

CNIT and BFT – Mandatory Unitary Combined Reporting

NOTE: Due to its complexity and the many sub-issues involved, the Chamber has prepared a separate extensive review of this issue entitled “Senate Bill 749 and Unitary Combined Reporting: A Critical Analysis and Recommendations for Change” dated July 2007. The review, which may be found on the Chamber’s website at www.wvchamber.com, will be provided to the Administration, the Legislature and other relevant parties. The following is the Executive Summary of the Chamber’s review.

The last-minute passage of mandatory unitary combined reporting requirements in Senate Bill 749 in the 2007 regular legislative session will significantly change the way that the income of corporations operating inside and outside of West Virginia is taxed. Unitary combined reporting is a method of taxing the income of certain groups of affiliated corporations that operate in more than one state and/or nation. In essence, it disregards the fact that members of such groups are separate legal entities if they, together, are operating a unitary business enterprise. Opponents of mandatory unitary combined reporting—consisting mostly of large multi-state and multi-national corporations—maintain that it allows a state to improperly tax income earned in other states and nations. Proponents of mandatory unitary combined reporting maintain that it better reflects the economic reality of integrated business enterprises and prevents abuses of separate reporting which, they say, is used to distort the taxable income earned in a particular state.

Experience and a review of recent literature suggests that multistate and multi-national businesses will perceive the state’s adoption of mandatory unitary combined reporting as represented in SB 749 as a negative for doing business in West Virginia. The question of what constitutes unitary business activity in the case of multi-state/multi-national companies—particularly diversified conglomerates—rarely has a simple answer. Unfortunately, it is also a question with which West Virginia tax administrators have little experience. Moreover, the current or expected capacity of the State Tax Department to have sufficient numbers of trained auditors to examine the records of such taxpayers, in order to apply the unitary business rules, is seriously in doubt. The Department will need taxpayer service representatives, internal auditors, lawyers and field auditors who are all trained to administer forced world-wide combination reporting, the water’s-edge election, and the difficult concept of unitary business.

The Chamber applauds the delay in the implementation of the combined reporting provisions of SB 749 until January 1, 2009 so that state leaders and taxpayers may examine them and the uncertain impacts upon economic development and state tax revenues. It is in that light and spirit that the Chamber presents the following recommendations:

#3. Governor Manchin and the Legislature should give serious consideration to New York’s quasidiscretionary combined reporting approach, or add-back of certain expenses as envisioned in HB 4670 (2004), as a substitute to the mandatory combined reporting structure enacted in SB 749. In any case, the option to file a West Virginia consolidated return when a federal consolidated return is filed should be retained and be in lieu of any requirement to file a combined report

Page 4

#4. However, if state leaders are so inclined as to retain the SB 749 mandatory unitary combined reporting structure, a number of changes must be considered:

- Except for motor carriers, a single apportionment factor—sales—should replace the three factor apportionment of sales, property and payroll.

- *The “throw out” rule in SB 749 should be repealed and it should not be replaced by a “throwback” rule.*
- *Financial institutions should not be penalized for having West Virginia as their domicile. Taxes should be derived from financial institutions based solely on their financial activity, irrespective as to their state of domiciliary.*
- *The nexus standards of pre-SB 749 law should be retained for non-domiciled financial institutions.*
- *The single-factor apportionment provisions of pre-SB 749 law should be retained for financial institutions.*
- *SB 749 should be clarified to indicate that, if the “throw out” provisions are not repealed, they shall not apply to revenues generated by financial institutions outside of West Virginia.*
- *The pre-SB 749 special apportionment rules with respect to motor carriers should be retained.*
- *The treatment of corporate partnerships should not depend upon whether the partnership is engaged in unitary business activity. Conflicts between provisions of SB 749 in this regard need to be addressed.*
- *All members of a unitary group should be able to utilize the full amount of tax credits earned by a member of the group.*
- *All insurance companies should be excluded from the CNIT, excluded from the West Virginia combined report, and excluded from a West Virginia combined return.*
- *Allow the use of consolidated net operating loss (NOL) carry-forwards against the tax liability of any member of a unitary combined group of taxpayers which was included in the filing of the consolidated return during the year that the West Virginia consolidated NOL’s were incurred.*
- *W.Va. Code §11-24-13e (designation of surety) should be rewritten to make it a viable option for corporations; otherwise, it should be repealed.*
- *The combined group, for purposes of filing a West Virginia combined return, should include only the affiliated group of corporations as defined for purposes of filing a consolidated federal income tax return, with such increasing and decreasing modifications to their business income as are required to arrive at a true water’s-edge determination of West Virginia combined taxable income and apportionment factors.*
- *If the Chamber’s recommendation is accepted that SB 749 be amended to limit the combined group for West Virginia filing purposes to the affiliated group of corporations, as defined for purposes of filing a consolidated federal income tax return, the “tax haven” definition contained in §11-24-3a(25) should also be eliminated.*