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SEP 15 1997

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Via Facsimile

Mr. Brian W. Toman  
Director, Multistate Tax Bureau  
Franchise Tax Board  
Legal Branch  
P.O. Box 1720  
Rancho Cordova, CA 95741-1720

Re: Multistate Tax Commission Regulation Project  
Definition of Unitary Business  
Correlation of Business Income to Property Factor

Dear Brian:

As requested, we have reviewed Mr. John Warren's suggested changes to the definition of a unitary business regulation as well as suggestions regarding the correlation between business income and the property factor and offer the following comments on each topic.

Definition of Unitary Business

While Mr. Warren acknowledges that courts have recited the existence of either the three unities test or the contribution/dependency tests for determining the existence (or lack thereof) of a unitary business, he proposes to downgrade the significance of these tests in this regulation in favor of the functional integration, centralization of management and economies of scale elements noted in recent United States Supreme Court decisions. We respectfully disagree with this proposal.

First, such a radical change is without legal justification or support. The existence of a unitary business is determined based upon a showing of a sharing or exchange of value between segments of a single corporation or between commonly owned or controlled entities. I am aware of no authority that exists that purports to elevate one test over the other and suggest that we not do so in this endeavor. In fact, in the FTB's diverse business regulation white paper, the staff tried to elevate the contribution/dependency test over the three unities test but this approach failed.

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Second, the purpose of the regulation should be to outline the indicia of a unitary business. As we know, there are more than one indicium of a unitary business and these various tests merely represent different ways of expressing such indicia. No one expression, in my opinion, is better than the other.

Third, elevating the functional integration, centralization of management, and economies of scale elements to the detriment of the other two tests, in my opinion, will have the opposite effect than that which the task force is striving for --namely clarifying this area and promoting uniformity. Few, if any decisions, have attempted to clarify the meaning of these terms since the United States Supreme Court first used them. Further litigation will inevitably result as taxpayers and administrators argue over the scope and meaning of such terms.

Finally, the downplaying of these other tests will call into question the precedential value of various state court and administrative decisions that have ruled on this issue based upon one or both tests. This, in turn, may jeopardize taxpayers' settled expectations of the make-up of their unitary business and the prior transactions undertaken in reliance of such determinations.

Accordingly, we suggest that the task force continue to work off the draft as originally proposed and not consider the changes suggested by Mr. Warren in III.C., D., and E.

#### Correlation of Business Income and Property Factor

Mr. Warren suggests that there be a correlation between the amount treated as business income and the amount included in the property factor. Mr. Warren cites two examples in the regulation, one involving a five-story building with three floors used and two floors leased out and a second example involving a 20-story building where only two floors are used and 18 floors are leased out. In the first case, a majority rule was applied whereas in the second case, a pro-ration was used. Mr. Warren suggests that a pro-ration rule apply and thus to the extent the property produces non-business income, a portion of the property should be excluded from the property factor.

While Mr. Warren may be correct on a theoretical basis, such a suggestion creates administrative problems. Most taxpayers obtain information regarding the property factor from the financial books and records. Financial accounting does not concern itself with questions of pro-rating the cost of an asset; it merely records the total cost. If an asset produces non-business income, taxpayers can easily remove such costs from its calculation of the factor. If Mr. Warren's suggestion is followed, however, taxpayers (and auditors who have to verify the accuracy of the factor) would be required to pro-rate the cost of the property to be included.

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The courts have said that an apportionment formula need only be a rough approximation of the extent of the taxpayer's activities in a state. In my opinion, any change to the property factor (and thus to the overall apportionment formula) would be minimal at best. In those instances where the change would be substantial, pro-ration could be required. However, in the vast majority of situations where this issue could arise, the change in liability would not justify the effort to compute it or for an auditor to verify.

Very truly yours,

A handwritten signature in cursive script that reads "Barry Weissman".

Barry Weissman

cc: Michael Mazerov