

Wisconsin Department of Revenue

**Frequently Asked Questions:
Combined Reporting**

For taxable years beginning on or after January 1, 2009, corporations that are commonly controlled and engaged in a unitary business are generally required to compute their Wisconsin income using combined reporting. The department is building a collection of frequently asked questions (FAQs) and answers about combined reporting and will make them available on its combined reporting web page, at <http://www.revenue.wi.gov/combrep/index.html>.

The combined reporting FAQs are currently divided into the following categories:

- A. Who Must Use Combined Reporting
- B. Income Includable in Combined Report
- C. Apportionment
- D. Business Losses
- E. Credits
- F. Forms, Payments, and Administrative Issues
- G. Other Issues Affecting Combined Filers

This collection will grow as implementation of the new law continues. Below are answers to some FAQs that are currently available.

A. Who Must Use Combined Reporting

Question A1: What types of entities are required to use combined reporting?

Answer A1: Only regular “C” corporations are required to use combined reporting. Tax-option (S) corporations and individuals must file separate returns. Income earned by a pass-through entity such as a partnership, limited liability company, estate, or trust is included in a combined report to the extent the income passes through to a corporation.

However, the Department of Revenue has authority to require entities other than “C” corporations to use combined reporting in cases where separately reporting those entities would result in an avoidance or evasion of tax (sec. 71.255(2)(f), Wis. Stats.).

Question A2: Are any industries or specific types of corporations exempt from combined reporting?

Answer A2: No, except for corporations that are specifically exempt from Wisconsin income and franchise taxes altogether. For example, tax exempt organizations under sec. 71.26(1), Wis. Stats., or foreign insurers exempt under sec. 71.45(1), Wis. Stats., are not required to include any of their income in a combined report. For more about how combined reporting affects domestic insurance companies, see Question A8.

Question A3: How does a corporation know if combined reporting applies?

Answer A3: The corporation must use combined reporting if three tests are met:

- **Test 1:** The corporation is in a *commonly controlled group* of corporations (see Question A4 for details),
- **Test 2:** The corporation and at least one other member of the commonly controlled group are engaged in a *unitary business* (see Question A5 for details), and
- **Test 3:** The corporation meets the “*water’s edge*” test (see Question A6 for details).

Question A4: What is a “commonly controlled group” of corporations?

Answer A4: A corporation may be required to use combined reporting if it is in a “commonly controlled group” of corporations. A “commonly controlled group” is defined in the combined reporting statute (sec. 71.255(1)(c), Wis. Stats.). Under this definition, corporations are in a commonly controlled group if:

- There is common ownership (either directly or indirectly) of stock representing more than 50% of the voting power of each corporation in the group, or
- Stock representing more than 50% of the voting power in each corporation are interests that cannot be separately transferred.

Question A5: What is a “unitary business”?

Answer A5: A “unitary business” is defined in the combined reporting statute (sec. 71.255(1)(n), Wis. Stats.) as a single economic enterprise made up of one or multiple related entities which are sufficiently interdependent, integrated, and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts.

The statute provides that entities are presumed to be a unitary business if the entities have unity of ownership, operation, and use as indicated by the presence of one or more specific factors. These factors include:

- Centralized management;
- Centralized executive force;
- Centralized purchasing, advertising, or accounting;
- Intercorporate sales or leases;
- Intercorporate services, including administrative, employee benefits, human resources, legal, financial, or cash management services;
- Intercorporate debts;
- Intercorporate use of proprietary materials;
- Interlocking directorates or corporate officers.

However, the statute provides that these factors are not an all-inclusive list.

Question A6: What is the “water’s edge” test?

Answer A6: Under Wisconsin’s combined reporting law, the “water’s edge” test determines whether a foreign corporation is includable in a combined report. (A foreign corporation means a corporation incorporated outside the United States). The water’s edge test also determines whether any of a domestic corporation’s foreign-source income is includable in the combined report.

A corporation meets the water’s edge test (and may be required to be included in a combined report) if less than 80% of its worldwide income is “active foreign business income” as defined in section 861(c)(1)(B) of the Internal Revenue Code.

“Active foreign business income” is income which is:

- Derived from non-U.S. sources, and
- Attributable to the active conduct of a trade or business by a corporation (or its subsidiary) in a foreign country or possession of the U.S.

For more information on how the water’s edge test affects the types of income includable in a combined report, see Questions B1 and B2.

Question A7: Will the Wisconsin combined group be the same as the federal consolidated group?

Answer A7: The Wisconsin combined group may be larger or smaller than the federal consolidated group. There are three differences between the Wisconsin combined group and federal consolidated group. These differences are:

- The Wisconsin combined group must only include companies that are engaged in the same unitary business, while the federal consolidated group may include companies that are not unitary. This may cause the Wisconsin combined group to be smaller than the federal consolidated group.
- The Wisconsin combined group includes companies that are more than 50% commonly controlled, while the federal consolidated group includes only companies that are more than 80% commonly owned or controlled. This may cause the Wisconsin combined group to be larger than the federal consolidated group.
- The Wisconsin combined group includes foreign corporations that meet the “water’s edge” test, while the federal consolidated group generally does not include foreign corporations. This may cause the Wisconsin combined group to be larger than the federal consolidated group.

However, in some cases, the Wisconsin combined group and federal consolidated group may be the same group of corporations.

Question A8: How does combined reporting affect insurance companies?

Answer A8: Domestic insurers compute their Wisconsin income or franchise tax liability using the lesser of two computations: 1) 7.9% of Wisconsin net income or 2) 2% of gross premiums as defined in sec. 76.62, Wis. Stats. A domestic insurer must use combined reporting to determine the amount of Wisconsin net income under computation 1). However, computation 2) is not affected by combined reporting.

Thus, if a domestic insurer’s income or franchise tax liability based on 2% of gross premiums is less than its income or franchise tax liability based on Wisconsin net income using combined reporting, the insurer may use the 2% of gross premiums computation.

Foreign insurers exempt from taxation under sec. 71.45(1), Wis. Stats., are not affected by combined reporting.

Question A9: If a corporation is not included in a combined report because it doesn't meet the three tests (described in Question A3), is it still required to file a Wisconsin return?

Answer A9: Yes, if it has nexus in Wisconsin. If a corporation is not includable in a combined report, it must still file a Wisconsin return on a separate entity basis if it has nexus in Wisconsin.

B. Income Includable in a Combined Report

Question B1: When do I have to include foreign sourced income in a combined report?

Answer B1: The answer depends on whether the corporation earning the income is a domestic corporation (i.e. incorporated in the U.S.) or a foreign corporation.

- **For foreign corporations:** Do not include foreign source income (or loss) of a foreign corporation in a combined report. You must also exclude the expenses associated with the foreign source income (or loss).
- **For domestic corporations:** In general, you must include foreign source income (or loss) of a domestic corporation if it is taxable under the Internal Revenue Code as modified for Wisconsin purposes. However, if 80% or more of the domestic corporation's worldwide income is active foreign business income as described in Question A6, you should not include foreign source income (or loss) or the expenses associated with that income (or loss).

Any income excluded from a combined report but which is still taxable under the Internal Revenue Code as modified for Wisconsin purposes must be reported to Wisconsin on a separate entity basis if the corporation has nexus in Wisconsin.

Also, the Department of Revenue has authority to require this income to be included in the combined report in cases where excluding it would result in an avoidance or evasion of tax (sec. 71.255(2)(f), Wis. Stats.).

Question B2: When do I have to include income of a foreign corporation in a combined report?

Answer B2: It depends on whether the foreign corporation meets the water's edge test described in Question A6. If a foreign corporation does not meet the water's edge test (in other words, if 80% or more of its income is active foreign business income), it can be considered to be on the "foreign side of water's edge."

- **If on foreign side of water's edge:** None of the foreign corporation's income (or loss) is includable in the combined report. You must also exclude expenses associated with this income (or loss).
- **If on U.S. side of water's edge:** Include the foreign corporation's income (or loss) in the combined report, along with the associated expenses. However, only include this income (or loss) and associated expenses to the extent they are U.S. sourced.

Any income excluded from a combined report but which is still taxable under the Internal Revenue Code as modified for Wisconsin purposes must be reported to Wisconsin on a separate entity basis if the corporation has nexus in Wisconsin.

Also, the Department of Revenue has authority to require this income to be included in the combined report in cases where excluding it would result in an avoidance or evasion of tax (sec. 71.255(2)(f), Wis. Stats.).

Question B3: How do I know if income is U.S. sourced or foreign sourced?

Answer B3: The combined reporting statute uses sections 861 through 865 of the Internal Revenue Code to distinguish U.S. sourced income from foreign sourced income.

Question B4: Are intercompany transactions between members of the combined group eliminated for purposes of determining the combined group's income?

Answer B4: In general, yes. Since the incomes of the corporations are combined before apportionment, intercompany transactions generally "wash out" in the same manner they would in a federal consolidated return.

C. Apportionment

Question C1: How is a corporation's share of the combined group's Wisconsin income computed?

Answer C1: Each corporation in the group multiplies the combined group's unitary business income by an apportionment fraction. The numerator of the fraction is the numerator of the corporation's modified sales factor. The denominator of the fraction is the sum of the denominators of all group members' modified sales factors. The "modified sales factor" is a single apportionment factor equal to a corporation's sales apportionment factor, receipts factor, or premiums factor – whichever applies to that corporation.

For companies that use multiple-factor formulas under the Department of Revenue's administrative rules, those multiple-factor formulas are converted to a modified sales factor as described in Question C4.

Question C2: Is there any apportionment computation for 100% Wisconsin corporations?

Answer C2: It depends on whether there is at least one member of the combined group that is engaged in business outside Wisconsin. If there is at least one member of the combined group that is engaged in business outside Wisconsin (and at least one member that is engaged in business in Wisconsin), the entire combined group uses the apportionment computation described in Question C1. However, if no corporation in the group is engaged in business in any state other than Wisconsin, the combined group does not apportion its income.

Question C3: Are intercompany transactions eliminated when computing the apportionment factors?

Answer C3: Yes, you must eliminate intercompany transactions in computing the apportionment factors of each member of the combined group.

Question C4: How does a corporation that uses a multiple-factor apportionment formula convert it to a modified sales factor for purposes of combined reporting?

Answer C4: The combined reporting statute (sec. 71.255(5)(a)5, Wis. Stats.) provides a formula that converts a multiple-factor apportionment formula into a modified sales factor. The steps to this formula are as follows:

- **Step 1:** Compute the corporation's apportionment percentage on a separate entity basis, using the multiple-factor formula that applies under current administrative rules. Exclude from these factors any intercompany transactions between members of the combined group.

- **Step 2:** Compute the corporation's total company sales on a separate entity basis. For this purpose, "sales" means sales as defined in sec. 71.25(9)(e), Wis. Stats. Exclude any transactions between members of the combined group.
- **Step 3:** Compute the corporation's modified sales factor numerator. The modified sales factor numerator is the apportionment percentage from Step 1 multiplied by the total company sales from Step 2.
- **Step 4:** The corporation's modified sales factor denominator is the total sales amount from Step 2. Add this amount to the denominators of the other members of the group to arrive at the combined group's modified sales factor denominator.

D. Business Losses

Question D1: If a corporation has net business loss carryforwards as of the beginning of its 2009 taxable year, what happens to those net business loss carryforwards under combined reporting?

Answer D1: Losses generated by a combined group member for taxable years beginning before January 1, 2009 are allowed only to that member. In other words, Wisconsin's combined reporting law does not allow members of the combined group to share net business losses that were generated in taxable years beginning before January 1, 2009.

E. Credits

Question E1: If a corporation has credit carryforwards as of the beginning of its 2009 taxable year, what happens to those credit carryforwards under combined reporting?

Answer E1: Credits and any credit carryforwards are available only to the separate corporation that generated them. However, credits from prior year estimated tax overpayments or excess withholding may be shared at the group level.

F. Forms, Payments, and Administrative Issues

Question F1: Is there a registration process for the combined group?

Answer F1: A combined group does not have to pre-register as a combined group. The return filed by the designated agent of the combined group will identify the members of the combined group included in the return.

Question F2: Who is the "designated agent" of the combined group?

Answer F2: The designated agent plays an important role and has significant responsibilities. The designated agent is generally the parent corporation, but may also be appointed by the members.

The designated agent does the following duties on behalf of the entire combined group, to the extent those duties relate to the unitary business:

- Files the combined return, any extensions, amended returns, and claims for refund or credit;
- Remits all taxes, including estimated taxes;

- Sends and receives correspondence;
- Participates in audits of the combined return, including the production of documents for audit;
- Executes waivers, POAs, and closing agreements; and
- Receives notices and refunds.

Also, an appeal filed by the designated agent is considered filed by all members of the group.

Question F3: Before a combined group files a combined return for the first time, will the designated agent have to register with the department as the designated agent?

Answer F3: The designated agent does not have to register in advance. The department will be able to identify the designated agent at the time the designated agent files the combined return on behalf of the combined group.

Question F4: When should I start considering combined reporting in my computation of estimated tax payments?

Answer F4: The law provides a grace period for the designated agent to make any estimated payments for the combined group that are due less than 45 days after March 6, 2009. The due date of these payments is extended to the next subsequent installment due date. Thus, the following due dates apply:

- For combined groups on a calendar year, the first estimated payment is due on June 15, 2009. This payment must take into account the combined group's first and second installment payments.
- For combined groups on a fiscal year beginning February 1, 2009, the first estimated payment is due on July 15, 2009. This payment must take into account the combined group's first and second installment payments.
- For combined groups on a fiscal year beginning March 1, 2009, the first estimated payment is due on May 15, 2009. This payment only needs to take into account the combined group's first installment payment.

Question F5: How does a designated agent make an estimated payment on behalf of the entire combined group?

Answer F5: The designated agent should use electronic funds transfer or a Form 4-ES, *Corporation Estimated Payment Voucher*, in the same manner as it would make payments under separate entity filing.

The designated agent is not required to register as the designated agent in order to submit estimated payments on behalf of the group. The designated agent is also not required to identify the members of the group at the time that it makes an estimated payment on behalf of the group. Rather, when the designated agent files the group's combined return, it will submit a department-prescribed form with the return to identify the corporations included. The designated agent's payments will be deemed to be made on a pro rata basis by all members of the combined group unless the designated agent specifies otherwise.

Question F6: How would the combined group determine its taxable year when members of the combined groups have taxable years beginning on different dates?

Answer F6: If two or more members of a combined group file in the same federal consolidated return, the combined group's taxable year is the taxable year of the federal consolidated group. In all other cases, the taxable year is the taxable year of the corporation that is the designated agent.

G. Other Issues Affecting Combined Filers

Question G1: How does combined reporting affect the applicability and determination of the recycling surcharge?

Answer G1: Each corporation in a combined group is considered a separate corporation for purposes of imposing the recycling surcharge. Therefore, the \$4,000,000 gross receipts threshold, the \$25 minimum recycling surcharge, and the \$9800 maximum recycling surcharge are determined separately for each entity in the combined group. However, since the recycling surcharge for corporations is based on the corporation's gross tax liability under Chapter 71, Wis. Stats., combined reporting may impact the amount of the surcharge owed by each corporation in the combined group.