Massachusetts Finalizes Combined Reporting Regulations

by Joseph X. Donovan, David Nagle, and Sarah Wellings

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On May 29 the Massachusetts Department of Revenue promulgated a final regulation governing combined reporting in the state.[1] That step marked the culmination of a long process beginning with adoption of the statutory mandate for unitary combination in July 2008, effective for tax years beginning on or after January 1, 2009.[2] Along the way, the DOR issued both a working draft regulation and a formal proposal, about which a public hearing was held. According to the chief of the DOR's Rulings and Regulations Bureau, who was the principal author of the regulation, the drafts attracted more practitioner and business community input than any others released during his 19-year career.[3] In final form, the regulation occupies some 70 pages of text, and includes 40 examples intended to clarify the thornier issues of interpretation raised by the statute, section 32B of Chapter 63 of the General Laws.[4]

It is not the purpose of this article to cover all of the ground of the regulation. The authors refer readers to previous *State Tax Notes* coverage of the unitary saga in Massachusetts, coverage that includes a comprehensive review of the rules in the first-released working draft.[5] This article instead highlights ways in which the final regulation adds to, changes, or clarifies previous positions of the DOR that were reflected in earlier versions of the regulation.

Definition of Common Ownership

Massachusetts, like most unitary states, requires common ownership of more than 50 percent before corporations can be combined. For that purpose:

> The words "common ownership" shall mean that more than 50 per cent 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.[6]

Insofar as it refers to control by "a common owner or owners," without specifying whether the owners have to be related, the cited statutory language is susceptible to a very broad interpretation, one that would, for example, treat two corporations as commonly owned if more than 50 percent of their voting stock were held by five unrelated mutual funds.[7] The final regulation, like the formal proposal, makes it clear, however, that the DOR will not read the provision so broadly. The final regulation provides that corporations will not be treated as commonly owned solely because they have one or more unrelated owners in common, when aggregation of the ownership of the unrelated owners would be necessary to represent more than 50 percent of the voting

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[1]For a comparison showing the changes to the proposed regulation, see http://www.sandw.com/services-area-84.html.

[2]*See* sections 48 and 101 of Chapter 173 of the Acts of 2008.

[3]Michael Fatale, panel speech at a seminar sponsored by the Massachusetts Society for Certified Public Accountants (June 1, 2009).

[4]*See generally* 830 CMR 63.32B.2.

[5]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*; Donovan and Wellings, "Radical Changes on the Horizon for Massachusetts," *State Tax Notes*, Sept. 15,

(Footnote continued in next column.)

2008, p. 733, *Doc 2008-17979*, or *2008 STT 180-2* [hereinafter "Radical Changes"]; Donovan, David Nagle, and Wellings, "New Regs Set the Framework for Combined Reporting in Massachusetts," *State Tax Notes*, Feb. 9, 2009, p. 415, *Doc 2009-520, or 2009 STT 25-1 [hereinafter "New Regs"].*

[6]G.L. c. 63, 32B(b)(2). *See* 830 CMR 63.32B.2(2). (Except as otherwise noted, all references herein to the combined reporting regulation are to the regulation in the form in which it was finally promulgated.)

[7]"New Regs," *supra* note 5, at p. 417.

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control of any of the corporations.[8] Thus, common ownership of corporations X and Y will not exist when unrelated individuals A and B each own 30 percent of the shares of each corporation. For purposes of establishing whether owners are considered to be related, the constructive ownership rules of IRC section 318 generally are applied, but the regulation lays out some ways in which those rules are modified for these purposes.[9]

Treatment of Foreign Corporations Doing Business in Massachusetts

The statutory mandate for combined reporting in section 32B of Chapter 63 reads as follows:

> A corporation subject to tax under this chapter and engaged in a unitary business with 1 or more corporations subject to combination within the meaning of this section shall . . . calculate its taxable net income derived from this unitary business as its share, attributable to the commonwealth, of the apportionable income or loss of the combined group engaged in the unitary business, determined in accordance with a combined report.[10]

Further, the statute specifically includes among the corporations that are subject to combination "an entity of the kind that is subject to tax or would be subject to tax if doing business in the state" under various provisions of Chapter 63, including those that govern regular business corporations.[11]

It would seem fairly clear that any regular business corporation that is subject to Massachusetts tax is potentially combinable.

It would seem fairly clear, then, that any regular business corporation that is subject to Massachusetts tax is potentially combinable. However, the definition of a water's-edge group, for purposes of the default rule that limits combination to the members of such a group, includes only the following:

- members incorporated in the United States or any of its territories or possessions;
- members wherever incorporated, the average of whose property, payroll, and sales factors in the United States is 20 percent or more (so-called 80/20 corporations); and
- members that earn more than 20 percent of their income from intangible property or service-related activities, the costs of which generally are deductible for federal income tax purposes against the business income of other members of the group (hereinafter called 20+ corporations).[12]

The question therefore arises whether a corporation organized outside the United States, that is neither an 80/20 corporation nor a 20+ corporation, but that is subject to the taxing jurisdiction of Massachusetts on a separate-company basis, is required to file a combined return with other corporations with which it is unitary that fit within the water's-edge definition. The final regulation answers that question in the affirmative.[13]

Computation of Tax When a 20+ Corporation Is Included in the Group

The combined reporting statute provides that 20+ corporations, which by definition receive income from U.S. payments for intangibles or services, are included in the water's-edge group, "but only to the extent of that income and the apportionment factors related thereto."[14] That is a peculiar caveat, because it is black letter unitary law that income derived from payments within the group is eliminated, as it is for purposes of determining federal income in a consolidated return. Likewise, intercompany payments are eliminated in a unitary return for purposes of determining the sales factor of a member. Practitioners therefore speculated when the statute was passed that perhaps this provision had no effect other than to disallow a deduction for those U.S. payments for intangibles or services.[15] It has since become clear that this is not how the DOR reads the provision. Rather:

- The income attributable to those payments is included in the combined return.
- The receipts are eliminated for purposes of determining the sales factor of the apportionment factor, but property and payroll of the member is included in the combined group's apportionment factor "to the extent that such property and payroll produced such income."[16]

The proposed regulation would have permitted taxpayers to deduct only expenses "directly attributable" to the included gross income in determining the net income of the member.[17] The final regulation

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[8]*See* 830 CMR 63.32B.2(2)(b)(2) and Example 5 therein. So-called stapled entities, however, are considered to be commonly owned. 830 CMR 63.32B.2(2)(c).

[9]830 CMR 63.32B.2(2)(e).

[10]G.L. c. 63, section 32B(a).

[11]G.L. c. 63, section 32B(c)(1).

[12]G.L. c. 63, section 32B(c)(3)(i)-(iii).

[13]*See* 830 CMR 63.32B.2(5)(b) and the example included therein.

[14]G.L. c. 63, section 32B(c)(3)(iii).

[15]*See* "New Regs," *supra* note 5, at pp. 417-418.

[16]830 CMR 63.32B.2(5)(b)(3).

[17]Proposed Regulation 830 CMR 63.32B.2(5)(b)(3).

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liberalizes that rule, permitting expenses to be deducted if they are "reasonably related and not disproportionate to such gross income, as determined pursuant to such guidance as may be issued by the Commissioner."[18] It goes on, however, to articulate a new rule to the effect that in no event may the deduction of those expenses reduce the income of a 20+ corporation below zero.[19]

The authors consider that rule to be unreasonable, and hardly justified (as DOR sources have tried to suggest) by the statutory caveat that 20+ corporations are to be included in the group "only to the extent of [the relevant] *income*."[20] The word "income" can be said to be used here, as it is in other places in the statute,[21] as shorthand for "income or loss," and there is no principled reason why a company, even a hypothetical one, as in the case of the portion of a 20+ corporation that is included in a unitary group, should be so included but not permitted to bring in losses if indeed its expenses exceed its gross income.

> ***There is no principled reason why a company should be included in a unitary group but not permitted to bring in losses if indeed its expenses exceed its gross income.***

More broadly, the rules that sweep in 20+ corporations have been criticized because they often will have the effect of disallowing legitimate deductions of U.S. companies that are owned by foreign-based multinationals for the use of technology that was developed outside the United States, without corresponding "factor relief" because the sales of such companies are not counted for apportionment purposes, and their property and payroll attributable to the intercompany payments generally are small. The criticism of such rules is expected to find its way into legislative proposals for technical corrections to the combination statute.

[18]830 CMR 63.32B.2(5)(b)(3).
[19]*Id.*
[20]G.L. c. 63, section 32B(c)(3)(iii) (emphasis added).
[21]*See, e.g.,* the core unitary mandate in G.L. c. 63 section 32B(a), which provides that "a corporation engaged in a unitary business . . . shall . . . calculate its *taxable net income* derived from this unitary business. . ." (emphasis added); *see also* the special rule in G.L. c. 63, section 32B(b)(3), which attributes the business of partnerships owned by corporations to the corporations "to the extent of the partner's distributive share *of the partnership's income*. . ." (emphasis added).

Treatment of Capital and Section 1231 Gains and Losses

The final regulation includes some entirely new rules, the effect of which is to strip out of the income base of the unitary group capital gains and losses and IRC section 1231 gains and losses of each taxable member, before any netting; assign them to Massachusetts based on the apportionment and allocation rules applicable to that member; and only then net the gains and losses of the member that are attributable to Massachusetts.[22] Gains and losses that are allocable to a state other than Massachusetts accordingly are not part of the netting computation.[23] DOR officials have characterized these new rules as relief provisions intended to afford taxpayers a more correct and fair result than would be the case if netting took place before allocation and apportionment.

The Massachusetts Affiliated Group Election and the Statutory Business Purpose/Economic Substance Test

The formal proposed combined reporting regulation (but not the initial working draft) included language that practitioners found troubling regarding the so-called Massachusetts affiliated group election. That election permits taxpayers to define the unitary group as corresponding to the federal consolidated return group, with the provisos that a 50 percent ownership test is substituted for the federal 80 percent ownership test, and that corporations within the water's-edge definition are included regardless of whether they are part of the federal consolidated return group.[24] If the election is made, the taxpayer in effect waives its right to treat any income or loss as allocable; it is all included in the base for apportionment.[25]

The election was included in the combination statute to address concerns that, especially in the world of FASB Interpretation No. 48, the inherent fuzziness of the contours of a unitary business would leave taxpayers uncertain about how much exposure they ultimately would have to Massachusetts audit adjustments.[26] The statute expressly permits taxpayers to make the election "without the consent of the commissioner."[27] Nevertheless, the proposed regulation provided that:

[22]*See* 830 CMR 63.32B.2(6)(c)(8).
[23]*Id.*
[24]*See* G.L. c. 63, section 32B(g)(i).
[25]*Id.*
[26]*See* "Radical Changes," *supra* note 5, at 737-738.
[27]G.L. c. 63, section 32B(g)(ii).

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> the Commissioner may disregard the tax effects of such an election pursuant to G.L. c. 63, § 3A [the Massachusetts statutory business purpose/economic substance provision], in situations where the primary motivation of the election is tax avoidance and it appears, from facts available at the time of the election, that the election will not have meaningful application for a ten-year period. For example, and without limitation, the Commissioner would disregard the tax effects of an affiliated group election made in anticipation of the sale of material portions of a business where the anticipated gain from the disposition would be allocated to Massachusetts in the absence of the election and the sale would reduce the remaining affiliated group to a single entity, such that the continued application of the affiliated group election would be anticipated to have no meaningful impact.[28]

This rule was criticized on the grounds that it threatened to eliminate the certainty regarding composition of the group that motivated the election in the first place.

The final regulation alleviates those concerns by making it clear that where the election has continuing effect it will not be overridden by the DOR even if it has a favorable tax effect:

> [T]he Commissioner would not seek to disregard an otherwise proper election that results in a reduction of Massachusetts tax liability, whether or not such reduction is foreseeable at the time of the election, provided that at the time of the election the taxpayer anticipates material business operations in Massachusetts subject to and affected by the filing requirements of the election.[29]

Sharing of Research Credits

When the combination proposal was pending, business interests and practitioners pushed hard for DOR recognition that credits and net operating losses should be broadly shareable within a unitary group.[30] The DOR seemed to acquiesce in that approach as part of the political compromise that led to enactment of the new law, acceding specifically to the inclusion of a provision authorizing it to adopt regulations regarding combination that would:

> include rules to address . . . the sharing within the combined group of credits that may be validly claimed by a taxpayer and that are attributable to the combined group's unitary business, to the extent such sharing of credits by a particular member . . . is consistent with the statutory requirements for claiming such credits, taking into account the nature of such member's business and related activities . . . , but the carry forward of . . . credits that arise before the effective date of [new section 32B of Chapter 63] shall be available only to the extent permitted by law as in effect before the effective date.[31]

Once the statute was enacted, however, the DOR reverted to its historical resistance to the sharing of credits and even included a restriction on the use of research credit carryforwards that never applied under the precombination regime.

In years before 2009, research and development credits generated by a stand-alone corporation could be carried forward and applied against the income of other group members after the generating taxpayer became a member of the group.[32] In the working draft regulation on combined reporting, however, the DOR included a rule that pre-2009 credits would be shareable in a combined return only if, in the year the credits were generated, the sharing corporations participated in a preunitary combined return.[33] When it was pointed out that that restriction violated the spirit of the statutory provision permitting credit carryforwards "to the extent permitted by law as in effect before the effective date" of the unitary regime,[34] the DOR responded by substituting an even harsher restriction, also not present in the preexisting law. Regarding that point, the final regulation provides:

> In the case of a credit that was generated by a taxpayer for a taxable year beginning prior to January 1, 2009, a credit carry forward may be applied in a subsequent tax year consistent with the statutory rules that applied to such credits in the year the credit was generated. Consequently, in tax years beginning on or after January 1, 2009, such a credit carry forward may be shared by the taxpayer that generated the credit with one or more taxable members of its combined group only if such sharing is consistent with the statutory rules that applied to the credit in the year that the credit was generated and, if those rules required the filing of a combined return of income under the predecessor version of M.G.L. c. 63, § 32B for the credit to be shared, *only if the taxpayer that generated the credit and the other members seeking to share the credit jointly filed*

[28]Proposed Regulation 830 CMR 63.32B.2(10)(h).
[29]830 CMR 63.32B.2(10)(h).
[30]*See* "New Regs," *supra* note 5, at pp. 424 et seq.
[31]G.L. c. 63, section 32B(f).
[32]830 CMR 63.38M.1(12)(c).
[33]Working Draft Regulation 830 CMR 63.32B.1(9)(c)(ii).
[34]*See, e.g.*, "New Regs," *supra* note 5, at p. 427.

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such a return for the last tax year beginning prior to January 1, 2009.[35]

We think it is clear that the statute's incorporation of preexisting limits on the sharing of credits means that the same statutory and administrative conditions for use should be imposed as before the change in the law. It surely does not mean that the particular companies seeking to share credits in a unitary return must have filed a preunitary combined return. Further, requiring those companies to have filed on that basis in 2008 is completely arbitrary. The DOR rule makes no sense and reflects an almost irrational DOR hostility to the sharing of positive pre-2009 tax attributes in a unitary environment.[36]

Net Operating Loss Limitations

Before 2009, NOL carryforwards could be used in a combined return only by the corporation that generated the NOL.[37] That limitation, like the credit limitations, remains in place for losses generated before 2009 and carried forward into a unitary return.[38] In a Massachusetts combined return, each taxable member computes its separate Massachusetts income by reference to the income of the group, the denominators of the group, and its own separate-company numerators (together with any sales-factor numerator increment of nontaxable members that may be assigned to it under the Massachusetts version of the *Finnigan* rule).[39]

The DOR rule on sharing credits makes no sense and reflects an almost irrational DOR hostility to the sharing of positive tax attributes in a unitary environment.

The DOR apparently fears that taxpayers will move property and payroll to a taxable member with a pre-2009 NOL in order to maximize the amount of the loss that it is allowed to take in the combined return. The DOR already gave itself one powerful mechanism to combat that perceived abuse in the working draft regulation — the ability to reattribute property and payroll to the company or companies to which, in the view of the DOR, they belong.[40] Apparently believing that this authority would be insufficient, the DOR inserted a special limitation in the proposed regulation limiting the amount of an NOL that the generating corporation can use after 2008:

> Where a taxable member of a combined group is carrying forward a NOL from a year or years beginning prior to January 1, 2009, or from a year or years in which the corporation was not a member of a combined group, the use of the corporation's pre-apportionment NOL from such year(s) is limited to the amount of the current year combined group taxable income that would be apportioned to the member as determined by using:
>
> a. the dollar amounts of the member's Massachusetts apportionment factor numerators in the year(s) in which the loss was incurred (determined, in the case of the sales factor, by excluding all "throwback sales" other than destination sales "thrown back" in the year of the loss from jurisdictions in which no member of the combined group is subject to tax in the year the NOL deduction is taken) and
>
> b. the current year group denominators.
>
> In the case of [an] NOL carry forward from two or more such years, the Massachusetts apportionment factor numerators shall be averaged for all such loss years, weighting the factors for each loss year in accordance with the amount of the loss carried forward to the current year calculated on a post-apportionment basis, and the resulting average Massachusetts property, payroll, and sales factor numerators shall be divided by the current year group denominators to determine an apportionment percentage. The apportionment percentage thus determined shall be multiplied by the current year combined group taxable income. The product is the maximum current year income of the member that may be offset in the taxable year by its pre-combination NOL carry forward, subject to any other applicable loss carry forward limitation. The Commissioner may disregard material transactions among affiliated entities on or after November 1, 2008, to the extent that such transactions would affect the limitation. . .[41]

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[35] 830 CMR 63.32B.2(9)(c)(2) (emphasis added).

[36] The same can be said of the DOR's continued adherence, in a unitary setting, to the view that IRC section 381 principles generally do not apply in Massachusetts. *See*, *e.g.*, 830 CMR 63.32B.2(8)(c); "New Regs," *supra* note 5, at pp. 425-426.

[37] *See* Example 8 in 830 CMR 63.32B.1 (the regulation governing combined returns before enactment of the statutory mandate for unitary combination).

[38] 830 CMR 63.32B.2(8)(d).

[39] G.L. c. 63, section 32B(d)(2)(ii)-(iv); 830 CMR 63.32B.2 (7)(a)-(d).

[40] *See* 830 CMR 63.32B.2(7)(g)(3) and (4). It is disheartening that in the new world of combined reporting, taxpayers will continue to argue with the DOR's auditors about the geography of separate-company income and loss, albeit not in the context of transfer pricing, but in the context of factor attribution.

[41] 830 CMR 63.32B.2(8)(f).

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This rule was subject to criticism that it arbitrarily capped the NOLs available to a growing business. If nothing changed between the years in which an NOL was generated and the year in which it was used, except that the business grew in the same proportion everywhere, the generating company's NOL carryforward available for use in years after 2008 would be shrunken insofar as the limitation would be measured by multiplying unitary income by historical numerators over current-year denominators.

In the final regulation, as in the proposed regulation, the DOR has included a relief provision, by way of a new election, intended to meet that objection:

> For purposes of the application of the limitation . . . the dollar amounts of a member's Massachusetts apportionment factor numerators in years when losses were incurred may, at the election of the combined group, be increased in proportion to any over-all growth in Massachusetts property and payroll for all combined group members between the year of the loss and the tax year, commencing on or after January 1, 2009, for which a pre-2009 loss carry forward is claimed. Under this method, the dollar amount of all Massachusetts property and payroll for all combined group members, including all predecessor entities in existence in the year that the loss was incurred, regardless of prior year ownership of any predecessor entities, are totaled for each apportionment factor and are compared to the total dollar amounts of Massachusetts property and payroll in the year in which the carry forward is claimed. The dollar amounts of Massachusetts property, payroll, and sales for an individual corporation . . . in a particular loss year are then increased or decreased in proportion to the combined group's Massachusetts increase or decrease for each apportionment factor. A taxpayer electing this methodology must recalculate the dollar amount of Massachusetts property and payroll for each factor using this methodology and must apply the methodology for purposes of calculating NOL carry forward limitations . . . to all group members with pre-2009 loss carry forwards. In the case of NOL carry forward from two or more loss years, the limitation . . . must be calculated by adjusting the prior numerators to reflect the change in Massachusetts activity separately for each loss year, before applying the weighted average methodology.[42]

The new rule does indeed meet the objection, but at the expense of further complicating what is already a daunting set of rules regarding pre-2009 NOL use.

[42]*Id.*

The authors submit that, instead of adopting the election, the DOR should have scrapped the limitation and relied on its ability to reattribute factors within the group as appropriate in abusive situations.

Treatment of Dividends

As is conventional in a unitary system, dividends paid by one member of the group to another out of unitary earnings are eliminated in their entirety under the Massachusetts system. If that rule does not apply because a dividend is not considered to have been paid out of unitary earnings, the usual statutory rules for the treatment of intercompany dividends apply. The final regulation newly addresses the interplay between those sets of rules in two ways:

- Assume that Corporation A owns all of Corporation B, which in turn owns all of Corporation C. All three are regular business corporations. In 2009 Corporation C pays a dividend to Corporation B out of earnings accumulated in 2008. Corporation B then pays a dividend in the same amount to Corporation A. Because all earnings from years before the adoption of a unitary system are considered to be nonunitary earnings regardless of the relationship between payor and payee corporations,[43] the dividend received by Corporation B is not eliminated, but is subject to a 95 percent dividends-received deduction.[44] The dividend received by Corporation A is, however, considered to have been paid out of unitary earnings and accordingly is eliminated.[45]
- Financial institutions are entitled to a 95 percent DRD for dividends received from another financial institution, as long as the recipient owns at least 15 percent of the voting stock of the payor.[46] The DRD for regular business corporations, by contrast, is available for dividends from all corporations.[47] The final regulation seems to equivocate on the question whether "institution" is limited in this context to a company that qualifies as a "financial institution" for purposes of the Massachusetts bank tax regime.[48] Dividends received by a

[43]830 CMR 63.32B.2(6)(c)(4)(a).

[44]830 CMR 63.32B.2(6)(c)(4)(b). *See* 830 CMR 63.32B.2(6)(c)(4)(e), Example 1.

[45]*See* 830 CMR 63.32B.2(6)(c)(4)(e), Example 1.

[46]G.L. c. 63, section 1 (definition of "net income").

[47]G.L. c. 63, section 38(a)(1). But note the exception for dividends paid out of some corporate trust earnings. G.L. c. 63, section 38(a)(1); 830 CMR 63.32B.2(6)(c)(4)(d).

[48]Contrast the discussion of the DRD for utilities in 830 CMR 63.32B.2(6)(c)(4)(a) and (b) with the discussion of the DRD for financial institutions in the same subsections.

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financial institution from a nonfinancial institution clearly are eliminated if they are paid out of unitary earnings and no DRD applies.[49]

Treatment of Hybrid Entities

Before 2009, Massachusetts did not follow the federal check-the-box rules except for limited liability companies.[50] A common planning technique for Massachusetts-based companies selling manufactured goods was to reduce tax in separate-filing states other than Massachusetts by segregating the distribution function in a controlled partnership — one that checked the box to be treated as a corporation for federal purposes, and hence for state purposes in separate-filing states that followed check-the-box.[51] In that structure, the manufacturing activities and intellectual property typically were left in the parent corporation.

The availability of those hybrid structures was viewed by the DOR as a form of elective combination.[52] With the adoption in 2009 of both check-the-box and a unitary system, the constituent entities in those structures continued to pool their income much as they had before. However, the two statutory changes threatened some tax benefits that the hybrids enjoyed in the state before 2009. Manufacturing corporations are entitled to use a single-sales-factor apportionment approach in lieu of the usual three-factor approach with double weighting of sales,[53] and they are entitled to an investment tax credit measured by 3 percent of the cost of depreciable property placed in service in Massachusetts.[54] Those benefits generally are conferred, even in a postunitary environment, on a separate-company basis, because nothing in the combined reporting statute has changed their application in that respect.[55] Practitioners therefore feared that, with the adoption of check-the-box, the distribution partnership in the classic hybrid structure would become a separate, nonmanufacturing corporation that would lose single-sales-factor apportionment and the ability to generate ITCs. However, while the statutory changes were pending, DOR officials suggested that relief would be offered to such companies. The DOR recognized that the hybrid structures were generally set up without any motive to reduce Massachusetts tax, and perhaps the DOR wanted to blunt any political opposition to unitary and check-the-box that might have come from companies that used that structure.

In the working draft regulation, the DOR offered relief for the hybrid structures, to the extent of treating the distributor's sales of goods acquired from the affiliated manufacturer as sales of manufactured property for purposes of qualification to use single-sales-factor apportionment.[56]

Some commentators and businesses asked that the DOR extend the relief by making it clear that the hybrid structures would be treated as one corporation for purposes of entitlement to ITCs. In both the formal proposal and the final regulation, the DOR addressed those concerns by adopting the following language:

> In any case where a corporation is deemed to be engaged in substantial manufacturing . . . pursuant to [the original relief provision related to single-sales-factor apportionment], and such manufacturing activity occurs in Massachusetts, such corporation will similarly be deemed entitled to claim the [investment] credit for the limited purpose of being able to share [the] credit that has been generated by [the] other group member.[57]

This provision by its terms does not seem to address whether the distributor in the classic hybrid structure can itself generate ITCs, in addition to using those that were generated by an affiliated manufacturer.

What's Next?

As taxpayers begin to think more concretely about what combined reporting will mean for them in 2009 and beyond, it can be expected that more gray areas will be identified, despite the level of

[49]830 CMR 63.32B.2(6)(c)(4)(a).

[50]*See* G.L. c. 62, section 1, both before and after amendment by Chapter 173, section 11 of the Acts of 2008; *see also* G.L. c. 63, section 30, both before and after amendment by Chapter 173 section 38 of the Acts of 2008. Even limited liability companies were considered, and continue to be considered, separate entities for purposes of sales and use, deeds excise, and many other Massachusetts tax purposes.

[51]*See* Mass. Letter Rul. 99-13 (June 24, 1999).

[52]*See* "Radical Changes," *supra* note 5, at 734.

[53]G.L. c. 63, section 38(l).

[54]G.L. c. 63, section 31A(i).

[55]*See* 830 CMR 63.32B.2(7)(a)(2) (stating "[t]he apportionment method used by each . . . member depends on the classification of the individual member, *e.g.*, whether the individual member is a general business corporation, a manufacturing corporation, financial institution, utility corporation, mutual fund service corporation, etc.").

[56]*See* Working Draft Regulation 830 CMR 63.32B.1 (7)(g)(2)(c) and the examples therein. It is important to note that many businesses whose commercial domicile is outside Massachusetts, particularly those in unitary states, have similar structures designed to reduce the tax in separate-filing states. Those businesses are also likely to be subject to single-sales-factor apportionment in Massachusetts by virtue of the cited rule. Generally, that will be a detriment for those companies. *See* 830 CMR 63.32B.2(7)(g)(2)(b), Example 3.

[57]Proposed Regulation 830 CMR 63.32B.2(7)(g)(2)(d); 830 CMR 63.32B.2(7)(g)(2)(d). In the new unitary system, ITCs generated by one member can be used by another if the other corporation, on a separate-entity basis, qualifies to generate them.

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detail in the regulations. That should generate questions that will give rise to more guidance in the form of letter rulings, technical information releases, or DOR directives. Further, the DOR even now is struggling with the challenge of translating the rules that already are in place into forms and instructions that are consistent with the rules and yet workable from a compliance point of view.

At the same time, some of the rules in the final regulation have generated sufficient controversy that the legislature may be asked to overturn them. Among those rules are:

- the treatment of 20+ corporations;[58]
- the treatment of intercompany dividends, which could be greatly simplified by the adoption of a 100 percent DRD for dividends received from a controlled corporation;
- the limitations on the use of NOLs and credits in a combined return; and
- failure to adhere to the principles of section 381 of the Code in a unitary environment.

While a strong case can be made for legislative relief in each of those areas, proponents of change will not find it easy to articulate their importance in terms that legislators can understand. Moreover, Massachusetts faces the most difficult fiscal environment in memory, and if the DOR assigns a revenue cost to those measures, regardless of whether they are viewed as mere clarifying amendments, that fact alone will give pause to the legislative leadership in its deliberations. ✰

[58]It has been suggested that there should be a "reasonableness" exception to the inclusion of those corporations in a combined group, analogous to the exception that applies to the statutory presumptive addbacks for intercompany interest and royalty payments under G.L. c. 63, sections 31I and 31K.

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