

CORPORATE TAX MODELING FOR COMBINED REPORTING

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FTA Conference on Revenue Estimating and Tax Research
New Orleans, Louisiana
September 21-24, 2003

Background

- Current Wisconsin law: separate entity reporting -- each separately incorporated entity files its own tax return, reporting its own net income and tax liability.
- Traditional state corporate tax sample data are drawn from returns filed by separate corporate entities.

- No information exists to allow the separate affiliated entities to be placed into corporate groups. Thus, unable to measure the effects of combined reporting.
- To answer questions about the effects of combined reporting, it is necessary to capture basic group level data.

Sources of Group-Level Data

- The Wisconsin return for a member of a group may include a copy of the federal consolidated return for the group.
- In cases where all or most of the members of a group have filed a Wisconsin return, the group-level data may be derived by adding up the individual members' data. When doing this, intra-group transactions need to be eliminated if found.

- A third source is another state's tax agency – a combined reporting state willing and able to match tax returns.
- A fourth source is the Federal business tax master file, if the group's parent corporation is a Wisconsin-located corporation that filed a federal return for the group.

Matching Against Other States' Tax Records

- 1984 Combined Reporting Study:
 - ◆ Selected 68 of the top 173 corporations with the highest state tax liabilities for the 1977-80 period.
 - ◆ Turned to California, a combined reporting state, to provide information from California tax records of these companies.

- ◆ The California information was used to calculate the tax liabilities of the 68 corporations and 81 affiliates assuming combined reporting.

- 1996 Multi-Dimensional Approach that combined Wisconsin Department of Revenue tax records with group level data from Minnesota Department of Revenue tax records.

- ◆ Similar in concept to the 1984 approach except more comprehensive: more returns, more rigorous search of the affiliates, and better technology to permit merging of the data from various sources.

- ◆ Wisconsin identified 2,300 Wisconsin corporations that reported >\$2 million Wisconsin income or >\$2 million Wisconsin loss carryforwards.
- ◆ Minnesota matched the FEINs with their file of Minnesota-nexus corporations.

- ◆ Where match was successful, Minnesota provided 1994 or 1995 data permitting construction of group level income (federal and Minnesota apportionable net income) and apportionment information.
- ◆ Minnesota also provided the FEINs and names of other corporations in the unitary group and identified list of 2,050 corporations and affiliates with Minnesota nexus.

- ◆ Wisconsin matched the Minnesota list against Wisconsin files and 1,089 matched a Wisconsin nexus corporation. These 1,089 belonged to 470 unitary groups.
- ◆ Using the Department's tax administrative records for 1994 and 1995, information was extracted for the matches identified by Minnesota.
- ◆ Group-level data from Minnesota was merged with entity level data from Wisconsin administrative records.

Microsimulation Models

- The Department of Revenue has maintained a corporate tax microsimulation model since the early 1980's.
- Previous models were mainly single-entity.

■ Sample selection criteria for past samples:

- 100% selection for corporations that had high Wisconsin income;
- the remaining corporations were stratified on the basis of various criteria (e.g., income, industry-type, whether the corporation was a 100% Wisconsin firm or apportioned, and presence of certain credit claims).

■ For the 1996 sample, two other criteria were added:

- 100% sample selection of those corporations for which there was a Minnesota match, and.
- 100% sample of corporations that had more than \$5 million Wisconsin loss.
- Both of these new criteria are especially relevant for combined reporting.

- Besides the additional sampling criteria, the 1996 sample also incorporated affiliate and group data searches as returns were being pulled.

2001 Corporate Tax Model & Federal Tape Match

- Another source of group level data is the federal tax return.
- But the federal business tax master file does not provide information on the affiliates that belong to the group. Individual returns have to be examined to extract the affiliate information.

- Tax year 2001 Wisconsin corporate tax returns are being matched to the 2002 federal business master tax file (which consists of mainly tax year 2001 data as well as some returns from prior or later years.)

- The 2001 Corporate Tax Model is being built in five phases. The phases are not necessarily in chronological sequence, since different activities in the various phases may be occurring simultaneously.
- Phase 1: Stratified sample of S corporations (881 corporations selected from a population of about 48,000), and 100% sample of insurance companies (123 corporations).

- Phase 2: 100% sample of corporations with special credits (R&D, Historic, and Development Zone credits). Search also made for additional affiliates with Wisconsin nexus.
(333 corporations + 116 additional affiliates, belonging to 87 corporate groups).

- Phase 3: Corporations taxed under a special apportionment formula (e.g., utility companies, airlines, transportation companies):
 - ◆ income >\$0 before the loss carryforward: will be sampled at 100%. (568 corporations + 98 additional affiliates, in 61 groups. Affiliate search still in progress).
 - ◆ those with income <\$0 or \$0 before the loss carryforward will be subject to stratified sampling, followed by affiliate search.

- Phase 4: Large Wisconsin corporations (>\$2 million net Wisconsin income) will be sampled at 100%.
(341 corporations + 299 additional affiliates, in 155 groups).

- Phase 5: All other Wisconsin corporations – their sampling rate depends on whether they match the same Federal tax year, and whether Wisconsin and Federal incomes are equal:
 - ◆ The more unequal the incomes, the higher the likelihood that there are affiliates and the higher the sampling rate.

- ◆ About 30,000 Wisconsin returns are matched to a federal tax year 2001 returns. Of these, the majority have incomes that are the same on both returns. Only 1,700 returns do not -- the Wisconsin income is either higher or lower than the Federal counterpart , which may indicate the presence of affiliates.
- ◆ About 15,000 returns either match a different federal tax year , or have no matches at all. These will be subject to the stratified sample and subsequent affiliate search.
- ◆ Phase 5 is still ongoing.

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TABLE 1
2001 CORPORATE TAX SAMPLE
STRATIFICATION SCHEME AND SAMPLING RATES

Wis. Income (\$)	2001 Form 5 (C Corps. - 100% WI)		2001 Form 4 (C Corps. - Apportioned)		2001 Form 5S (S Corporations)		2001 Form 41 (Tr	
	-	-	-	-	-	-		

CHART 1 - SAMPLE DESIGN

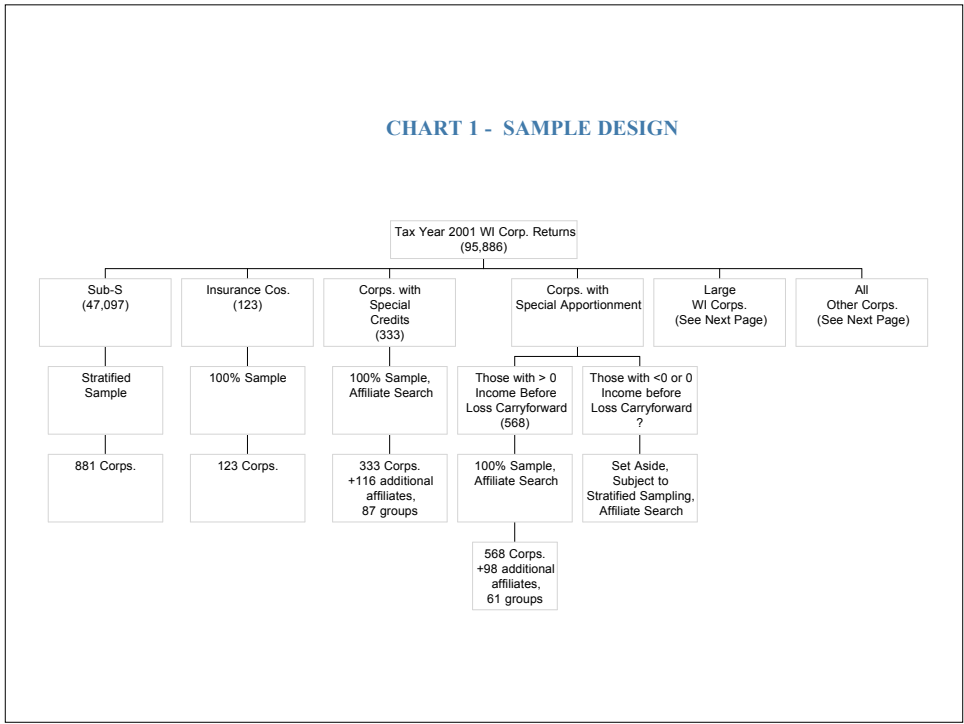
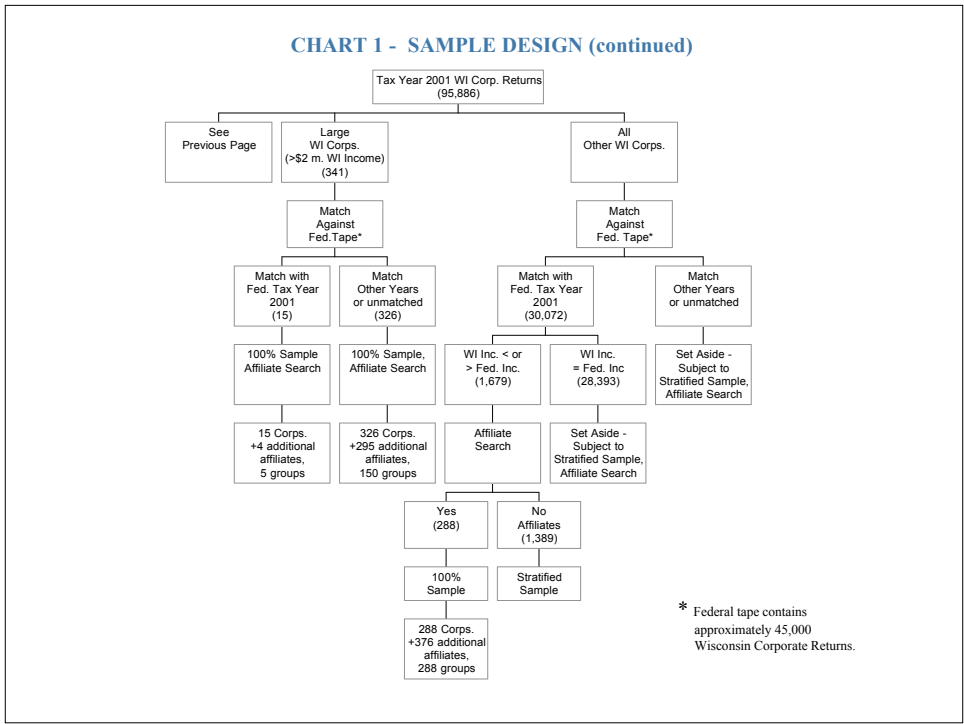


CHART 1 - SAMPLE DESIGN (continued)



* Federal tape contains approximately 45,000 Wisconsin Corporate Returns.