State of Rhode Island and Providence Plantations

Rhode Island Division of Taxation
(Department of Revenue)

Business Corporation Tax

Combined Reporting

Regulation CT 16-17

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Preamble

I. Background

Legislation approved by the Rhode Island General Assembly and signed into law by then-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 returns -- 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 then-Governor Chafee on June 19, 2014.[2]

This preamble is an informal, plain-language summary of recently enacted legislation regarding combined reporting. This preamble is provided in accordance with Rhode Island Division of Taxation Regulation TRR 98-1, Rhode Island Governor Gina M. Raimondo's Executive Order 15-07, and the Rhode Island Office of Regulatory Reform, all of which prescribe that regulatory and other tax information be clearly written, in plain language. This preamble is for general information purposes only; it is not a substitute for Rhode Island General Laws or for Rhode Island Division of Taxation regulations -- including the regulation on combined reporting, which follows this preamble. Nothing contained in this preamble in any way alters or otherwise changes any provisions of Rhode Island statutes, regulations, or formal rulings.

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]

[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, among other things, RIGL § 44-11-4.1.

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 11-15, "Combined Reporting (*pro forma*)."[4]

The Division of Taxation has carried forward a number of elements of Regulation CT 11-15 into the following regulation involving mandatory unitary combined reporting – in keeping with provisions of Rhode Island General Laws, 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, an affiliated group is still able to elect to use the same members that the affiliated group includes in filing its federal consolidated return.
- A tracing protocol applies to net operating losses (NOLs).
- A tracing protocol applies to tax credits.
- The combined group still must appoint a designated agent. The agent is required to act on behalf of the combined group in its own name in all matters related to the combined return.
- For a combined group filing on extension, the extended due date will be seven months after the normal filing deadline. Thus, for a combined group whose return is due March 15, the deadline will be October 15.[5]

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[4] Rhode Island Division of Taxation Regulation CT 11-15, "Combined Reporting (*pro forma*)," was filed in 2011, amended and renamed as Regulation CT 12-15 in 2012, and repealed effective November 4, 2014.
[5] The seven-month extension applies to all filers of Form RI-1120C regardless of whether combined reporting is involved. It is an extension of the time to file, not of the time to pay.

Key regulatory differences

The following 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 following 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 following regulation spells out, only the Finnigan method is now used for apportionment by entities that are treated as C corporations for federal income tax purposes.

- When the prior regulation was promulgated, three-factor apportionment applied, using sales (total receipts), property, and payroll. However, for tax years beginning on or after January 1, 2015, a single factor – sales (total receipts) – is used for apportionment purposes by entities that are treated as C corporations for federal income tax purposes, whether or not part of a combined group.[8]

- When the prior regulation was promulgated, the sales factor for apportionment purposes was determined by C corporations using the cost-of-performance method. However, for tax years beginning on or after January 1, 2015, market-based sourcing is used by entities treated as C corporations for federal income tax purposes, whether or not part of a combined group, in place of the cost-of-performance method.

- For Rhode Island combined reporting purposes, an affiliated group of corporations uses the same members that the affiliated group 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.

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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] The sales factor represents that part of the taxpayer's total receipts from sales or other sources during the taxable year which is attributable to the taxpayer's activities or transactions within this state during the taxable year. See RIGL § 44-11-14(b)(1) for additional information.
[9] "FAS 109" is also known as FASB Accounting Standards Codification 740, or "ASC 740".

- 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 franchise tax is repealed and the corporate income tax rate is seven percent (7%).

- The following regulation clarifies that, for purposes of combined reporting, gross receipts include, among other things, gross income from intangible personal property as well as from the performance of services.

- The following regulation makes clear that "captive insurance companies" taxed under RIGL Chapter 27-43 shall not be included in a combined return.

- Due to the length of the following regulation, and the complexity of combined reporting, the Division of Taxation has added a table of contents for the convenience of taxpayers and their advisers. The preamble is not part of the table of contents because the preamble is not part of the following regulation. The following regulation also includes an appendix with additional examples.

II. Explanation of provisions

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

COMBINED REPORTING OVERVIEW

For tax years beginning on or after January 1, 2015, a business which is treated as a C corporation for federal income tax purposes, and which is part of a combined group engaged in a single or common business enterprise – a "unitary" business – must file a combined return 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, an entity treated as a C corporation for federal income tax purposes must 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 must 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 is then 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 UDITPA, 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.[10] 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 or will be taxed under RIGL Chapter 44-11 is subject to combined reporting.

However, the following entities are not subject to combined reporting:[11]

- 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;
- captive insurance companies taxed under RIGL Chapter 27-43;
- 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"[12]); 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.

[10] "The Project to Revise UDITPA," 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).
[11] 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 limited liability companies (LLCs), limited liability partnerships (LLPs), limited partnerships, general partnerships, and single-member limited liability companies (SMLLCs). Form RI-1120S is filed by S corporations.
[12] See U.S. Treas. Reg. § 301.7701-2.

Although a pass-through entity is not, in and of itself, included in a combined return, the combined group's share of the pass-through entity's income, normally reported on federal Schedule K-1, must be reported as part of the combined group's income. "Pass-through entities" for this purpose include, but are not limited to, limited liability companies that are taxed as partnerships (not as corporations) or treated as disregarded entities under federal law, single member LLCs, and S corporations that are not themselves members of the combined group. Such entities may have their own filing requirement for Rhode Island tax purposes. For further information on entities that are and are not included in a combined group for purposes of Rhode Island's combined reporting statute, please see Rule 7.

To summarize, the legislation as enacted in 2014 represented the most sweeping changes to Rhode Island's corporate tax structure in nearly 70 years. Consequently, the Division of Taxation is promulgating the following regulation on mandatory unitary combined reporting to provide guidance that will assist corporations and preparers in complying.

In a similar way, the Division of Taxation is promulgating separate regulations to provide guidance on single sales factor apportionment, market-based sourcing, nexus, and other tax matters that were affected by the 2014 law that restructured the Rhode Island corporate tax.

The following regulation on combined reporting provides only summary information on apportionment and related matters and should be read in concert with the Division of Taxation's regulations on those subjects.

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 the following regulation.

COMBINED GROUP

The term "combined group" means a group of two or more C corporations in which more than fifty 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.

Combined reporting is limited to those entities that are treated as C corporations for federal income tax purposes. For combined reporting to apply, such 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, an entity treated as a C corporation for federal income tax purposes that stands alone – i.e., a C corporation with no affiliates or related companies -- is not subject to combined reporting.

However, an entity treated as a C corporation for federal income tax purposes 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, include the income and sales factors of all of its affiliated corporations -- no matter where they are situated in the United States and no matter if the affiliates have nexus in Rhode Island. The combined return also must include the income and apportionment factor of each foreign corporation if such corporation's sales factor in the United States is more than twenty percent (20%).

The use of a combined return does not disregard the separate identities of the taxpayer members of the combined group. Therefore, each taxpayer member doing business in Rhode Island is responsible for tax based on its taxable income or loss apportioned to Rhode Island.[13]

WATER'S EDGE

In general, the term "water's edge" is a term used in tax discussions regarding to what extent a combined group should include overseas members for purposes of combined reporting. Some states require all or substantially 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.

Thus, a combined group must include the entire income and apportionment factor of any member not incorporated in the United States, regardless of the place incorporated or formed, if its sales factor in the United States is 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. The following 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.

[13] Although each taxpayer member is responsible for tax, the combined group must appoint a designated agent, which is required to act on behalf of the combined group in its own name in all matters relating to the combined return. Please see Rule 19.

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's Model Apportionment Statute, describes in part Rhode Island's law:

> 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 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 *or* are dependent upon the activities of another business, those businesses are part of a unitary business.[14]

For Rhode Island corporate income tax purposes, the term "unitary business" means the activities of a group of two or more C 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. (Although a corporation may be "unitary" with other corporations, it is still necessary under the Due Process and Commerce Clause of the United States Constitution to identify the scope of the unitary business.)

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

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 U.S. 159 (1983)
- *Edison California Stores v. McColgan*, 30 Cal.2d 472 (1947)

Rhode Island 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 following regulation.

INTERDEPENDENCE OF FUNCTIONS TEST

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

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 fifty percent (50%) 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.

Rhode Island also will consider factors such as functional integration, centralization of management, and economies of scale.

For purposes of determining whether a group is in a unitary business, Rhode Island will also rely on definitions and other guidance in the Multistate Tax Commission allocation and apportionment regulations.[15]

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

Consolidated election

For tax years beginning on or after January 1, 2015, in determining the members of the combined group for purposes of Rhode Island mandatory unitary combined reporting, the affiliated group may elect to use the same members that the affiliated group includes in filing its federal consolidated return.[16]

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 affiliated groups may find that such an election eases the administrative and compliance burden of identifying which members to include in the group for Rhode Island combined reporting purposes. The group's return for Rhode Island purposes can include entities that would not otherwise be subject to combination.

The election shall be upon the condition that all C corporations which are included on the federal consolidated return for the taxable year consent to be included in the group. The filing of a Rhode Island return for the combined group, with the appropriate box checked, 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 January 1, 2015, once the election is made, it must continue for five years, including the year the election is made.

If an entity is treated as a C corporation for federal income tax purposes, is included on a group's federal consolidated return, and is also taxed by Rhode Island under RIGL Chapter 44-13 ("Public Service Corporation Tax"), Chapter 44-14 ("Taxation of Banks"), Chapter 44-17 ("Taxation of Insurance Companies"), or Chapter 27-43 ("Captive Insurance Companies"), that entity shall be excluded from the group for purposes of the Rhode Island combined reporting regime's federal consolidated election. (See Rule 9 for additional information about entities that must be included or excluded from the federal consolidated group for Rhode Island combined reporting purposes.)

Apportionment – single sales factor

For tax year 2014, Rhode Island's formulary apportionment system typically uses three factors, each weighted equally to determine in-state presence: sales (gross receipts), property, and payroll.[17]

Effective for tax years beginning on or after January 1, 2015, all entities that are treated as C corporations for federal income tax purposes and that are or will be taxed under the Rhode Island business corporation tax (RIGL Chapter 44-11) must use single factor –

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[16] IRC § 1501 *et seq.*

[17] RIGL § 44-11-14, but see also RIGL § 44-11-14.1 through § 44-11-14.6, and RIGL § 44-11-15.

sales (gross receipts) – for apportionment purposes. (See also “Finnigan method” and “market-based sourcing” further in this preamble.)

Single sales factor apportionment applies to all entities treated as C corporations for federal income tax purposes, regardless of whether a C corporation is part of a combined group.

Entities not treated as C corporations for federal income tax purposes, 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 three-factor apportionment formula, which typically includes sales, payroll, and property.

This preamble, as well as the following regulation, provide only summary information about apportionment, market-based sourcing, and nexus. It is recommended that the Tax Division’s regulation on combined reporting be read in concert with the Tax Division’s regulation on apportionment and the Tax Division’s regulation on nexus.

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. [18]

For purposes of applying the Finnigan method, the entire combined group as a whole is treated as the taxpayer for apportionment purposes: All sales of members of the combined group attributable to Rhode Island are included in the sales factor numerator – regardless of whether or not 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.

The denominator shall include the combined group’s gross receipts from sales everywhere during the taxable year.

APPORTIONMENT – MARKET-BASED SOURCING

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

[18] *Appeal of Finnigan Corp.*, California State Board of Equalization, 88-SBE-022, August 25, 1988.

Cost-of-performance sourcing, which is in effect for tax year 2014, shall 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 and/or intangible personal property receives benefit from the service and/or intangible personal property.[19]

Rhode Island apportionment – tax years beginning on or after January 1, 2015	
Apportionment formula:	*Applies to:*
Single sales factor	C corporations
Three-factor formula	Taxpayers other than C corporations
Sourcing method:	*Applies to:*
Market-based sourcing	C corporations
Cost-of-performance	Taxpayers other than C corporations
"C corporations" means entities treated as C corporations for federal income tax purposes.	

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. (See Rule 13 of the following regulation for details.)

NOLs created before January 1, 2015, may be carried forward and applied only against the income 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 the corporation was not taxed under the Rhode Island corporate income tax.

NOLs created in tax years beginning on or after January 1, 2015, shall 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 therefore can be offset among members of the group.[20]

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

[19] 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.
[20] Groups that make the federal consolidated election are nevertheless not allowed to carryback NOLs. Also, consolidated groups must follow the same tracing provisions as combined groups. (See Rule 13.)

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

INTANGIBLES ADD-BACKS, CAPTIVE REITS

For tax year 2014 and prior years, 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, captive real estate investment trusts (also known as captive REITs) are required to add back dividends paid for purposes of computing their Rhode Island income.

For tax years beginning on or after January 1, 2015, the intangibles add-back provision and the captive REIT provision are repealed. If a combined group includes a parent and a captive-REIT subsidiary, there shall be no elimination for the REIT payment to the parent, and no dividends-received deduction for the parent. In the case of a group filing a Rhode Island consolidated return in lieu of a combined report, there shall be no dividends-received deduction for the parent of a captive REIT.

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.

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 one hundred percent (100%) 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 one hundred percent (100%) of the current year tax liability.

TAX ADMINISTRATOR'S AUTHORITY

Although certain elements of the following regulation are interpretive, the following regulation is largely legislative in nature. In promulgating the following regulation, the Tax Administrator is relying on the broad authority granted under RIGL § 44-11-4.1(g), which states:

> The tax administrator shall prescribe and amend, from time to time, rules and regulations as he or she may deem necessary in order that the tax liability of any group of corporations filing as a combined group and each corporation in the combined group, liable to taxation under this chapter, may be determined, computed, assessed, collected, and adjusted in a manner as to clearly reflect the combined income of the combined group and the individual income of each member of the combined group. 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.

The foregoing also applies to an affiliated group making the federal consolidated election for Rhode Island combined reporting purposes (as described in Rule 9).

SPECIAL APPEALS

The Division of Taxation is required by statute to establish an independent appeals process – for tax years beginning on or after January 1, 2015 – 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.[21] The Division of Taxation intends to address the requirement in the following manner:

When a dispute arises between the Tax Administrator and a taxpayer with respect to the method of apportionment applied, both the taxpayer and the Tax Administrator shall be entitled to initiate an appeals process through an independent arbitrator. (The Division of Taxation's regulation on apportionment provides additional information on this matter.)

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.[22]

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[21] RIGL § 44-11-15.

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

To help ensure that the Tax Administrator's report is filed in as complete and timely a fashion as possible, the Division of Taxation intends to design Form RI-1120C in such a way so that an NAICS[23] code for each member of a combined group is prominently displayed. The Division also intends to work with providers of computerized tax preparation software programs to require the inclusion, in a prominent place on returns, of an NAICS code for each member of a combined group.

NOTE ABOUT EXAMPLES IN FOLLOWING REGULATION

- The annual corporate minimum tax under RIGL § 44-11-2(e) is $500 for 2015. For convenience, a number of examples in the following regulation assume that $500 is the amount of the minimum tax – no matter the year. However, under recently enacted legislation, the annual corporate minimum tax (and annual filing fee or filing charge for pass-through entities) is $450 for tax years beginning on or after January 1, 2016.[24] Taxpayers are advised to check applicable law at the time they compute their Rhode Island corporate tax liability to ensure that the correct minimum tax amount is used.

- As of September 2015, the corporate tax rate under RIGL § 44-11-2(a) was seven percent (7%) of net income, applying for tax years beginning on or after January 1, 2015. For convenience, a number of examples in the following regulation assume that the corporate tax rate is seven percent (7%). However, taxpayers are advised to check applicable law at the time they compute their Rhode Island corporate tax liability to ensure that the correct tax rate is used.

[23] The North American Industry Classification System (NAICS) is the standard used by federal statistical agencies in classifying business establishments for the purpose of collecting, analyzing, and publishing statistical data related to the U.S. business economy. In general, corporations are required to list their principal business activities and their associated codes (based on the NAICS system) on their federal returns. The NAICS was developed under the auspices of the U.S. Office of Management and Budget, and adopted in 1997 to replace the Standard Industrial Classification (SIC) system. In general, the codes from both systems identify a firm's primary business activity.

[24] House Bill H 5900, Substitute A, as amended, art. 11, § 15, enacted June 30, 2015, and effective for tax years beginning on or after January 1, 2016.

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Rhode Island Division of Taxation: Regulation on Combined Reporting

Following is the Rhode Island Division of Taxation regulation on combined reporting:

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 § 44-11-4.1(g), which requires the Rhode Island Tax Administrator to prescribe and amend, from time to time, rules and regulations as he or she may deem necessary in order that the tax liability of any group of corporations filing as a combined group and each corporation in the combined group, liable to taxation, may be determined, computed, assessed, collected, and adjusted in a manner as to clearly reflect the combined income of the combined group and the individual income of each member of the combined group. These rules and regulations are also promulgated pursuant to RIGL § 44-1-4, which authorizes and empowers the Rhode Island Tax Administrator to make rules and regulations, as he or she may deem necessary, for the proper administration and enforcement of the tax laws of this state. 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 § 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, as well as other applicable state laws and regulations. This regulation explains Rhode Island's mandatory unitary combined reporting regime for entities that are treated as C corporations for federal income tax purposes. All examples in this regulation are provided solely for the purpose of illustrating basic concepts that are set forth in the rules herein, and may not introduce all relevant considerations. Such examples shall not serve as precedents in administrative hearings or other legal proceedings, and are not intended to cover all possible situations.

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 (IRC) § 1504.

"Apportionment" means, for purposes of Rhode Island's combined reporting requirements, the formula used to determine the amount of a combined group's income that is to be taxed under the Rhode Island corporate income tax.

"Captive REIT" means, as further defined in RIGL § 44-11-1(a), a corporation, trust or association (1) that is considered a real estate investment trust for the taxable year under IRC § 856; (2) that is not regularly traded on an established securities market; and (3) more than fifty percent (50%) of the voting power or value of the beneficial interests or shares of which at any time during the last half of the taxable year, is owned or controlled, directly or indirectly, by a single entity that is subject to the provisions of Subchapter C of the Internal Revenue Code.

"Combined group" means a group of two or more entities treated as C corporations for federal income tax purposes in which more than fifty percent (50%) of the voting stock of each member entity 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.[25] In this regulation, the term "combined group"

[25] RIGL § 44-11-1(2).

may refer to an affiliated group making the federal consolidated group election for Rhode Island combined reporting purposes.[26]

"Combined reporting" means the corporate taxation framework under which 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.

"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.[27]

"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*.

"Corporate income tax rate" means the Rhode Island corporate income tax rate that applies to a corporation's taxable income apportioned to Rhode Island.[28]

"Corporation" has the meaning set forth in RIGL § 44-11-1(4), and for purposes of mandatory unitary combined reporting under the Rhode Island General Laws, includes an LLC, partnership, or other entity electing to be taxed as a corporation for federal tax purposes. Although a partnership or other pass-through entity may not always be considered a corporation includible in the combined group on an entity basis as a member when a partnership or other pass-through entity is directly or indirectly held by a corporation, the business conducted by such a partnership or pass-through entity is considered the business of the corporation to the extent of the corporation's distributive share of the partnership or pass-through entity income.

"Cost of performance sourcing" means the sourcing method used for gross receipts from transactions other than sales of tangible personal property under the three-factor apportionment formula in RIGL § 44-11-14(a). Entities that are treated as C corporations for federal income tax purposes shall use the market-based sourcing method instead of the cost-of-performance sourcing method. (See "market-based sourcing" method 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 return.

[26] As further described in Rule 19.
[27] RIGL § 44-11-1(3).
[28] See RIGL § 44-11-2(a). The Rhode Island corporate income tax is also sometimes referred to as the business corporation tax.

"Division of Taxation" means the Rhode Island Department of Revenue, Division of Taxation. The Division may also be referred to in this regulation as the "Division of Taxation", "Tax Division", or "Division".

"Estimated tax payments" means, for purposes of Rhode Island combined reporting, the amount computed according to RIGL § 44-26-2.1(m) that must be paid by, or on behalf of, a combined group subject to Rhode Island combined reporting.

"Everywhere" as used in this regulation to describe sales does not include sales of a foreign corporation in a place that is located outside the United States.

"FAS 109" means Financial Accounting Standard 109, "Accounting for Income Taxes."[29]

"Federal income tax treaty"[30] 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

"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.

"Intangible property" within the meaning of this regulation generally includes, without limitation, copyrights; patents; trademarks; trade names; brand names; franchises; licenses; trade secrets; trade dress; information; know-how; methods; programs; procedures; systems; formulas; processes; technical data; designs; licenses; literary, musical, or artistic compositions; information; ideas; contract rights including broadcast rights; agreements not to compete; goodwill and going concern value; securities; and computer software. Intangible property is also referred to in this regulation as "intangible personal property" or "intangibles".

"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.

"Internal Revenue Code" means the most current edition of Title 26 of the United States Code. (It is abbreviated in this regulation as IRC.)

"Internal Revenue Service" means the bureau of the U.S. Treasury that is responsible for the determination, assessment, and collection of internal revenue in the United States. (It is also referred to in this regulation as the IRS.)

[29] Also known as FASB Accounting Standards Codification 740, or "ASC 740".
[30] RIGL § 44-11-4.1(d).

"Jobs Development Act" means the Rhode Island corporate income tax rate reduction enacted in 1994[31] and available to eligible entities under RIGL § 42-64.5-1 *et seq*.

"Life sciences tax rate reduction" means the Rhode Island corporate income tax rate reduction enacted as "The I-195 Redevelopment Act of 2011"[32] and available to eligible entities under RIGL § 42-64.14-1 *et seq*.

"Market-based sourcing" means the sourcing method used for gross receipts from transactions other than sales of tangible personal property under the single sales factor apportionment formula set forth at RIGL § 44-11-14(b). For tax years beginning on or after January 1, 2015, market-based sourcing is the method that all entities treated as C corporations for federal income tax purposes must use to determine how to treat a corporation's sales of services and/or intangible personal property – whether or not they are part of a combined group.

"Member" means, for purposes of Rhode Island combined reporting, a corporation included in a unitary business.[33]

"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,[34] 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.

"Pass-through entity" means a corporation that for the applicable tax year is treated as an S corporation under IRC § 1362(a), and a general partnership, limited partnership, limited liability partnership, trust, or limited liability company that for the applicable tax year is not taxed as a corporation for federal tax purposes under the state's check-the-box regulation.[35]

"Person" means any individual, firm, partnership, general partner of a partnership, limited liability company, registered limited liability partnership,[36] foreign limited liability partnership, association, corporation regardless of whether the corporation is or will be taxed under RIGL Chapter 44-11, company, syndicate, estate, trust, business trust, trustee, trustee in bankruptcy, receiver, executor, administrator, assignee or organization of any kind.

[31] Public Law 1994, ch. 84, § 1.
[32] Public Law 2011, ch. 245, § 3, and Public Law 2011, ch. 267, § 3.
[33] RIGL § 44-11-1(6).
[34] RIGL § 7-12-17.
[35] RIGL § 44-11-2.2.
[36] RIGL § 7-12-13.

"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".

"Single 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 treated as C corporations for federal income tax purposes and that are or will be taxed under the Rhode Island business corporation tax (RIGL Chapter 44-11) – whether or not they are part of a combined group.[37] The sales factor may also be referred to in this regulation as the "receipts factor" or "gross receipts factor" or "total receipts".

"Sourcing" – See "cost of performance sourcing" and "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 and includes any person that is or will be taxed under Rhode Island General Laws. For tax years beginning on or after January 1, 2015, a combined group is included within the definition of "taxpayer".

"Taxpayer member" means, for purposes of this regulation, a corporation which is a member of a combined reporting group which is required to file a tax return in this state.

"Tax haven"[38] 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's 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;

[37] RIGL § 44-11-14(b).
[38] RIGL § 44-11-1(8).

(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.

"Three-factor apportionment" means the apportionment formula set forth in RIGL § 44-11-14(a). The three-factor apportionment formula takes into account the property factor, the payroll factor, and the sales factor of the trade or business of the taxpayer.

"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 Rhode Island to the broadest extent permitted under the United States Constitution.[39]

"United States" means the fifty (50) states of the United States, the District of Columbia, and the United States' territories and possessions.[40]

"United States Code" means the consolidation and codification by subject matter of the general and permanent laws of the United States, as prepared and published by the Office of the Law Revision Counsel of the U.S. House of Representatives. (It is abbreviated in this regulation as U.S.C. or USC.)

"Voting stock" means shares of capital stock of a corporation entitled to vote generally in the election of directors.[41]

"Water's edge rules" means the rules, described elsewhere in this regulation, under which some or all of a foreign corporation's income derived from a unitary business carried on in part in Rhode Island is not subject to combination because of the degree of the corporation's activities outside the United States.[42]

"Worldwide" – See "water's edge rules" above.

[39] RIGL § 44-11-1(11).
[40] RIGL § 44-11-1(12).
[41] RIGL § 7-5.2-3(17).
[42] RIGL § 44-11-4.1(d).

Rule 6. Combined Reporting – Overview

(a) For tax years beginning on or after January 1, 2015, each entity treated as a C corporation[43] for federal income tax purposes which is part of a combined group, under common ownership, and engaged in a unitary business with one or more other 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.[44] (See, also, Rule 17, "Filing of Return," and Rule 19, "Designated Agent.")

(b) Where an entity treated as a C corporation for federal income tax purposes is taxed or will be taxed under RIGL Chapter 44-11, the entity 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 return, unless it is an excluded entity as further described in Rule 7 of this regulation. The use of a combined return 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.[45] (See also "Designated Agent" in Rule 19.)

(c) A "combined return" 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 of the taxpayer member's combined group, as well as any supporting information required by the Tax Administrator.

The combined 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;

(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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[43] For purposes of combined reporting, Rhode Island follows federal "check-the-box" rules regarding the classification of business entities. See Treas. Reg. § 301.7701-1 *et seq*.
[44] 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.
[45] RIGL § 44-11-4.1(c).

(7) Combined receipts for everywhere using Finnigan method;

(8) Combined Rhode Island tax;

(9) First four pages of the completed U.S. Form 1120 as filed with the IRS;

(10) Separate company income and loss consolidation spreadsheet as filed with the IRS; and

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

(d) The following example shows how related entities might be affected by combined reporting.[46] For purposes of apportionment calculations in this example, the denominators reflect worldwide sales for corporations 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 combined group engaged in a unitary business, and have common ownership.[47]

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 is included in the combined return). 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 return
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	75	900	7,500	8,475
In-state taxable income	48	462	0	1,046
Total taxable income to Rhode Island	510			1,046

[46] The example in this section is 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.).

[47] 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 entities treated as C corporations for federal income tax purposes 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. Common ownership is determined without regard to the location, residence, or domicile of the owner(s).

(1) **Example**:

Parent Corp. is organized and based in Japan. Its two subsidiaries – Unit One Corp. and Unit Two Corp. – are U.S. corporations and are treated as C corporations for federal tax purposes. Unit One Corp. and Unit Two Corp. have Rhode Island nexus. Parent Corp. owns seventy-five percent (75%) of each subsidiary. Because of their common ownership, Unit One Corp. and Unit Two Corp. are deemed to comprise a combined group for purposes of Rhode Island's mandatory unitary combined reporting regime. Common ownership is determined without regard to the location, residence, or domicile of the owner(s). (The entities in this example must be engaged in a unitary business to file a combined return for Rhode Island.)

(b) The use of a combined return 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 shall be deemed a combined group even if all corporations in the group apportion one hundred percent (100%) of their income to Rhode Island.

(d) A combined group remains in existence for as long as two or more corporations are under common ownership and are engaged in a unitary business – and at least one member of the combined group has nexus in Rhode Island.

(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 9 in this regulation.

(1) If a corporation is not includible in a combined return, or in a consolidated group for Rhode Island combined reporting purposes, it must still file a Rhode Island return on a separate entity basis and pay any required tax if it has nexus in Rhode Island.

(g) For additional information about non-U.S. corporations, please see the flow chart in the example at Rule 7(t).

(h) *Included corporations.*

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

(i) U.S. corporations; and

(ii) Any member, regardless of where it is incorporated or formed, if the average of its sales factor within the United States is twenty percent (20%) or more.[48]

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

(i) 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 factor related thereto.

(i) *Excluded corporations.* Members of a combined group shall exclude as a member and disregard the income and apportionment factor 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.[49]

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.

[48] For treatment of income from domestic international sales corporations (DISCs) and foreign sales corporations (FSCs), see RIGL § 44-11-11.

[49] RIGL § 44-11-4.1(d).

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 the U.S. are 80 percent (80%) or more. Newport is a non-U.S. corporation, but its sales factor for total receipts outside the U.S. is only 75 percent (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 regardless of its U.S. sales factor.

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 revenue.[50] 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 intangible personal property, 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. 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 factor 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) If an entity is treated as a C corporation for federal income tax purposes, is included on a group's federal consolidated return, and is also taxed by Rhode Island under RIGL Chapter 44-13 ("Public Service Corporation Tax"), Chapter 44-13.1 ("Taxation of Railroad Corporations"), Chapter 44-14 ("Taxation of Banks"), Chapter 44-17 ("Taxation of Insurance Companies"), or Chapter 27-43 ("Captive Insurance Companies") – or if such entity would be taxed under said chapters if it had Rhode Island nexus – said entity shall be excluded from the combined group. Furthermore,

[50] RIGL § 44-11-14.

neither the income or loss nor the apportionment factor of such a person or entity shall be included – directly or indirectly – in the combined return.

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

(m)) When a partnership, limited liability company, S corporation, estate, trust, or other such entity is treated as a pass-through entity for federal tax purposes, such an entity shall not be part of the combined group. However, the combined group's share of such a pass-through entity's income, normally reported on federal Schedule K-1, must be reported as part of the combined group's income. When income is reported or recognized by the pass-through entity to the combined group, and thus becomes included in the group filing, only the sales of the pass-through entity shall be used for apportionment purposes at the group level.

(n) In summary, the following entities are not subject to combined reporting:[51]

- 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;
- captive insurance companies taxed under RIGL Chapter 27-43;
- S corporations;
- partnerships treated as pass-through entities for federal tax purposes;
- limited liability companies treated as pass-through entities for federal tax purposes;
- any sole proprietorship or similar such entity that is treated as an entity disregarded as separate from its owner for federal income tax purposes ("disregarded entities"[52]); 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.

For additional information on which entities must be included or excluded from the federal consolidated group for purposes of Rhode Island combined reporting, please see Rule 9.

[51] The entities on this list 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); Form RI-1120S is filed for S corporations.

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

(o) *Fifty percent test.*

The fifty percent (50%) 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[53] with the parent, whether such ownership is direct or indirect, but only if –

(i) the parent owns more than fifty percent (50%) of the outstanding voting stock of at least one corporation, and,

(ii) more than fifty percent (50%) 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 fifty percent (50%) of the outstanding voting stock of each of the corporations is owned, or indirectly owned, by the same person.

(3) Any two or more corporations, more than fifty percent (50%) 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:

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

(ii) party to a civil union;

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

(iv) 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

[53] RIGL § 7-5.2-3(17). See also explanation of voting stock ownership in this Rule.

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 fifty percent (50%) 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 fifty percent (50%) of the voting stock of each of two or more corporations will be considered to be common owners of more than fifty percent (50%) 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.

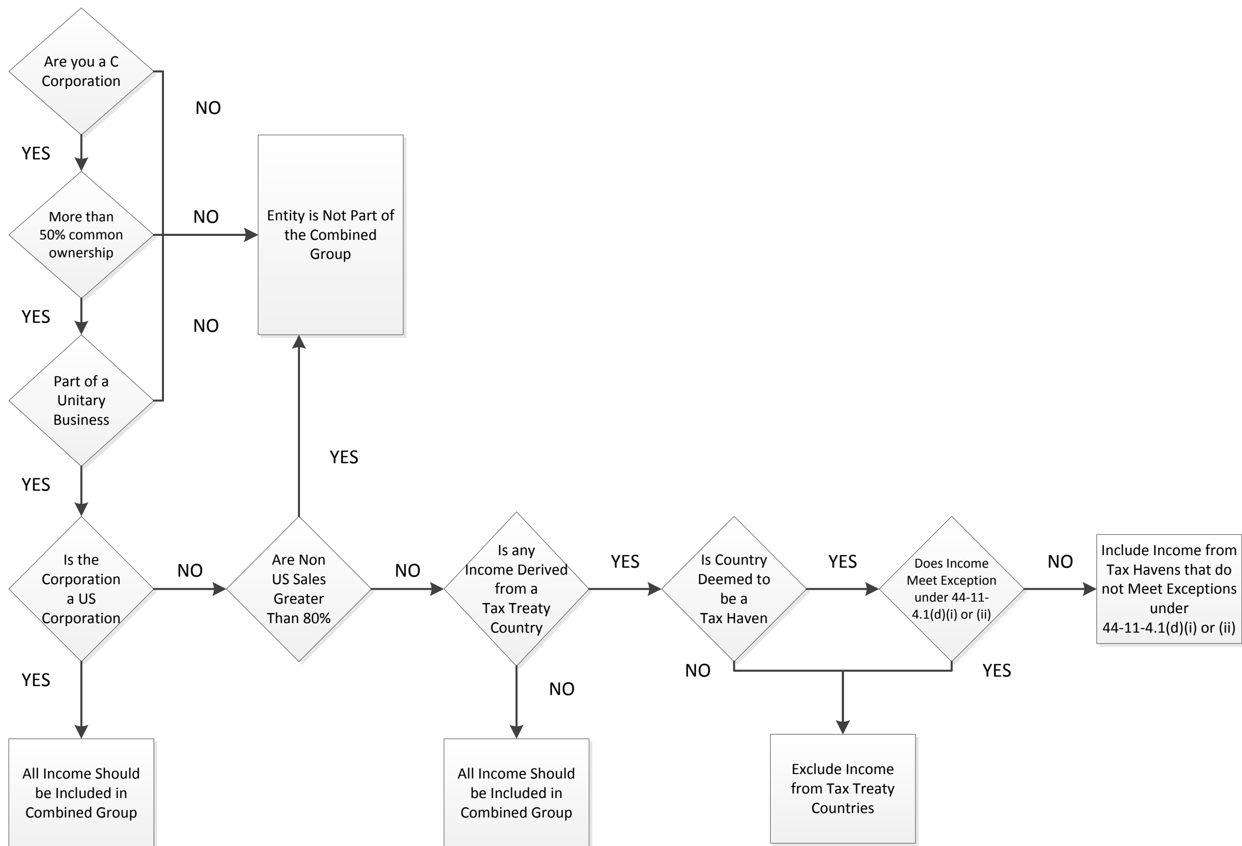
(r) In addition to the tests enumerated above, the Tax Administrator may consider any other circumstance that tends to demonstrate that the fifty percent (50%) direct or indirect common ownership test was met or was not met. The Tax Administrator may rely on constructive ownership rules under IRC § 318.

(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 in the apportionment computation – for purposes of Rhode Island's mandatory unitary combined reporting regime.



Additional information on flow chart[54].

(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 factor 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 return any expenses or apportionment factor attributable to income that is subject to the provisions of a federal income tax treaty.

[54] The first step in this flow chart, "Are you a C corporation," refers to any entity treated as a C corporation for federal income tax purposes.

(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 factor attributable to such income, shall not be included in the combined group net income or combined return 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 RIGL Chapter 44-11; 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 excludes the jurisdiction's resident taxpayers from taking advantage of the tax regime benefits, or prohibits enterprises 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) Combined reporting in Rhode Island is required only in those instances in which a unitary business exits. 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 combined group engaged in a unitary business with another entity 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.

(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 C corporation meets *either* of the tests set forth in this Rule – the "Interdependence of functions test" or the "Three unities test" – 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.[55]

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.

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[55] *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).

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.

(i) 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.

(ii) 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 there exists a joint, shared, or common activity which 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, and 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.

(e) *Three unities test.*

This test adopts the state law test for unity followed in *Butler Brothers*.[56]

(1) *Unity of ownership.* "Unity of ownership" exists with respect to corporations when the fifty percent (50%) ownership test is met.

(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. Factors that may be considered include, but are not limited to:

(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;

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

(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's 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 a periodic 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.

(f) *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 though 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.

(g) 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.

(h) *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.

(i) *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 combined 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.

(j) *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. The principal activities of the entities are different steps of a vertically structured business. Executive policy is set by a centralized management team in purchasing, accounting, legal services, and other areas. Entities in the group receive cost-savings from joint purchases. Thus, there is an interdependence of functions. For these and other reasons, 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 return must 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. Also, Mike Corp. sells products to the wholesale distribution operations, indicating a flow of value among the members of the group. This factor and other factors indicate that the enterprise is unitary – and that, combined with members being in the same line of

business, indicate a unitary relationship. Rhode Island combined reporting is therefore required.

Example:

Timco and some of its subsidiaries and affiliates are commonly owned and part of a combined group and are engaged in oil and oil-related businesses, including land, gas, pipeline, agricultural, and chemical activities. The oil and oil-related businesses are in the same general line of business; Timco sets policy and provides for legal services, human resources, marketing, and other functions for all subsidiaries and affiliates; there is common advertising, accounting, and computer systems among Timco and all subsidiaries and affiliates; and capital asset purchases cannot be made without prior approval by Timco. The group is deemed to be unitary due to functional integration, unity of operations and unity of use, and other reasons. However, Timco also has an affiliate in Rhode Island that is engaged in shipbuilding and ship repair. The shipbuilding and repair business stands alone; it sets its own policies and procedures, makes its own purchases, shares no common processes or procedures with Timco or other Timco units, and has virtually no involvement with Timco or Timco's other subsidiaries or affiliates. Thus, the shipbuilding and repair business is deemed not to be unitary with the Timco combined group and is therefore excluded from the group for purposes of Rhode Island mandatory unitary combined reporting.

Rule 9. Election to Use Federal Consolidated Group

(a) An affiliated group of C corporations, as defined in IRC § 1504, may elect to be treated as a combined group with respect to the combined reporting requirement imposed by Rhode Island General Laws. When such an election is made, the entities that appear on the federal consolidated return[57] shall be considered a combined group for Rhode Island corporate income tax purposes. To make the election, the affiliated group shall check the appropriate box on Form RI-1120C. The consolidated return can include entities that would not otherwise be subject to combination. The election shall be upon the condition that all entities which are included on the federal consolidated return for the taxable year consent to be included in the group for Rhode Island purposes. Checking the appropriate box on Form RI-1120C and filing the completed return shall be considered as such consent.

(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 eighty percent (80%) of the total voting power and at least eighty percent (80%) of the total value of the stock of at least one of the other includible corporations;

(2) Stock that represents at least eighty percent (80%) of the total voting power, and at least eighty percent (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 combined group for purposes of filing a combined return for Rhode Island, an affiliated group of C corporations, as defined in IRC § 1504 and shown or reflected in the

[57] IRC § 1501 *et seq.*

group's federal consolidated return, may instead use all of the members of its federal affiliated group.

(d) Affiliated groups that make the federal consolidated election are nevertheless not allowed to carryback NOLs. Also, affiliated groups that make the federal consolidated election must follow the same tracing provisions as combined groups. (See Rule 13.)

(1) To avoid double taxation, an affiliated group that makes the federal consolidated election for purposes of Rhode Island combined reporting shall exclude from the group for Rhode Island purposes those C corporations which are taxed under RIGL Chapter 44-13 ("Public Service Corporation Tax"), Chapter 44-13.1 ("Taxation of Railroad Corporations"), Chapter 44-14 ("Taxation of Banks"), Chapter 44-17 ("Taxation of Insurance Companies"), or Chapter 27-43 ("Captive Insurance Companies") – or which would be taxed under said chapters if they had Rhode Island nexus.

Example:

Assume that all of the entities in the following table are C corporations and comprise a combined group engaged in a unitary business. The group elects to file a federal consolidated return and includes, in that federal consolidated return, all of the entities in the table. For purposes of Rhode Island combined reporting, a group typically must include all of the entities included in its federal consolidated return. However, in this example, the number of entities included for Rhode Island purposes is modified: Only A Corp. and B Corp. will be included. C Corp. and D Corp. will not be included because if they were located in Rhode Island they would be taxed under RIGL Chapter 44-14 ("Taxation of Banks") Chapter 44-17 ("Taxation of Insurance Companies"), or Chapter 27-43 ("Captive Insurance Companies"). E Corp. is not included because it is taxed under RIGL Chapter 44-14. F Corp. is not included because it is taxed under RIGL Chapter 44-17.

Entities to be counted for Rhode Island combined reporting purposes		
Entity name:	*Description:*	*In Rhode Island combined return?*
A Corp.	Rhode Island manufacturer	Yes
B Corp.	Massachusetts retailer	Yes
C Corp.	Connecticut bank	No
D Corp.	Pennsylvania insurer	No
E Corp.	Rhode Island bank	No
F Corp.	Rhode Island insurer	No

(2) For purposes of Rhode Island combined reporting, a taxpayer shall modify the federal consolidated group by including foreign corporations if such corporations would otherwise be included in a Rhode Island combined group based on the flow chart in Rule 7 of this regulation.

(e) Should the affiliated group make this election, the election 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.[58]

Example:

X 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, assuming that the affiliated group has not petitioned the Tax Administrator for permission for earlier revocation and the Tax Administrator has not approved revocation.

(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. Standards for "reasonable cause" may include, but are not limited to, a significant restructuring of the affiliated group. The final determination shall be made by the Tax Administrator.

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

(h) The affiliated group making the election shall file, for the year concurrent with the filing of its Rhode Island combined return, 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.

(i) An affiliated group shall be allowed to make the election described in this Rule, but only if those entities in which it has an ownership stake of between fifty percent (50%) and eighty percent (80%) would not materially impact the combined return were they to be included in the combined return.

[58] RIGL § 44-11-4.1(b).

(j) To help ensure that returns are prepared in such a way so as to clearly reflect income, the Tax Administrator may require an affiliated group to include in its Rhode Island combined return certain entities that are not included in its federal consolidated return. Also, the Tax Administrator may require an affiliated group to exclude from its Rhode Island combined return certain entities that are included in its federal consolidated return, and to determine members of its combined return in accordance with the terms set forth in this regulation.

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

(a) For the convenience of taxpayers and their advisers, this Rule summarizes apportionment information for entities that are part of a combined group and that are engaged in a unitary business for purposes of Rhode Island's combined reporting regime. For additional information, taxpayers and their advisers should refer to the Rhode Island Division of Taxation's regulations on apportionment and nexus.

(b) For tax years beginning on or after January 1, 2015, all entities that are treated as C corporations for federal income tax purposes 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 entity's activities or transactions.[59]

(1) When income is reported or recognized by a pass-through entity to the combined group, only the sales (total receipts) of the pass-through entity are used for apportionment purposes at the group level.

(c) 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.

(d) As noted in Appendix I, the computation for Rhode Island's mandatory unitary combined reporting regime includes the following elements: combine the receipts of all members of the combined group using the Finnigan method, then calculate the apportionment ratio for the combined group, using – as the numerator – all Rhode Island receipts, regardless of whether a group member has nexus in Rhode Island, and using – as the denominator – everywhere receipts. Divide the numerator by the denominator to arrive at an apportionment ratio. Next, compute the apportioned Rhode Island taxable income of the combined group by multiplying adjusted taxable income by the combined apportionment ratio.

(e) To summarize, a combined group subject to Rhode Island mandatory unitary combined reporting shall use the Finnigan method, single sales factor apportionment, and market-based sourcing in its calculations.

(1) Entities that are not taxed as C corporations for federal income tax purposes shall use the cost-of-performance method in computing the sales factor in three-factor apportionment.

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[59] In general, for tax years beginning before January 1, 2015, an entity treated as a C corporation for federal income tax purposes and taxed by Rhode Island employed three-factor apportionment, using sales (receipts), property, and payroll. In certain cases, a corporation was able to use a special apportionment formula available under RIGL §§ 44-11-14.1 through 44-11-14.6.

(f) *Finnigan Method.*

Rhode Island applies the Finnigan method for purposes of calculating the sales factor. For purposes of applying the Finnigan method, the entire combined group as a whole – whether a combined group, or an affiliated group making the federal consolidated election for Rhode Island combined reporting purposes – is treated as the taxpayer for apportionment purposes: All sales of members of the group attributable to Rhode Island are included in the sales factor numerator – regardless of whether an individual member of the group has nexus with Rhode Island.

(g) *Example.*

Example:

The following example illustrates the application of the Finnigan method for apportioning the combined income of a combined group.

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.			

(h) *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, all of the group members apportion one hundred percent (100%) of their income to Rhode Island. Therefore, one hundred percent (100%) of the combined group's taxable income is taxable in Rhode Island.

(i) The provisions of this Rule shall also apply to affiliated groups making the federal consolidated group election for Rhode Island combined reporting purposes (as described in Rule 9).

Rule 11. Combined Net Income of Group

(a) In this Rule, “group” refers to the collective members of a combined group, at least one of which has corporate income tax nexus with 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 return does not disregard the separate identities of the taxpayer members of the group; each taxpayer member is responsible for tax based on its taxable income or loss apportioned to Rhode Island.

(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 taxable income of a combined group apportionable to this state.*

(1) The taxable income apportionable to Rhode Island of each combined group shall be the product of:

(i) the adjusted taxable income of the combined group, determined under this regulation, and

(ii) the apportionment percentage, including in the numerator the total sales (receipts) associated with the combined group’s business in Rhode Island, and including in the denominator the total sales (receipts) of all members of the combined group, which total sales (receipts) are associated with the combined group’s business wherever located.

(2) The combined return uses the income, losses, and factors of all members included on the combined return to more accurately determine the taxable income of those entities that have corporate income tax nexus with Rhode Island.[60]

(3) The principles set forth in the Treasury regulations promulgated under Section 1502 of the Internal Revenue Code, including the principles relating to deferrals, eliminations, and exclusions, shall apply to the extent consistent with the Rhode Island combined group membership and combined unitary reporting principles.

(e) *Pass-through entities.*

A combined group member’s numerator and denominator for purposes of the sales factor includes the apportionment factors (gross receipts) of pass-through entities

[60] *Barclay’s Bank, PLC v. Franchise Tax Board*, 512 U.S. 298 (1994).

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 group's income. However, a combined group member's sales factor shall 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.*

(1) If the taxable year of a member differs from the taxable year of the group, the designated agent shall elect to determine the portion of that member's income to be included in one of the following ways:

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

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

(2) 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.

(i) **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 example assumes ownership of a fictitious entity, Al's Bakery, which is located in Providence, Rhode Island.)

(1) Al's Bakery is owned and operated as a sole proprietorship.
A sole proprietorship is not subject to combined reporting.

(2) 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 – unless such an entity elects to be treated as a C corporation for federal income tax purposes.

(3) 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 entities treated as C corporations under common ownership engaged in a unitary business. However, Al's Bakery must use single sales factor apportionment and market-based sourcing for tax years beginning on or after January 1, 2015.

(4) 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, Connecticut, 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 in 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. Catrina LLC would still have a filing requirement for Rhode Island tax purposes and would still have to pay the annual filing charge under RIGL §7-16-67.

Rule 12. Corporate Minimum Tax

(a) The annual corporate minimum tax payable is the amount provided under RIGL § 44-11-2(e). The combined group pays either the tax due based on the amount of its net income apportioned to Rhode Island, using the applicable rate, 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). The sum must be compared to the actual tax due for the entire combined group. The combined group shall pay whichever amount is higher.

(1) Taxpayers and their advisers should review RIGL § 44-11-2 to determine the current tax rate and the current minimum tax, as well as other applicable provisions of Rhode Island General Laws, and the Division of Taxation regulation on nexus.

(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 assume that the minimum tax is $500 and the corporate income tax rate is seven percent (7%).

Example:

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

Application of Corporate Minimum Tax

Name	*Rhode Island nexus*	*NOL*	*Minimum 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 multiplies 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, which is seven percent (7%) of the income apportioned to Rhode Island). Because the group has a current-year NOL of $50,000, the group 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 which is engaged in a unitary business and is subject to Rhode Island combined reporting.

Application of Corporate Minimum Tax

Name	*R.I. nexus*	*R.I. apportioned income*	*Minimum 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 multiplies 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 which is engaged in a unitary business and is subject to Rhode Island combined reporting.

Application of Corporate Minimum Tax

Name	*R.I. nexus*	*R.I. apportioned income*	*Minimum tax*
Bryant Corp.	Yes	$10,000	$500
Bentley Corp.	Yes	$5,000	$500
Brandeis Corp.	Yes	$5,000	$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, as determined under standard formula, 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 has $1,610 in Rhode Island tax liability and must pay that amount because it is higher than the minimum tax of $1500.

(d) The provisions of this Rule shall also apply to affiliated groups making the federal consolidated group election for Rhode Island combined reporting purposes (as described in Rule 9).

Rule 13. Net Operating Losses

(a). For purposes of this regulation, a tracing protocol shall apply to net operating losses (NOLs).[61]

(1) 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.

(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.[62]

(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 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:

(i) Any NOL included in determining the deduction shall be adjusted to reflect the inclusions for, and exclusions from, entire net income required under the applicable section of RIGL Chapter 44-11;

(ii) The deduction shall not include any NOL sustained during any taxable year in which the member was not taxed under RIGL Chapter 44-11; and

(iii) 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.[63]

(5) Groups that make the federal consolidated election (see Rule 9) are nevertheless not allowed to carryback NOLs. Also, consolidated groups must follow the same tracing provisions as combined groups.

(b) *Departing member of combined group.*

(1) NOLs shall be carried forward from year to year separately by the individual entity that originally incurred the underlying loss. Therefore, such NOLs remain the tax attribute of that entity, although such carryforwards may be shared in

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

some cases with the other taxable members of a combined group, as described in this Rule.

(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 member becomes a member of a new combined group, the taxpayer member shall 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 member'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 member that has an 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 taxpayer 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 taxpayer 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 serve to illustrate some of the principles contained in this rule.

Example:

November Corp., Oscar Corp., and Papa Corp. are C corporations that have common ownership, are engaged 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 combined 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 are C corporations that 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 statute. 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. are C corporations that have common ownership, are engaged 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 combined reporting.

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 from 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. are C corporations that have common ownership, are engaged in a unitary business, and are a combined group. 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 2016 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 [filing as separate entity]
February Corp.	(500)	50	50 (300) (250) [filing as separate entity]
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; remaining 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) [tracks with Anne]

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.

(b) For tax year 2014, a corporate taxpayer 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.[64]

(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.[65]

(d) For purposes of Rhode Island combined reporting, all dividends paid by one member to another member of the combined group shall be eliminated from the income of the recipient.

(e) If a combined group includes a parent and a captive-REIT subsidiary, there shall be no elimination for the REIT payment to the parent, and no dividends-received deduction for the parent. In the case of a group filing a consolidated return in lieu of a combined return for Rhode Island tax purposes, there shall be no dividends-received deduction for the parent of a captive REIT.[66]

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[64] Ibid.
[65] Rhode Island Public Law 2014, ch. 145, art. 12.
[66] RIGL § 44-11-4.1(g)

Rule 15. Tax Rate

(a) For tax year 2014, corporations pay either the Rhode Island corporate income tax[67] or the Rhode Island franchise tax,[68] 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%)[69] and the franchise tax is repealed.[70] Thus, for tax year 2015, the maximum corporate income tax rate for a combined group engaged in a unitary business is seven percent (7.0%).[71]

(d) For additional information on the application of the minimum tax with respect to combined groups, please see Rule 12.

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[67] RIGL § 44-11-2.
[68] RIGL § 44-12-1 *et seq*.
[69] RIGL § 44-11-2(a). Tax rate applies to net income as defined in RIGL §§ 44-11-13 through 44-11-15.
[70] RIGL § 44-11-2(e).
[71] Annual corporate minimum tax is listed in RIGL § 44-11-2(e). For more information about the application of the minimum tax, please see Rule 12.

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.[72] The tracing protocol is the same as the one which applies to NOLs (see Rule 13).

(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, may be applied to other members of the group unless prohibited under the terms of this Rule.

(d) *Jobs Development Act.*

(1) The Jobs Development Act rate reduction under RIGL Chapter 42-64.5 applies to eligible companies filing as part of a combined group and to a group making the federal consolidated election for Rhode Island combined reporting purposes. 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%).

(4) As a result of legislation enacted on June 30, 2015 (House Bill H 5900, Substitute A, as amended), the tax rate reduction provision allowed under the Jobs Development Act is discontinued as of July 1, 2015. However, any company that has qualified for a rate reduction under the Jobs Development Act before July 1, 2015, will be allowed to maintain the rate reduction in effect as of June 30, 2015, although no additional rate reduction under the program will be allowed.

(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 filing as part

[72] RIGL § 44-11-4.1(f).

of a combined group and to a group making the federal consolidated election for Rhode Island combined reporting purposes. 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%).

(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 and in Rhode Island General Laws are met.

(3) In the event that a taxpayer that has a credit carryforward becomes a member of a new combined group, tracing protocol rules shall apply; any amount of credit carryforward that cannot be applied because of these limitations shall be carried forward consistent with the rules and limitations described in this Rule and in Rhode Island General Laws.

(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 associated 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 applicable Rhode Island statutes and regulations based upon the total credit previously taken by the taxpayer and its combined group members.

Example:

In general, a business that builds, acquires, constructs, erects, or reconstructs a building for use chiefly in the production process is allowed a four percent (4%) investment tax credit against the Rhode Island corporate income tax.

Recapture of the investment tax credit is required where property on which a credit has been taken is disposed of or ceases to be in qualified use prior to the end of its useful life, except (i) where property was in qualified use for its entire useful life, or (ii) where property was in qualified use for more than twelve (12) consecutive years.[73]

In such a case, the recapture formula is: tax credit taken on property ceasing to qualify times a fraction: the numerator is the useful life of property in months minus the qualified use in months; the denominator is the useful life of property in months.

The formula for recapture computation is expressed as follows:

Recapture =
Tax credit taken on property ceasing to qualify, times:
(useful life of property in months - qualified use in months) / (useful life of property in months)

[73] For more on the investment tax credit, see RIGL § 44-33-1 *et seq.* For more on the computation of such recapture, see Division of Taxation Regulation CR 03-04.

In this example, XYZ Corp. is treated as a C corporation for federal income tax purposes and is part of a combined group whose members are engaged in a unitary business and which is subject to Rhode Island combined reporting.

XYZ Corp., a calendar-year corporation, acquires a five-story building, including structural components, (each story of equal square footage) on January 1, 2015. The building's basis is $100,000. The building has a 20-year life. XYZ Corp. rents out or leases out one floor. XYZ Corp. uses the remaining four floors: three of them for production, one for administration and distribution. Thus, of the five stories in the building, four are for qualified use; one is not.

Investment Tax Credit = 4% x ($100,000 - $20,000) = $3,200.

(a) On January 1, 2016, XYZ Corp. rents out a floor that it had previously been using in administration and distribution. Thus, one of the four floors it had been using has fallen out of qualified use – and recapture is required. Recapture (expressed as "R" below) is computed as follows:

$$R = (\$3,200 \times 1/4) \times \frac{(240 \text{ months} - 12 \text{ months})}{240 \text{ months}}$$

R = $800 x 95%

R = $760

Example:

The facts and circumstances are the same as above, except that XYZ Corp. on January 1, 2016, rents out two floors that it had previously used in production. XYZ Corp. is therefore renting out three floors and using the remaining two floors: one for production, one for administration and distribution.

Because the entire building is not used more than fifty percent (50%) in production, there is a recapture of the entire remaining investment credit, computed as follows:

$$R = (\$3,200 \times 4/4) \times \frac{(240 \text{ months} - 12 \text{ months})}{240 \text{ months}}$$

R = $3,200 x 95%

R = $3,040

In both examples, because the credit was generated on or after January 1, 2015, by a member of the combined group (in this case, XYZ Corp.), recapture is the responsibility of the entire group.

(2) 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.

(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 Return

(a) For purposes of combined reporting, the Tax Administrator intends to 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, the designated agent of a combined group shall file the Rhode Island Business Corporation Tax Return, Form RI-1120C and, on schedules attached to the return, include information required by the Tax Administrator for each member of the combined group. (Please see Rule 19, 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 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, subject to any extended due dates permitted by the Tax Administrator under the authority granted in RIGL § 44-11-5, as set forth below in this Rule.

(c) The extended due date for a combined group's return on Form RI-1120C shall be seven months after the normal due date. Thus, for a calendar-year filer whose normal filing due date is March 15, the extended due date shall be October 15. It is an extension of the time to file, not of the time to pay; payments continue to be due by the regular due date.

(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 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 combined return is filed on behalf of a combined group, 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 included in the same combined return 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 whom the statute of limitations has expired and who were included in 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.

(g) A combined group's application of the rules set forth in this regulation must be based on objective criteria and must consider all sources of information reasonably available to

the taxpayer at the time of its tax filing including, without limitation, the taxpayer's books and records kept in the ordinary course of business. A taxpayer's method of determining the composition of the combined group and assigning its sales must be determined in good faith, applied in good faith, and applied consistently with respect to similar transactions and year to year. A taxpayer must retain contemporaneous records that explain the determination and application of its method of determining the composition of the combined group and assigning is sales, including underlying assumptions, and must provide such records to the Tax Administrator upon request.

(h) The provisions of this Rule shall also apply to affiliated groups making the federal consolidated group election for Rhode Island combined reporting purposes (as described in Rule 9).

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.

(b) Notwithstanding any other provisions of RIGL § 44-26-2.1, any taxpayer required to file a combined return 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 reporting provisions under RIGL § 44-11-4.1; or
>
> (2) The installments must equal one hundred percent (100%) of the current year tax liability.

(c) The provisions of this Rule shall also apply to affiliated groups making the federal consolidated group election for Rhode Island combined reporting purposes (as described in Rule 9).

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 return 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 may treat any member of the combined group as the designated agent.

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

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

(2) Filing any extension of time to file the combined return;

(3) Filing any amended combined returns – or other filings relating to the combined return, 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 return, 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 audit, investigation, or hearing by the Division of Taxation regarding the combined return, including producing all information requested;

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

(7) Receiving notices regarding the combined return. In general, a notice received by the designated agent is considered received by all members of the combined group, including any entities that were not included in the combined return 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 an entity 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 return was filed, the Tax Administrator may allow any entity which it asserts should be added to or eliminated from the combined group to represent itself after receipt of a written request from the entity. However, that entity shall still be bound by any action taken by the designated agent before the entity's request to represent itself has been accepted by the Tax Administrator.

(e) If the designated agent is unable or unwilling to fulfill its obligations with respect to the combined return, is unresponsive, or has not been identified to the Division of Taxation, the Tax Administrator 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 return 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 Tax Administrator against the combined 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 Tax Administrator 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 Tax Administrator 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.

(i) The provisions of this Rule shall also apply to affiliated groups making the federal consolidated group election for Rhode Island combined reporting purposes (as described in Rule 9).

Rule 20. Tax Administrator's Authority

(a) The Tax Administrator may 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.[74]

(b) Such rules and regulations may include, but are not be limited to, issues such as the inclusion or exclusion of an entity 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.[75]

(c) The provisions of this Rule shall also apply to affiliated groups making the federal consolidated group election for Rhode Island combined reporting purposes as described in Rule 9.

[74] RIGL § 44-11-4.1(g).
[75] 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 re-determine the tax.[76]

(b) The Division of Taxation is required by statute to establish an independent appeals process – for tax years beginning on or after January 1, 2015 – to attempt to resolve disputes between the Tax Administrator and the taxpayer solely regarding the method of apportionment applied regarding the corporate income tax under RIGL Chapter 44-11, including combined reporting.[77] The Division of Taxation intends to address the requirement in the following manner:

> (1) When a dispute arises between the Tax Administrator and a taxpayer with respect to the method of apportionment applied, both the taxpayer and the Tax Administrator shall be entitled to initiate an appeals process through an independent arbitrator. The Division of Taxation's regulation on apportionment provides additional information on this matter. It is recommended that the Tax Division's regulation on apportionment be read in concert with the Tax Division's regulation on combined reporting.

[76] RIGL § 44-11-15.

[77] Ibid. The independent appeals process does not to any aspects of combined reporting other than apportionment.

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.[78]

(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.[79]

(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.[80]

[78] Rhode Island Public Law 2014, ch. 145, art. 12.
[79] RIGL § 44-11-4.1(h).
[80] 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.

- NEENA S. SAVAGE
ACTING TAX ADMINISTRATOR

March 30, 2016

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, including NOLs in accordance with this regulation.

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 combined group for Rhode Island corporate income tax purposes.

Step 5. Combine the receipts of all members of the combined group using the Finnigan method. Calculate the apportionment ratio for the combined group. Use, as the numerator, all Rhode Island receipts – regardless of whether a group member has 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 apportioned Rhode Island taxable income of the combined group by multiplying adjusted taxable income by the combined apportionment ratio.

Step 7. Compute and combine Rhode Island adjustments, including research and development adjustments, pollution control and hazardous waste adjustment, and capital investment deduction.[81] Subtract total such adjustments from apportioned Rhode Island taxable income computed in Step 6 to arrive at Rhode Island adjusted taxable income.

Step 8. Multiply result from Step 7 by applicable tax rate. (For tax year 2015, applicable tax rate is seven percent (7%)).

Step 9. Calculate allowable credits in accordance with this regulation.

Step 10. Subtract result in Step 9 (above) from the result in Step 8 (above). This is the tax due under combined reporting, before annual corporate minimum tax. (See Step 11.)

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

[81] See RIGL § 44-32-1, § 44-11-11.1, § 44-11-11.2, § 44-43-2, and note applicable recapture provisions.

Appendix II – Further Examples

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

Example # 1:

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 in 2015; 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 pay $28,000 in Rhode Island corporate income tax, while K Corp. would pay the $500 corporate minimum tax (with a net loss carryforward).[82]

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 multiplies 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 net loss), the group owes $1,000 in Rhode Island tax.

(K Corp.'s current-year net loss 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 # 2:

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 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.

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

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 return. M Corp.'s $400,000 in net income is reduced by L Corp.'s $200,000 current-year net loss, 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 fifty percent (50%) (because L Corp. sales are fifty percent (50%) of the combined group's everywhere sales of $2 million). Thus, fifty percent (50%) of the combined group's net income of $200,000 is taxed at a rate of seven percent (7%). Therefore, the combined group pays $7,000 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 $7,000 in tax due under the standard formula is higher.)

L Corp. and M Corp.	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 # 3:

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 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 $1 million share of the partnership's income is included in the combined group's income.

Example # 4:

Tom and Jerry are equal owners of a bakery treated as a C corp. for federal income tax purposes which operates solely in Rhode Island with all sales in Rhode Island. They are also equal owners of a baked goods distribution business treated as a C corp. for federal income tax purposes 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 # 5:

Assume the same facts and circumstances as in Example # 4 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 # 6:

- 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 # 7:

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

All three are treated as C corporations for federal income tax purposes, 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.

Example # 8:

- Alfa Corp. is in Delaware.
- Bravo Corp. is in Delaware.
- Charley Corp. is in Vermont.

Alfa, Bravo, and Charley comprise a combined group engaged in a unitary business. Until recently, only Charley had Rhode Island sales. However, Alfa and Bravo elected to expand their business to the Rhode Island market. To do so, Alfa and Bravo formed a general partnership, Foxtrot Partnership, with Alfa and Bravo as owners. Foxtrot Partnership has annual Rhode Island sales of $1 million. The $100,000 in income from those sales passes through to the partnership's two corporate owners, Alfa and Bravo.

For tax year 2014, when Rhode Island separate entity reporting applied, Alfa and Bravo each filed its own Rhode Island corporate income tax return; Foxtrot Partnership filed a partnership information return with Rhode Island; Charley had no Rhode Island filing requirement.

For tax years beginning on and after January 1, 2015, the group is subject to Rhode Island combined reporting and must file a return on Form RI-1120C. That is because the group has Rhode Island nexus through its partnership, Foxtrot Partnership. To compute the tax, the group will include in its numerator the $1 million of Rhode Island sales from the partnership – plus all Rhode Island sales of all other C corporations in the group, including Charley Corp. The denominator will be everywhere sales.

Appendix III – Comprehensive Example

▪ Victor Corp. is a Rhode Island business treated as a C corporation for federal income tax purposes. It is a manufacturer of jewelry, chiefly under the “Zulu” brand. It has nexus only in Rhode Island.

▪ Whiskey Corp. is a Connecticut business treated as a C corporation for federal income tax purposes. It is a manufacturer of specialty packaging. Its packaging is used chiefly for “Zulu” brand jewelry. It has nexus only in Connecticut.

▪ X-ray Corp. is a Nevada business treated as a C corporation for federal income tax purposes. It provides management, accounting, and related services to Victor Corp. and Whiskey Corp. X-ray 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 X-ray Corp.’s land and buildings. Romeo’s income and expenses flow through to X-ray Corp. of Nevada.

Victor Corp., Whiskey Corp., and X-ray Corp. are under common ownership – 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.

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 loss.

As a result, Victor Corp.’s Rhode Island corporate income tax liability for tax year 2014 was the minimum required, $500.[83] (Please see table below.)

[83] RIGL § 44-11-2(e).

Tax Year 2014	Victor Corp. (separate)	Whiskey Corp. (separate)	X-ray Corp. (separate)	Combined return
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 X-ray 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 X-ray 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 net loss 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.	X-ray Corp.	Combined return
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

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.	X-ray 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	0.04838710

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 0.0483871.

To determine the amount of the combined group's combined income that is apportioned to Rhode Island, the combined group's apportionment factor of 0.0483871 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 seven percent (7%), down from nine percent (9%) 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 seven percent (7%) 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	0.04838710
Apportioned taxable income	4,852,984
x tax rate	0.07
Tentative Rhode Island tax	339,709