For 2016, the group's $150 income is wiped out by the $300 NOL carryforward; carry forward $150 NOL to 2017. For 2017, June Corp. joins group; June's income cannot be offset by a loss to which it was not a party. Thus, the $150 NOL carried to 2017 wipes out April's and May's income only, leaving the group with $50 in income from June; the remaining $50 NOL is carried forward to 2018 – and can apply only to April's and May's income that year.

Example:

July Corp. and August Corp. are Rhode Island C corporations under common ownership engaged in a unitary business and are subject to Rhode Island combined reporting for tax year 2015 and 2016. For 2017, September Corp. (a C corporation under common ownership) joins the group. As the following table shows, September Corp. has $60 in income for 2017, but only July Corp. and August Corp. get to use the NOL carryforward from 2016 – in other words, the group gets to use only $20 of the NOL; the remaining $80 NOL is carried forward.

New member of group (dollars in thousands)

	2015	2016	2017	
July Corp.	($100)	$50	$10	
August Corp.	(100)	50	10	
September Corp.	n/a	n/a	60	
Total	(200)	100 (200) (100)	20 (100) (80)	60

Note: For 2015, July and August each has current-year $100 NOL, which carries to 2016. For 2016, the NOL carryforward wipes out income, leaving $100 NOL for 2017. In 2017, $100 NOL carryforward can be used against income of July and August only; it cannot be applied against September's income because September is new to group that year. Thus, in effect, only $20 of the NOL can be used in 2017, leaving group with September Corp.'s $60 in income for that year. Remaining $80 NOL is carried forward to 2018, when it can be applied only to income of July and August.

Example:

Anne Corp. and Betty Corp. are Rhode Island C corporations under common ownership engaged in a unitary business and are subject to Rhode Island combined reporting for tax year 2015 and 2016. For 2017, Anne Corp. becomes a stand-alone corporation; Betty Corp. and Clara Corp. merge to become Doris Corp. Thus, the $100 NOL carried forward to 2017 can apply only to Anne Corp. (because it generated the loss in the first place), reducing its income to zero and resulting in a $50 NOL carryover only for Anne Corp. for 2018. In other words, the NOL tracks with Anne Corp. only; the newly formed entity Doris Corp. cannot use the NOL.

Combinations (dollars in thousands)			
	2015	2016	2017
Anne Corp.	($200)	$50	$50 (Anne becomes stand-alone corp.)
Betty Corp.	0	50	Betty & Clara merge to form D
Clara Corp.	n/a	n/a	Betty & Clara merge to form D
Doris Corp.	n/a	n/a	
Total	(200)	100 (200) (100)	50 [Anne income] (100) [Anne NOL] (50)

RULE 14. Add-Backs

(a) For tax year 2014, "net income" under RIGL 44-11-11 includes, for a captive REIT, an amount equal to the amount of the dividends paid deduction allowed under the Internal Revenue Code for the taxable year.[71] For tax years beginning on or after January 1, 2015, such add-back is repealed.

(b) For tax year 2014, a corporate taxpayer generally must add back to net income any otherwise deductible interest expenses and costs and intangible expenses and costs directly or indirectly paid, accrued or incurred to, or in connection directly or indirectly with one or more direct or indirect transactions with, one or more related members.[72]

(c) For tax years beginning on or after January 1, 2015, the captive REIT provision described in (a) and the intangibles add-back provision described in (b) above are repealed.[73] However, under Rhode Island's mandatory unitary combined reporting regime, payments to group members – including those described in (a) and (b) above – are eliminated.

[71] RIGL § 44-11-11.
[72] ibid.
[73] Rhode Island Public Law 2014, ch. 145, art. 12.

RULE 15. Tax Rate

(a) For tax year 2014, corporations pay either the Rhode Island corporate income tax[74] or the Rhode Island franchise tax,[75] whichever is higher.

(b) For tax year 2014, the corporate income tax rate is nine percent (9%); the franchise tax is equal to $2.50 per $10,000 of a corporation's authorized capital stock.

(c) For tax year 2015, the corporate income tax rate is seven percent (7.0%)[76] and the franchise tax is repealed.[77] Thus, for tax year 2015, the maximum corporate income tax rate for a combined group engaged in a unitary business is 7.0 percent (7.0%); the minimum tax is $500.[78]

(d) For additional information on the application of the minimum tax with respect to combined groups, please see Rule xx.

[74] RIGL § 44-11-2.
[75] RIGL § 44-12-1 *et seq*.
[76] RIGL § 44-11-2(a). Tax rate applies to net income as defined in RIGL §§ 44-11-13 through 44-11-15.
[77] For tax year 2015, the annual corporate minimum tax is $500, the same as it was for 2014. See RIGL § 44-11-2(e).
[78] Annual corporate minimum tax is $500 or whichever amount is listed in RIGL § 44-11-2(e). For more information about the application of the minimum tax, please see Rule XX.

RULE 16. Tax credits; Tracing; JDA; Life Sciences

(a) For purposes of this regulation, a tracing protocol shall apply to all Rhode Island corporate income tax credits.[79] The tracing protocol is similar to the one which applies to NOLs (see Rule xx).

(b) Rhode Island tax credits earned before January 1, 2015, shall be allowed to offset only the tax liability of the corporation that earned the credits; such credits cannot be shared with other members of the combined group.

(c) Rhode Island tax credits earned in tax years beginning on or after January 1, 2015, generally may be applied to other members of the group.

(d) *Jobs Development Act.*

(1) The Jobs Development Act rate reduction under RIGL Chapter 42-64.5 applies to eligible companies filling a Rhode Island consolidated return or filing as part of a combined group. The reduction shall be allowed against the net income of the entire combined group for credits earned in tax years beginning on or after January 1, 2015.

(2) For tax year 2014, the corporate income tax rate is nine percent (9.0%), and the amount of the Jobs Development Act rate reduction cannot exceed six (6) percentage points. Thus, the eligible corporation's tax rate cannot be less than three percent (3.0%).

(3) For tax year 2015, the corporate income tax rate is seven percent (7.0%), and the amount of the Jobs Development Act rate reduction cannot exceed four (4) percentage points. Thus, the eligible corporation's tax rate cannot be less than three percent (3.0%).

(e) *Life Sciences Rate Reduction*

(1) The life sciences rate reduction under the I-195 Redevelopment Act of 2011, RIGL Chapter 42-64.14, applies to eligible companies filling a Rhode Island consolidated return or filing as part of a combined group. The reduction shall be allowed against the net income of the entire combined group for credits earned in tax years beginning on or after January 1, 2015.

(2) For tax year 2014, the corporate income tax rate is nine percent (9.0%), and the amount of the life sciences rate reduction cannot exceed six (6) percentage points. Thus, the eligible corporation's tax rate cannot be less than three percent (3.0%).

[79] RIGL § 44-11-4.1(f).

(3) For tax year 2015, the corporate income tax rate is seven percent (7.0%), and the amount of the life sciences rate reduction cannot exceed four (4) percentage points. Thus, the eligible corporation's tax rate cannot be less than three percent (3.0%).

Corporate income tax rate reduction		
	Tax year 2014	Tax year 2015
Corporate income tax rate:	9.00%	7.00%
Maximum rate reduction	(6.00%)	(4.00%)
Tax rate cannot be less than:	3.00%	3.00%
Applies to Jobs Development Act rate reduction under RIGL Chapter 42-64.5 and life sciences rate reduction (The I-195 Redevelopment Act of 2011) under RIGL Chapter 42-64.14.		

(f) *Departing member of combined group.*

(1) Even though a tax credit (and a credit carryforward) may sometimes be shared among the taxable members of a combined group, as described above, the credit nonetheless remains the property of the taxpayer that initially generated the credit.

(2) In the event that a taxable member of a combined group ceases to be a member of the combined group, any credit carryforward owned by such taxpayer is no longer available for use by the other taxable members of the combined group with which the taxpayer was previously affiliated. In such a situation, if the taxpayer becomes a member of a new combined group, the taxpayer may not share the credit with the taxable members of its new combined group unless one of the taxable members of the new combined group was also a member of the taxpayer's combined group during the year that the credit was generated (and all other requirements described in this Rule are met).

(3) In the event that a taxpayer that has a credit carryforward becomes a member of a new combined group, change of ownership rules may apply, though any amount of credit carryforward that cannot be applied because of these limitations may be carried forward consistent with the rules and limitations described in this Rule.

(4) In the event that a member of a combined group has a credit carryforward and subsequently takes part in a merger or consolidation, the credit carryforward will be lost if, for example, the member liquidates or terminates as a result of the merger or consolidation.

(g) *Tax credit recapture.*

(1) In the event that a taxpayer generates a credit for a tax year beginning on or after January 1, 2015, and then subsequently disposes of the property, or where the

property otherwise ceases to be in qualified use within the meaning of the applicable credit statute, recapture of the credit shall be determined pursuant to RIGL § xxx based upon the total credit previously taken by the taxpayer and its combined group members. This rule applies even if the taxpayer first leaves the combined group, then in a subsequent year disposes of the qualified property or otherwise causes recapture, and therefore in such subsequent tax year is no longer included in a combined group with the corporations whose use of the credit must be considered for purposes of recapture.

(2) The formula to be used to compute the recapture on the credit shall be as follows: The tax credit taken on property ceasing to qualify times a fraction consisting of a numerator which is the useful life of property in months minus the qualified use in months and a denominator which is the useful life of property in months.

(3) Where a taxpayer generates a credit for a tax year beginning on or after January 1, 2015, there shall be no recapture if the taxpayer subsequently transfers the qualified property to another taxable member of its combined group with which the credit could be shared in accordance with the terms and conditions of this Rule. However, in this case, if the transferee leaves the combined group or subsequently transfers the property outside the combined group or to a member of the combined group with which the credit cannot be shared, there shall be recapture of the credit on the part of the taxpayer that generated the credit based upon the total credit previously taken by the combined group members. In any other case where a Rhode Island credit that is subject to recapture can be shared amongst combined group members, the recapture shall be evaluated in a similar manner.

Rule 17. Filing of Report

(a) For purposes of combined reporting, the Tax Administrator shall make the necessary schedule(s) and instructions available in a timely fashion for taxpayers, their advisers, and software developers.

(b) For tax years beginning on or after January 1, 2015, a corporation subject to Rhode Island's mandatory unitary combined reporting regime shall attach all required schedules related to combined reporting to the corporation's annual return: the Rhode Island Business Corporation Tax Return, Form RI-1120C. (Please see Rule xx, below, for appointment of a designated agent.) Thus, for combined reporting purposes, the annual return shall be filed as a single unit, with all the required combined reporting schedules attached to the taxpayer's Form RI-1120C; the schedules shall not be filed separately from the return. The return shall be filed in accordance with the provisions of RIGL § 44-11-3.

(c) For a corporation subject to mandatory unitary combined reporting, for tax years beginning on or after January 1, 2015, the annual Rhode Island corporate income tax return on Form RI-1120C shall automatically qualify for a six-month extension from the due date provided that the return is on extension and complies with instructions outlined in Form RI-7004. (No extension beyond the six-month extension is allowed.)

(d) If the statute of limitations applicable to refund claims and assessments is open with respect to a particular member of the combined group, the statute of limitations is open with respect to that particular taxpayer notwithstanding the fact that the statute of limitations may have expired for one or more other members of the combined group. The statute of limitations applicable to refund claims and assessments for members of a combined reporting group which have filed their tax return based on a fiscal reporting period matched to the accounting period of the designated agent shall be the statute of limitations determined and computed based on the fiscal accounting period.

(e) If a return is filed pursuant to a combined report, the Tax Administrator may examine and audit that return, and collect any deficiency from a combined group member for whom the statute of limitations for assessments has not expired, even if the statute of limitations for other members which filed pursuant to the same combined report has expired. Any deficiency assessed pursuant to the audit or examination will not cause a reopening of the statute of limitations for those other members for which the statute of limitations has expired who filed pursuant to the same combined report.

(f) A paid preparer filing a Rhode Island corporate income tax return reflecting combined reporting must file the return electronically in accordance with RIGL § 44-1-31.1 and Rhode Island Division of Taxation Regulation ELF 09-01.

Rule 18. Estimated Tax

(a) The provisions of RIGL Chapter 44-26, "Declaration of Estimated Tax by Corporations," shall apply to a combined group engaged in a unitary business – and to each member of such a group.

(b) Notwithstanding any other provisions of RIGL § 44-26-2.1, any taxpayer required to file a combined report in accordance with RIGL § 44-11-4.1 *et seq.* in a tax year beginning on or after January 1, 2015, shall compute estimated payments for that tax year as follows:

> (1) The installments must equal one hundred percent (100%) of the tax due for the prior year plus any additional tax due to the combined report provisions under RIGL § 44-11-4.1; or
>
> (2) The installments must equal one hundred percent (100%) of the current year tax liability.

Rule 19. Designated Agent

(a) A combined group engaged in a unitary business shall appoint a designated agent. The combined group may select any member of the combined group as the designated agent, subject to a limitation that the designated agent itself has a Rhode Island filing requirement under RIGL chapter 44-11.

(b) The corporation which files, or will file, the first combined report for the combined group is deemed to be appointed as the designated agent assuming it has a Rhode Island filing requirement under RIGL Chapter 44-11. The Tax Administrator reserves the right to appoint any member of the combined group to be the designated agent.

(c) The designated agent is generally required to act on behalf of the combined group in its own name in all matters relating to the combined report. This includes performing the following duties:

(1) Filing the combined report, including the reporting of any separate entity items attributable to combined group members;

(2) Filing any extension of time to file the combined report.

(3) Filing any amended combined reports – or other filings relating to the combined report, including any separate entity items attributable to combined group members.

(4) Sending and receiving all correspondence with the Rhode Island Division of Taxation regarding the combined report, except that if correspondence relates to separate entity items or a payment made by another member of the combined group, the Rhode Island Division of Taxation may send the correspondence to that other member or the designated agent, or both.

(5) Participating on behalf of the group in any investigation or hearing by the Division of Taxation regarding the combined report, including producing all information requested.

(6) Executing any and all documents relating to the combined report. (Unless the Division of Taxation and taxpayer agree otherwise in writing, any waiver, power of attorney, or other document executed by the designated agent relating to the combined report shall be considered executed by all members of the combined group, including any corporations that were not included in the combined report but which the department asserts are members of the combined group.)

(7) Receiving notices regarding the combined report. In general, a notice received by the designated agent is considered received by all members of the combined group, including any corporations that were not included in the combined report but which the Division of Taxation asserts are members the combined group.

(d) In general, no person other than the designated agent shall have authority to act for or represent itself or the combined group regarding the duties listed in this Rule. A combined group member, or a corporation which the taxpayer asserts is a combined group member, may assume any of the duties of designated agent under any of the following conditions:

(1) By election of the designated agent or the applicable combined group member, a combined group member may perform any of the duties listed in this Rule to the extent those duties relate to separate entity items. This may include the filing of a separate return to report the member's separate entity items.

(2) If a combined report was filed, the Division of Taxation may allow any corporation which it asserts should be added to or eliminated from the combined group to represent itself after receipt of a written request from the corporation. However, that corporation shall still be bound by any action taken by the designated agent before the corporation's request to represent itself has been accepted by the Tax Division.

(e) If the designated agent is unable or unwilling to fulfill its obligations with respect to the combined report, is unresponsive, or has not been identified to the Division of Taxation, the Division of Taxation may appoint a new designated agent, or it may deal directly with any member of the combined group in respect to its share of the combined report items in which case each member shall have full authority to act for itself.

(f) The members of a combined group shall be jointly and severally liable for any tax, penalty, and/or interest levied by the Division of Taxation against the group or against any member of the group, including the designated agent, to the extent permitted under the United States Constitution. Any assessment against any member of a combined group for the Rhode Island corporate income tax attributable to the group's income in a particular tax year, including any interest, additions to tax, and/or penalties, shall be deemed to constitute an assessment against all members of the combined group for that year.

(g) The Division of Taxation may provide information relating to any member of the combined group to the designated agent, including information relating to the member's separate entity items.

(h) Once a member of the combined group is appointed as the designated agent, it shall remain the designated agent of that group for all future years unless the designated agent notifies the Division of Taxation in writing that another member of the combined group (or successor corporation of any member of the combined group) will thereafter act as designated agent, or unless the Tax Administrator chooses to name another member as the designated agent.

Rule 20. Tax Administrator's Authority

(a) The Tax Administrator shall prescribe and amend, from time to time, rules and regulations as may be deemed necessary so that the tax liability of a combined group – or of any member of the combined group – may be determined, computed, assessed, collected, and adjusted in a manner so as to clearly reflect the combined income of the combined group and the individual income of each member of the combined group.[80]

(b) Such rules and regulations shall include but are not be limited to, issues such as the inclusion or exclusion of a corporation in the combined group, the characterization and sourcing of each member's income, and whether certain common activities constitute the conduct of a unitary business.[81]

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[80] RIGL § 44-11-4.1(g).
[81] Ibid.

Rule 21. Special Appeals

(a) If at any time the Tax Administrator, on his own motion or acting upon a complaint by a taxpayer, determines that the methods of apportionment provided are inequitable either to the State or to the taxpayer, the Tax Administrator – after affording the taxpayer reasonable opportunity to be heard – may apply any other method of apportionment that is equitable and, if necessary, shall redetermine the tax.[82]

(b) The Division of Taxation shall establish an independent appeals process to attempt to resolve disputes between the Tax Administrator and the taxpayer with respect to the method of apportionment applied.[83]

(c) The decision resulting from the independent appeals process shall not prohibit either party from pursuing any legal remedy otherwise available if the issue is not resolved as a result of the appeal process. The decision resulting from the independent appeals process can be used as evidence.[84]

[82] RIGL § 44-11-15.
[83] Ibid.
[84] Ibid.

Rule 22. Tax Administrator's Report

(a) On or before March 15, 2018, the Tax Administrator must file a report analyzing the policy and fiscal ramifications of the changes enacted to the Rhode Island business corporation tax statutes (RIGL Chapter 44-11), as enacted in Article 12 of the fiscal year 2015 budget bill.[85]

(b) The report must be based on actual tax filings of companies for a two-year period, and must include the impact based on business category, business size, and other information – using information similar to the report on *pro forma* combined reporting that the Tax Administrator filed in March 2014.[86]

(c) The report is due on or before March 15, 2018, to the chairs of the House Finance Committee and Senate Finance Committee, and to the House Fiscal Advisor and Senate Fiscal Advisor.[87]

[85] Rhode Island Public Law 2014, ch. 145, art. 12.
[86] RIGL § 44-11-4.1(h).
[87] Ibid.

Rule 23. Effective Date

(a) This regulation shall take effect for tax returns filed for tax years beginning on or after January 1, 2015.

- DAVID SULLIVAN
TAX ADMINISTRATOR

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Appendix I – Combined Reporting Calculation

Following are the basic steps in computing tax for purposes of Rhode Island's combined reporting regime:

Step 1. Combine the federal taxable income of all members of the combined group.

Step 2. Combine all deductions of all members of the combined group and subtract the total from combined federal taxable income for Rhode Island purposes.

Step 3. Combine all the additions of all members of the combined group.

Step. 4. Net the combined additions and the combined deductions against the combined federal taxable income of all members of the combined group. The result is the adjusted taxable income of the group for Rhode Island corporate income tax purposes.

Step 5. Combine the receipts of all members of the unitary group using the Finnigan method. Calculate the apportionment ratio for the combined group. Use, as the numerator, all Rhode Island receipts – no matter if a group member has no nexus in Rhode Island. Use, as the denominator, everywhere receipts. (Divide the numerator by the denominator to arrive at an apportionment ratio.)

Step. 6. Compute the Rhode Island taxable income of the combined group by multiplying adjusted taxable income by the combined apportionment ratio.

Step 7. Multiply result from Step 6 by applicable tax rate. (For tax year 2015, applicable tax rate is seven percent (7%)).

Step 8. Calculate allowable credits in accordance with this regulation.

Step 9. Subtract Step 8 (above) from the result in Step 7 (above). This is the tax due under combined reporting, before annual corporate minimum tax. (See Step 10.)

Step. 10. For purposes of the minimum tax, determine the number of members of the group that have Rhode Island nexus. Multiply that number by the amount of the annual corporate minimum tax under RIGL § 44-11-2(e). (For tax year 2015, the annual corporate minimum tax is $500.) Compare that sum to the amount of net tax liability (after credits) from Step 9. Pay whichever amount is higher.

Appendix II – Further Examples

The following examples help to illustrate the impact of mandatory unitary combined reporting, which is effective for tax years beginning on or after January 1, 2015.

Example

J Corp. and K. Corp. are both C corporations that comprise a combined group engaged in a unitary business. (The corporations may have a parent-subsidiary or brother-sister relationship.) Both are based entirely in Rhode Island with all sales in Rhode Island. J Corp. has $400,000 of Rhode Island net income; K Corp. has a current year net loss in 2015 of $500,000.

If separate entity reporting were in effect for tax year 2015, J Corp. would have paid $28,000 in Rhode Island corporate income tax, while K Corp. paid the $500 corporate minimum tax (with a net loss carryforward).[88]

But because mandatory unitary combined reporting applies for tax year 2015, the combined group pays a total of $1,000 in tax – which is the annual corporate minimum tax. (The group determines that the two corporations have Rhode Island nexus, and multiples that number by the minimum tax of $500, for a total of $1,000. Because the group has no tax due under the standard formula (given the current-year NOL), the group owes $1,000 in Rhode Island tax.

(K Corp.'s current year NOL is shared with J Corp., wiping out J Corp.'s $400,000 of net income for the year; the remaining $100,000 of K Corp. NOL is carried forward.)

	J Corp.	K Corp.	Combined group
Net income (loss) for 2015	$400,000	($500,000)	($100,000)
Rhode Island tax due			$1,000
Note: Because the combined group has a net loss, it must pay the $500 annual corporate minimum tax for tax year 2015, multiplied by the number of group members with Rhode Island nexus.			

Example

L Corp. and M Corp. are both C corporations that comprise a combined group engaged in a unitary business. (The corporations may have a parent-subsidiary or brother-sister relationship.) L Corp. is based entirely in Rhode Island and all its sales are in Rhode Island. It has a current year net loss of $200,000 for tax year

[88] For tax year 2015, the Rhode Island corporate income tax rate is 7 percent. The franchise tax is no longer in effect.

2015. M Corp. does not have Rhode Island nexus, is based in another state, and has no sales in Rhode Island. It has net income of $400,000.

If separate entity reporting were in effect for tax year 2015, L Corp. would pay the $500 corporate minimum tax. No tax would be due from M Corp.
But because mandatory unitary combined reporting applies in Rhode Island for tax year 2015, M Corp.'s income is included in the combined report. M Corp.'s $400,000 in net income is reduced by L Corp.'s $200,000 current year NOL, resulting in $200,000 of net income for the combined group.

For tax year 2015, L Corp. has $1 million in sales, all in Rhode Island. M Corp. has $1 million in sales in other states, none in Rhode Island. Based on single sales factor apportionment, the combined group's apportionment factor is 50 percent (because L Corp. sales are 50 percent of the combined group's everywhere sales of $2 million). Thus, 50 percent of the combined group's net income of $200,000 is subject to Rhode Island corporate income tax, at a rate of 7 percent. Therefore, the combined group pays $14,000 in Rhode Island corporate income tax. (In a separate step, the group determines the number of members that have Rhode Island nexus, and multiplies that sum by $500. In this example, only one member has Rhode Island nexus, so the minimum tax is $500. However, the group must pay the higher of the tax due under the standard formula or the tax due under the minimum tax. In this example, the $7,500 in tax due under the standard formula is higher.

	Combined group
Combined group's net income	$200,000
Group's net income apportioned to Rhode Island	100,000
Rhode Island tax (applied at rate of 7%)	7,000
Total Rhode Island tax due	7,000

Example

Q Corp. and R Corp. are both C corporations that comprise a combined group engaged in a unitary business. (The corporations may have a parent-subsidiary or brother-sister relationship.) Q Corp. is a 10 percent partner in a partnership that is treated as a pass-through entity for federal income tax purposes. Q Corp.'s share of income derived from that partnership is $1 million.

Although a partnership that is treated as a pass-through entity for federal tax purposes is not subject to Rhode Island combined reporting, and is not part of a combined group, Q Corp.'s 10 percent share of the partnership's $1 million in income is included in the combined group's income.

Example

Tom and Jerry are equal owners of a bakery organized as a C corp. which operates solely in Rhode Island with all sales in Rhode Island. They are also equal owners of a baked goods distribution business organized as a C corp. which operates in Rhode Island with all receipts in Rhode Island. The bakery and the distribution company have common ownership and are engaged in a unitary business (they share common management, sales, and other functions). Both C corporations therefore are subject to Rhode Island's combined reporting regime.

In addition, Tom and Jerry are equal owners of a limited liability company which is treated as a pass-through entity for federal tax purposes, operates solely in Rhode Island, and whose only function is to own the real estate on which the bakery and baked goods distribution business operate, as well as the vehicles which the distribution company uses.

An LLC that is treated as a pass-through entity for federal tax purposes is not subject to Rhode Island combined reporting, and is not part of a combined group. In this example, the income that is generated by the LLC passes directly through to Tom and Jerry, the LLC's owners, and is not counted as income of the combined group.

Example

Assume the same facts and circumstances as in the example above, except that Tom and Jerry are Connecticut residents who are equal owners of the Rhode Island bakery C corporation, the Rhode Island baked goods distribution company C corporation, a Connecticut C corporation management business, and the LLC which owns all of the real estate of all of the businesses plus the vehicles that the distribution corporation uses. The bakery's business is entirely in Rhode Island; it sells its goods to the distribution company, which distributes the goods to customers throughout Rhode Island, Connecticut, and Massachusetts.

In this example, the combined group consists of the bakery in Rhode Island, the distribution company in Rhode Island, and the management services business in Connecticut.

The LLC charges rent to all of the businesses in both states. The Connecticut management corporation charges all of the businesses in both states a management fee. Principally as a result of the fees levied by the LLC and the management company, the bakery and distribution business in Rhode Island have reported *de minimis* net income for some years, a net loss for others, and each has paid to Rhode Island the $500 corporate minimum tax before combined reporting took effect.

Under Rhode Island's mandatory unitary combined reporting regime, the combined group pools its income and apportions it to Rhode Island using single sales factor apportionment. The LLC is not part of the combined group; its income flows through to its owners, Tom and Jerry. However, the LLC must apportion its income, at the entity level, using Rhode Island's three-factor apportionment formula. Both Tom and Jerry have Rhode Island source income from the LLC and are subject to Rhode Island pass-through withholding, which is calculated by the LLC. Both Tom and Jerry report their apportioned LLC income on their Rhode Island nonresident and Connecticut resident personal income tax returns.

Example

- TT Corp. is a C corporation.
- UU Corp. is an S corporation
- VV LLC is a limited liability company treated as a pass-through entity for federal tax purposes.

All are Rhode Island entities doing business in multiple states, share common ownership, and are engaged in a single, common business enterprise. None is subject to Rhode Island's combined reporting regime. Even though all of the entities are engaged in a unitary business and are under common ownership, only one is a C corporation; for combined reporting to apply, two or more C corporations must be involved (and must have common ownership and must be engaged in a unitary business).

The C corp. will apportion its income to Rhode Island using single sales factor apportionment, and using market-based sourcing for purposes of the sales factor.

The S corp. and the LLC will apportion their income at the entity level using three-factor apportionment and the cost-of-performance method for purposes of the sales factor.

Example

- AA Corp. is in Providence, R.I.
- BB Corp. is in Cranston, R.I.
- CC Corp. is in Middletown, R.I.

All three are organized as C corporations, under common ownership, engaged in a unitary business – all are micro-manufacturers that sell products throughout the world. Each has nexus in Connecticut and Massachusetts.

For tax year 2014, each was a separate entity for Rhode Island corporate income tax purposes. Each filed its own Rhode Island corporate income tax return, apportioned its income to Rhode Island based on three-factor apportionment, with a double-weighted sales factor. For apportionment purposes, each used the cost-of-performance method for sourcing sales of services. Thus, the sale of services was assigned to the state in which the income-producing activity was performed. If the corporation performed the income-producing activity in two or more states, the sale was assigned to the state in which the corporation performed a greater proportion of the income-producing activity than in any other state, based on the costs of performance.

For tax year 2015 and later, they will be subject to combined reporting – i.e., they will combine their income, disregarding intercompany transactions; the resulting combined pool of income will be apportioned to Rhode Island using a single factor – sales (receipts) – for apportionment purposes. Also for apportionment purposes, they will assign sales of services to the state in which the benefit of the service is received. If a customer receives only a portion of the benefit of the service in Rhode Island, the gross receipts are assigned to Rhode Island in proportion to the extent the customer benefits from the service in Rhode Island.

Appendix III – Comprehensive Example

▪ Victor Corp. is a Rhode Island business organized as a C corporation. It is a manufacturer of jewelry, chiefly under the "Zulu" brand. It has nexus only in Rhode Island.

▪ Whiskey Corp. is a Connecticut business organized as a C corporation. It is a manufacturer of specialty packaging. Its packaging is used chiefly for "Zulu" brand jewelry. It has nexus only in Connecticut.

▪ Xray Corp. is a Nevada business organized as a C corporation. It provides management, accounting, and related services to Victor Corp. and Whiskey Corp. Xray Corp. has nexus only in Nevada.

▪ Romeo is a limited liability company (LLC) based in Delaware that is treated as a pass-through entity for federal income tax purposes. It owns Xray Corp.'s land and buildings. Romeo's income and expenses flow through to Xray Corp. of Nevada.

Victor Corp., Whiskey Corp., and Xray Corp. are under common ownership – more than 50 percent of the voting control of each member of the group is directly or indirectly owned by a common owner or owners.

As a result, they together comprise a combined group for purposes of Rhode Island combined reporting. The activities of the group 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 among the separate parts.

Thus, the combined group is deemed to be engaged in a common business enterprise, a unitary business, for purposes of Rhode Island's mandatory unitary combined reporting regime.

TAX YEAR 2014

For tax year 2014, when Rhode Island had separate entity reporting for corporate income tax purposes, only Victor Corp. was required to file a Rhode Island corporate income tax return, and only Victor Corp. had a Rhode Island corporate income tax liability.

Due chiefly to the expenses Victor Corp. incurred through payments it made to its Nevada affiliate for management, accounting, and related services, Victor Corp. suffered a $5,000 current-year net operating loss.

As a result, Victor Corp.'s Rhode Island corporate income tax liability for tax year 2014 was the minimum required, $500.[89] (Please see table below.)

Tax Year 2014	Victor Corp. (separate)	Whiskey Corp. (separate)	Xray Corp. (separate)	Combined report
Federal taxable income	$100,000	$1,000,000	$180,000,000	n/a
- deductions	(110,000)	(750,000)	(90,000,000)	n/a
+ additions	5,000	50,000	10,000,000	n/a
Adjusted taxable income	(5,000)	300,000	100,000,000	n/a
Rhode Island tax	500	0	0	n/a

TAX YEAR 2015

For tax year 2015, Rhode Island combined reporting is in effect. As a result, the income of all of Victor Corp.'s affiliates must be combined for Rhode Island corporate income tax purposes into a single pool of income. (For convenience, the example assumes that income and expenses of all the affiliates are the same for tax year 2015 as they were for tax year 2014.)

The income of Xray Corp. for tax years 2014 and 2015 reflects the income and expenses of Romeo LLC in Delaware. However, for tax year 2015, the income and expenses of Romeo LLC, which pass through to Xray Corp., must be included as part of the overall combined group's income.

Under Rhode Island combined reporting rules, NOLs created before January 1, 2015, are allowed to offset the income only of the corporation that created the NOL; the NOL cannot be shared with other members of the combined group. Thus, in this example, the NOL created by Victor Corp. for tax year 2014 cannot be shared with the group for tax year 2015.

However, Victor Corp. created a current-year NOL for tax year 2015, which *is* allowed to be shared with other members of the combined group. (Please see table below.)

Tax Year 2015	Victor Corp.	Whiskey Corp.	Xray Corp.	Combined report
Federal taxable income	$100,000	$1,000,000	$180,000,000	$181,100,000
- deductions	(110,000)	(750,000)	(90,000,000)	(90,860,000)
+ additions	5,000	50,000	10,000,000	10,055,000
Adjusted taxable income	(5,000)	300,000	100,000,000	100,295,000

[89] RIGL § 44-11-2(e).

Although the income of all of the members of the combined group must be combined for Rhode Island corporate income tax purposes, not all of that income will be taxed by Rhode Island; only a portion will be.

Under Rhode Island combined reporting rules, a series of calculations must be performed to determine the amount of the combined group's pool of income to be apportioned to Rhode Island and subjected to Rhode Island tax. The calculation is based on a single factor – sales, also known as gross receipts or total receipts.

The apportionment formula includes a numerator and a denominator:

▪ For purposes of the numerator, all Rhode Island receipts are counted – including receipts of corporations that do not have Rhode Island nexus. (Please see table below.)

▪ For purposes of the denominator, all gross receipts – including, in this example, all overseas sales of all taxable members of the group – are included. (Please see table below.)

Apportionment:	Victor Corp.	Whiskey Corp.	Xray Corp.	Combined
Rhode Island receipts	$5,000,000	$10,000,000	$0	$15,000,000
Everywhere receipts	10,000,000	100,000,000	200,000,000	310,000,000
Apportionment ratio	0.500000	0.100000	0.000000	0.048387

As the table above shows, the combined Rhode Island receipts of the group are divided by the combined everywhere receipts of the group. The result is an apportionment factor of 0.048387.

To determine the amount of the combined group's combined income that is apportioned to Rhode Island, the combined group's apportionment factor of 0.048387 is applied to the combined group's Rhode Island adjusted taxable income of $100,295,000.

The result is the combined group's apportioned Rhode Island taxable income. The income (after any applicable adjustments) is then subject to Rhode Island's corporate income tax rate. (For tax year 2015, the Rhode Island corporate income tax rate is 7 percent, down from 9 percent for tax year 2014.) In this example, the combined group's Rhode Island apportioned taxable income of $4,852,984 is multiplied by the tax rate of 7 percent for tax year 2015 to arrive at the tentative Rhode Island corporate income tax of $339,709. (Please see table below.)

Any allowable credits, subject to Rhode Island combined reporting rules, would then be applied to arrive at Rhode Island tax.

Tax computation for tax year 2015:	Combined group
Federal taxable income	$181,100,000
- deductions	(90,860,000)
+ additions	10,055,000
Adjusted taxable income	100,295,000
x apportionment factor	0.048387
Apportioned taxable income	4,852,984
x tax rate	0.07
Tentative Rhode Island tax	339,709