Multistate Tax
EXTERNAL ALERT

Rhode Island Enacts Significant Tax Reforms

June 25, 2014

Overview

Rhode Island Governor Lincoln Chafee recently signed into law the fiscal 2015 Budget, Bill No. H 7133 SUB A as amended ("H.B. 7133").[1] The new law substantially modifies and reforms various aspects of the Rhode Island Tax Law, including the following:

- Requires water's edge combined reporting for members of a unitary group of affiliated business entities that are more than 50% commonly owned and controlled. Such combination may, by way of a five year binding election, be done on an affiliated group basis. Rhode Island passive investment companies with five or more full-time employees are excluded from combined reporting.[2]
- Provides rules regarding the treatment of net operating losses ("NOLs") and credits, including certain limitations.
- Repeals the related-party expense addback requirement.
- Repeals the franchise tax.
- Reduces the corporate income tax rate from 9% to 7%.[3]
- Imposes the $500 minimum tax on S corporations.
- Adopts single-sales factor apportionment, with market-based sourcing for sales of other than tangible personal property. Each unitary business group member's receipts will be included without regard to whether the member has nexus in the state (i.e., the "*Finnigan"* approach).[4]

In this Tax Alert we summarize the more significant law changes contained in H.B. 7133, which are effective for tax years beginning on or after January 1, 2015, unless otherwise noted.

Combined Reporting

Required Combined Reporting. For tax years beginning on or after January 1, 2015, Rhode Island will require each C corporation that is a part of a unitary business with one or more corporations to file a combined report.[5] A "corporation" is generally defined as every corporation, joint-stock company, or association, wherever incorporated, and includes real estate investment trusts, regulated investment companies, registered personal holding companies, and any trustee conducting business and deriving income from sources or engaging in any activities or transactions within Rhode Island. It does not include banks, public service corporations, insurance and surety companies, not-for-profit entities and passive investment companies that employ not less than five

[1] 2014 H 7133 Substitute A As Amended, *An Act Relating to Making Appropriations for the Support of the State for the Fiscal Year Ending June 30, 2015*; signed into law by the Governor on June 19, 2014. A copy of the adopted law is accessible at: **http://webserver.rilin.state.ri.us/BillText14/HouseText14/H7133Aaa.pdf.**

[2] H.B. 7133 Article 12 §15; R.I. Stat. §44-11-1 (2), (3); H.B. 7133 Article 12 §16; R.I. Stat. § 44-11-4.1(a), (b). All citations are to Rhode Island law as added or amended by H.B. 7133.

[3] Tax rate reductions under the Jobs Development Act are preserved in H.B. 7133; however, such reductions are subject to updated limitations set forth in R.I. Stat. §42-64.5-4(a)(ii) and R.I. Stat. §42-64.14-11(a), (b).

[4] The "*Finnigan*" approach is in reference to the California State Board of Equalization ("SBE") decisions in Appeal of Finnigan Corp. (88-SBE-022), decided on August 25, 1988 ("Finnigan I") and Appeal of Finnigan Corp. (88-SBE-022-A), Opinion on Petition for Rehearing, decided on January 24, 1990 ("Finnigan II"). In these decisions, for purposes of calculating the California sales factor, the SBE interpreted the term "taxpayer" to mean all members of a unitary group.

[5] H.B. 7133 Article 12 §16; R.I. Stat. § 44-11-4.1(a). Note that "unitary business" means the activities of a group of two or more corporations under common ownership that are sufficiently interdependent, integrated or interrelated through their activities so as to provide mutual benefit and produce a significant sharing or exchange of value among them or a significant flow of value between the separate parts. H.B. 7133 Article 12 §15; R.I. Stat. § 44-11-1(11).

full-time employees in Rhode Island and whose activities are generally limited to the maintenance and management of intangible assets.[6]

Any corporation not incorporated in the United States ("non-US corporation") is excluded from the combined group if the sales factor of such corporation outside the United States is 80% or more. In such cases, the income and apportionment factors of the non-US corporation are disregarded for Rhode Island purposes. If a non-US corporation is includible as a member in the combined group, to the extent that the non-US corporation's income is subject to the provisions of a federal income tax treaty between the US and a foreign jurisdiction ("tax treaty"),[7] such income is not includible in the determination of the combined group's net income. Similarly, any expenses or apportionment factors of the non-US corporation that are attributable to income that is subject to the provisions of a tax treaty are not included in the combined report.[8]

However, the income of a non-US corporation that is otherwise excludible because it is subject to the provisions of a tax treaty will be included in the combined report if the foreign jurisdiction is defined as a "tax haven." A tax haven is generally defined as a jurisdiction that: has no or a nominal effective tax rate; does not exchange information for tax purposes with other governments; lacks transparency; facilitates the establishment of foreign-owned entities without the need for a local substantive presence; or has created a tax regime that is favorable for tax avoidance.[9]

Nonetheless, if the tax administrator determines that a combined group member, non-US corporation is organized in a "tax haven" that has a tax treaty with the US, the non US corporation's income and expenses will not be included in the combined group net income if: i) the transactions conducted between such non-US corporation and other members of the combined group are done on an arm's length basis and not with the principal purposes of tax avoidance; or ii) the member established that the inclusion of such net income is unreasonable.[10]

Affiliated Group Election. Under the new law, an affiliated group of C corporations may elect to be treated as a combined group with respect to the combined reporting requirement regardless of whether they are engaged in a unitary business. The election shall be upon the condition that all members of the affiliated group consent to be included in such group (the filing of a consolidated return for the combined group shall constitute deemed consent), and such election may not be revoked in less than five years without the approval of the Rhode Island Division of Taxation.[11]

Treatment of NOLs and Credits. NOLs generated before January 1, 2015, will be allowed to offset *only* the income of the member that created the loss, and losses cannot be shared with other members of the combined group.[12] No deduction is allowable for a NOL sustained during a tax year in which a taxpayer was not subject to Rhode Island business corporation tax.[13] NOLs generated in tax years beginning on or after January 1, 2015, will generally follow the provisions of IRC § 172 and may be carried forward for five years.[14] Similarly, Rhode Island tax credits earned before tax years beginning on or before January 1, 2015, shall be allowed to offset only the tax liability of the corporation that earned the credits and cannot be shared with other members of the combined group.[15] Credits generated in tax years beginning on or after January 1, 2015, may be applied to other members of the group.[16]

Intangible Expenses. Subject to certain exceptions, the law in effect for years prior to 2015 requires an addback for otherwise deductible interest and intangible expenses and costs directly or indirectly paid, accrued or

[6] H.B. 7133 Article 12 §15; R.I. Stat. §44-11-1 (4).
[7] A "federal income tax treaty" is defined as a comprehensive income tax treaty between the US and a foreign jurisdiction other than a tax haven. H.B. 7133 Article 12 §16; R.I. Stat. § 44-11-4.1(d).
[8] H.B. 7133 Article 12 §16; R.I. Stat. § 44-11-4.1(d).
[9] H.B. 7133 Article 12 §15; R.I. Stat. §44-11-1 (8).
[10] H.B. 7133 Article 12 §16; R.I. Stat. § 44-11-4.1(d).
[11] H.B. 7133 Article 12 §16; R.I. Stat. § 44-11-4.1(b). Affiliated group is as defined in IRC §1504.
[12] H.B. 7133 Article 12 §16; R.I. Stat. § 44-11-4.1(e).
[13] *Id.*
[14] H.B. 7133 Article 12 §16; R.I. Stat. § 44-11-4.1(e)(3).
[15] H.B. 7133 Article 12 §16; R.I. Stat. § 44-11-4.1(f)(1).
[16] *Id.*

incurred to a related member. For tax years beginning on or after January 1, 2015, this requirement is repealed.[17]

Franchise Tax Repealed

The existing Franchise Tax is imposed to the extent that it exceeds the business corporation tax and is assessed on corporations, joint stock companies, and associations at a rate of $2.50 for each $10,000 of capital (minimum tax of $500). Effective for tax years beginning on or after January 1, 2015, the Franchise Tax will be repealed.[18]

Corporate Income Tax Rate Reduced / Minimum Tax Imposed on S Corporations

The new law reduces the corporate income tax rate from 9% to 7%,[19] and imposes the $500 minimum tax on S corporations.[20] These changes are effective for tax years beginning on or after January 1, 2015.

Single Sales Factor Apportionment Adopted

Under current law, Rhode Island apportions income using an equally-weighted, three-factor method measured by property, payroll and receipts.[21] Under the new law, corporate taxpayers will use a single receipts factor that provides for the inclusion of throwback sales (i.e., sales of tangible personal property shipped from Rhode Island to a state where the taxpayer is not taxable).[22] Also, under the new law, sales of other than tangible personal property will be sourced on a market basis. Under this provision, gross income from the performance of services will be sourced to Rhode Island if the recipient of the service receives the benefit of the service in Rhode Island. If the recipient of the service receives some, but not all, of the benefit in the state, income shall be included in the numerator in proportion to the extent the service is received in Rhode Island.[23]

Under the new law, each unitary business group member will include all receipts in Rhode Island without regard to whether the member has nexus in Rhode Island (the "*Finnigan*" approach).[24]

ASC 740 Treatment

Pursuant to ASC 740 (formerly known as "Statement 109, *Accounting for Income Taxes*" or "FAS 109"), companies are required to account for the effect of a change in income tax law in the period that includes the enactment date of that law change. Therefore, the enactment of H.B. 7133 could have significant financial statement implications in the reporting period that includes the June 19, 2014 enactment date. Companies may wish to consult with applicable advisors for guidance regarding the ASC 740 impact of these law changes.

Contacts

If you have questions regarding these Rhode Island law changes, please contact any of the following Deloitte Tax professionals.

Michael Degulis
Senior Manager
Deloitte Tax LLP, Boston
mdegulis@deloitte.com
(617) 585-5968

Robert Carleo
Director
Deloitte Tax LLP, Boston
rcarleo@deloitte.com
(617) 437-2349

Michael Porter
Principal
Deloitte Tax LLP, Boston
mikeporter@deloitte.com
(617) 437-2607

Jennifer Tansey
Manager
Deloitte Tax LLP, Boston
jtansey@deloitte.com
(617) 437-3431

---

[17] H.B. 7133 Article 12 §17; R.I. Stat. §44-11-11(e).
[18] H.B. 7133 Article 12 §20; R.I. Stat. §44-12.
[19] H.B. 7133 Article 12 §15; R.I. Stat. §44-11-2(a). Tax rate reductions under the Jobs Development Act are preserved in H.B. 7133; however, such reductions are subject to updated limitations set forth in R.I. Stat. §42-64.5-4(a)(ii) and R.I. Stat. §42-64.14-11(a), (b).
[20] H.B. 7133 Article 12 §15; R.I. Stat. §44-11-2(d).
[21] R.I. Stat. §44-11-14(a).
[22] H.B. 7133 Article 12 §17; R.I. Stat. §44-11-14(b).
[23] H.B. 7133 Article 12 §17; R.I. Stat. §44-11-14(b)(1)(ii).
[24] H.B. 7133 Article 12 §17; R.I. Stat. §44-11-14(b)(1)(vii).

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see **www.deloitte.com/about** for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms. Please see **www.deloitte.com/us/about** for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.