MINNESOTA Department of Revenue

Appeals, Legal Services and Criminal Investigation Division (612) 215-5940

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TO: PPWG, Task Force B

FROM: Stephen Krenkel

SUBJECT: Instant Unity/ Discussion Paper

The topic of instant unity, how to treat acquired corporations, on the acquisition of a new member corporation of a unitary group is an issue assigned to Task Force B as part of the examination of issues which may be addressed in a rule defining the unitary business.

The issue presented is:

> When the controlling interest of voting stock in a corporation is acquired and that stock ownership meets the statutory requirement for filing a combined income report, and the acquired entity continues in existence as a subsidiary of the acquiring corporation, how is that acquired corporation required to file its tax return in the short period, if any, between the acquisition date and the beginning of the tax year of the acquiring unitary group of corporations.

In that instance the proposed regulation can treat the acquired entity in four ways for filing a combined income report.

- The regulation can presume that the acquiring corporation and the acquired corporation are unitary and require filing a combined income report including the acquired corporation.
- The regulation can require an inquiry into the facts and circumstances of each acquisition to determine on a case-by-case basis whether the acquired corporation becomes a member of a unitary group, with the usual presumption of the correctness of the administrative agency's decision.
- The regulation can presume that for the first short-period after acquisition the acquired corporation is rebuttably presumed not to be a member of the unitary group.
- The regulation can conclusively presume that an acquired corporation is not a member of a unitary group for the first short period unless the acquiring corporation makes an election within a specified period of time, thirty or sixty days.

All of these treatments are subject to the standards for presumptions set forth in the discussion of presumptions.

I have attached two California cases, Appeal of Atlas Hotels, Inc, State Board of Equalization, January 8, 1985, and Appeal of The Signal Companies, and set forth the treatment of instant unity in Minnesota, on of the few states with a Rule governing the subject, for your consideration. Not included are regulations dealing with accounting issues of annualization of short periods and their inclusion on a combined income report.

The Multistate Tax Commission Regulations are silent regarding the treatment of an acquired corporation in the initial tax periods after acquisition. Reg.IV.1.(b) only sets forth general rules that apparently are applied to an ongoing enterprise and a recently acquired subsidiary equally. The regulation states that "The determination of whether the activities of a taxpayer constitute a single trade or business of more than one trade or business turn on the facts in each case." UDITPA appears to follow a facts and circumstances test which are appropriate under the statute.

California's regulations are silent as determining when an acquired corporation is includable on a combined income report, but the problem has been considered by the S.B.E. (***Appeal of Atlas Hotels, Inc., et at.***, January 8, 1985, ***Appeal of the Signal Companies, Inc.***, January 24, 1990). In both of these cases the taxpayer was able to overcome the presumed correctness of the FTB's order and show that there existed a unitary relationship, in *Atlas* instantly, in *The Signal Companies* prior to accrual of substantial losses by the acquired company. The SBE analyzed both cases on the facts and applied the three-unities test found generally in *Butler Bros.*, and the contribution and dependency test set forth in *Edison California Stores*. The cases support the position that instant and accreting unity can occur over a short tax period. The taxpayer prevailed against a FTB position that an acquired corporation had not developed a sufficiently integrated relationship with an acquiring corporation to be included on a combined income report.

Minnesota has enacted strong presumptions in its statute in favor of taxation of business enterprises as unitary businesses. M.S., sec. 290.17, subd. 3 includes presumptions beyond the three unities test, that dissimilar businesses within and without the state are unitary "unless it can be shown to the contrary."

Although the statute contains the strong presumptions for taxing commonly-owned businesses as unitary businesses, the rule promulgated, Rule 8019.0300, provides a safe harbor for acquired corporations for a short-year tax period following acquisition. Rule 8019.0300, Subp. 7 states as follows:

> "**Business Acquisition**" When a corporation acquires another corporation and starts a unitary business with that corporation, the new corporation must be included on the combined income report and its income or loss reported starting with the first taxable year of the acquiring corporation that begins on or after the date of acquisition. Acquiring another corporation does not include creating a corporation from a part of the corporation's unitary group as it previously existed."

The pro's and con's of the various rules, in short and in the order presented above are as follows.

1. The presumption that the acquiring and acquired corporation are unitary would lead to a certain result in most instances. The clear and cogent standard for overcoming the presumption would leave the presumption undisturbed except in cases made by either the state or taxpayer that clearly showed the application was inappropriate. The presumption would not, however, lead to an incorrect result where the unitary relationship was not clearly present, but the level of evidentiary proof that the relationship did not exist could not be met. A proposed rule following this approach, imposing tax on an acquired corporation not doing business in the taxing state, may be subject to a *prima facie* Constitutional challenge as attempt to tax extraterritorial values not connected to the taxing state.

2. A facts-and-circumstances regulation should reach a correct result regarding inclusion or exclusion of an acquired member in the unitary group in all cases because the taxing authority should properly apply the law. The regulation requires the administrative agency to engage in fact-finding in the case of each acquisition, and after that decision is made the presumption of a correct decision is afforded that agency. The taxpayer can appeal the determination through normal administrative and judicial appeals process to correct erroneous determinations.

3. A regulation that presumes that an acquired corporation is not unitary for the first short period after acquisition would probably be a correct application of most state statutes in most cases. Usually a period of time is required before integration necessary to meet a state's requirements for filing a combined income report. Placing the burden of proof to overcomes the presumption on the moving party, be it the state or taxpayer, avoids the problem of any party attempting to change the result unless that result is clearly outside the normal workings of the statute.

4. The regulation that has both a presumption that the acquired corporation is not unitary, and a taxpayer election. The taxpayer election affords a taxpayer the ability to include or exclude a corporation for the short period after acquisition, but it does not require a unitary relationship for that election. That could lead to the result that an acquired corporation could be included on a combined income report for the short period, but be statutorily unable to be included from the combined income report after the short period. Further, it can be safely assumed that electing to include the acquired corporation is of benefit to the taxpayer, so there may be some impairment to the fisc of the state.

It should be clear from the above-discussion that the proposed treatment only applies to a transaction where there is a transfer of cash or notes for stock or stock for stock. Certain types of entities and transactions are assumed excluded from the discussion. I have assumed that those entities that are formed from an existing enterprise, but which still meet ownership criteria for inclusion in a unitary group, are included in the unitary group. This is similar to the continuity of interest doctrine, but the ownership requirements are governed by the various state or UDITPA provisions. IRC sec. 355 spin-offs, split-offs and split-ups may all be the subject of instant unity depending on the degree of common ownership after the transaction. California Reg. 25115(f)(2) "Division" appears to describe most of the transactions excluded, "The division or separation of an entity into two or more entities." Realigning or creating corporate divisions or subsidiary corporations within an existing unitary entity are presumed to not be the subject of any discussion of "instant unity" because those entities are assumed to be in an ongoing unitary relationship.

The acquisition of assets or the merger of existing corporations into a single surviving entity are also not at issue. It is assumed that managerial and operational control meet the requirements of unitary combination at the time of acquisition or merger.