

## New England Combined Filing Guide

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Full Text Published by taxanalysts<sup>®</sup>

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### I. Introduction

With Massachusetts having recently enacted its legislation instituting unitary combined reporting effective for tax years beginning in 2009<sup>1</sup> and with Vermont having recently enacted its unitary combined reporting regime effective for tax years beginning in 2006, taxpayers doing business in New England now face complex issues regarding the application of the unitary business principle to their corporate structures.<sup>2</sup> As practitioners who have worked extensively with unitary combined reporting rules in New Hampshire and now Vermont, as well as other states including Illinois, we offer

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<sup>1</sup> HB 4904, 185th Gen. Court, Reg. Sess. (Mass. 2008) (An Act Relative to Tax Fairness and Business Competitiveness), at chapter 173 of the Acts of 2008.

<sup>2</sup> For detailed discussion of the Vermont legislation and significant Vermont unitary issues, see our prior articles, William F.J. Ardinger, Stan Arnold, and Kathryn H. Michaelis, "Vermont Goes Unitary in 2006 and Beyond," *State Tax Notes*, July 2, 2007, p. 59, Doc 2007-14764, or 2007 STT 128-27; and Ardinger, Arnold, and Michaelis, "An Update on Vermont's Shift to Combined Filing," *State Tax Notes*, Aug. 18, 2008, p. 502, Doc 2008-17069, or 2008 STT 161-3.

a preliminary overview and comparison of the unitary rules of New Hampshire, Vermont, and Massachusetts.

Our guide is not intended to be a precise technical analysis of every unitary issue, but instead a practical overview of issues that taxpayers doing business in New England must address when configuring their unitary groups in these states. Our discussion of Massachusetts's unitary rules is of course preliminary because the Massachusetts Department of Revenue has not yet issued substantive guidance on many important questions, though it recently issued a technical information release<sup>3</sup> and a statement of anticipated regulatory positions,<sup>4</sup> which provided its first summary explanations of the new law. For a more in-depth analysis of the technical aspects of the Massachusetts legislation, we recommend that practitioners review the analysis by Joseph Donovan previously published in *State Tax Notes*.<sup>5</sup>

## II. Discussion of Major Issues

Before presenting our guide, we address several "hot topics" that warrant further discussion.

### A. Definition of Unitary Business

Since 1986 New Hampshire's business profits tax statute has contained a definition of unitary business that is rooted in California law. Vermont adopted its unitary business definition (which is very similar to New Hampshire's definition) for tax years beginning in 2006. The New Hampshire and Vermont definitions are broad, providing two distinct alternative tests for establishing a unitary relationship between separate entities -- the three unities test or the interdependence in functions test.<sup>6</sup> By contrast, the

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<sup>3</sup> Mass. Tech'l Info. Release, TIR 08-11, Aug. 15, 2008.

<sup>4</sup> See "Statement of Anticipated Regulatory Positions relating to Implementation of Combined Reporting," available under "Legal Notices" on the Massachusetts DOR's Web site at: <http://www.mass.gov>.

<sup>5</sup> Joseph X. Donovan and Sarah Wellings, "Massachusetts Combined Reporting Proposal Survives Study and Becomes Law," *State Tax Notes*, July 21, 2008, p. 193, *Doc 2008-15443*, or *2008 STT 141-5*; and Donovan and Wellings, "Radical Tax Changes on the Horizon for Massachusetts," *State Tax Notes*, Sept. 15, 2008, p. 733, *Doc 2008-17979*, or *2008 STT 180-2*.

<sup>6</sup> For both New Hampshire and Vermont, the unitary business definition reflects two alternative tests -- the three unities test or the interdependence in functions test. N.H. Rev. Stat. Ann. section 77-A:1; Vt. Stat. Announcement Tit. 32, section 5811(23). New Hampshire regulations define the three unities as follows: "unity of ownership" means "that the activities conducted inside and outside the state are directly or indirectly owned by the same economic entity or group of entities (N.H. Code Admin. R. Announcement 301.33); "unity of operation" means "that all of the activities flow from a centralized executive structure that directs operations commonly referred to as staff functions" (N.H. Code Admin. R. Announcement 301.32 and 302.11); and "unity of use" means that there is an executive authority with control over major policy matters and

Massachusetts definition of a unitary business is derived from the Multistate Tax Commission model regulation, Regulation IV.1(b)(1)(A).<sup>7</sup> It is also important to note that the Massachusetts legislation requires that the term "unitary business" be construed to the broadest extent permitted under the U.S. Constitution. No such explicit statutory construction rule exists in New Hampshire or Vermont statutes.<sup>8</sup>

The subtleties in the statutory definitions of a unitary business require a different analysis among those three states, and could very well result in different unitary filings in New England for the same taxpayer. As a preliminary matter, we have identified significant comparison issues. First, as illustrated in our guide, the definition of an eligible member differs drastically among the three states -- not only among type of entity, but among industries. In fact, conformity to federal entity classification -- the "check-the-box rules" -- was a separate but intertwined issue that was hotly debated in the Massachusetts legislature.<sup>9</sup>

Another significant difference is derived from the common ownership requirement. While Vermont and Massachusetts have a more-than-50-percent ownership requirement for a business to be considered unitary, New Hampshire is constitutionally prohibited from requiring a numerical ownership safeguard. Rather, unity of ownership is defined by New Hampshire regulations to mean that the "activities outside the taxing jurisdiction, together with the in-state activities are owned either directly or indirectly by the same economic entity or group of economic entities."<sup>10</sup> That vague and rather broad definition of ownership may lead to a unity of ownership finding for two entities that have less than 50 percent common ownership, especially in the partnership context.

Third, in the Vermont and New Hampshire unitary business definitions, a unitary group exists only if at least one member of the group is engaged in business activity outside the state, effectively prohibiting an intrastate unitary combined report. No such requirement exists in the Massachusetts legislation.

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activities of the business organization (N.H. Code. Admin. R. Announcement 301.34 and 302.12). New Hampshire regulations further define the "interdependence in their functions" as meaning that "the relationship in which the New Hampshire entity is an integral part of a larger system where the business done within the state is dependent upon or contributes to the operation of the business without the state as demonstrated by such factors as: (a) Centralized management; (b) Functional integration; and (c) Economies of scale." (N.H. Code Admin. R. Announcement 301.18). Vermont regulations provide similar definitions, which are located at Vt. Code R. section 1.5862(d)-6.

<sup>7</sup> Additional states adopting the MTC definition include Idaho and West Virginia. See definitions in Idaho Admin. Rules section 35.01.01.340 and W.Va. Code section 11-24-3a(35).

<sup>8</sup> *But see* Vt. Reg. 1.5862(d)-6(b), which provides that Vermont's "interdependence in functions test" extends "as far as, but no further than" the constitutional limits set forth by the U.S. Supreme Court.

<sup>9</sup> See Donavan and Wellings, *supra* note 5.

<sup>10</sup> See N.H. Code Admin. R. Announcement 301.33.

Finally, an open issue is whether the common owner of a unitary group that establishes the ownership requirement has to be an eligible (or taxpaying) member of the group to fulfill the ownership test for other eligible members of the group. Massachusetts has addressed the issue directly in its new legislation by answering in the negative.<sup>11</sup> That issue has yet to be formally clarified in New Hampshire and Vermont.<sup>12</sup>

## B. Eligible Members of a Unitary Business

Another distinguishing factor among the three states -- and a frequent issue addressed in any New Hampshire unitary group -- is the type of entity that constitutes an eligible member of the group. Vermont has adopted the "normal" approach espoused by most unitary states by including in the group only corporations (or entities classified as C corporations for federal income tax purposes). Massachusetts has deviated from the normal approach by including not only C corporations (and entities classified as C corporations for federal income tax purposes) but also treating some S corporations as C corporations.<sup>13</sup> Not surprisingly, New Hampshire is unique, requiring any "business organization" to be included in the group, which is defined to include all corporate and noncorporate "enterprise[s] . . . organized for gain or profit, carrying on any business activity within the state."<sup>14</sup> New Hampshire's broad definition has led to controversy regarding the meaning of "carrying on any business activity," especially for partnerships and sole proprietorships. Interestingly, Vermont's definition uses the terms "business organization" and "business activity," which are also used in the New Hampshire statute

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<sup>11</sup> In defining common ownership, the Massachusetts legislation says that requirement will be met "whether or not the owner or owners are members of the combined group." See Mass. Gen. Laws ch. 63, section 32B(b)(2).

<sup>12</sup> *But see* N.H. Declaratory Ruling 7654, Feb. 15, 2002 (unity of ownership prong satisfied through individual ownership).

<sup>13</sup> As under previous law, S corporations with total receipts for the tax year of less than \$6 million are not subject to the net income measure of the Massachusetts corporate excise tax. Mass. Gen. Laws ch. 63, section 32D(a). Under the new legislation, S corporations with total receipts of \$6 million or more are subject to an entity-level tax on the net income measure at a rate that is tied to the corporate rate less the individual tax rate. See Mass. Gen. Laws ch. 63, section 32D (consisting of a two-tiered rate structure depending on the level of receipts). A plain reading of the new legislation appears to indicate that all S corporations, regardless of the level of receipts, are included in the unitary group (whether the group consists exclusively of other S corporations or of a mix with both S and C corporations). It remains to be seen how S corporations not meeting the \$6 million receipt threshold are taxed, if at all. Based on the separate-unitary calculation of the Massachusetts unitary group, theoretically the income and factors of all S corporations, including those not meeting the threshold, would be included in the combined calculation but those S corporations not meeting the threshold would not be individually subject to tax as members of the group. See Mass. Gen. Laws ch. 63, section 32D(b); 830 CMR section 62.17A.1(3)(b).

<sup>14</sup> N.H. Rev. Stat. Announcement section 77-A:1, I.

and have particular definitions, significance, and history in New Hampshire but no counterpart in Vermont law. In summary, based on the eligible member requirements, a unitary business group doing business in all three states could very well have three differently composed unitary business groups.

### C. Specialized Industries

Related to the issue of what type of entity constitutes an eligible member is the issue of whether some types of industries are exempt from the corporate income tax or from inclusion in the unitary business group -- obviously two separate but related issues. Once a determination is made as to "who's in and who's out," the next level of analysis must address any deviations in the calculation of the tax base and the application of the apportionment formula. The varying answers raise thorny issues of income attribution (or misattribution), the effect of being included but exempt, whether the apportionment rules fairly represent activity done in the state, and the potential for distortion of income attributable to the state. For example, Vermont's inclusion of otherwise exempt members in the unitary group has the potential to misattribute income to the state.

Massachusetts's unique apportionment rules likewise have the potential to produce distorted results. In a Massachusetts combined group consisting of members that are subject to different apportionment rules, each member determines its apportionment percentage based on the specific apportionment formula imposed on that member by statute. In determining each member's denominator, a group denominator is used consisting of the sum of the separate denominators of the other members, including those not statutorily required to compute that factor. For example, a manufacturing company required to apportion its income using a single sales factor will now be required to compute a property and payroll factor for purposes of including those amounts in the denominator of a general corporation subject to a three-factor formula if both corporations are included in the same unitary business group.<sup>15</sup>

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<sup>15</sup> The standard three-factor apportionment formula applies to corporations not included in the following specialized categories: manufacturing corporations, which apportion their income by a single-sales factor; financial institutions, which apportion their income by an even-weighted three-factor formula; and mutual fund service corporations, which apportion their income by a single-sales factor. See Mass. Gen. Laws ch. 63, 38 and 830 CMR 63.38. In computing each member's factor, each taxable member must determine its apportionment percentage based on its specific apportionment formula. Mass. Gen. Laws ch. 63, section 32B(d)(2)(i). However, in determining each member's denominators, each member must determine the factor denominators of every member of the group based on the apportionment provisions that apply to that member, regardless of whether any particular member is taxable. Mass. Gen. Laws ch. 63, section 32B(d)(2)(ii). Thus, in calculating the property and payroll factors for a standard three-factor company, such member includes the property and payroll of all members, including members subject to a single-sales factor apportionment formula. *Id.* Special apportionment rules applicable to groups that combine both financials and nonfinancials in Mass. Gen. Laws. ch. 63, section 32B(d)(2)(ii).

## D. Sales Factor Treatment

Each of the three states uses a three-factor formula -- property, payroll, and sales -- to apportion unitary business income, and each requires a double-weighted sales factor for general corporations.<sup>16</sup> Regarding sales of tangible personal property, each of the states adopts a throwback rule, whereby sales that are shipped or delivered to a purchaser outside the state are included in the sales factor numerator if the selling taxpayer is not in the state of destination. In a somewhat surprising move, the Massachusetts legislature adopted the minority *Finnigan* approach for throwback sales. By comparison, New Hampshire and Vermont remain in the majority of states, including the MTC states, by adopting the *Joyce* rule.<sup>17</sup>

As an additional twist on the *Finnigan* approach, Massachusetts also requires that the sales factor numerators of nonnexus members be aggregated and included in the sales factor numerators of the group's nexus members based on a ratio, the numerator of which is the taxable member's Massachusetts sales and the denominator of which is the aggregate Massachusetts sales of all the taxable members of the group.<sup>18</sup>

The result of that approach may have a significant effect on New England-based taxpayers. The *Finnigan* throwback rule is generally favorable to in-state companies in that sales that have historically been included in the sales factor numerator (in Massachusetts's preunitary regime) may potentially be removed in a combined filing, in effect producing "nowhere sales" if another unitary group member is taxable in the state of destination. However, any such reduction to the factor may be offset by the inclusion of Massachusetts's sales into the numerator by nonnexus members.

## III. Concluding Observations

As Vermont and Massachusetts proceed to implement their new unitary combined reporting statutes, we believe that the issues we have highlighted in our guide will come to the forefront. As other states consider adopting unitary combined reporting regimes, we hope issues concerning the unitary definition, income combination, and apportionment are given thoughtful consideration so that a fair tax regime is achieved -- namely, that the amount of income taxed by the state fairly represents the amount of a taxpayer's activity that is performed in that state. Unitary apportionment raises unique issues for businesses trying to comply with the tax laws of the various states.

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<sup>16</sup> See note 15, which summarizes the different apportionment rules for specialized industries in Massachusetts.

<sup>17</sup> Generally, under the *Finnigan* rule, the numerator of the sales factor includes throwback sales made to a state regardless of whether the member is subject to taxation in the state of destination. In contrast, under the *Joyce* rule, the numerator of the sales factor includes throwback sales only if the individual member making the sale was not subject to tax in the state of destination. See "Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272," Multistate Tax Commission, July 29, 1994.

<sup>18</sup> Mass. Gen. Laws ch. 63, section 32B(d)(2)(iv).

One would hope that the states would strive for more uniformity rather than less uniformity. Disparate treatment increases tensions for "tax planning" on one side and to break down that planning through aggressive auditing on the other side.

**(Table begins on the next page.)**

**New England Combined Filing Guide:  
Comparison of Key Elements**

<b>Issue</b>	<b>New Hampshire</b>	<b>Vermont</b>	<b>Massachusetts</b>
<b>I. Composition of Unitary Group</b>			
Unitary Filing Effective Tax Year Beginning On or After	1986	January 1, 2006	January 1, 2009
Unitary Business Definition	"One or more related business organizations engaged in business activity both within and without this state among which there exists a unity of ownership, operation and interdependence in their functions" <sup>a</sup>	"One or more related business organizations engaged in business activity both within and without this state among which there exists a unity of ownership, operation and use; or an interdependence in their functions" <sup>b</sup>	"Activities of two or more corporations under common ownership that are sufficiently interdependent, integrated or interrelated through their activities so as to provide mutual benefit and produce a significant sharing or exchange of value among them or a significant flow of value between the separate parts" <sup>c</sup>
Common Ownership Requirement	No percentage threshold test; "unity of ownership" is defined by regulation to mean the "activities outside the taxing jurisdiction, together with the in-state activities are owned either directly or indirectly by the same economic entity or group of entities" <sup>d</sup>	"more than 50 percent of the voting stock of each member corporation is directly or indirectly owned by a common owner or owners, either corporate or noncorporate, or by one or more of the member corporations"; regulations require specific family ownership attribution <sup>e</sup>	"more than 50 percent of voting control of each member of the group is directly or indirectly owned by a common owner or owners"; common owner can be corporate or non-corporate, and need not be member of the group <sup>f</sup>
Eligible Entities Included in	Any "business organization,"	Any entity taxable as a C corporation	Any entity taxable as a C corporation

Unitary Business Group	which is defined to include corporate and noncorporate entities (including partnerships, LLCs and federally disregarded entities); <sup>g</sup> no conformity to check-the-box	for federal purposes; full conformity to check-the-box	for federal purposes and S corporations (see note 13); full conformity to check-the-box
80/20 Definition for Water's-Edge Group	Exclusion for "overseas business organizations" (OBOs); <sup>h</sup> New Hampshire OBOs are defined to mean "foreign incorporated business organizations" and "business organizations with 80 percent or more of the average of their payroll and property assignable to a location outside" the 50 states and D.C.; 80/20s are excluded only if a certification is made on intercorporate transactions <sup>i</sup>	Exclusion for overseas business organizations (OBOs) <sup>j</sup> ; a Vermont OBO is defined as any "business organization that ordinarily has 80 percent or more of its payroll and property" outside the 50 states and D.C. <sup>k</sup>	Statute as written includes the following members in the water's-edge group: (1) all members incorporated domestically; (2) any member (regardless of place of incorporation) if it has 20% or more payroll, property or sales in the U.S.; (3) any intangible property/service company (see note) but only to the extent of the related income/factors; <sup>l</sup> the 80/20 test is based on average of payroll, property, and sales within the U.S.; note the intangible property/service company exclusion (above) <sup>m</sup>
Worldwide Election Available?	No	No	Yes (on original return, binding for 10 years) <sup>n</sup>
Consolidated Elections	No	Yes, nexus-only, but subject to unitary requirements <sup>o</sup>	Affiliated group election <sup>p</sup> available (on original return, binding for 10 years) <sup>q</sup>
Same Line of Business an Indication of Unity?	No <sup>r</sup>	Yes by regulation: being in the same line of business is an indicator of interdependence in functions	No (not by statute or other existing authority)
"Intrastate	At least one	At least one	No such

Unitary Twist"	member of the group must be engaged in business activity outside New Hampshire to file a combined return	member of the group must be engaged in business activity outside Vermont to file a combined return	requirement (not by statute or other existing authority)
Treatment of Specialized Industries: Who Is Included in Group	Included: financial institutions, insurance companies (but credit for insurance taxes paid), real estate investment trusts (recomputed tax base), public utilities. Excluded/exempt: qualified investment companies <sup>s</sup>	Included but individually exempt from tax: financial institutions, insurance companies, transportation companies, telephone companies, and railroad companies. <sup>t</sup> Excluded/exempt: captive insurance companies and corporations not taxable under the IRC	Included: financial institutions, insurance companies not taxed as insurance companies for federal income tax purposes (e.g., captive insurance companies), REITs, and regulated investment companies. <sup>u</sup> Excluded/exempt: security corporations and insurance companies

**II. Composition of Tax Base**

Computation of Unitary Income	"Pure Combined" <sup>v</sup> -- tax is imposed on unitary group as a whole	"Separate Combined" (see note v) -- tax is imposed on individual company basis	"Separate Combined" (see note v) -- tax is imposed on individual company basis
Intercompany Eliminations	Rejects federal rules; adopts "eliminations" rule; <sup>w</sup> special rules for 80/20s	Adopts federal rules <sup>x</sup>	Rules analogous to those under IRC section 1502 to be promulgated; <sup>y</sup> intercompany addback provisions still remain; watch for future guidance addressing this issue
Taxation of Dividends Received From Non-Group Corporations	Does not follow federal dividends received deduction (DRD); Department of Revenue Administration allows DRD to avoid double taxation of income; <sup>z</sup> dividends from OBOs included, but eligible for factor	Does not follow federal DRD; no state DRD; dividends from OBOs included, but eligible for factor modification; express indication in regulation that inclusion of lower tier foreign entities may be warranted <sup>bb</sup>	Does not follow federal DRD; statute allows a general 95% DRD for dividends received from 15% or greater owned corporations; dividends from RICs or REITs not eligible for DRD; no factor modification for dividends from

	modification <sup>aa</sup>		excluded foreign subsidiaries <sup>cc</sup>
Net Operating Loss Treatment	Preapportioned state-specific NOL computation; NOL is treated as an attribute of each member	Postapportioned state-specific NOL computation beginning in 2007, with special conversion rules for 2007; NOL is treated as an attribute of each member	Preapportioned state-specific NOL computation but limitations unclear to date; DOR anticipates proposing regulations that will limit the use of NOL carryforwards to the loss generator (for NOLs generated before 2009) <sup>dd</sup>
Business/ Nonbusiness Income Distinction?	No	Yes <sup>ee</sup>	Distinction exists for separately allocable items of income <sup>ff</sup>
Treatment of Specialized Industries: Method of Inclusion of Income	Same as any other business organization	Industries identified as "included but individually exempt from tax" (above) are required to include their income in the combined group's pre-apportioned tax base	Each "included" member's income is in the group's combined tax base; special rules apply to groups that are comprised of both financials and nonfinancials <sup>gg</sup>
Standard Apportionment Factor	Three-factor, double-weighted sales factor	Three-factor, double-weighted sales factor	Three-factor, double-weighted sales factor, including in the denominator the separate denominators of all members, including those not subject to the standard apportionment formula <sup>hh</sup>
Sales Factor -- Sales of Tangible Personal Property	Destination-based	Destination-based	Destination-based; nonnexus members' Massachusetts sales apportioned to nexus members
Sales Factor -- Throwback Rule	Department of Revenue Administration applies <i>Joyce</i> rule for throwback (for sales originating in New Hampshire)	<i>Joyce</i> rule for throwback (if property is shipped from an office, store, warehouse, factory or other place in Vermont) <sup>ii</sup>	<i>Finnigan</i> rule for throwback (if property was not sold by an agent "chiefly situated at, connected with or sent out from premises" outside Mas-

Sales Factor -- Sales Other Than Sales of Tangible Per- sonal Property	Income-producing activity/cost of performance rule; royalties based on use; services based on performance; other income based on where earned <sup>kk</sup>	Income-producing activity/cost of performance rule; royalties based on use; services based on performance; other busi- ness receipts apportionable <sup>ll</sup>	sachusetts) <sup>jj</sup> For general corporations (see note): income- producing activity/cost of performance rule; specific sourcing rules addressed by regulation <sup>mm</sup>
Specialized Industries: Method of Apportionment	Special apportionment method for airlines, financial institutions, publishers, rail-roads, transportation companies, and broadcasting	No special industry appor- tionment rules; however, in- dustries identified as "included but individually exempt from tax" (above) are required to compute a de- nominator which is included in each taxable member's combined denominator	Special apportionment factor for manufacturing corporations, financial institutions, and mutual fund service cor- porations (see note hh); each member determines its own apportionment factor based on its specific formula (con- sisting of each member's separate-entity numerator over the combined group's denominator); special rules apply to groups that are com- posed of both financial and nonfinancial organizations <sup>nn</sup>

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**IV. Other Material Issues**

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Treatment of Partnership In- come and Factors	Taxes partnership at entity level	Aggregate treatment <sup>oo</sup>	Aggregate treatment; exemp- tion for nonresident limited partners of investment part- nership
Transition Issues	None because of long-standing application of unitary combined reporting	NOLs, new guidance being issued, including new forms for calculating unitary group income in fall of 2008 <sup>pp</sup>	Complex special deduction permitted for some groups with publicly traded companies when the enacting of new combined reporting re- quirements re-

sults in an increase to group's net deferred tax liability (as defined in the Act); prorated over seven-year period beginning in 2012; statement due July 1, 2009

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<sup>a</sup>For both New Hampshire and Vermont, the unitary business definition reflects two alternative tests -- the three unities test or the interdependence in functions test. N.H. Rev. Stat. Ann. section 77-A:1; Vt. Stat. Ann. Tit. 32, section 5811(23). New Hampshire regulations define the three unities as follows: "unity of ownership" means that the activities conducted inside and outside the state are directly or indirectly owned by the same economic entity or group of entities (N.H. Code Admin. R. Ann. 301.33); "unity of operation" means "that all of the activities flow from a centralized executive structure that directs operations commonly referred to as staff functions" (N.H. Code Admin. R. Ann. 301.32 and 302.11); and "unity of use" means that there is an executive authority with control over major policy matters and activities of the business organization (N.H. Code Admin. R. Ann. 301.34 and 302.12). New Hampshire regulations further define the "interdependence in their functions" as meaning that "the relationship in which the New Hampshire entity is an integral part of a larger system where the business done within the state is dependent upon or contributes to the operation of the business without the state as demonstrated by such factors as: (a) Centralized management; (b) Functional integration; and (c) Economies of scale." (N.H. Code Admin. R. Ann 301.18). Vermont regulations provide similar definitions, which are located at Vt. Code R. section 1.5862(d)-6.

<sup>b</sup>Vt. Stat. Ann. tit. 32, section 5811(23); see also note a.

<sup>c</sup>Mass. Gen. Laws ch. 63, section 32B(b)(1).

<sup>d</sup>See note a.

<sup>e</sup>Vt. Code R. section 1.5862(d)-6(d)(1).

<sup>f</sup>Mass Gen. Laws ch. 63, section 32B(b)(2).

<sup>g</sup>A "business organization" is defined in N.H. Rev. Stat. Ann. sections 77-A:1, I.

<sup>h</sup>N.H. Rev. Stat. Ann. sections 77-A:1, XV; sections 77-A:2-b, 77-A:6, IV; N.H. Code Admin. R. Ann. 307.07.

<sup>i</sup>N.H. Rev. Stat. Ann. sections 77-A:1, XIX; 77-A:1, XV; N.H. Code Admin. R. Ann. 301.12.

<sup>j</sup>Vt. Stat. Ann. tit. 32, section 5811; Vt. Code R. section 1.5862(d)-5.

<sup>k</sup>Vt. Stat. Ann. tit. 32, section 5811(22); Vt. Code R. section 1.5862(d)-5.

<sup>l</sup>Mass. Gen. Laws ch 63, 32B(c)(3). Our reference to "intangible property/service companies" means any member earning more than 20 percent of its income from intangible property or service related activities, the costs of which are federally deductible against business income of members of the combined group. Such entity is included in the water's edge group, but only to the extent of the income and factors related to such intercompany cost. See Mass. Gen. Laws ch 63, section 32B(c)(3)(iii).

<sup>m</sup>Mass. Gen. Laws ch. 63, section 32B(c)(3).

<sup>n</sup>Mass. Gen. Laws ch. 63, section 32B(c)(3).

<sup>o</sup>In implementing its unitary legislation, Vermont retained the ability to elect a consolidated (nexus only) group. As we pointed out in an

earlier article (Ardinger, *supra* note 2), this may result in two scenarios: (1) the unlikely scenario wherein a federal consolidated group, or subgroup therein, that has nexus in Vermont but is not unitary, is still permitted to elect to file on a consolidated basis; or (2) the more likely scenario wherein a consolidated group that is unitary, at least in part, may elect to treat its Vermont taxpayer members as one consolidated member as part of a larger combined (unitary) group with nontaxpayer members (or tax-payer members that are not part of the same federal consolidated group). In the latter scenario, the department has in effect permitted the statutory retention of the "consolidated" reference to be converted into a "consolidated member" concept. As clarified in the "Unitary Filing Instructions for 2006 and 2007 Tax Years," located on the department's Web site, the department has indicated that the consolidated election provisions "remain intact but underneath the umbrella of 5862(d)."

<sup>P</sup>The Massachusetts affiliated group is defined with reference to IRC section 1504, without regard to the unitary rules, and includes all domestic corporations that are commonly owned, directly or indirectly, by any member of such affiliated group and other commonly owned corporations as described in section 32B(c)(iii) (describing the members included in the water's edge group), except that the federal 80 percent ownership requirement is dropped to more than 50 percent. See Mass. Gen. Laws ch. 63, section 32B(g)(ii). The definitional reference to section 32B(c)(iii) means that foreign incorporated 80/20 corporations and "intangible property/service companies" (pursuant to our definition in note m) are also included in the affiliated group. Pursuant to such election, all income of all group members must be treated as apportionable income regardless of whether or not such income would otherwise be subject to apportionment or allocation to a particular state in the absence of such election. *Id.*

<sup>Q</sup>Mass. Gen. Laws ch. 63, section 32B(g). The statutory wording regarding the period by which the taxpayer is bound by the affiliated group election is somewhat ambiguous, but it is believed at this time that the intent is that the period be 10 years, inclusive of the year of election, and not 11 years as interpreted by other commentators.

<sup>R</sup>Depending on the case, the New Hampshire Department of Revenue Administration has suggested that if two business organizations are not engaged in the same line of business, a presumption of nonunity exists. The authors strongly disagree with such a position.

<sup>S</sup>Our designation of "Included" means that such entity is included in the combined return as any other entity (income is included in the combined group's tax base and its factors are included in the combined apportionment formula). Our designation of "Excluded/Exempt" means that such entity's income and factors are not included at all in the calculation of the combined income of any member of the unitary group.

<sup>T</sup>Our designation of "Included but individually exempt from tax" refers to the fact that Vermont includes such entities in the unitary business group in that their income is included in the combined pre-apportioned tax base and their denominators are included in each member's apportionment factor; however, such entities are not individually subject to Vermont corporate income tax. As we discuss in Ardinger, *supra* note 2 2008 STT 161-3, this may produce distortive results for the unitary business group and misattribution of income to the state.

<sup>U</sup>The inclusion of REITs and RICs is expressly made in Mass. Gen. Laws ch. 63, section 32B(c)(1). However, it is unclear at this time why RICs are included in the unitary group given that they are exempt from taxation at the entity level in Massachusetts.

<sup>V</sup>Our designation "Pure Combined" refers to a computation whereby each member's income is included in one combined pre-apportioned tax base and is apportioned by one apportionment factor consisting of the combined numerator of all members over the combined denominator of all members to arrive at one combined taxable unitary income. In contrast, "Separate/Combined" refers to a computation whereby each member's income is included in one combined pre-apportioned tax base (as with "Pure

Combined") but is apportioned by each member separately through an apportionment factor consisting of that member's stand-alone numerator over the combined denominator of all members to arrive at that member's share of taxable unitary income.

<sup>w</sup>N.H. Code Admin. R. Ann. 307.07(C).

<sup>x</sup>Vt. Tech'l Bulletin No. TB-36, March 16, 2007.

<sup>y</sup>Mass. Gen. Laws ch. 63, section 32B(d)(2)(v), (f).

<sup>z</sup>See N.H. Taxpayer Information Release, TIR 2008-1, March 4, 2008.

<sup>aa</sup>Rev. Stat. Ann. 77-A:1, XVII, 77-A:3, II(b). In our experience, the New Hampshire Department of Revenue Administration has accepted settlements based upon the inclusion of lower tier attributes.

<sup>bb</sup>Vt. Code R. 1.5862(d)-8(b), citing Vt. Code R. section 1.5862(d)-12 for support that a taxpayer may include factors of foreign lower-tier entities if additional factor relief is appropriate.

<sup>cc</sup>Mass. Gen. Laws ch. 63, section 38(a)(1).

<sup>dd</sup>See "Statement of Anticipated Regulatory Positions relating to Implementation of Combined Reporting," available under "Legal Notices" on the Massachusetts DOR's Web site at: <http://www.mass.gov>. The method by which the pre-unitary NOL will be limited to the loss generator's income in a pre-apportioned NOL combined group calculation may be significant for certain taxpayers. Accordingly, the authors strongly encourage affected companies to become actively involved in the regulatory process in the fall of 2008.

<sup>ee</sup>Vt. Code R. section 1.5833-1(d),(e).

<sup>ff</sup>See 830 CMR 63.38.1.

<sup>gg</sup>A "financial institution" is defined in Mass. Gen. Laws ch. 63, section 1.

<sup>hh</sup>The standard three-factor apportionment formula applies to corporations not included in the following specialized categories: manufacturing corporations, which apportion their income by a single sales factor; financial institutions, which apportion their income by an even-weighted three-factor formula; and mutual fund service corporations, which apportion their income by a single sales factor. See Mass. Gen. Laws ch. 63, section 38 and 830 CMR 63.38. In computing each member's factor, each taxable member must determine its apportionment percentage based on its specific apportionment formula. Mass. Gen. Laws. ch. 63, section 32B(d)(2)(i). However, in determining each member's denominators, each member must determine the factor denominators of every member of the group based on the apportionment provisions that apply to that member, regardless of whether any particular member is taxable. Mass. Gen. Laws ch. 63, section 32B(d)(2)(ii). Thus, in calculating the property and payroll factors for a standard three-factor company, such member includes the property and payroll of all members, including members subject to a single sales factor apportionment formula. Id. Special apportionment rules applicable to groups that combine both financials and non-financials in Mass. Gen. Laws. ch. 63, section 32B(d)(2)(ii).

<sup>ii</sup>Vt. Code R. section 1.5862(d)-8.

<sup>jj</sup>Mass Gen. Laws ch. 63, section 38(f)(2).

<sup>kk</sup>N.H. Rev. Stat. Ann. section 77-A:3, I(c); N.H. Code Admin. R. Ann 304.04(c).

<sup>ll</sup>Vt. Stat. Ann. tit: 32, section 5833; Vt. Code R. section 1.5833-1.

<sup>mm</sup>Mass. Gen. Laws ch. 63, section 38(f); 830 CMR 63.38.1(9)(d). The stated rule applies to general corporations, not specialized corporations identified in note hh.

<sup>nn</sup>A "financial institution" is defined in Mass. Gen. Laws. ch. 63, section 1.

<sup>oo</sup>Our reference to "Aggregate Treatment" means that the state adopts a conduit theory in which the partnership is viewed as though each

partner owned the assets and liabilities directly. Accordingly, for state tax purposes, each partner is taxed on its distributive share of items from state-source income of the partnership, unless otherwise indicated by statute.

<sup>PP</sup>See William F.J. Ardinger, Stan Arnold, and Kathryn H. Michaelis, "An Update on Vermont's Shift to Combined Filing," *State Tax Notes*, Aug. 18, 2008, p. 502; or 2007 STT 161-3.