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New Regs Set the Framework for Combined Reporting in Massachusetts

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On November 6, the Massachusetts Department of Revenue issued a roughly 50-page draft regulation explaining the state's new combined reporting regime, which was enacted in July 2008 and took effect for tax years beginning on or after January 1, 2009.[1] The regulation is an impressive achievement, coming as quickly as it has following the statutory changes that prompted it. It is comprehensive and clear, and for the most part it adopts sensible rules that reflect a good understanding of unitary theory and practice.

When the unitary tax bill was pending, opponents argued that the legislature — not "unelected bureaucrats," who are assumed to be insensitive to business concerns — should resolve major questions of interpretation.[2] Whatever the general merits of that argument, the regulation demonstrates that it would be all but impossible to have a workable, consistent combined reporting regime without extensive administrative guidance, and that it was unrealistic to expect to provide rules for combined reporting solely by statute.

However, the regulation proves correct the critics who raised concerns that unitary would add layers of complexity to a Massachusetts business tax regime that is already much too complicated.[3] A great deal of the added complexity results from the state's continued statutory adherence to different apportionment regimes for different classifications of corporation. With some exceptions, those differing regimes continue to be applied under the new law on a separate-company basis. Also, the regulation fails to provide bright-line rules that would have provided greater certainty for those who remain concerned that the new regime gives the DOR and its auditors too much discretion.[4]

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In this article, we will attempt a comprehensive review of the major features of the regulation and suggest areas in which the rules that have been

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[1]*See* Working Draft Regulation 830 CMR 63.32B.1; Chapter 173 of the Acts of 2008, "An Act Relative to Tax Fairness and Business Competitiveness" (the act). For prior coverage of the new law, see Joseph X. Donovan and Sarah D. 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* [hereinafter "Proposal Survives Study"]; Joseph X. Donovan and Sarah D. Wellings, "Radical Changes on the Horizon for Massachusetts," *State Tax Notes*, Sept. 15, 2008, p. 733, *Doc 2008-17979*, or *2008 STT 180-2* [hereinafter "Radical Changes"].

[2]*See* "Radical Changes," *supra* note 1 at 738.

[3]The complexity of the state's business tax structure was a major concern of the Study Commission on Corporate Taxation, whose findings helped move the General Court — the Massachusetts legislature — toward enactment of combined reporting. *See* the commission's report at http://www.mass.gov/Ador/docs/dor/Publ/PDFS/Study%20Commission%20on%20Corporate%20Taxation%20-%20Final%20Report.pdf [hereinafter "Study Commission Report"]. Members of the study commission also signaled that the unitary proposal could gain greater support if it were coupled with a reduction in the tax rates. *See* "Proposal Survives Study," *supra* note 1 at 195. In fact, rate reductions were also part of the act. *See* "Radical Changes," *supra* note 1 at 733-734.

[4]*See* discussions *infra* regarding the scope of the definition of "commonly owned," the applicability of 26 CFR 1.1502-13, the scope of document production after either a worldwide or Massachusetts affiliated group election has been made, and the separate company examination provided for under the wage and property attribution rules.

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adopted might be improved, as well as gaps in coverage that the DOR may be wise to address as it implements the new regime.

What Is a Massachusetts Unitary Group?

In General

The regulation requires that a corporation engaged in a unitary business with one or more other corporations that are related by common ownership file a combined report to calculate its taxable net income derived from the unitary business as its share, attributable to the state, of the apportionable income or loss of the combined group engaged in the unitary business.[5] Corporations are commonly owned if more than 50 percent of the voting control of one or more of the corporations resides directly or indirectly in one or more common owners (the 50 percent ownership test).[6] In lieu of identifying and including each corporation that is a member of the unitary business in the combined report, the regulation allows an election to report the income of the Massachusetts affiliated group, which is a variation of the federal consolidated return group, as is further explained below.[7] For those corporations not making a Massachusetts affiliated group election, the regulation allows an election to determine the combined group's income on a worldwide basis,[8] in the absence of which a water's-edge approach is taken.

The combined group comprises those corporations required to be included in the combined report under G.L. c. 63, section 32B, as enacted by St. 2008, c. 173.[9] The corporations may include those taxable under G.L. c. 63, sections 2 (financial institutions), 2B (financial institutions that are S corporations), 20-29E (some insurance companies),[10] 32D (S corporations), 39 (general business corporations), and 52A (utility corporations).[11] We refer to corporations in those categories as combinable corporations.

Although real estate investment trusts and regulated investment companies are combinable corporations, the regulation suggests that publicly held REITs and RICs will generally not be included in the combined group because it is unlikely that they will meet the 50 percent ownership test.[12] A public REIT and its taxable REIT subsidiaries (TRSs) typically will meet the 50 percent ownership test, however, and be engaged in a unitary business. Whereas a REIT generally has zero net income because of the dividends paid deduction, combining a REIT and its TRSs may cause a portion of a TRS's income to be apportioned to Massachusetts even if it has no Massachusetts presence on a separate-entity basis. We believe that REITs and RICs were swept into the list of potentially combinable entities so that DOR would have another tool for attacking so-called captive REITs and RICs. We suggest that the regulation should be amended to exclude TRSs from combination with their parent REITs, because they do not present any of the problems associated with captive entities.

> ***The regulation should be amended to exclude TRSs from combination with their parent REITs, because they do not present any of the problems associated with captive entities.***

The regulation excludes some corporations from a combined report, even if those corporations are engaged in a unitary business with a taxable member of the group.[13] The corporations excluded from the combined report are those described in G.L. c. 63, sections 38B (securities corporations) and 38Y (entities exempt under IRC section 501); insurance companies qualifying as life insurance companies under IRC section 816; and insurance companies subject to tax under IRC section 831.[14]

Unitary Business

Under the regulation, a unitary business is "a group of two or more corporations related by 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."[15] The term is required to be "construed to the broadest extent permitted under the constitution of the United States."[16]

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[5]830 CMR 63.32B.1(2). Presumably, whether an entity is a corporation will be determined under federal standards now that Massachusetts follows the check-the-box rules.

[6]*Id.*

[7]830 CMR 63.32B.1(2), (10).

[8]830 CMR 63.32B.1(2), (5), (10)(b).

[9]830 CMR 63.32B.1(2).

[10]Only insurance companies that do not qualify either as life insurance companies under IRC section 816 or as insurance companies subject to tax under IRC section 831 are required to be included in the combined return. 830 CMR 63.32B.1(4)(b).

[11]830 CMR 63.32B.1(2), (4)(a)-(b).

[12]830 CMR 63.32B.1(4)(b). See, however, the discussion *infra* regarding the breadth of the definition of common ownership and its potential to tie companies together via mutual fund ownership.

[13]830 CMR 63.32B.1(4)(c).

[14]*Id.*

[15]830 CMR 63.32B.1(2).

[16]*Id.* That proviso will render moot most questions about the statutory definition of unitary ties.

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The regulation describes several presumptions and inferences concerning whether and when two or more corporations under common ownership will be deemed to be engaged in a unitary business. Those include the following:

- When a voting interest is directly or indirectly acquired by or in a taxpayer, or by or in a member of a taxpayer's combined group, such that common ownership is achieved for the first time, it will be presumed that the acquiring and the acquired corporation are not engaged in a unitary business for the taxable period including the period of acquisition.[17] That presumption does not apply if the corporations were in the same line of business, or composed different steps in a vertically structured business, before the acquisition. In contrast, when two such corporations merge, it will be presumed that the businesses are unitary from the date of the merger. Either of those presumptions may be rebutted by the taxpayer or the commissioner.[18]

- A passive holding company that directly or indirectly controls one or more operating companies will be deemed to be unitary with such subsidiary operating companies. Any intermediate passive holding company will also be deemed unitary with the operating subsidiary.[19]

- Commonly owned corporations that either are in the same general line of business (for example, a multistate grocery chain) or that comprise different steps in a vertically structured business (for example, a business engaged in the exploration, development, extraction, and processing of a natural resource and the sale of a product based on the extracted natural resource) will generally constitute a unitary business.[20]

- The sharing of intellectual property or technical information and significant common or intercompany financing, if the financing activity serves an operational purpose, constitutes evidence of a unitary business.[21] Also, the sale, exchange, or transfer of products, services, or intangibles between companies is evidence of a unitary business. Notably, that evidence is not negated by arm's-length pricing.[22]

Regardless of the guidance of those presumptions and inferences, which are common to unitary regimes, the question whether a business is unitary is likely to be the subject of extensive litigation when companies choose not to make a Massachusetts affiliated group election.[23] In fact, just determining whether two or more companies are commonly owned may be subject to litigation. The regulation does not specify what attribution rules, if any, apply for purposes of determining the 50 percent ownership test.[24] When those rules have not been specifically referenced by statute or regulation, the courts may look to federal or state attribution rules for guidance.[25]

Without that guidance, a literal reading of the definition of commonly owned could result in corporations being treated as potential members of a combined group in which the owners are completely unrelated in lay terms. Suppose, for example, that several different and otherwise unrelated mutual funds own in the aggregate more than 50 percent of each of two publicly traded companies, A and B. Are A and B commonly owned? If A and B are in the same line of business, might the DOR treat them as presumptively unitary and require them to file a combined return? Rather than leave those questions to the Appellate Tax Board and the courts, the authors believe the DOR should clarify how common ownership is determined and specify attribution rules.

Unless an election is made to determine taxable income on a worldwide basis,[26] the unitary group includes the income and apportionment information only of each combinable member that is one of the following:

- a member incorporated in the United States or formed under the laws of any state, the District of Columbia, or any U.S. territory or possession;
- a member, regardless of the place of incorporation or formation, if the average of its property, payroll, and sales factors within the United States is 20 percent or more; or
- a member that earns more than 20 percent of its income, directly or indirectly, from intangible property or service-related activities, the

[17] That is commonly referred to as the "no instant unity" presumption.

[18] 830 CMR 63.32B.1(3)(c)(1)-(2), (3)(b).

[19] 830 CMR 63.32B.1(3)(d).

[20] 830 CMR 63.32B.1(3)(b); *see also Radical Changes*, *supra* note 1 at 736.

[21] 830 CMR 63.32B.1(3)(e). Query what impact the decision of the U.S. Supreme Court in *MeadWestvaco Corp. v. Illinois Dep't of Revenue*, 128 S. Ct. 1498 (2008), may have on the operational function test in this context. *See* 128 S. Ct. at 1508. (For the decision, see *Doc 2008-8409* or *2008 STT 74-1*.)

[22] 830 CMR 63.32B.1(3)(f).

[23] It may be suggestive of how fact-intensive the inquiry is that an RIA checkpoint search in California case law for the term "unitary" returns more than 530 cases.

[24] In contrast, California regulations provide specific guidance for the attribution of ownership involving individuals, partnerships, and corporations. Calif. Revenue and Taxation Code section 25105(e).

[25] *E.g.*, IRC sections 318, 382; G.L. c. 63, section 31I(a).

[26] 830 CMR 63.32B.1(5)(a).

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costs of which are generally deductible for federal income tax purposes against the business income of the other group members.[27]

For a foreign corporation earning more than 20 percent of its income from intercompany transactions related to intangible property or services, the income and apportionment factors of such corporation are taken into account in the Massachusetts affiliated group only to the extent of the referenced income and the apportionment factors that relate to that income.[28] It is unclear what that rule means, because intercompany transactions are otherwise excluded in computing income and factors under general unitary principles. It has been suggested that the import of the rule is that the domestic group is simply denied a deduction for payments to foreign affiliates that are included in the group by virtue of the rule. If the rule is intended to do more than deny that deduction, we believe that an example should be provided to explain how the provision will be applied.

Worldwide Election

A group that has made a worldwide election includes the income and apportionment information of all of the combinable corporations that are engaged in a single unitary business. A group that has made a Massachusetts affiliated group election may not make a worldwide election.[29]

The worldwide election must be made by the principal reporting corporation of the combined group on an original, timely filed return, or as otherwise required in writing by the commissioner, and must include a statement that every corporation that is a member of the combined group has agreed to be bound by the election.[30] The worldwide election is binding for the tax year for which it was made and the nine later years,[31] and any corporation entering the unitary group after the year in which the election was made will be deemed to have waived any objection to such inclusion and will be included in the group.[32] After the election has been in effect for 10 years, it may be affirmatively renewed or revoked or, if no action is taken, it will terminate.[33] The worldwide election may be renewed for additional 10-year periods.[34] There is no apparent waiting period during which the group may not make a worldwide election after a revocation or termination.[35]

The making of a worldwide election constitutes consent to the production of documents or other information that the commissioner reasonably requires, and that information must be produced in a form and language acceptable to the commissioner.[36]

Massachusetts Affiliated Group Election

To avoid litigation regarding which affiliates are unitary and therefore constitute part of the combined group, many companies may choose to make a Massachusetts affiliated group election, which generally provides a bright-line test for determining the members of the combined group. The regulation defines a Massachusetts affiliated group as an affiliated group under IRC section 1504, except that the Massachusetts group includes all corporations incorporated in the United States or formed under the laws of the United States that are commonly owned, directly or indirectly, by any member of that affiliated group.[37] The Massachusetts affiliated group also includes any commonly owned corporation that, regardless of its place of incorporation, either has property, payroll, and sales factors within the United States that average 20 percent or more, or earns more than 20 percent of its income, directly or indirectly, from intangible property or service-related activities, the costs of which are generally deductible for federal income tax purposes against the business income of the other group members.[38]

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[27]830 CMR 63.32B.1(5)(b). *See* the discussion below regarding the import of including a member that earns more than 20 percent of its income from intangible property or service-related activities.

[28]*Id.*

[29]830 CMR 63.32B.1(5)(c)(4), (10)(b). *See* the discussion below regarding the Massachusetts affiliated group election.

[30]830 CMR 63.32B.1(5)(c)(1). A return will be considered timely only if it is filed by the taxpayer on or before the earliest due date or extended due date for the filing of the taxpayer's return under G.L. c. 63. *Id.*

[31]830 CMR 63.32B.1(5)(c)(2).

[32]830 CMR 63.32B.1(5)(c)(3). Presumably, a corporation "entering the unitary group" will in fact be unitary with the other members of the group and is merely waiving the procedural requirement of participating in the election, not its right to be excluded if it is not in fact unitary. Notably, the regulation is silent as to the consequences of a company or companies leaving the group. Query whether it would make a difference, for example, if an entire group, including a holding company that was the principal reporting corporation, were acquired by another group, or if all of the subsidiaries were acquired without the parent holding company.

(Footnote continued in next column.)

[33]*Id.*

[34]*Id.*

[35]*See id.*

[36]830 CMR 63.32B.1(5)(c)(5). Query whether there are circumstances in which the DOR's auditors would rely on that consent as grounds for requiring production of tax accrual workpapers or documents that would otherwise be protected by attorney-client privilege or the work product doctrine.

[37]830 CMR 63.32B.1(2).

[38]*Id.* To the extent those corporations are in fact unitary, they are of course included in the group regardless of whether a Massachusetts affiliated group election is in effect. 830 CMR 63.32B.1(5)(b).

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Rather than apply the 80 percent control test under IRC section 1504, the regulation provides that the 50 percent common ownership test applies.[39]

The election to treat the Massachusetts affiliated group as the combined group must be made on an original, timely filed return in the manner prescribed by the commissioner and must indicate that every corporation that is a member of the Massachusetts affiliated group has agreed to be bound by that election.[40] If the group previously filed a combined return in Massachusetts, the election must be made by the principal reporting company of the previous group; otherwise, any member of the group may make the election.[41] The election does not require the consent of the commissioner.[42] A taxpayer may not, however, make a Massachusetts affiliated group election and a worldwide election for the same tax year, and may not make a Massachusetts affiliated group election in any year in which a worldwide election is in effect.[43]

The Massachusetts affiliated group election is binding on the group for the tax year in which it was made and the next nine years.[44] Any corporation that enters the Massachusetts affiliated group while the election is in effect must be included in the combined report and will be deemed to have waived any objection to its inclusion in the group.[45] After the election has been in effect for 10 years, it may be affirmatively renewed or revoked; if no action is taken, the election will terminate. Any affirmative renewal or revocation must be made in the manner prescribed by the commissioner and must include notice that each member of the group consents to that renewal or revocation.[46] If the election is either affirmatively revoked or terminated because of inaction, the group may make a new Massachusetts affiliated group election in the fourth tax year after such revocation or termination.[47]

The making of a Massachusetts affiliated group election constitutes consent to the production of documents or other information that the commissioner reasonably requires for verifying that the appropriate members of the group have been included.[48]

Determining the Income Base

In General

Even though, in the Massachusetts system, each corporation must separately apportion the group's income to determine which portion is attributable to it, the regulation does contemplate that a true combined report will be used as the base document from which each corporation's income from the unitary group is derived.[49]

The potential components of a particular member's Massachusetts income and loss include:

- its share of any unitary business income or loss apportionable to Massachusetts, for each group of which it is a member;
- its Massachusetts apportioned income or loss from any business that the member conducts by itself;
- all of the income or loss of any discrete business that it conducts entirely within the state;[50]
- income or loss allocable to Massachusetts;[51] and

[39]830 CMR 63.38B.1(10)(c); *see also* G.L. c. 63, section 32B(g)(i). Since the 80 percent control test under the IRC section 1504 rules is replaced with the 50 percent common ownership test, a Massachusetts affiliated group election appears to be available even if the corporations are not filing, or not eligible to file, a federal consolidated return.

[40]830 CMR 63.32B.1(10)(d). A return will be considered timely only if it is filed by the taxpayer on or before the earliest due date or extended due date for the filing of the taxpayer's return under G.L. c. 63. *Id.*

[41]*Id.*

[42]830 CMR 63.32B.1(10)(a).

[43]830 CMR 63.32B.1(5)(c)(4), (10)(b).

[44]830 CMR 63.32B.1(10)(e). The regulation provides that the election continues irrespective of whether a federal consolidated group to which the combined group belongs discontinues the filing of a federal consolidated return. *Id.* Presumably, this does not imply that a federal consolidated return must be filed to make a Massachusetts affiliated group election. *See supra* note 39.

[45]*Id. See also supra* note 32 (questioning the consequences of a corporation or corporations leaving the group).

[46]830 CMR 63.32B.1(10)(f).

[47]*Id.*

[48]830 CMR 63.32B.1(10)(g). *See also supra* note 36.

[49]*See* 830 CMR 63.38B.1(6)(b), as well as the definition of combined report in section (2). DOR has shown a strong bias over the last few years toward simplification of corporate reporting so as to facilitate electronic filing and the efficiencies and data mining opportunities that are associated with it. The combined report and the other complexities of unitary reporting are likely to work against those goals.

[50]Query whether that member will have a right to apportion the income from a discrete business within and without Massachusetts if its activities that trigger a right to apportion under G.L. c. 63, section 38 are conducted as part of a different business that it conducts either on its own or as part of a combined group.

[51]Massachusetts allocates only income that may not be included in the apportionment base of a nondomiciliary corporation under the U.S. Constitution. *See* G.L. c. 63, section 38(b); 830 CMR 63.38.1(1)(b). If a group makes an affiliated group election, all of the constituent members of the group are deemed to be unitary, and all of the income or loss of the group is treated as apportionable. In effect, each member waives its right to treat any income or loss as allocable. *See* 830 CMR 63.32B.1(2) (defining affiliated group income as the aggregate net taxable income or loss of the group, regardless of whether some or all of the income would have been allocable to another state or apportionable).

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- its share of net operating loss carryforwards, within the constraints set forth in the regulation.[52]

The total income of the combined group is the sum of the separately determined incomes of each member.

For any member that is not incorporated in the United States or included in a consolidated federal corporate income tax return, the income is determined from a profit and loss statement prepared in the currency in which its books of account are kept, adjusted to conform to U.S. generally accepted accounting principles.[53] That income and the apportionment factor values for the member are translated into the currency in which the parent company maintains its books and records "on any reasonable basis consistently applied on a year-to-year and entity-by-entity basis."[54] Income that is sourced to Massachusetts is then translated into U.S. dollars.[55]

In lieu of taking the approach outlined above, a non-U.S. corporation may, subject to the commissioner's approval, determine its income on the basis of "any other reasonable method consistently applied on a year-to-year and entity-by-entity basis."[56] The availability of that fallback approach is very important to the workability of a unitary system that will sometimes include non-U.S. corporations in a group that otherwise ends at the water's edge.[57]

If the unitary business includes income from a partnership, the combined group must include in its total income the direct and indirect distributive shares of the partnership's unitary business income of each member.[58]

Treatment of Intercompany Dividends

In a unitary system, intercompany dividends (dividends received from another member of a combined return group) generally are eliminated, consistent with the treatment of the group for most purposes as if it were a single entity. In unitary states it is common, however, to limit the elimination to dividends paid out of profits earned while unitary ties existed between the payer and payee corporation.[59] The new regulation follows this general approach,[60] but to understand why the approach is important, it is necessary to outline the treatment of dividends in Massachusetts outside the context of combined reporting.

Massachusetts generally adds back to income the federal dividends received deduction,[61] but allows its own deduction for 95 percent of dividends received from a corporation in which the recipient owns at least 15 percent of the voting stock (the DRD).[62]

Further, there is a statutory exception to the 95 percent DRD for dividends received from a corporate trust doing business in the commonwealth.[63] Accordingly, those dividends paid to a regular business corporation generally have been fully taxed. For tax years beginning on or after January 1, 2009, the corporate trust or Massachusetts business trust disappeared as a specially taxed entity under Massachusetts law by virtue of adoption of the federal check-the-box rules.[64] One might suppose, then, that that exception to the DRD will become moot as of 2009. To the contrary, the regulation requires that taxpayers treat dividends paid out of historical corporate trust earnings that were not taxed at the trust level as qualifying neither for the DRD nor for the 100 percent elimination normally afforded to intercompany dividends.[65] That treatment can be said to reflect hostility on the part of the DOR specifically toward "Massachusetts business trust holding companies" — MBTs that were permitted,

[52]830 CMR 63.32B.1(6)(b)(2). *See* 830 CMR 63.32B.1(8) and discussion *infra*.

[53]The regulation does not specify whether at some point in the calculation U.S. federal book-tax differences and adjustments from federal to Massachusetts income have to be taken into account.

[54]830 CMR 63.32B.1(6)(c)(2)(b)(i).

[55]*Id.*

[56]830 CMR 63.32B.1(6)(c)(2)(b)(ii).

[57]California employs similar rules. Cal. Code Regs. 25106.5-10(e).

[58]830 CMR 63.32B.1(7)(g). In determining what partnership income is unitary, the DOR presumably will apply the rules predating combined reporting that are set forth in the general apportionment regulation, 830 CMR 63.38.1, at (12). Here again, if an affiliated group election has been made, the entire partnership distributive share of each partner that is a member of the group is deemed to be unitary. *See* 830 CMR 63.32B.1(2).

[59]*E.g.*, Calif. Revenue and Taxation Code section 25106(a)(1); W.Va. Code section 11-24-13(d); Code of Vt. Rules 1.5862(d)-7(e)(4).

[60]It appears that the intercompany elimination will not be allowed for dividends paid out of pre-2009 earnings and profits, even if the payer and payee corporations conducted a unitary business together before the adoption of combined reporting. *See* 830 CMR 63.32B.1(6)(c)(4).

[61]G.L. c. 63, section 30.

[62]G.L. c. 63, section 38(a)(1). While the corporate excise statute no longer reflects the rationale for the 5 percent "haircut," it seems clear that it was enacted in lieu of a disallowance of expenses attributable to untaxed dividend income. G.L. c. 63, section 30(4). For purposes of the rule, the DOR does not apply the attribution rules of IRC section 318. Thus, if parent P owns all of the stock of subsidiaries S1 and S2, and S1 owns 10 percent of the stock of S3 and S2 owns the remainder, S1 is not entitled to the DRD. *See* DOR Directive 98-1. S1 and S3 should qualify, however, for 100 percent elimination of the intercompany dividend in a combined report if other conditions are met.

[63]G.L. c. 63, section 38(a)(1)(i).

[64]*See* G.L. c. 62, section 1; G.L. c. 63, section 30. Massachusetts business trusts are eligible entities within the meaning of the federal check-the-box rules. 26 CFR 301.7701-3.

[65]830 CMR 63.32B.1(6)(c)(4).

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before 2004, to pay no tax at all, and that were commonly used as intercompany financing vehicles in Massachusetts to depress the income of regular business corporations via intercompany loans.[66]

The regulation provides that when a member of a combined return group has earnings and profits from the unitary business of the group and also from activities that were not a part of the unitary business "and therefore not included in a combined report" and pays out dividends, it is deemed to be paid out of E&P on a last-in, first-out basis as between tax years and on a pro rata basis as between unitary and nonunitary earnings for each individual tax year.[67] Accordingly, so long as a unitary payer has sufficient unitary E&P in the year in which the dividend is paid to support the dividend payment, it will generally be entitled to the 100 percent elimination.

If, however, a corporation pays out earnings attributable to a corporate trust — either from a period when the payer was such a trust, or apparently if attributable to a trust that was, for example, merged or liquidated into it — and those earnings were not taxed to the trust,[68] the distribution will be entitled neither to an elimination nor to the 95 percent DRD.[69] Further, in an exception to the LIFO rule cited above, it will be "presumed" that any dividends paid by that member are first paid out of untaxed MBT earnings and profits.[70]

The regulation recognizes special rules that apply to intercompany dividends received by a utility corporation. Generally, those companies are entitled to a 100 percent DRD for dividends received from another utility in which there is at least 80 percent ownership.[71] However, no DRD is allowed for dividends received by a utility from a nonutility corporation.[72] The regulation seems to imply that no intercompany elimination is allowed for such dividends, either, but it is unclear on that point.[73]

When an affiliated group election has been made, the intercompany elimination rules are applied to the members of the group as if they were unitary.[74]

While the rules in the regulation for the treatment of intercompany dividends are generally sound in principle, the complex tracing of E&P that they require hardly seems justified given the minor difference — generally 95 percent deduction versus 100 percent elimination — in the treatment of dividends that turns on whether they are paid out of unitary earnings. We suggest legislation changing the deduction from 95 percent to 100 percent, consistent with the law in most other states, in the interest of simplicity.

Treatment of Other Intercompany Transactions

The regulation provides that income from intercompany transactions between members of the same combined return group that relate to the unitary business are deferred "in a manner similar to 26 CFR 1.1502-13."[75] That language implies a broad adoption of the rules in the federal consolidated return regulations relating to intercompany deferrals, which taxpayers generally should applaud for the sake of predictability. But it also suggests some discretion to depart from those rules when differences between federal and state regimes justify a departure.

The following circumstances will trigger deferred income in the seller that must be apportioned as unitary income:

- when the buyer disposes of an asset acquired in a deferred transaction in a sale to an entity that is not a member of the group;
- when the buyer uses an asset acquired in a deferred transaction outside the common unitary business or resells it to another member for use outside the unitary business; or
- when the buyer and seller are no longer members of the same group.[76]

If a member of a unitary group incurs an expense that is directly or indirectly attributable to allocable, as opposed to apportionable, income of another member, the expense is allocated to that member for purposes of determining its total income subject to Massachusetts tax.[77]

[66]*See* G.L. c. 62, section 8(b), before amendment by 2004 Mass. Acts. c. 262 section 13. MBT holding companies could also undertake stock sales of subsidiaries without incurring any Massachusetts tax liability. Typically, the cash received in the sale was loaned to affiliates to generate further savings.

[67]830 CMR 63.32B.1(6)(c)(4).

[68]That could be the case because the trust was an exempt MBT holding company or because it apportioned some or all of its income out of Massachusetts, for example. *See* G.L. c. 62, section 8(b), before amendment by 2004 Mass. Acts. c. 262 section 13; 830 CMR 62.8.2(3)(d).

[69]830 CMR 63.32B.1(6)(c)(4); G.L. c. 63, section 38(a)(1).

[70]830 CMR 63.32B.1(6)(c)(4). This would seem to be the sort of presumption that cannot be overcome.

[71]G.L. c. 52A(a)(b); 830 CMR 63.32B.1(6)(c)(4).

[72]*Id.*

[73]It is interesting that no similar rule is articulated for financial institutions, which are generally entitled to a 95 percent DRD for dividends received from a 15 percent or more owned "institution." G.L. c. 63, section 1. By its silence on the point, the DOR seems to concede here that financial institutions are entitled to the DRD even if the payer does not technically qualify as a "financial institution" within the meaning of G.L. c. 63, section 1.

(Footnote continued in next column.)

[74]830 CMR 63.32B.1(6)(c)(4).

[75]830 CMR 63.32B.1(6)(c)(5).

[76]830 CMR 63.32B.1(6)(c)(5)(a)-(c).

[77]830 CMR 63.32B.1(6)(c)(7).

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The regulation implies that capital gains and losses can be netted only if they result from disposition of an asset used in the same unitary business.[78]

Basis in Subsidiaries

Perhaps the most significant single gap in coverage within the regulation is its failure to address basis in the stock of subsidiaries in a unitary context.

> ***Perhaps the most significant single gap in coverage within the regulation is its failure to address basis in the stock of subsidiaries in a unitary context.***

In principle, it would seem that rules similar to those set forth in the IRC section 1502 regulations at -32 should be applied for those purposes,[79] but unitary states do not always take that approach.[80]

Apportionment of Unitary Business Income

Approximately one-third of the regulation explains the apportionment of income among members combined group. The accompanying examples illustrate how different apportionment formulas continue to apply on a separate-entity basis. For example, general business corporations remain subject to three-factor, double-weighted sales factor apportionment; manufacturing corporations and mutual fund service corporations (to the extent of their mutual fund sales businesses) remain subject to single-sales-factor apportionment; and financial institutions remain subject to three-factor apportionment with unique sourcing rules.[81] The examples also illustrate some additional sources of complexity, including so-called Finnigan adjustments, the effect of intercompany transactions on the qualifications of manufacturing corporations, the apportionment of Massachusetts-source income to nonresident S corporation shareholders, and some provisions intended to dampen the effect of a financial institution's inclusion within a combined group.[82] The apportionment examples do not illustrate throwback sales, partnership factors, affiliated group elections, or worldwide elections, although the regulation otherwise addresses each of those. Each of the examples assumes that the members are engaged in a unitary business.[83]

Basic Rules

In general, a taxable member's net income from the combined group's unitary business activities is the product of its separately determined apportionment percentage times the combined group's taxable income.[84] The tax is the product of each taxable member's net income times its separately determined tax rate.[85] For that purpose, each taxable member separately determines the numerators of its applicable apportionment factors, adding to its sales factor numerator a pro rata portion of the aggregate sales factor numerators of the nontaxable members in the group (the so-called Finnigan adjustment).[86] The denominators of the applicable apportionment factors include the aggregate property, payroll, and sales factor denominators, respectively, of the corporations in the combined group, including both the hypothetical denominators of nontaxable members, and the property and payroll denominators of members that are actually or hypothetically subject to single-sales-factor apportionment. Consistent with the Finnigan approach, for purposes of determining whether sales to purchasers are sourced to Massachusetts under the throwback rule, a taxable member is considered taxable in any state in which any member of its combined group is subject to tax on income derived from the group's unitary business.[87]

An example in the regulation illustrates the separately determined apportionment percentage of different types of corporations and a Finnigan adjustment.[88] As a manufacturing corporation, Member X computes its apportioned income by applying single-sales-factor apportionment to the combined group's taxable income. Member Y, by contrast, is a general

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[78]830 CMR 63.32B.1(6)(c)(8).

[79]*See* Joseph X. Donovan, "What Is Massachusetts Corporate Tax Basis?" *State Tax Notes*, Apr. 9, 2007, p. 104, *Doc 2007-5955*, or *2007 STT 69-1* (discussing whether basis in subsidiaries should have been adjusted under pre-2009 Massachusetts law in accordance with the IRC section 1502 regulations at -32).

[80]*See* 18 CCR 25106.5-1(d)(3).

[81]G.L. c. 63, section 38(c) and 830 CMR 63.32B.1(7)(k), examples 1-7 (general business corporations); G.L. c. 63, section 38(l)(2) and 830 CMR 63.32B.1(7)(k), examples 3 (p. 429) and 5 (p. 431) (manufacturing corporations); G.L. c. 63, section 38(m)(2) and 830 CMR 63.32B.1(7)(k), Example 7 (p. 432) (mutual fund service corporations); G.L. c. 63, section 2A(b) and 830 CMR 63.32B.1(7)(k), Example 4 (p. 430) (financial institutions).

[82]830 CMR 63.32B.1(7)(k), examples 2, 3 and 7 (Finnigan); 830 CMR 63.32B.1(7)(g)(2), examples 1 and 2 (substantiality of manufacturing); 830 CMR 63.32B.1(7)(k), Example 5 (S corporation shareholders); 830 CMR 63.32B.1(7)(k), Example 4 (financial institutions).

[83]Four of the examples are reproduced in full and three examples are provided in summary form at the end of this article, with citations to where they appear in the regulation.

[84]830 CMR 63.32B.1(7)(a).

[85]830 CMR 63.32B.1(1)(c)(1).

[86]830 CMR 63.32B.1(7)(b).

[87]830 CMR 63.32B.1(7)(c).

[88]830 CMR 63.32B.1(7)(k), Example 3 (building on examples 1 and 2).

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business corporation that applies a three-factor, double-weighted sales factor apportionment percentage. The two corporations' sales factor numerators each include a pro rata portion of the $1 million of Massachusetts sales attributable to Member Z, which has no nexus with Massachusetts.

Financial Institutions and Nonfinancial Institutions

When the combined group includes a financial institution and another type of corporation, the regulation modifies the otherwise applicable apportionment methods "to provide more consistent methodology in the determination of apportionment factors." Specifically, financial institutions reduce the intangible property component of their property numerators and denominators by 80 percent, which may significantly reduce the group's aggregate property factor denominator.[89] Also, the other members of the combined group must increase their sales factor numerators and denominators as though they were subject to the financial institution apportionment rules and include some interest and other receipts in their sales factors.[90] Finally, sales receipts from goodwill and other intangibles are excluded from the combined group's aggregate sales factor numerator and denominator.[91]

An example in the regulation illustrates the computation of apportionment factors for a group that includes a financial institution and two general business corporations.[92] As a financial institution, Member X computes its apportioned income by applying its three-factor apportionment percentage to the combined group's taxable income, and applies a 10.5 percent tax rate to compute its tax. Member Y is a general business corporation that applies a three-factor, double-weighted sales factor apportionment percentage and the general 9.5 percent tax rate.

Member X has $100 million of intangible property, $20 million of which is apparently sourced to Massachusetts. For that reason, Member X reduces its property numerator by $16 million (80 percent of $20 million) and its property denominator by $80 million (80 percent of $100 million). For its part, Member Y increases its sales factor numerator and denominator by $500,000 and $1 million, respectively, to reflect sales amounts that would have been included if Member Y were subject to the financial institution apportionment rules.

S Corporations

An example in the regulation illustrates the differing apportionment methods for S corporations that are subject to "sting tax" on their share of a combined group's apportionable income, and for nonresident shareholders whose distributive shares of the S corporation's Massachusetts-source income are subject to tax.[93] As a manufacturing corporation, Member S1 computes its apportioned income by applying single-sales-factor apportionment to the combined group's taxable income. Member S2, by contrast, is a general business corporation that applies a three-factor, double-weighted sales factor apportionment percentage.

For purposes of apportioning income subject to the entity-level sting tax, the denominators of the applicable apportionment factors include the aggregate property, payroll, and sales factor denominators, respectively, of the corporations in the combined group. By contrast, for purposes of apportioning the nonresident shareholder's Massachusetts-source income, each S corporation uses its own factor denominators and presumably its own income base.[94]

Mutual Fund Service Corporations

For apportionment purposes, a mutual fund service corporation (an MFSC) that has income from both mutual fund services and other activities is treated as two separate members, one with a mutual fund sales business and one with a nonmutual fund sales business, each having its own apportionment percentage based on its own apportionment factors and method. The regulation provides an example of that type of computation.[95]

Intercompany Transactions

The regulation provides that intragroup transactions related to the unitary business are generally disregarded, as are related transactions between a combined group member and a partnership whose

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[89]830 CMR 63.32B.1(7)(h)(1).

[90]830 CMR 63.32B.1(7)(h)(2).

[91]830 CMR 63.32B.1(7)(h)(3). G.L. c. 63, section 32B(d)(2)(ii).

[92]830 CMR 63.32B.1(7)(k), Example 4.

[93]830 CMR 63.32B.1(7)(k), Example 5.

[94]G.L. c. 62, section 5A(b) (directing the commissioner to "adopt regulations providing for the method of determining the items and amounts of Massachusetts gross income derived from sources within the commonwealth by a nonresident, based upon the method set forth in [G.L. c. 63, section 38] or upon any other reasonable method").

[95]830 CMR 63.32B.1(7)(k), Example 7. Query whether MFSCs are combinable corporations at all. The argument to the contrary is that the MFSC apportionment rules in G.L. c. 63, section 38 call for the segregation of MFSC income into mutual fund and nonmutual fund income, and the MFSC apportionment regulation interprets the statutory provision as requiring an allocation of expenses as between the mutual fund and nonmutual fund divisions of such a corporation — effectively, a separate accounting approach that is fundamentally inconsistent with a unitary regime. G.L. c. 63, 38(c), (m); 830 CMR 63.38.1(1)(c)(2). The DOR will no doubt argue that its new rules trump the MFSC apportionment regulation, and that the statutory rule in section 38 is neutral as between separate accounting and treating each division as a separate member.

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income is included in the group's unitary business.[96] Nevertheless, while intercompany sales are generally disregarded for sales factor purposes, special rules intended to "avoid distortion of applicable apportionment formulas" apply in the case of intragroup sales of manufactured products. As explained below, those rules may affect a corporation's eligibility for single-sales-factor apportionment, in the case of a combined group member that makes sales outside the group. They may also affect the group members' sales apportionment percentages.

In general, a combined group member reduces its sales factor by the amount of manufactured property that it sells to another group member, and it makes comparable reductions to its property and payroll factors.[97] For purposes of single-sales-factor apportionment, the combined group member that acquires such property and sells it outside the group, combines its property, payroll, and receipts with a prorated portion of the manufacturing-related property and payroll of the group member from which it acquired the property.[98]

The regulation provides three examples that illustrate the effect of those intercompany transactions on a member's apportionment percentage. [99] In each example, Member A manufactures property and sells at least some of it to Member B, which then resells the property to a party outside the combined group. In each example, a portion of Member A's property and payroll are attributed to Member B. Also, the adjustments to Member A's sales affect its sales factor and, hence, its own apportionment percentage as a manufacturing corporation. For convenience of reference, the last example at the end of this article summarizes the three examples in the regulation, assuming for the sake of simplicity that all sales outside the combined group are to Massachusetts customers.

The regulation also includes provisions intended to prevent potential distortion of the property and payroll factors via factor "shifting." For example, wages paid to an employee are to be included in the payroll factor of the group member for whom the employee is providing actual services, and intercompany leases of employees are disregarded for purposes of the payroll factor.[100]

For property factor purposes, lease payments to a nongroup member are similarly attributed to the group member making actual use of the leased property, to the extent of that actual use.[101] The wage and property attribution rules have the ironic effect of creating fertile ground for DOR auditors — in a unitary system intended to treat related corporations as if they were one — to examine factors on a separate-company basis and move them from one company to another. The shift can make a profound difference in tax liability, even under combined reporting, because of the disparate apportionment regimes that have been retained on a separate-company basis.

Also, leases between group members are generally disregarded for purposes of the property factor, except that the property is included in the property factor of the combined group lessee, to the extent of its actual use of the property, at eight times the net annual rent; and the owner, at the property's original cost, reduced (but not below zero) by the dollar amounts included in the numerator or denominator, respectively, of lessee members within the combined group. Those adjustments are illustrated in the following example:

Corporation	**A**	**B**
Real Property Interest	Lessor	Lessee
Original Cost/ Fair Market Annual Rent	$10,000,000	$250,000
MA Property (building)	$10,000,000	$0
Adjustment for Intragroup Lease	($2,000,000)	$2,000,000
Adjusted Property Factor Numerator Values	$8,000,000	$2,000,000

The regulation provides that the intragroup rental of property shall be at fair market value for purposes of determining the property factors of the lessor and the lessee.

Treatment of NOLs and Credits

The Tax Study Commission considered whether restrictions under old law on the intragroup use of tax attributes would make sense under a unitary regime. The consensus of the commission was that NOLs and credits should be broadly available within a group, because in a unitary system, for apportionment purposes, a group is considered in rough terms as if it were a single taxpayer.[102]

[96]830 CMR 63.32B.1(7)(g).

[97]830 CMR 63.32B.1(7)(g)(2).

[98]Generally, a corporation will be a manufacturer if any one of four numerical tests, each based roughly on one or more apportionment factors, is met. 830 CMR 58.2.1(6)(d). Thus, determining the seller's apportionment factors by adding a prorated portion of the manufacturing-related receipts, property, and payroll to the seller's own may enable the seller to qualify as a manufacturing corporation for single-sales-factor purposes.

[99]830 CMR 63.32B.1(7)(g)(2)(c), (d), and (e).

[100]830 CMR 63.32B.1(7)(g)(3).

[101]830 CMR 63.32B.1(7)(g)(4).

[102]*See* "Study Commission Report," *supra* note 3 at Part II, appendices K and T.

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The unitary law as enacted reflects this consensus, but with some caveats. It directs the DOR to clarify the sharing of attributes as follows:

> The commissioner shall adopt regulations to implement [section 32B] and to coordinate [its] application with the other provisions of this chapter. The regulations shall include rules to address without limitation, the following: . . . (ii) 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 of the combined group is consistent with the statutory requirements for claiming such credits, taking into account the nature of such member's business and related activities; (iii) the application of any carry forwards, including the sharing of any net operating loss or tax credit carry forwards that are attributable to the activities of the combined group's unitary business, but the carry forward of losses, credits or other tax benefits that arise before the effective date of this section shall be available only to the extent permitted by law as in effect before the effective date.[103]

The parts of the regulation that implement this subsection alter the rules for use of NOLs and credits in fundamental ways. For example, as the statute suggests, in the case of both NOLs and credits, even after the combined reporting regime takes effect, the rules differ depending on whether a loss or credit arose before or after the effective date of the act.

NOLs Arising After the New Law Takes Effect

For tax years beginning on or after January 1, 2009, a taxable member of a combined return group can carry forward an NOL for five years as provided in G.L. c. 63, section 30.5, and it must first use those losses against the income attributed to it in the combined return before sharing it with other group members.[104] As under existing law, neither a financial institution nor a utility corporation can carry forward an NOL.[105]

Under the regulation, postapportionment losses are carried forward for use in the combined return.[106] Historically, in Massachusetts, losses have been carried forward on a preapportionment basis. Nothing in the combined reporting statute specifically authorizes departure from the old approach, but apparently the DOR considers the new approach more appropriate in a unitary environment.[107]

Any loss remaining after separate-company use may be shared with other group members, but only if they are not financial institutions or utility corporations, and only if they were members of the same combined return group during the year in which the loss was generated.[108] The other group members must use their own NOLs before using a shared NOL. The shared NOL is used by each other member in the same proportion that its own income, after absorption of its own separate-company NOLs, bears to the total of such income for all companies that share the NOL.[109]

If there is a loss remaining after sharing within the group, it continues to be attributed to the company that generated it for purposes of computing carryforwards.[110] If that member leaves the group, it takes the carryforward with it for use against the income that it subsequently generates, but it may share the carryforward with a member of the new group only if it too was a member of the old group in the year in which the loss was generated.[111]

The regulation holds to the DOR's long-standing but dubious position that the principles of IRC section 381, which permits tax attributes to survive some structural changes within a commonly controlled group, are not applied in Massachusetts,[112] but the principles of IRC section 382, which limits the use of losses of acquired companies, are followed.[113] We suggest that, with the movement to combined reporting, the premise for nonconformity

[103]G.L. c. 63, section 32B(f).

[104]830 CMR 63.32B.1(8)(a).

[105]*Id. See* G.L. c. 63, sections 1, 52A(1)(b)(ii) (definitions of net income).

[106]830 CMR 63.32B.1(8)(a).

[107]It is unclear whether the DOR will move from pre- to postapportionment loss use for companies that file separately, and not as part of a combined return. On the one hand, nothing has changed in the statutory NOL rules that would authorize such a shift; on the other hand, it would seem dubious to have differing rules depending on whether a company is filing as part of a unitary group.

[108]830 CMR 63.32B.1(8)(b)(i).

[109]830 CMR 63.32B.1(8)(b)(ii).

[110]830 CMR 63.32B.1(8)(c).

[111]*Id*.

[112]*Id.*; *see Macy's East, Inc. v. Commissioner of Revenue*, 441 Mass. 797 (2004), *cert. den.*, 543 U.S. 957. Reorganizations governed by section 368(a)(1)(F) of the code are excepted from that rule. *See* Massachusetts Letter Ruling 95-4. (For the decision, see *Doc 2004-22452* or *2004 STT 106-13*.)

[113]830 CMR 63.32B.1(8)(c). *See* 830 CMR 63.30.2(11)(b).

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to IRC section 381 in Massachusetts has been undermined, and the liquidation of a subsidiary with losses, for example, should not by itself extinguish those losses.[114]

NOLs Arising Before the New Law Takes Effect

Under Massachusetts law before the adoption of combined reporting, loss carryforwards could be used only by the company that generated the loss.[115] That rule will be retained for losses incurred before the new law takes effect, so as to limit use within a combined return group.[116] Further, taxpayers will be required to go back to the year in which a loss was incurred and recompute the loss on a postapportionment basis before carrying it forward for application against the income attributed to the company that generated it.[117]

Carryforwards From Years Before Inclusion In a Combined Group

As for NOLs arising before combined reporting became law, carryforwards for years before inclusion in a combined group must be recomputed on a postapportionment basis.[118]

Precombination Limitation

In any case in which a company is bringing forward a loss from a precombination year, either because the loss arose in a tax year beginning before January 1, 2009, or because it arose before the company was a member of the group, the company must compute a special limitation on the use of the carryforward. The limitation is computed by applying to the current-year combined group income an apportionment factor computed by using average numerators for the years in which the loss was incurred, weighted by the losses in each year, and denominators that are simply the current-year group denominators.[119] It is unclear to the authors why the DOR has set up that special limitation, rather than simply to say that in those circumstances the company's loss can be used to offset only the income that is attributed to it in the year in which the loss is used. The special limitation is unfair to any taxpayer in a growing business, because the numerators will be historical and therefore relatively smaller than the current denominators, for no reason other than the growth of the business.

The regulation provides that the commissioner may disregard material transactions among affiliated entities on or after November 1, 2008, to the extent that they would affect the limitation.[120]

Credits Generally

Before the adoption of unitary combination, there were significant restrictions on the use of credits within a Massachusetts combined return group. While the Massachusetts research and development credit has been computed on an aggregate basis and generally has been available to offset the tax attributable to all of the members of the group,[121] other commonly available credits, including the 3 percent investment tax credit (ITC) allowed to manufacturers and research and development corporations,[122] could not be shared, even by other members that themselves qualified to generate such credits.[123]

Under the new regime, an ITC that is generated for a tax year beginning on or after January 1, 2009, may be applied against the tax due from other members if the property generating the ITC is used in the group's unitary business[124] and the other members qualify to generate ITC.[125]

When a credit can be shared, it must first be applied against the excise of the taxpayer that generated it.[126]

Under the Massachusetts research and development credit statute, a company with an R&D credit can use it to absorb the first $25,000 of its tax liability and 75 percent of the remainder,[127] but the credit cannot reduce the corporate excise below the $456 statutory minimum.[128] The regulation explains in an example that the $25,000 amount is spread

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[114]Note that the opinion of the Supreme Judicial Court in *Macy's East, supra,* explained its blessing of the DOR's position as follows:

> The [Appellate Tax] board correctly concluded that the "commissioner's regulation was a reasonable interpretation of the corresponding statutory provisions, . . . and that the regulation's 'denial of the deductions at issue is consistent with the complete body of Massachusetts tax law, namely the statutes and cases interpreting those statutes, which establishes the Commonwealth's corporate tax structure as adopting an individual-entity approach.'" (Citation omitted.)

[115]*See* 830 CMR 63.32B.1, Example 8, before amendment. *See also NYNEX Corp. v. Commissioner of Revenue*, 61 Mass. App. Ct. 575 (2004). This rule does not apply to so-called start-up NOLs, but those NOLs are not available to subsidiary corporations or to corporations that have been in existence for more than five years. G.L. c. 63, section 30(5)(c); *see* 830 CMR 63.32B.1, Example 6, before amendment. (For the decision in *NYNEX*, see *Doc 2004-16176* or *2004 STT 155-12*.)

[116]830 CMR 63.32B.1(8)(d); 830 CMR 63.32B.1(8)(g), Example 3.

[117]830 CMR 63.32B.1(8)(d).

[118]830 CMR 63.32B.1(8)(e).

[119]830 CMR 63.32B.1(8)(f).

[120]*Id.*

[121]G.L. c. 63, section 38M(e).

[122]G.L. c. 63, section 31A.

[123]G.L. c. 63, section 31A(h).

[124]This condition does not have to be met if the affiliated group election has been made. 830 CMR 63.32B.1(9)(a).

[125]830 CMR 63.32B.1(9)(a).

[126]830 CMR 63.32B.1(9)(b).

[127]G.L. c. 63, section 38M(d).

[128]G.L. c. 63, section 38M(c).

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among members of a combined group in proportion to their individual excises before credits. Thus, if the precredit excises of companies X, Y, and Z are $10,000, $20,000, and $10,000, respectively, $6,250 of the $25,000 amount is allocated to companies X and Z and $12,500 to Company Y.[129]

A different example in the regulation implies that once the corporation that generated an R&D credit has used a carryforward to reduce its excise to the extent permissible, the excess can all be taken by a single other member of the group, or it can be shared among the other members, as the taxpayer prefers.[130]

Carryforward of Post-2008 Credits

When a taxpayer generates a credit for a tax year beginning on or after January 1, 2009, it may carry forward the portion of the credit that is not taken by any group member, but the carryforward may be shared only with a member of the current group that was a member of the taxpayer's combined group during the year that the credit was generated or is a successor to such a member "such that there is 100% continuity of ownership as between the successor corporation and one or more corporations that were in the combined group during such prior year."[131] A credit carryforward is first used against the tax attributable to the corporation that generated it, and then shared with other group members, subject to the same constraints that apply to credits generated in the current year.[132]

Carryforward of Pre-2009 Credits

For credits generated before 2009, the regulation provides that carryforwards may be applied "consistent with the statutory rules that applied . . . in the year the credit was generated."[133] For example, since investment credits were not sharable within a group, ITCs generated before 2009 cannot be shared in a combined return even among companies qualified to generate ITC.[134]

In some respects, though, the regulation is more restrictive than "the statutory rules that applied in the year that the credit was generated." It provides, for example, that R&D credits generated before 2009 may be shared in a combined return only if, in the year the credits were generated, the sharing corporations participated in a preunitary combined return.[135] In fact, in years before 2009, R&D credits generated by a stand-alone corporation could be carried forward and applied against the excise of other group members after the generating taxpayer became a member of the group.[136]

Treatment of Credits When a Taxpayer Leaves the Group

When a member of a combined group ceases to be a member, any credit carryforward owned by the taxpayer is no longer available for use by the other members.[137] If the taxpayer becomes a member of a new group, it may not share the credit unless one of the members of the new group was also a member of the old group when the credit was generated and the other conditions for sharing the credit are met.[138]

The regulation provides that the postacquisition limits on credit use set forth in IRC section 383 "may apply," but that if a member liquidates or terminates as a result of a merger or consolidation, a credit carryforward will be lost.[139]

Recapture of Credits

When a Massachusetts credit like an ITC is subject to recapture, if the credit is generated in a tax year beginning on or after January 1, 2009, and the property that generated the credit is transferred to another member of the unitary group that is entitled to share the credit, the transfer will not be considered a recapture event.[140] If a corporation sells property whose post-2008 acquisition generated a credit to an affiliate that was not a member of the same unitary group in the acquisition year, the transfer will be considered a recapture event.[141]

When recapture of credits generated in post-2008 years does apply, the member that acquired the property bears the entire recapture tax, even the amount attributable to credits used to reduce the tax

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[129]*See* 830 CMR 63.32B.1(9)(b), Example 1.

[130]*See* 830 CMR 63.32B.1(9)(c)(ii), Example 5.

[131]830 CMR 63.32B.1(9)(c)(i). Thus, if a member of a group that has three divisions contributes one of the divisions to a new, wholly owned subsidiary, the subsidiary may share in the use of credits to the same extent that its parent could have had the subsidiary not been created. *See* 830 CMR 63.32B.1(9)(c)(i), Example 3.

[132]830 CMR 63.32B.1(9)(c)(i).

[133]830 CMR 63.32B.1(9)(c)(ii).

[134]*Id.*

[135]*Id.*

[136]*See* 830 CMR 63.38M.1(12)(c), which provides that "members of combined groups may share the credit . . . regardless of whether the group filed a combined return for the taxable year in which the credit was generated." We see no reason why the move to a unitary system should change this result.

[137]830 CMR 63.32B.1(9)(d).

[138]*Id.*

[139]*Id*. As is noted above regarding IRC section 382, it seems plainly inconsistent for the DOR to piggyback on the taxpayer-unfriendly rules of section 383, while decoupling from the taxpayer-friendly rules of section 381. *See supra* note 114.

[140]830 CMR 63.32B.1(9)(e). This rule seems to imply that if there is a transfer within the unitary group and the credit was generated in years before 2009, the transfer may generate recapture. As a matter of policy, that result seems to be wrong, because the group in 2009 and thereafter is equally unitary and therefore should be treated as a single taxpayer regardless of whether the property was acquired post-2008.

[141]*See* 830 CMR 63.32B.1(9)(e), Example 9.

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of other members, and even if, in the recapture year, the generating corporation has left the group.[142]

Recommended Changes and Additions

We close our review with a summary of the recommendations that appear earlier in this article for improving the draft regulation:

- amend the regulation to exclude TRSs from combination with their parent REITs;
- specify what attribution rules apply for purposes of determining 50 percent common ownership;
- specify whether in all cases corporations that have participated in a worldwide election or a Massachusetts affiliated group election escape the consequences of the election if they leave the group;
- clarify the rule that includes in the water's-edge group and the Massachusetts affiliated group the income and apportionment factors of foreign corporations earning more than 20 percent of their income from certain intercompany transactions only to the extent of such income and factors;
- clarify the document-production burdens placed on corporations that make either a Massachusetts affiliated group or worldwide election;
- clarify whether an intercompany elimination is allowed for dividends received by a utility company from a nonutility company;
- clarify whether an intercompany elimination is allowed for dividends received by a financial institution from a nonfinancial institution;
- clarify whether capital gains and losses may be netted only if they result from disposition of an asset used in the same unitary business;
- address basis in the stock of subsidiaries in a unitary context;
- conform to IRC section 381;
- in fairness to growing businesses, amend the regulation to provide that when a company brings forward a loss from a precombination year, the loss can be used to offset the income attributable to it in the year in which the loss is used, in lieu of the special limitation that now appears in the draft regulation; and
- amend the regulation to remove the new prohibition on the sharing within a combined group of R&D credits of a company that was not part of the group when the credit was generated.

(Examples begin on the next page.)

[142]830 CMR 63.32B.1(9)(e).

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830 CMR 63.32B.1(7)(k), Example 3
Manufacturing Corporation and General Business Corporations

Assumptions	**Member X**	**Member Y**	**Member Z**	
Nexus in Massachusetts	Yes	Yes	No	
Classification	Manuf. Corp	Bus. Corp	Bus. Corp	
Combined Group's Apportionable Taxable Income	$100,000			
Member's Apportionment Information	**Member X**	**Member Y**	**Member Z**	**Total**
Massachusetts Property	$5,000,000	$1,000,000		
Everywhere Property	$17,000,000	$1,000,000	$2,000,000	$20,000,000
Massachusetts Payroll	$1,000,000	$5,000,000		
Everywhere Payroll	$2,000,000	$5,000,000	$1,000,000	$8,000,000
Massachusetts Sales	$5,000,000	$1,000,000	$1,000,000	
Everywhere Sales	$10,000,000	$3,000,000	$2,000,000	$15,000,000
Finnigan Adjustment	Yes			
Total Nexus Member Massachusetts Sales	$6,000,000			
Taxable Member's Adjustment Fraction	83.33%	16.67%	n/a	
Taxable Member's Share of Nontaxable Member's Sales	$833,333	$166,667	n/a	$1,000,000
Apportionment Factor Computation	**Member X**	**Member Y**	**Member Z**	
Property Numerator	n/a	$1,000,000	n/a	
Property Denominator	n/a	$20,000,000	n/a	
Property Factor	n/a	5.00%	n/a	
Payroll Numerator	n/a	$5,000,000	n/a	
Payroll Denominator	n/a	$8,000,000	n/a	
Payroll Factor	n/a	62.50%	n/a	
Sales Numerator	$5,833,333	$1,166,667	n/a	
Sales Denominator	$15,000,000	$15,000,000	n/a	
Sales Factor	38.89%	7.78%	n/a	
Tax Determination Under Chapter 63	**Member X**	**Member Y**	**Member Z**	**Total**
Apportionment Percentage	38.89%	20.76%	n/a	
Combined Group's Taxable Income	$100,000	$100,000	n/a	
Apportioned Income	$38,890	$20,760	n/a	
Tax rate	9.50%	9.50%	n/a	
Tax	$3,695	$1,972	n/a	$5,667

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830 CMR 63.32B.1(7)(k), Example 4
Financial Institution and General Business Corporations

Assumptions	Member X	Member Y	Member Z	
Nexus in Massachusetts	Yes	Yes	No	
Classification	Fin. Inst.	Bus. Corp	Bus. Corp	
C Corporation or S Corporation	C Corp	C Corp	C Corp	
Combined Group's Apportionable Taxable Income	$100,000			
Combined Group's Gross Receipts (if any S Corp)	n/a			
Member's Apportionment Information	**Member X**	**Member Y**	**Member Z**	**Total**
Massachusetts Property	$20,000,000	$2,000,000		
Massachusetts Property Adjusted (Less 80% Fin. Inst. Intangibles)	$4,000,000	$2,000,000		
Everywhere Property	$105,000,000	$2,000,000	$3,000,000	$110,000,000
Everywhere Property Adjusted (Less 80% Fin. Inst. Int.)	$25,000,000	$2,000,000	$3,000,000	$30,000,000
Massachusetts Payroll	$1,000,000	$5,000,000		
Everywhere Payroll	$2,000,000	$5,000,000	$1,000,000	$8,000,000
Massachusetts Sales	$5,000,000	$1,000,000		
Massachusetts Sales Adjusted (hypothetical Fin. Inst.)	$5,000,000	$1,500,000	$6,500,000	
Everywhere Sales	$10,000,000	$3,000,000	$2,000,000	$15,000,000
Everywhere Sales Adjusted (hypothetical Fin. Inst.)	$10,000,000	$4,000,000	$2,000,000	$16,000,000
Apportionment Factor Computation	**Member X**	**Member Y**	**Member Z**	
Property Numerator	$4,000,000	$2,000,000	n/a	
Property Denominator	$30,000,000	$30,000,000	n/a	
Property Factor	13.33%	6.67%	n/a	
Payroll Numerator	$1,000,000	$5,000,000	n/a	
Payroll Denominator	$8,000,000	$8,000,000	n/a	
Payroll Factor	12.50%	62.50%	n/a	
Sales Numerator	$5,000,000	$1,500,000	n/a	
Sales Denominator	$16,000,000	$16,000,000	n/a	
Sales Factor	31.25%	9.38%	n/a	
Tax Determination Under Chapter 63	**Member X**	**Member Y**	**Member Z**	**Total**
Apportionment Percentage	19.03%	21.98%	n/a	
Combined Group's Taxable Income	$100,000	$100,000	n/a	
Apportioned Income	$19,030	$21,980	n/a	
Tax rate	10.50%	9.50%	n/a	
Tax	$1,998	$2,088	n/a	$4,086

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830 CMR 63.32B.1(7)(k), Example 5
S Corporation With Nonresident Shareholder

Assumptions	**Member S1**	**Member S2**	**Member C**	
Nexus in Massachusetts	Yes	Yes	Yes	
Classification	Manuf. Corp	Bus. Corp	Bus. Corp	
C Corporation or S Corporation	S Corp	S Corp	C Corp	
Combined Group's Apportionable Taxable Income	$4,000,000			
Combined Group's Gross Receipts (if any S Corp.)	$9,000,000			
Member's Apportionment Information	**Member S1**	**Member S2**	**Member C**	**Total**
Massachusetts Property	$20,000,000	$12,000,000	$4,000,000	
Everywhere Property	$60,000,000	$24,000,000	$20,000,000	$104,000,000
Massachusetts Payroll	$1,000,000	$5,000,000	$100,000	
Everywhere Payroll	$2,000,000	$5,000,000	$2,000,000	$9,000,000
Massachusetts Sales	$15,000,000	$6,000,000	$1,000,000	
Everywhere Sales	$30,000,000	$10,000,000	$20,000,000	$60,000,000
Apportionment Factor Computation	**Member S1**	**Member S2**	**Member C**	
Property Numerator	n/a	$12,000,000	$4,000,000	
Property Denominator	n/a	$104,000,000	$104,000,000	
Property Factor	n/a	11.54%	3.85%	
Payroll Numerator	n/a	$5,000,000	$100,000	
Payroll Denominator	n/a	$9,000,000	$9,000,000	
Payroll Factor	n/a	55.56%	1.11%	
Sales Numerator	$15,000,000	$6,000,000	$1,000,000	
Sales Denominator	$60,000,000	$60,000,000	$60,000,000	
Sales Factor	25.00%	10.00%	1.67%	
Apportionment Percentage	25.00%	21.77%	2.07%	
Apportionment to Nonresidents Under Ch. 62	**Member S1**	**Member S2**	**Member C**	
Property Numerator	n/a	$12,000,000	n/a	
Property Denominator	n/a	$24,000,000	n/a	
Property Factor	n/a	50.00%	n/a	
Payroll Numerator	n/a	$5,000,000	n/a	
Payroll Denominator	n/a	$5,000,000	n/a	
Payroll Factor	n/a	100.00%	n/a	
Sales Numerator	$15,000,000	$6,000,000	n/a	
Sales Denominator	$30,000,000	$10,000,000	n/a	
Sales Factor	50.00%	60.00%	n/a	
Apportionment Percentage	50.00%	67.50%	n/a	

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830 CMR 63.32B.1(7)(k), Example 7
Mutual Fund Service Corporation

Assumptions	**Member X**	**Member Y**	**Member Z**
Nexus in Massachusetts	Yes	Yes	No
Classification	Mut. Fund	Bus. Corp	Bus. Corp
Combined Group's Apportionable Taxable Income	$100,000		

Member's Apportionment Information	**Member X** Mut. Fund	**Member X** Other Sales	**Member Y**	**Member Z**	**Total**
Massachusetts Property	$3,000,000	$2,000,000	$1,000,000		
Everywhere Property	$15,000,000	$2,000,000	$1,000,000	$2,000,000	$20,000,000
Massachusetts Payroll	$850,000	$150,000	$5,000,000	$100,000	
Everywhere Payroll	$1,600,000	$400,000	$5,000,000	$1,000,000	$8,000,000
Massachusetts Sales	$4,000,000	$1,000,000	$1,000,000	$1,000,000	
Everywhere Sales	$8,000,000	$2,000,000	$3,000,000	$2,000,000	$15,000,000
Finnigan Adjustment	Yes				
Total Nexus Member Massachusetts Sales	$6,000,000				
Taxable Member's Adjustment Fraction	66.67%	16.67%	16.67%	n/a	
Taxable Member's Share of Nontaxable Member's Sales	$666,667	$166,667	$166,667	n/a	$1,000,000

Apportionment Factor Computation	**Member X**	**Member X** Mut. Fund	**Member Y** Other Sales	**Member Z**
Property Numerator	n/a	$2,000,000	$1,000,000	n/a
Property Denominator	n/a	$20,000,000	$20,000,000	n/a
Property Factor	n/a	10.00%	5.00%	n/a
Payroll Numerator	n/a	$150,000	$5,000,000	n/a
Payroll Denominator	n/a	$8,000,000	$8,000,000	n/a
Payroll Factor	n/a	1.88%	62.50%	n/a
Sales Numerator	$4,666,667	$1,166,667	$1,166,667	n/a
Sales Denominator	$15,000,000	$15,000,000	$15,000,000	n/a
Sales Factor	31.11%	7.78%	7.78%	n/a

Tax Determination Under Chapter 63	**Member X** Mut. Fund	**Member X** Other Sales	**Member Y**	**Member Z**	**Total**
Apportionment Percentage	31.11%	6.86%	20.76%	n/a	
Combined Group's Taxable Income	$100,000	$100,000	$100,000	n/a	
Apportioned Income	$31,110	$6,860	$20,760	n/a	
Tax rate	9.50%	9.50%	9.50%	n/a	
Tax	$2,955	$652	$1,972	n/a	$5,579

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Intragroup Sales of Manufactured Products for Purposes Of Single-Sales-Factor Qualification

Corporation	Example 1 A	Example 1 B	Example 2 A	Example 2 B	Example 3 A	Example 3 B
Nexus in Massachusetts	Yes	Yes	Yes	Yes	No	Yes
Ratio of (i) A's Sales to B to (ii) A's Total Sales	100%		30%		30%	
Massachusetts Property (manufacturing)	$1,000	$0	$1,000	$0	$1,000	$0
Adjustment for Intragroup Sales (manufacturing)	($1,000)	$1,000	($300)	$300	($300)	$300
Massachusetts Property (nonmanufacturing)	$0	$50	$0	$50	$0	$50
Adjusted Property Attributable to Manufacturing	0%	95%	100%	86%	100%	86%
Massachusetts Payroll (manufacturing)	$150	$0	$150	$0	$150	$0
Adjustment for Intragroup Sales (manufacturing)	($150)	$150	($45)	$45	($45)	$45
Massachusetts Payroll (nonmanufacturing)	$0	$150	$0	$150	$0	$150
Adjusted Payroll Attributable to Manufacturing	0%	50%	100%	23%	100%	23%
Massachusetts Sales/Receipts (manufacturing)	$300	$500	$1,000	$500	$1,000	$500
Adjustment for Intragroup Sales (manufacturing)	($300)	$0	($300)	$0	($300)	$0
Massachusetts Sales/Receipts (nonmanufacturing)	$0	$0	$0	$1,500	$0	$1,500
Adjusted Sales/Receipts Attributable to Manufacturing	0%	100%	100%	25%	100%	25%
Finnigan Adjustment						
Nontaxable Members Massachusetts-Source Sales/Receipts	n/a	n/a	n/a	n/a	n/a	$700
Taxable Member's Adjustment Fraction	n/a	n/a	n/a	n/a	n/a	100%
Taxable Member's Share of Nontaxable Member's Sales	n/a	n/a	n/a	n/a	n/a	$700
Sales Summary (Taxable Members)						
Massachusetts Sales (before intragroup and Finnigan adjustments)	$300	$500	$1,000	$2,000		$2,000
Massachusetts Sales (adjusted)	$0	$500	$700	$2,000		$2,700
Sales Factor Denominator	$0	$500	$2,700	$2,700		$2,700
Apportionment Percentage	0%	100%	26%	74%		100%

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