

## **COMBINED RETURN INSTRUCTIONS**

### **2010 Schedule U-M Instructions**

#### **Member's Income and Expenses**

Schedule U-M is the starting point for the determination of the combined group's taxable income. The members of the combined group are to report their unadjusted income as determined for federal income tax purposes in column (a) of this schedule, with further adjustments as required by Massachusetts law to be reflected in columns (b) through (e), and a final statement of the member's Massachusetts combined group income or expense to be tallied in column (f). Each member of the combined group, whether it is subject to taxation in Massachusetts or not, is to file a Schedule U-M; no member is to submit more than one Schedule U-M. In some cases in the instance where the combined group has made and is subject to an affiliated group election, multiple members of a combined group can be included on a single Schedule U-M. See below.

If there are eliminations as to transactions between combined group members required under Massachusetts law, these eliminations are to be referenced on a separate Schedule U-M (the "eliminations schedule"), to be filed by the principal reporting corporation with the totals to be reported in column (f). See below. The totals from column (f) for every Schedule U-M, including the eliminations schedule, if any, are to be reported on Schedule U-CI.

#### **Header for Schedule U-M**

For each Schedule U-M filed, enter the name of the member (as shown on its federal income tax return, if filed), its Federal Identification number and the beginning and ending dates of the combined group's taxable year. If the member is a non-U.S. corporation that does not have a Federal Identification number, enter "Foreign" in the space provided for the FIN. Note that if the non-U.S. corporation is taxable on its income in Massachusetts, the member will require a FIN to complete other schedules required as part of the combined report.

For each Schedule U-M, indicate whether or not the member is a non-U.S. corporation.

For each Schedule U-M, indicate whether or not the member is claiming a treaty based income exclusion. Non-U.S. corporations that are members of water's edge group may exclude from a Massachusetts combined return those items of income that are exempt from federal income tax due to a federal tax treaty but must disclose the position taken. See *Rules for Non-U.S. Corporations in a Water's Edge Combined Group* (below).

For each Schedule U-M, indicate whether or not the group has made an election to file as either an affiliated group or a worldwide election. This response must match the election shown on Form 355U, question number 2.

For each Schedule U-M, identify the name of the combined group's principal reporting corporation and the Federal Identification number of the principal reporting corporation. For each Schedule U-M, check the box that indicates from where the amounts referenced on lines 1 through 28, column (a) are reported from. See below.

**Filing Box to be Checked and Source of Federal Tax Information to be Reported:**

**Column (a)**

Column (a) reports the unadjusted amounts of income and expense of each member filing a Schedule U-M as included in a federal income tax return as filed or on a pro-forma basis if the taxpayer filed a federal income tax return other than a U.S. Form 1120. How an individual member determines the amounts to report in column (a) depends upon how, or whether, the member of the group is to report its income federally, as follows.

*Consolidated return as filed (applicable only in the case of an affiliated group election):*

If the combined group is filing subject to a Massachusetts affiliated group election and no member of the federal consolidated group is an "excluded corporation" with respect to the Massachusetts combined group complete only one Schedule U-M for all of the members of the federal consolidated group checking the box "*consolidated return as filed*" and report in column (a) the amounts referenced on the federal consolidated return.

"Excluded corporations" that may be part of a federal consolidated return but that are excluded from a Massachusetts combined group in all cases, including in the instance in which the combined group has made and is subject to an affiliated group election, include certain insurance corporations and Massachusetts security corporations. See 830 CMR 63.32B.2 (4) (c).

Where the combined group members of a federal consolidated group are to file a single Schedule U-M as stated above but the Massachusetts combined group also includes additional members who are not members of such federal consolidated group (e.g., S corporations; certain corporations that are not formed or incorporated under U.S. law, see 830 CMR 32B.2(5)(b); and certain corporations that are subject to greater than 50% "common ownership" within the meaning of the Massachusetts combined reporting rules but that are not 80% owned as required for purposes of federal consolidation), a separate Schedule U-M is required for each such additional member of the combined group (i.e., in addition to the single Schedule U-M that is filed for the members of the federal consolidated group). See below for more information as to the manner of filing in the case of a Massachusetts affiliated group election.

Where the Massachusetts affiliated group includes more than one federal consolidated group, each federal consolidated group is to report the income of the corporations that are members of that federal group on a Schedule U-M that corresponds to the tax return filed by the federal group. For example, if the Massachusetts affiliated group includes all the members of two federal consolidated groups, two Schedules U-M must be filed (and possibly an elimination schedule must be filed as well if there are transactions between the groups).

*Pre-consolidation separate company:* If the member is filing its federal return as part of a consolidated group but the group does not qualify to submit consolidated return data (generally applicable where a combined the group files a federal consolidated return but is not subject to a Massachusetts affiliated group election), each member of the each member of the federal consolidated group that is also part of the Massachusetts combined group must file a separate Schedule U-M and report in Schedule U-M, column (a) the separate amounts referenced for the member on the consolidation schedule filed with the federal consolidated tax return before any eliminations or consolidation adjustments. In these cases, each member of the federal consolidated group must check the “*pre-consolidated separate company*” box.

*Separate U.S. 1120 as filed:* If the member is filing U.S. Form 1120 on a separate company basis it must check the box “*separate U.S. 1120 as filed*” and report in Schedule U-M, column (a) the amounts referenced on its federal income tax return.

*Pro-forma, U.S. 1120S filed:* If the member is filing U.S. Form 1120S it must report, in column (a) the member’s pro-forma federal totals including the gross income and expenses of a qualified subchapter S subsidiary, if any, but without taking into account subchapter S of the Internal Revenue Code (I.R.C.). Each S corporation filing Schedule U-M must check the box “*pro-forma, U.S. 1120S filed.*”

*Pro-forma, other U.S. return filed:* If the member is filing any U.S. Income tax return other than from 1120 or 1120S (e.g. Form 1120F or 1120-REIT), it must report in column (a) the income and deductions referenced on that return. Amounts not included on the federal return (e.g. any U.S. Source income of non-U.S. corporations that was not reported on U.S. form 1120F), will be reported in column (c). Each such member will check the box “*pro-forma, other U.S. return filed.*”

*Pro-forma, no U.S. return filed:* If the member is not filing a U.S. Income tax return for any reason, it must check the box “*pro-forma, no U.S. return filed*” and leave column (a) blank. All income and deductions of such corporations is reported in column (c). See below for more information on filing Schedule U-M where the combined group member is a non-U.S. corporation, including the situation where the combined group has made and is subject to a worldwide election.

*Eliminations:* If the members of the combined group have engaged in one or more transactions as between one another that require inter-company elimination as to such transactions for Massachusetts purposes, the principal reporting corporation shall check the eliminations box and file a separate Schedule U-M as an “eliminations schedule” for the combined group. The eliminations to be reported on this schedule do not include eliminations and adjustments that are reported for federal purposes and that are already incorporated in the amounts reported in column (a) by a federal consolidated group submitting a single schedule U-M as discussed above (i.e., there is to be no duplication in the reporting as to such eliminations or adjustments). The additional “group” Schedule U-M, i.e., the eliminations schedule, shall be in addition to the other Schedule U-M’s to be filed by the members of the combined group. Entries on the elimination schedule are to be made in columns (a) and (f). See below for further details on filing the eliminations schedule.

## **Members with Different Fiscal Years and “Fiscalization”:**

### **Column (b)**

Massachusetts requires all members of a combined group to determine their taxable share of the combined group’s taxable income based on a common tax year, i.e., the combined group’s taxable year. If the taxable year of one member of a combined group does not begin or end on the same date or dates as the combined group’s taxable year, that member’s accounting periods must be adjusted in order to properly calculate both group income and the member’s apportioned share of that income. In such cases, the member reports in column (a) the amounts from its most recently completed federal income tax return and reports in column (b) adjustments to those amounts to reflect income and expense for the combined group’s taxable year.

This “fiscalization” may be done by an interim closing of the books or, provided it does not materially distort income apportioned to Massachusetts, by a pro-rata method that includes appropriate shares of income from more than one of the member’s tax years (e.g., if the combined group’s taxable year is a calendar year and the member’s federal tax year ends on March 31st such that the group’s taxable year overlaps two of the member’s tax years, that member would include 9/12ths of its income from one year and 3/12ths of its income from the other year in the combined group’s taxable income). See 830 CMR 63.32B.2 (12) (b). Any fiscalization adjustments are to be made in Schedule U-M, column (b).

## **Combined Reporting Adjustments:**

### **Column (c)**

Column (c) is used to report certain additions or modifications to the income and deductions reported in columns (a) or (b) that are required to calculate the combined group’s taxable income under Massachusetts law. Note that adjustments that reduce an item of income or expense to be included in the determination of the combined group’s taxable income are to be reported as negative amounts in the respective line item of income or expense.

Examples of these adjustments may include but are not necessarily limited to:

- Reporting of certain income and deductions by a non-U.S. corporation that is a member of the combined group where such income or deductions are not reported for federal income tax purposes, but are to be reported for Massachusetts purposes (e.g., items of non-effectively connected income on which the U.S. federal income tax may be collected through withholding imposed upon the payers of such items). See the discussion below with respect to reporting on column (c), in the case of a non-U.S. corporation.
- Adding to a member’s income the dividend to such member from another group member where the dividend is eliminated in a federal consolidated return. In the case of dividends that are subject to elimination under 830 CMR 63.32B.2(6) or are eligible for a dividends received deduction under c. 63, the elimination or deduction will be reported on Schedule U-E.

- Reducing the amount of any dividends paid deduction claimed for federal income tax purposes by a REIT or a RIC that is a member of the combined group to the extent that such distribution is made to one or more other group members and is eliminated under 830 CMR 63.32B.2(6)(c)4. See Directive 10-5.
- Reversing the application of federal limitations and the use of federal carryovers in computing the federal charitable contributions deduction shown on lines 19(a) or 19(b) as necessary to compute a charitable contributions deduction for Massachusetts purposes, including (1) reversing any reduction in the federal amounts required by a percentage of income limitation; (2) eliminating any contributions included in the federal totals that represent contributions made in prior tax years and carried forward to the current tax year for federal income tax purposes; and (3) increasing the contributions by any amount disallowed in calculating net income for a Massachusetts return in the prior tax year based on the percentage of income limitation. See 830 CMR 63.32B.2 (6) (c) 6.
- Reversing federal adjustments made in the context of offsetting capital gains and losses and I.R.C. § 1231 gains and losses for federal income tax purposes so that this offset can be done for Massachusetts income tax purposes, including (1) reversing the elimination of a net capital loss made in computing the amount shown as taxable income on lines 8(a) or 8(b); (2) reversing the deduction of a capital loss carryforward reflected in computing capital gain or loss as shown in lines 8(a) or 8(b), as such capital loss carry forward is not permitted for Massachusetts purposes; and (3) reversing the reclassification and offsetting of § 1231 gains against capital losses to the extent such adjustments are reflected in computing taxable income as shown in column (a) or (b). See 830 CMR 63.32B.2 (8) and Directive 10-05.

**Income from Sources other than the Unitary Business:**

**Columns (d) and (e) (note: not applicable in the case of an affiliated group election)**

Columns (d) and (e) only apply in cases in which the combined group has not made and is therefore not subject to an affiliated group election. In these cases, a member of a combined group (including a non-taxable member of such group) may have income or loss that derives from sources other than the combined group's unitary business. Columns (d) and (e) of Schedule U-M report this income of the group member, which can include allocable income that is not taxable in Massachusetts, to be reported in column (d), and allocable or apportionable income that is taxable in Massachusetts, to be reported in column (e). A member with a taxable year that is different than the combined group's taxable year should also use column (d) to exclude any income that it has from sources other than the combined group's unitary business that is to be reported on the member's separate Massachusetts tax return (i.e., Form 355 or 355S or other applicable return) filed for the member's different taxable year. (Note that in these latter cases, with respect to this member, the Massachusetts rules concerning the timing for the offset or sharing of losses, including capital and I.R.C. § 1231 losses, and the use of NOL carry forwards, may be impacted by the fact that the member is making filings for different tax years).

The income to be reported in column (e), allocable or apportionable income that is taxable in Massachusetts, is further accounted for on Schedule U-MTI. Gains and losses incurred within the same tax year, including those to be reported on column (e), may be offset (to the extent allowed by the I.R.C. and Massachusetts law) in the calculation of the member's overall taxable Massachusetts income.

If the combined group is subject to a Massachusetts affiliated group election, all of the members' income or loss, irrespective as to whether it derives from a unitary business, is treated as the apportionable income of the combined group. In such cases, columns (d) and (e) of Schedule U-M have no application and no entries in these columns are permitted.

### **Adjusted Total:**

#### **Column (f)**

Column (f) is used to report the adjusted income and deductions for each member's Schedule U-M. The figures are a mathematical calculation, subtracting the amounts in columns (d) and (e) from the total of the amounts in columns (a), (b) and (c).

Line 11 must match the total of lines 3 through 10.

Line 28 must match line 11 minus line 27.

The amounts in lines 1-28, column (f) for all Schedules U-M completed for all members of the group and the eliminations schedule are to be totaled on lines 1-28 of Schedule UCI.

### **Rules for a Combined Group that makes an Affiliated Group Election**

A combined group that has made and is subject to an affiliated group election is to submit a single Schedule U-M for all members of a single federal consolidated group if the federal consolidated group includes no "excluded corporations" (see the discussion of this concept in the discussion of column (a) above). However, in these cases if the Massachusetts affiliated group includes one or more members that are not included in the federal consolidated group, those additional members must each submit a separate Schedule U-M in addition to the Schedule U-M that is to be submitted by the group members that are included in the federal consolidated group.

### **Examples that Compare Filings Where the Group is Either Subject to or Not Subject to an Affiliated Group Election**

*Example 1.* Acme Corp. is the common parent of a group of 9 corporations that file a federal consolidated return. The 9 corporations, including 5 corporations that are not taxable on their income in Massachusetts, are all engaged in a unitary business and therefore are required to determine and apportion their taxable income from the unitary business on a combined basis.

If no affiliated group election is made, a separate Schedule U-M must be filed for each of the 9 members of the group, referencing the separate company totals as stated on the federal consolidation schedules, to be set forth in column (a). Each member must determine if it has items of income, expense or deduction from sources other than the unitary business and, if so, must enter this information on its Schedule U-M in column (d) or (e), as appropriate (i.e., as an adjustment eliminating such item or items).

The group must also submit an eliminations schedule, i.e., one additional Schedule U-M, to eliminate inter-company transactions, if any, which relate to the unitary business. In total, assuming that the group is to file an eliminations schedule, the combined group is required to submit 10 Schedules U-M.

If Acme makes an affiliated group election and none of the members of the federal consolidated return are excluded corporations, a single Schedule U-M is to be filed, using the totals stated on the federal consolidated return. Massachusetts income adjustments to these federal totals are then to be stated in column (c). In such cases, no eliminations schedule should be filed, as there are no adjustments eliminating income or expenses that are required or allowed.

*Example 2.* Same facts as in Example 1 except that Acme Corp is 51% owned by a U.S. parent corporation that is not included in the federal consolidated group and in addition the parent is engaged in activities that are part of the combined group's unitary business. The combined group includes the parent corporation because the parent's activities constitute part of the group's unitary business. If the combined group does not make an affiliated group election, the group will file Schedule 355U and enclose 11 Schedules U-M; 9 schedules for the corporations that are subject to federal consolidation, 1 for the parent corporation and 1 as an eliminations schedule (i.e., assuming that an eliminations schedule is necessary).

If the combined group makes an affiliated group election, the affiliated group will file a total of 3 Schedules U-M; one such Schedule U-M for the 9 members of the combined group, 1 additional Schedule U-M reporting the income and expenses of the parent corporation and a final Schedule U-M to eliminate all inter-company transactions between the parent and the other members of the combined group (i.e., again, assuming that there are such inter-company transactions to be eliminated).

### **Rules for Non-U.S. Corporations in a Water's Edge Combined Group**

Each non-U.S. corporation that is not treated as a U.S. corporation for federal income tax purposes that is included in a "water's edge" combined report (i.e., where no worldwide election is in effect) must complete schedule 355U-M on a pro-forma basis, checking the box "*Pro-forma, other U.S. return filed*" if the member filed US 1120F and checking "*Pro-forma, no U.S. return filed*" in all other cases.

Where the non-U.S. corporation is included in a combined group because it otherwise meets the requirements for inclusion and the corporation is either subject to tax under M.G.L. c. 63 or the average of the corporation's U.S. apportionment factors exceed 20%, see 830 CMR 63.32B.2 (5) (b), the corporation must include in the combined group's taxable income all of its income that is includible in its federal gross income. This income includes all of the corporation's gross income that is effectively connected with the conduct of a trade or business within the U.S. and gross income from sources within the U.S. that is not effectively connected income. The gross income of a non-U.S. corporation includes, among other things, items of non-effectively connected income on which the U.S. federal income tax may be collected through withholding imposed upon the payers of such items. See 830 CMR 63.32B.2 (6) (c) 2.1.a (referencing I.R.C. § 882(b), as well as I.R.C. §§ 881(a), 882(a)).

An item of income of a corporation that is organized outside of the United States shall not be included in the combined group's taxable income to the extent that such item is exempt from United States federal income tax by virtue of a federal income tax treaty. See M.G.L. c. 63, § 32B(c) 3(iv). In any case in which such a treaty merely reduces the federal rate of tax to be applied to an item of federal gross income, this income is to be included in the combined group's taxable income without any reduction.

Where a combined group member's federal gross income taken into account in determining taxable net income is limited under the Code (or pursuant to Massachusetts adjustments), any deductions in determining taxable net income are also limited to those permitted to be taken under the Code (and any such Massachusetts adjustments) with respect to the items of gross income taken into account. See 830 CMR 63.32B.2 (6) (c) 2.

In addition to the above, a non-U.S. corporation shall also be included in a water's edge combined report in cases not referenced above where it earns 20% or more of its gross income, directly or indirectly, from intangible property or service-related activities, the costs of which generally are deductible for federal income tax purposes, whether currently or over a period of time, against the business income of other members of the group. In these cases, the non-U.S. corporation shall only be included to the extent of such income (and the apportionment factors that relate thereto). In determining whether the 20% income threshold has been exceeded, the items of gross income in the numerator and denominator of the corporation's calculation shall not be limited to items of federal gross income. However, where a corporation's calculation meets the 20% threshold, the income of the corporation to be included in the combined group's taxable income shall be limited to items of federal gross income as reduced by the deduction of expenses of the member that are reasonably related and not disproportionate to such federal gross income, as determined pursuant to such guidance as may be issued by the Commissioner, provided that in no event in these cases shall the corporation's gross income to be included in the combined group's taxable income be reduced below zero. The rules referenced above with respect to the impact of any applicable U.S. tax treaties also apply in these cases. The regulatory rules that explain the concepts discussed in this paragraph are generally set forth at 830 CMR 63.32B.2 (5) (b) 1.c and 830 CMR 63.32B.2 (5) (b) 3 and 4.

In those cases where a non-U.S. corporation included in a water's edge combined group files Form 1120F the member must report in column (a) all of the member's effectively connected income and the deductions allowable with respect to that income under the Code as reported on its Form 1120F. Further, any such corporation must report in column (c) any additional items of federal gross income that are required to be included in the combined report but that is not reported on a federal Form 1120F and any deductions from such additional federal gross income that are allowed for purposes of determining the combined group's taxable income. In the case of a corporation that is includible only as provided in the preceding paragraph (pursuant to 830 CMR 63.32B.2 (5) (b) 1.c.), the income inclusion to be reported in column (c) is limited to the gross income received from the other combined group members for certain intangible property or services, see above, and the deductions to be offset against this income shall not exceed the total of gross income reported by the member on line 11(c).

Where a non-U.S. corporation is included as a member of a water's edge combined report but has no items of federal gross income or only has items of federal gross income that are treated as excluded from the combined group's taxable income by reason of the application of a federal income tax treaty, a Schedule U-M must be filed to indicate the fact of the non-U.S. corporation's inclusion, though there will be no items of income or deductions to report as being part of the combined group's taxable income. In any case where a member excludes any amount from gross income by virtue of a federal treaty, the member must also complete and file schedule U-TTP identifying the treaty position taken and the income being excluded from the return. In any case where such filing is not made, the commissioner may, *inter alia*, deny expenses paid by group members to such non-U.S. member.

Column (b) adjustments (fiscalization) may be required for a non-U.S. corporation that is included in a water's edge combined group if the amounts reported by the member in column (a) are for a period other than the combined group's taxable year. Further, columns (d) and (e) adjustments may also apply to a non-U.S. corporation if the member has income or deductions reported in columns (a), (b) or (c) that are from sources other than the unitary business and the combined group is not subject to an affiliated group election. See above discussion of columns (d) and (e). Only amounts included in the member's income as reported in columns (a), (b) or (c) may be excluded in columns (d) and (e).

### **Rules for Non-U.S. Corporations where a Worldwide Election is in Effect**

In any case in which the combined group has made and is subject to a worldwide election, a non-U.S. corporation that is not treated as a U.S. corporation for federal income tax purposes and that is a member of such combined group is to include in the combined group's taxable income all of its income from the unitary business, wherever derived. Such income is not limited to items of federal gross income under the Code. See 830 CMR 63.32B.2 (6) (c) 2.b.

Each such non-U.S. corporation that is included in a “worldwide” combined report must complete schedule 355U-M on a pro-forma basis, checking the box “*Pro-forma, other U.S. return filed*” if the member filed US 1120F and checking “*Pro-forma, no U.S. return filed*” in all other cases. In those cases where the non-U.S. corporation included in a worldwide combined group files federal Form 1120F, the member must report in column (a) all of the member’s effectively connected income and the deductions allowable with respect to that income under the Code as reported on its Form 1120F.

Further, the non-U.S. corporation must also report in column (c) any additional gross income of the non-U.S. corporation that is not effectively connected income and any additional income of the member (that is, assuming that the income to be reported in column (c) is from the combined group’s unitary business). The corporation must also report in column (c) any deductions from such additional income.

Columns (b), (d) and (e) may also apply to the non-U.S. corporation that is included in a worldwide combined group. The non-U.S. corporation that is included in such group and which has income from sources other than the combined group’s unitary business must follow the same procedures to exclude such income as would a U.S. corporation (see above discussion of columns (d) and (e)). Only amounts included in the member’s income as reported in columns (a), (b) or (c) may be excluded in columns (d) and (e).

#### **Instructions for the Eliminations Schedule (a separately filed “group” Schedule U-M)**

Enter the name and other identifying information of the principal reporting corporation in the header section, then check the box indicating that this is an eliminations schedule (i.e., check the last of the six boxes referenced at the top of Schedule U-M). In completing the rest of the header, check “N” for the question about whether or not this Schedule U-M is being filed by a non-U.S. corporation regardless of whether or not the principal reporting corporation is a non-U.S. Corporation.

Unless otherwise provided for under Massachusetts law, income from inter-company transactions between members of the same combined group that relates to the unitary business of the group (or, where the combined group is subject to an affiliated group election, without regard to any unitary determination) is generally deferred in a manner similar to that provided in U.S. Treas. Reg. § 1.1502-13 (see 830 CMR 63.32B.2 (6) (c) 9).

To the extent that such transactions are reflected in the income or expenses referenced on the Schedules U-M filed by the various group members, enter a single set of Schedule U-M totals reflecting eliminations and any other adjustments required by the combined group filing. When the tax items at issue are recognized in a later tax year, those items will be accounted for at such time, most likely on Schedule U-M (in column (a) if the item is recognized at the same time for Massachusetts and federal tax purposes or in column (c) if the deferral terminates for Massachusetts purposes at a different time than it terminates federally).

Enter the amounts reducing income (or expenses) as negative amounts on lines 1-28 in both column (a) and column (f).

Do not eliminate on this schedule any inter-company dividends. Intercompany dividend eliminations, where allowable, are to be reported on Schedule U-E.

Do not offset on this schedule any net I.R.C. § 1231 gains or losses of group members with any net capital gains/losses of group members or eliminate any net capital loss. These items, if any, are to be separately stated for a member in determining the member's overall taxable income. The member will report these adjustments, if any, on Schedule U-ST.

Do not make any adjustments on this schedule for federal/state basis differences or limitations on deductions based on taxable net income as determined under the I.R.C. These adjustments, if any, are to be made on Schedule U-E.

The combined report may not include more than one eliminations schedule.