# DEPARTMENT OF TAXATION
# 2020 Fiscal Impact Statement

**1. Patron** Sally L. Hudson

**2. Bill Number** HB 1109

**House of Origin:**
X **Introduced**
____ **Substitute**
____ **Engrossed**

**Second House:**
____ **In Committee**
____ **Substitute**
____ **Enrolled**

**3. Committee** House Finance

**4. Title** Corporate Income Tax; Mandatory Unitary Combined Reporting and Public Disclosure Report

**5. Summary/Purpose:**

This bill would adopt mandatory unitary combined reporting for Virginia income tax purposes. This would require any taxpayer engaged in a unitary business with one or more other corporations to file a combined report that includes the income and apportionment factors of all the affiliates of the taxpayer that are members of the unitary business. In addition, this bill would require corporations to submit a public disclosure report to the Department of Taxation ("the Department") with certain data related to their state taxes, which would be redacted prior to publication.

This portion of this bill adopting mandatory unitary combined reporting for Virginia income tax purposes would be effective for taxable years beginning on or after January 1, 2021.

The portion of this bill requiring a public disclosure report would be effective for taxable years beginning on or after January 1, 2020.

**6. Budget amendment necessary:** Yes.
Item(s): Page 1, Revenue Estimates
Items 282 and 284, Department of Taxation

**7. Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

**7a. Expenditure Impact:**

| *Fiscal Year* | *Dollars* | *Positions* | *Fund* |
|---|---|---|---|
| 2020-21 | $1,063,921 | 4 | GF |
| 2021-22 | $447,923 | 4 | GF |
| 2022-23 | $419,281 | 4 | GF |
| 2023-24 | $419,281 | 4 | GF |
| 2024-25 | $419,281 | 4 | GF |
| 2025-26 | $419,281 | 4 | GF |

## 8. Fiscal implications:

Administrative Costs

The Department would incur estimated administrative costs of $1,063,921 in Fiscal Year 2021; $447,923 in Fiscal Year 2022; and $419,281 in Fiscal Year 2023 and each fiscal year thereafter. These costs include hiring four full-time employees, as well as the costs of updating the Department's forms, systems, and website.

Revenue Impact

This portion of this bill adopting mandatory unitary combined reporting for Virginia income tax purposes would have an unknown and potentially significant positive General Fund revenue impact beginning in Fiscal Year 2021. Developing a reliable revenue impact for adopting unitary combined reporting is significantly limited by insufficient data. Estimating the revenue impact would require information regarding the income, accumulated net operating losses, and apportionment factors of corporations that are not currently required to file income tax returns with Virginia. It would also require information regarding which corporations in an affiliated group are engaged in the same unitary business.

Current Virginia data only identifies subsidiaries that corporations elect to be included in Virginia combined or consolidated returns. For corporations that elect to file on a separate basis, Virginia does not collect information that links related subsidiaries or makes determinations as to whether partially owned subsidiaries meet the requirements to be included in the Virginia combined or consolidated returns.

Although federal tax data may be used to identify ownership of corporations in an affiliated group, and their income, federal returns do not have data on the apportionment factors or the nature of each corporation's business and its functional integration, centralized management and economies of scale that would identify the members of a unitary group. While other states have produced revenue estimates for adopting unitary combined reporting, it is unclear that their methodologies adequately address such concerns.

Based on estimates produced by Maryland relating to the consideration of a unitary combined reporting bill in 2019, the Department estimates that this bill could increase General Fund revenue in an amount ranging between $60 million and $80 million annually. However, this estimate is highly speculative for the reasons stated above. In addition, the 2019 Maryland bill would have adopted unitary combined reporting using the Finnegan method, which is generally thought to raise more revenue than the Joyce method that would be imposed by this bill. Therefore, this estimate may overstate the amount of General Fund revenue gain attributable to this bill.

In addition, certain businesses would benefit from mandatory unitary combined reporting and others would realize an increased Virginia tax liability. This has revenue implications because the Department anticipates that businesses that benefit from this change would comply immediately. In contrast, those with increased tax liabilities may resist to an unknown extent.

The portion of this bill requiring a public disclosure report would have no General Fund revenue impact.

**9. Specific agency or political subdivisions affected:**

Department of Taxation

**10. Technical amendment necessary:** Yes.

The bill text appears to be derived from model legislation developed by the Multistate Tax Commission, but has not been fully adapted to Virginia law. This bill would require that several policy and technical issues are resolved in order to properly implement this bill. The conflicting policy issues include, but are not limited to, the following:

- Virginia has not historically based its allocation and apportionment rules on the distinction between business and non-business income, and Virginia has no definitions in its law for such terms. Instead, *Va. Code* § 58.1-408 et seq. apportions all income other than dividends. Dividends are the only type of income allocated in the *Code of Virginia*. See *Va. Code* § 58.1-407.

- The rolling conformity definition of "Internal Revenue Code" this bill would require conflicts with the fixed date conformity definition used in *Va. Code* § 58.1-301.

- The exclusive use of property, payroll and sales under mandatory combined reporting conflicts with the special formulas that Virginia provides for certain industries.

- The broad discretion under unitary combined reporting conflicts with the restrictive allowance of alternative methods of allocation and apportionment under *Va. Code* § 58.1-420.

In addition, this bill would use the definition of the term “tax haven” that was contained in model legislation originally approved by the MTC on August 17, 2006. That definition relies, in part, on classifications of the Organisation for Economic Co-operation and Development (“OECD”) that are no longer maintained. The MTC amended its model legislation on July 29, 2011 to base its definition on new criteria rather than relying on OECD classifications. Accordingly, the Department recommends that this bill be changed to adopt the definition of “tax haven” in the amended model legislation.

Finally, this bill would require corporations submit public disclosure reports to the Department beginning with Taxable Year 2020. Under current Virginia law, corporations filing on a calendar year basis have until April 15, 2021 to file their Taxable Year 2020 returns. If such corporation files on extension or files on a basis other than a calendar year, its due date will be even later. However, this bill would require the Department and the Tax Commissioner to make available for public inspection a list of all taxpayers who are required to file a public disclosure report by April 1, 2020, and by April 1 of each taxable year thereafter. Because the public disclosure report’s due date is tied to the original due date and that due date is April 15, 2021 for calendar year corporations, it is unclear if the Department would have any data to publish a list on either April 1, 2020 or April 1, 2021.

**11. Other comments:**

<u>Background</u>

When imposing a corporation income tax, a state must provide standards for determining:

- Whether a corporation or any of its affiliates have sufficient nexus with the state to be subject to taxation;
- Which of the state's allocation and apportionment formulas applies to a corporation, and how to apply such formula; and
- How a corporation is to report its income and that of any affiliates to the state.

*Nexus Determination*

Corporations are only subject to a state's corporate income tax if they have sufficient nexus with such state. Nexus occurs when a non-resident entity has sufficient contacts with a state to subject it to income tax. In 1959, Congress enacted Public Law 86-272, which prohibits states from subjecting the sale of tangible personal property to a net income tax where the taxpayer's only business activities within the state during the taxable year are the solicitation of orders by the taxpayer or the taxpayer's representative for the sale of tangible personal property. By the application of Public Law 86-272, such corporations lack nexus with the taxing state. Accordingly, Virginia does not subject a business to its corporate income tax if the only business activities within Virginia are activities protected by Public Law 86-272. In the early 1980s, as an administrative policy, the Department voluntarily extended the protections set forth in Public Law 86-272 to sales of intangible property and services in Virginia.

*Allocation and Apportionment Formulas*

For corporate income tax purposes, multistate corporations are generally required to allocate and apportion income among the various states. Virginia generally requires the Virginia taxable income of a multistate corporation to be apportioned to Virginia by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor, plus twice the sales factor, and the denominator of which is four. No allocation or apportionment is necessary when the entire business of a corporation is conducted or transacted within Virginia.

*Reporting and Filing Methods*

In general, every corporation that is incorporated in Virginia, has registered with the State Corporation Commission for the privilege of conducting business in Virginia, or receives income from Virginia sources is required to file a Virginia corporation income tax return. Virginia allows an affiliated group of corporations to elect to file in one of the following ways: (i) separately, (ii) on a consolidated basis, or (iii) using a Virginia combined return. A group of two or more corporations is considered an "affiliated group" if:

- One corporation owns at least 80 percent of the voting stock of the other or others; or
- At least 80 percent of the voting stock of two or more of the corporations is owned by the same interests.

If an affiliated group of corporations elects to file separately, each corporation in the affiliated group that has nexus in Virginia is required to file its own separate corporate income tax return and report only its income, expenses, gains, losses, and allocation and apportionment factors on such return. This type of reporting follows the separate entity concept, in which each corporation in an affiliated group is treated as distinct and separate from the other corporations in such group for purposes of determining each corporation's corporate income tax liability.

A consolidated return includes the aggregate income, expenses, gains, and losses, allocation and apportionment factors of all of the corporations in an affiliated group that have nexus with Virginia. The corporate income tax liability of the affiliated group is computed in the aggregate, and the entire affiliated group files one corporate income tax return.

Virginia offers a variation of consolidated reporting called a combined return (hereinafter referred to as a "Virginia combined return" to distinguish it from the "unitary combined return"). In a Virginia combined return, each corporation in an affiliated group that has nexus with Virginia determines its income, expenses, gains, losses, and allocation and apportionment factors separately. Each corporation then separately computes its individual corporate income tax liability. The final corporate income tax liability, after apportionment, of each corporation is then combined and included on one corporate income tax return.

For Virginia income tax purposes, the election to file on a separate, consolidated or combined basis is made in the first year in which a group of affiliated corporations becomes eligible to file a Virginia consolidated or combined return in Virginia. The filing of the Virginia combined or consolidated income tax return is an election made by the affiliated group. As a general rule, once the election is made, subsequent returns are required to be filed on the same basis, unless the Tax Commissioner grants permission to the affiliated group to change their election. The election is also binding on any corporations that subsequently join the affiliated group and have nexus with Virginia.

Unitary Combined Reporting

There is another reporting method not currently utilized by Virginia that is known as mandatory unitary combined reporting. In a unitary combined reporting state, a corporation is required to combine the income, expenses, gains, losses, and allocation and apportionment factors of all related corporations that are engaged in a unitary business ("unitary group" or "combined group") on its corporate income tax return, regardless of the state's nexus with or the location of the corporations in the unitary group. In theory, the resulting tax burden of the unitary group is comparable to the tax burden that would result if the corporations were merged into a single firm. The U.S. Supreme Court has held that a unitary group is a single economic enterprise, and that a state may apportion transactions and operations within its borders to determine its taxable income (see *Mobil Oil Corp v. Commissioner of Taxes*, 445 U.S. 425 (1980)). Unlike Virginia, states that require unitary combined reporting generally do not provide other reporting options for corporations with affiliates in other states. Instead, unitary combined reporting is generally mandatory in such states.

Unlike the consolidated return and Virginia combined reporting methods, unitary combined reporting takes into consideration both the ownership and business relationships of related corporations. In most unitary combined reporting states, a group of two or more corporations will be treated as related only if they share common ownership exceeding 50 percent.

A group of two or more corporations is generally considered to be a unitary group if their business activities are interdependent, interrelated, and integrated. States that have enacted unitary combined reporting use some combination of factors to determine whether a group of corporations is a unitary group including, but not limited to, whether the corporations have centralized management, centralized administrative services or functions resulting in economies of scale, or whether the flow of goods, resources, or services demonstrates functional integration between the corporations.

Purpose of Unitary Combined Reporting

There are several explanations that proponents offer for enacting unitary combined reporting, including providing an accurate measure of income, controlling income shifting, and increasing corporate income tax revenues. In a 2009 report, Wisconsin asserted that the adoption of unitary combined reporting "closes tax loopholes that allow very large multi-state corporations to shift profits from one subsidiary to another, enabling them to move profits out of Wisconsin and thereby minimize or avoid paying state income tax." The report also claims that by closing these loopholes, the state will increase its revenues.

Unitary combined reporting is intended to address the tax planning strategies used by various types of entities, including intangible holding companies. An intangible holding company ("IHC") is generally a corporation formed to hold intangible assets such as trademarks, trade names, or patents. The IHC is typically located in states that do not impose a corporate income tax on them. Corporations transfer their intangible assets to their IHC and enter into an agreement to pay for the continued use of its intangible assets. When the corporation computes its state corporate income tax, it deducts the expenses that it paid to the IHC to use these intangible assets. Unitary combined reporting would correct this tax avoidance because the IHC would be included in the unitary combined return.

Another tax planning method creates an affiliate that qualifies as a real estate investment trust ("REIT"). REITs were established in the 1960s by Congress and are exempt from paying taxes on dividends paid to its investors. Some retail stores created a "captive REIT" that owned the land and buildings in which the retail stores were located. The retail chain pays rent, based on a percentage of sales, to the captive REIT, but the rent is paid back to the retail company or an affiliate as untaxed dividends. Unitary combined reporting would include the REIT dividends in apportionable "business income" as well as the affiliates that received them.

Some states have implemented add-back laws to specifically address these types of income shifting techniques, whereby taxable income that is shifted to an entity like an intangible holding company or captive REIT is added back to a taxpayer's income to determine taxable income. Proponents of unitary combined reporting assert that although states can address tax avoidance strategies through add-backs, these types of laws must be specifically tailored to address certain income shifting practices, and are difficult for tax agencies to administer. Unitary combined reporting does not require a tax agency to identify income-shifting transactions through audit and compliance procedures, and instead requires corporations in a unitary group to combine all income into one report in order to determine the amount of apportionable income.

Considerations for Adopting Unitary Combined Reporting

A state legislature that is considering adopting unitary combined reporting must, at a minimum, make determinations regarding the following: (i) how to define a unitary group; (ii) how to treat members of the unitary group without nexus; (iii) how to treat international corporations in a unitary group; and (iv) how to handle certain transitional issues.

*Definition of a Unitary Group*

The United States Supreme Court has stated that the hallmarks of a unitary relationship consist of functional integration, centralized management, and economies of scale. The states have developed various definitions of a unitary group to make the application of these standards more certain.

The challenge for tax administrators, as well as taxpayers, in defining the term "unitary group" is determining whether a group of corporations is engaged in a unitary business, and how to define the trade or business that is unitary. In order to be considered unitary, members of a unitary group must share more than a passive investment relationship, and have developed interdependent economic relationships.

In order to determine whether a unitary business exists, tax administrators must be able to identify the activities undertaken by each corporation in the group and the resulting flow of goods and services. This process is highly complex, and often leads to disagreements over the measures used to determine whether group of corporations is unitary. Moreover, when a unitary determination is contested, it often results in complex audits and appeals, and increased litigation.

For situations in which states share the same statutory definition of a unitary group, there still remains significant variation in how the states and courts have interpreted the statutory definition. Therefore, it is possible that a group of corporations may be treated as unitary in one state, but as nonunitary in other states.

*Treatment of Members of the Unitary Group without Nexus*

Under Public Law 86-272, a state is prohibited from taxing a company whose only activity within a state is the solicitation of sales of tangible personal property and, therefore, lacks nexus. However, the concept of a unitary group allows a state to require unitary combined reporting, which includes the income and apportionment factors of all members of a unitary group, even when a member of a unitary group does not have nexus in the state. This raises concerns over whether unitary combined reporting violates Public Law 86-272. Some states have determined that members of a unitary group should be taxed as one taxpayer and include the apportionment and income from all members of the unitary group. Other states have determined that a state is not allowed to tax any individual corporation that is protected under Public Law 86-272. The federal courts have not issued a decision on this issue, thereby, leaving it to the state courts to decide.

There are two approaches that states that have enacted unitary combined reporting have applied for determining whether to include corporations who do not have nexus in a unitary group. These approaches are called Joyce and the Finnigan, which are the names for two California Board of Equalization ("BOE") administrative appeals issued in 1996 (Joyce) and 1988 (Finnigan).

Those states that are worried about litigation over the issue of whether Public Law 86-272 protects nonnexus entities have chosen to adopt what has come to be called the Joyce approach. Under Joyce, apportionment is done on an entity-by-entity basis. Each nexus entity must generally apportion its income to the state based upon the total income of the unitary business, including income attributed to entities over which it lacks jurisdiction, and based upon apportionment factors that include:

- In the numerator, the state-sourced amounts for that particular nexus entity; and

- In the denominator, the everywhere amounts for the entire unitary business, including factor amounts attributed to entities over which the state lacks jurisdiction.

Joyce does not require non-nexus entities to apportion their share of total income.

According to a 2018 report by the MTC, state positions have shifted over time regarding the Joyce approach. While many states have in the past adopted Joyce rather than Finnegan because they wanted to avoid litigation over the Public Law 86-272 issue, the risks that litigation may have posed do not appear to have not materialized. Moreover, the MTC report explains that certain taxpayers have been able to use Joyce as a tax planning opportunity. Specifically, some taxpayers have tried to reduce their state income taxes by avoiding having sales included in a state's sales factor for the unitary group by isolating activities into separate entities for that purpose.

As a result, the MTC report states that the recent trend has been away from Joyce and toward Finnigan, although the states are still split. Under the Finnigan approach, apportionment is done at the group level. As a result, the unitary group as a whole generally apportions income to the state based upon total income for the unitary business—including income attributed to entities over which it lacks jurisdiction—and based upon apportionment factors that include:

- In the numerator, the state-sourced amounts for the unitary group, including factor amounts attributed to entities over which the state lacks jurisdiction; and

- In the denominator, the everywhere amounts for the unitary group, including factor amounts attributed to entities over which the state lacks jurisdiction.

*Treatment of International Corporations of a Unitary Group*

A state that enacts unitary combined reporting must determine whether the state will place limitations on the inclusion of certain types of unitary corporations in the taxpayer's income and apportionment calculation, in particular foreign corporations. Generally, there are three types of unitary combination that are used by the states which address this issue: (i) domestic combination; (ii) water's-edge combination; and (iii) worldwide combination. Domestic combination includes only unitary corporations that are incorporated in the United States. Waters-edge combination includes all unitary corporations of a business regardless of the location of the affiliates; however, foreign corporations are included only to the extent that they do business in the United States. The definition of doing business in the United States varies among the states, but typically includes "80/20" corporations, corporations with more than 20 percent of their business in the United States. Worldwide combination includes all of the corporations of a unitary group regardless of the location of the corporations.

While the business community generally opposes any form of unitary combined reporting, worldwide combination is especially disfavored. As a result it has been prohibited in many states. During the 1981 Session, the Virginia General Assembly specifically prohibited worldwide combination.

*Transitional Issues*

There are also several transitional issues related to moving to unitary combined reporting. A state must determine how to treat overpayments and calculate estimated payments from previous taxable years. Other more difficult considerations are how to handle tax incentives, including net operating losses and credits that were allocated for a taxable year prior to the enactment of unitary combined reporting. The first year of unitary combined reporting would see many corporations included in a state's corporate income tax returns for the first time. If corporations filed on a separate return basis, they may have accumulated substantial net operating losses, credits or deductions that could be used to offset income of the unitary group. Unrestricted use of tax incentives from previous taxable years may cause revenue losses to the state during the transition to unitary combined reporting.

<u>Other States</u>

Of the 45 jurisdictions that impose a corporate income tax, 28 have enacted mandatory unitary combined reporting. In addition to these 28 jurisdictions, Texas requires unitary combined reporting for purposes of its gross receipts tax. Therefore, 26 jurisdictions are considered to be unitary combined reporting jurisdictions.

| **Unitary Combined Reporting Jurisdictions** | |
|---|---|
| **Finnegan States** | **Joyce States** |
| Arizona | Alaska |

| | |
|---|---|
| California | Colorado |
| Connecticut | District of Columbia |
| Kansas | Hawaii |
| Maine | Idaho |
| Massachusetts | Illinois |
| Michigan | Kentucky |
| Minnesota | Mississippi |
| Montana | Nebraska |
| New York | New Hampshire |
| Rhode Island | New Jersey |
| Utah | New Mexico |
| Wisconsin | North Dakota |
| | Texas |
| | Vermont |
| | West Virginia |

*Studies Regarding Unitary Combined Reporting*

In recent years, Indiana, Louisiana, Maryland, and Rhode Island have conducted studies regarding adopting unitary combined reporting.

## Unitary Business Principle in Virginia

As noted above, in 1981 Virginia prohibited worldwide unitary combination. Nevertheless, Virginia has had to grapple with defining the scope of a unitary business. In 1992, the United States Supreme Court held that a corporation was allowed to exclude certain investment income from its apportionable income because it was not derived from an unrelated business activity constituting a discrete business enterprise (see *Allied-Signal v. Director, Div. of Taxation*, 504 U.S. 768 (1992)). The Court ruled that the taxpayer's gain on the sale of stock could not be excluded from the apportionment formula unless the capital asset sold served an investment function that was completely unrelated to any operational activities carried on in the taxing state. Subsequently, the Department issued Tax Bulletin 93-4, which provides guidance to corporations seeking to allocate certain nonapportionable investment income away from Virginia (see Public Document 93-93B (4/6/1993)). There have been numerous administrative appeals involving this issue.

## Proposed Legislation

This bill would adopt mandatory unitary combined reporting for Virginia income tax purposes. This would require any taxpayer engaged in a unitary business with one or more other corporations to file a combined report that includes the income and apportionment factors of all the affiliates of the taxpayer that are members of the unitary business. In addition, this bill would require corporations to submit a public disclosure report to the Department with certain data related to their state taxes, which would be redacted prior to publication.

"Unitary business" would be defined as a single economic enterprise that is made up either of separate parts of a single business entity or of a commonly controlled group of business entities that is sufficiently interdependent, integrated, and interrelated through its activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among the separate parts and a significant flow of value to the separate parts. Any business conducted by a partnership would be treated as conducted by its partners, whether directly held or indirectly held through a series of partnerships, to the extent of the partner's distributive share of the partnership's income, regardless of the percentage of the partner's ownership interest or its distributive or any other share of partnership income.

A business conducted directly or indirectly by one corporation would be unitary with that portion of a business conducted by another corporation through its direct or indirect interest in a partnership if there is a synergy, exchange and flow of value between the two parts of the business, and the two corporations are members of the same commonly controlled group.

Business conducted by any corporation through a partnership would be treated as conducted directly by that corporation, to the extent of the corporation's distributive share of the partnership income. This would be the case whether the partnership is a general partnership, a limited partnership, an LLC, or other entity treated as a partnership, or an S corporation. Other commonly-controlled, unitary entities, not otherwise subject to be included in the combined group because they are not income taxpayers, may also be required to be included in the combined group by regulation if doing so would better reflect the proper apportionment of income of the entire unitary business, or on a case-by-case basis if there is tax evasion.

*Adoption of the Joyce Method*

This bill would adopt the Joyce method of mandatory combined reporting. Such method would require that the report filed by the combined group not disregard the separate identities of the taxpayer members of such group. Each taxpayer member would be responsible for tax based on its apportioned share of the business income of the combined group, together with that member's own allocated, nonbusiness income, and its apportioned share of business income from any other combined group of which the taxpayer is a member. Business income of the combined group would be calculated as the sum of all members' individually determined net business incomes. Dividends paid by one to another member of the combined group would be eliminated from income, and no special treatment would be provided for included foreign source income.

Because individual group members would be recognized as separate taxpayers under the Joyce method, as a general rule, a deduction or credit would be allowed to be taken only by the specific taxpayer that earned it, and not against the total combined income or liability of the group. Likewise, the amount of total combined business income apportioned to Virginia would be calculated as a function of each taxpayer's own factors in Virginia. This is in contrast to the Finnigan method of mandatory combined reporting, where the amount of total combined business income apportioned to a state is calculated as a function of the factors for the entire group as a whole that are in the state.

This bill would provide an exception to this general rule preserving the separate identity of the taxpayer. A charitable contribution deduction would be allowed to be taken first against the business income of the combined group, subject to federal income limitations as applied to the entire business income of the group. Any remaining amount would then be allowed to be treated as a nonbusiness expense allocable to the member that incurred the expense, subject to the federal income limitations applied to the nonbusiness income of that taxpayer member.

*Worldwide Combination General Rule and Water's Edge Election*

Combination of eligible entities would be required on a worldwide basis, unless taxpayers choose to make a water's-edge election. A water's-edge election would limit the combined group to eligible domestic corporations, foreign corporations with U.S. source income, and corporations doing business in tax-haven countries.

A water's-edge election would limit the combined group to eligible domestic corporations, foreign corporations with U.S. source income, and corporations doing business in tax-haven countries. A domestic corporation would be a corporation that either:

- Is incorporated in the United States or formed under the laws of any state, the District of Columbia, or any territory or possession of the United States;
- Has an average of it property, payroll, and sales factors within the United States that it 20 percent or more;
- A domestic international sales corporation under the IRC;
- a foreign sales corporation under the IRC; or
- An export trade corporation under the IRC.

A foreign corporation would be any corporation that is not a domestic corporation. If no water's-edge election is made, combination of eligible entities would be required on a world-wide basis.

A water's-edge election would be effective only if made on a timely-filed, original return for a taxable year by every member of the unitary business subject to Virginia income tax. The Tax Commissioner would be required to develop rules and regulations governing the impact, if any, on the scope or application of a water's-edge election, including termination or deemed election, resulting from a change in the composition of the unitary group, the combined group, the taxpayer members, and any other similar change. Such election would constitute consent to the reasonable production of documents and taking of depositions in accordance with the laws of the Commonwealth relating to discovery. In the discretion of the Tax Commissioner, a water's-edge election would be allowed to be disregarded in part or in whole, and the income and apportionment factors of any member of the taxpayer's unitary group would be permitted to be included in the combined report, if any member of the unitary group fails to comply with any provision of law or if a person otherwise not included in the water's-edge combined group was availed of with a substantial objective of avoiding state income tax.

A water's-edge election would be binding for and applicable to the taxable year it is made and all tax years thereafter for a period of 10 years. It would be allowed to be withdrawn or reinstituted after withdrawal, prior to the expiration of the 10-year period, only upon written request for reasonable cause based on extraordinary hardship due to unforeseen changes in state tax statutes, law, or policy, and only with the written permission of the Commissioner. If the Commissioner grants a withdrawal of election, he would be allowed to impose reasonable conditions as necessary to prevent the evasion of tax or to clearly reflect income for the election period prior to or after the withdrawal. Upon the expiration of the 10-year period, a taxpayer would be allowed to withdraw from the water's edge election. Such withdrawal would be required to be made in writing within one year of the expiration of the election, and would be binding for a period of 10 years, subject to the same conditions as applied to the original election. If no withdrawal is properly made, the water's edge election would be in place for an additional 10-year period, subject to the same conditions as applied to the original election.

*Tax Haven*

As a general rule, combined groups who have made a water’s edge election would not be required to include foreign corporations that have no U.S. source income. If the foreign corporation has U.S. source income, it would only be required to include the portion of its income derived from or attributable to sources within the United States, as determined under the IRC, and any related apportionment factors.

However, this bill would provide an exception to this general rule for any corporations doing business in a tax haven. Under this exception, a corporation doing business in a tax haven would be required to include their entire income and apportionment factors. This bill would define a "tax haven" as a jurisdiction that, during the tax year in question is identified by the OECD as a tax haven or as having a harmful preferential tax regime or exhibits the following characteristics established by the OECD in its 1998 report entitled "Harmful Tax Competition: An Emerging Global Issue" as indicative of a tax haven or as a jurisdiction having a harmful preferential tax regime, regardless of whether it is listed by the OECD as an uncooperative tax haven:

- Has no or nominal effective tax on the relevant income; and
- Has any one of the following:
  - Laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime;
  - A tax regime that lacks transparency. A tax regime lacks transparency if the details of legislative, legal, or administrative provisions are not open and apparent or are not consistently applied among similarly situated taxpayers, or if the information needed by tax authorities to determine a taxpayer's correct tax liability, such as accounting records and underlying documentation, is not adequately available;
  - Facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy;

- o Explicitly or implicitly excludes the jurisdiction's resident taxpayers from taking advantage of the tax regime's benefits or prohibits enterprises that benefit from the regime from operating in the jurisdiction's domestic market; or

- o Has created a tax regime that is favorable for tax avoidance, based upon an overall assessment of relevant factors, including whether the jurisdiction has a significant untaxed offshore financial and related services sector relative to its overall economy.

*Single Return Election*

The bill would allow members of a combined reporting group to annually elect to designate one taxpayer member of the combined group to file a single return in the form and manner prescribed by the Department, in lieu of filing their own respective returns. However, the taxpayer designated to file the single return would be required to consent to act as surety with respect to the tax liability of all other taxpayers properly included in the combined report and would be required to agree to act as agent on behalf of those taxpayers for the year of the election for tax matters relating to the combined report for that year. If for any reason the surety would be unwilling or unable to perform its responsibilities, tax liability could continue to be assessed against the taxpayer members. This portion of the bill regarding the designation of a taxpayer to file a single return for the combined group would be allowed only as a filing convenience and would not be allowed to change the respective liability of the group members.

*Public Disclosure Report*

This bill would require that every corporation filing a Virginia income tax return must make a public disclosure report to the Department on or before the fifteenth day of the fourth month following the close of every taxable year with certain information from such tax return or other documents on a form prepared by the Department. The public disclosure report would be required to be included with its Virginia income tax return, and the public disclosure report or any amended public disclosure report would be retained by the Department and the Tax Commissioner as a public record. However, the public disclosure report or amended public disclosure report would be available for public inspection only after the Department has expunged the name of the taxpayer and the location, including the street address, of the taxpayer's principal office.

The forms of the public disclosure report prepared by the Department would be made available to taxpayers required to submit such report on December 1 in each taxable year prior to the taxable year in which such public disclosure report is required to be submitted. Such forms would be required to provide cross-references to any other forms required by the Department to ensure information required by this bill is reported identically.

In the case of corporations required to submit a public disclosure report by this bill, the forms of such public disclosure report would require reporting of the following information exactly as such information was reported to the Department on the taxpayer's income tax return:

- The name of the taxpayer;

- The location, including the street address, of such taxpayer's principal office;
- The gross receipts and sales of such taxpayer;
- The gross profit of such taxpayer;
- Any excess tax credit or credits subject to carry over to future years, as reported to the Department or claimed on such taxpayer's income tax return;
- All income of the taxpayer subject to apportionment;
- All income of the taxpayer taxable in Virginia;
- The total non-income tax assessed;
- The total excise due;
- The total amount of tax credit taken by the taxpayer against the excise imposed; and
- Any other information required by the Department and Tax Commissioner for such public disclosure report.

Any taxpayer required to make a public disclosure report under this bill would be permitted to supplement the required information listed above with additional information or documents on the form provided by the Department.

For purposes of this bill, all references to a tax return or other forms or information would refer to those submitted to or prescribed by the Department used for each taxable year beginning on and after Taxable Year 2020. Where the amount of any item reported pursuant to this bill changes, the taxpayer would be required, within 30 days of the final determination of such change, file an amended public disclosure report in a form prescribed by the Department. The Department and the Tax Commissioner would make available for public inspection a list of all taxpayers who are required to file a public disclosure report pursuant to this bill by April 1, 2020, and by April 1 of each taxable year thereafter.

Upon receipt of a public disclosure report filed under this bill, the Department would be required to assign the public disclosure report a number, chosen at random by the Department, which would be used to identify the report for purposes of public inspection of the report and any amendments to it. A taxpayer would be assigned the same number for its public disclosure reports and any amendments to it each year. The Department and the Tax Commissioner would make available for public inspection the copies of all public disclosure reports and amendments to it filed under this bill only after assigning numbers and expunging from each copy the name of the taxpayer and the location, including the street address, of the taxpayer's principal office. All documents published by the Department under this bill would be made available and searchable in electronic form.

This bill would amend Virginia's law regarding confidentiality to provide that nothing contained in that law is to be construed to prohibit the publication of statistics and information in public disclosure reports so classified and redacted as to prevent the identification of particular taxpayers.

This portion of this bill adopting mandatory unitary combined reporting for Virginia income tax purposes would be effective for taxable years beginning on or after January 1, 2021.

The portion of this bill requiring a public disclosure report would be effective for taxable years beginning on or after January 1, 2020.

Similar Bills

**House Bill 739** would adopt unitary combined reporting using the Joyce method.

**House Bill 1676** and **Senate Bill 1058** would allow a group of affiliated corporations to elect to change to or from a consolidated filing status if such group has filed under the same filing status for at least five prior years without first requesting permission from the Department to make such a change.

cc : Secretary of Finance

Date: 01/30/2020 JJS
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