

Multistate Tax Commission



TO: PPWG – UNIFORMITY COMMITTEE LIAISON GROUP
AND SUBGROUPS

FROM: ALAN H. FRIEDMAN, MODERATOR

SUBJECT: UNITARY BUSINESS DEFINITIONS

DATE: APRIL 22, 1999

I am attaching two documents for your review and consideration. The first is another revision of the Dependency/Contribution Test dated April 22, 1999. I have noted the revised sections in *italics*. Again, as per our earlier understanding, the entire Liaison Group will have a continuing opportunity to revisit and amend the Dependency/Contribution Test off and on during our work with the other two tests; and no test definition will go forward to the Uniformity Committee until the full Liaison Group has had a final opportunity to comment on the last version of each test. I would hope that by our teleconference in June, we can have the Dependency/Contribution Test alternatives finalized, as well as maybe the Three Unities Test.

The second document, also dated April 22nd, represents my initial effort at offering the Subgroups a skeletal beginning point for the Three Unities Test. It is for you to put more flesh on the skeleton or toss it out, as you deem appropriate. As per my earlier notice, the Unity of Ownership Subgroup meets at 11:30 AM (Eastern); the Unity of Operations Subgroup at 1:30 PM; and the Unity of Use Subgroup at 4:30 PM (Eastern) on next Wednesday, April 28th. Again, all of you are invited to fully participate in all Subgroup discussions should you have the time.

You may reach the Subgroups next Wednesday by calling 703-736-7307 (*I just proof read the number and it is correct*). Ask for the Multistate Tax Commission teleconference for which I am the moderator. I will be traveling next week, but I have made arrangements to moderate each Subgroup's call; so the designated back-ups can rest on the bench for awhile. We will first address the assigned Unity in each Subgroup; then, if time permits, we may address the suggested changes in the Dependency/Contribution Test alternatives.

I look forward to hearing from you next Wednesday.

PROPOSED DEFINITION ONE
THREE UNITIES TEST
April 22, 1999 Draft

I. Three Unities Test for Determining a Unitary Business.

A. Definitions.

For the purposes of this section, the following definitions shall apply and control:

1. "Business" means a single entity or two or more entities under common ownership or control with respect to which [this State's income/franchise tax] law requires a determination of whether the activities of the entity or entities within and without this State constitute one or more unitary businesses within this State.
2. "Entity" means each type of organization that [this State's income/franchise law] recognizes as a reporting person, except such term does not include an individual or [insert other applicable exceptions].
3. "Segment" means a subdivision of an entity consisting of any grouping of business activities, functions or transactions.

B. Three Unities Test.

A unitary business includes each entity or segment of a business among which there exists a unity of ownership; and a unity of operation or a unity of use, or both.

1. The "unity of ownership" element of this test is satisfied when one or more entities directly or indirectly owns, in whole or in part, an ownership interest in each entity sought to be included in the unitary business. The unity of ownership element may be satisfied for apportionment of income purposes even though an entity owns less than a 50+% ownership in the entity sought to be included in the unitary business. **;** **however, to determine whether entities that are included within the same unitary business may be combined for income reporting purposes, see the ownership requirements set forth in []**.

Illustrations of this “ownership” element are as follows:

- a.
- b.
- c.

2. The “unity of operation” element of this test is satisfied when each entity or segment within such entity that is to be included within the unitary business receives support, guidance or direction from all or part of [the same] [common] staff [resources] [personnel].

Illustrations of this “operation” element are as follows:

- a. Common purchasing
- b. Common advertising
- c. Common accounting and legal support
- d. Financing support
- e. Common retirement plan
- f.
- g.
- h.

3. The “unity of use” element of this test is satisfied when each entity or segment within such entity that is to be included within the unitary business receives support, guidance or direction from all or part of [the same] [common] line or executive [resources] [personnel].

Illustrations of this “use” element are as follows:

- a. Common management
- b. Control of major policies
- c. Inter-entity transactions
- d.
- e.
- f.

C. Facts and Circumstances; Presumptions.

The determination under paragraph B. of whether an entity or segment forms part of a unitary business with another shall be determined by the facts and circumstances of each case. It shall be presumed, subject to rebuttal, that a unitary business exists between entities or segments when the “unity of ownership” and either the “unity of operation” or the “unity of use” elements have been satisfied.

D. Illustrations

The above principles are illustrated by the following examples:

Example 1

* * * * *

For background purposes, members of the PPWG-Uniformity Liaison Group may wish to review:

Butler Brothers v. McColgan, 17 Cal.2d 664, aff'd. 315 U.S. 501 (1942)

A.M. Castle & Co. v. California Franchise Tax Board, 36 CA4th 1794, 43 CRptr 340 (1995)

Waltow Winona, Inc. v. Minnesota Commissioner of Revenue, 495 N.W.2d 427 (MN 1993)

The Coca Cola Co. v. Oregon Department of Revenue, Oregon Tax Court No. 647, 5 OTR 405 (Feb. 25, 1974) reciting criticism of the three unities test as too broad and vague.

Chase Brass & Copper Co., Inc. v. Franchise Tax Board, 10 CA3d 496; app. den., 400 U.S. 961 (1970)

PROPOSED DEFINITION ONE OF
DEPENDENCY/CONTRIBUTION TEST
April 22, 1999

(DISJUNCTIVE)

I. Dependency/Contribution Test for Determining Unitary Business

A. Definitions.

For the purposes of this section, the following definitions shall apply and control:

1. "Business" means a single entity or two or more entities under common ownership or control with respect to which [this State's income/franchise tax] law requires a determination of whether the activities of the entity or entities within and without this State constitute one or more unitary businesses within this State.
2. "Entity" means each type of organization that [this State's income/franchise law] recognizes as a reporting person, except such term does not include an individual or [insert other applicable exceptions].
3. "Segment" means a subdivision of an entity consisting of any grouping of business activities, functions or transactions.

B. Dependency/Contribution Test.

1. An entity or segment of a business is part of a unitary business with (i) each other entity or segment upon which it is dependent or to which it contributes; and with (ii) each other entity or segment which is dependent upon or contributes to any other entity or segment which is part of the unitary business.
2. In order to satisfy this test, the operations of the entities and segments need not be (i) interdependent or of mutual benefit to one another, (ii) *nor essential or necessary to the operations of one another.*

C. Facts and Circumstances; Presumptions.

The determination under paragraph B. of whether an entity or segment forms part of a unitary business with another shall be determined by the facts and circumstances of each case. It shall be presumed, subject to rebuttal, that sufficient dependency or contribution exists between entities or segments under paragraph B. to form a unitary business when one or more of the following factors are present:

1. When the principal activities of the entities or segments are in the same general line of business. Illustrations of the same general line of business, but not limitations, are manufacturing, wholesaling, retailing of tangible personal property, insurance, transportation or finance. *In determining whether two entities or segments are in the same general line of business, consideration shall be given to the nature and character of the basic operations of each entity or segment, including, but not limited to, sources of supply, goods or services produced or sold, labor force and market. Two entities or segments are in the same general line of business when their operations are sufficiently similar to reasonably conclude that the entities or segments are likely to depend upon or contribute to one another.*
2. When the entities or segments are engaged in different steps of a vertically structured business. Illustrations of such different steps, but not limitations, are exploration, mining/drilling, production, refining, marketing, and/or transportation of natural resources.
3. When there exists a strong centralized management among the entities or segments. Illustrations of such management, but not limitations, are executive level policy decisions in the areas of purchasing, accounting, financing, tax compliance, legal services, human resources, health/retirement plans, product lines, capital investment, marketing and the like are determined by a central person or persons or committee and not by each entity or segment.

4. When the business segments are in the same entity.

[Note: There was support expressed to eliminate this subparagraph 4. as possibly duplicative of the other three subparagraphs, especially subparagraph 3.]

D. Illustrations.

The above principles are illustrated by the following examples:

Example 1: Corporation A has an ownership interest in Corporations B, C, and D. Corporation A is dependent upon or contributes to Corporation C. Corporation C is dependent upon or contributes to Corporation D. Corporation B does not contribute to and is not dependent upon Corporations A, C, or D. In this example, Corporations A, C, and D constitute a unitary business. This is the result even though Corporation A is not directly dependent upon and does not directly contribute to Corporation D.

Example 2: Corporation A has an ownership interest in Corporations B, C, and D. Corporation A consists of Segments A1, A2, and A3. The presumption that A1, A2, and A3 are part of a unitary business has not been successfully rebutted. Segment A1 is dependent upon or contributes to Corporation C. Corporation C is dependent upon or contributes to Corporation D. Corporation B does not contribute to and is not dependent upon Corporations A (or any of its segments), C, or D. In this example, Corporations A (including each of its segments), C, and D constitute a unitary business.

Example 3: Same as Example 2, except that the presumption that Segment A3 is part of a unitary business with the other segments of Corporation A has been successfully rebutted. Furthermore, Segment A3 does not contribute to and is not dependent upon Corporations C or D. In this example, Corporations A (including Segments A1 and A2), C, and D constitute a unitary business.

**PROPOSED DEFINITION TWO OF
DEPENDENCY/CONTRIBUTION TEST**
April 22, 1999

(CONJUNCTIVE)

I. Dependency/Contribution Test for Determining Unitary Business

A. Definitions.

For the purposes of this section, the following definitions shall apply and control:

1. "Business" means a single entity or two or more entities under common ownership or control with respect to which [this State's income/franchise tax] law requires a determination of whether the activities of the entity or entities within and without this State constitute one or more unitary businesses within this State.
2. "Entity" means each type of organization that [this State's income/franchise law] recognizes as a reporting person, except such term does not include an individual or [insert other applicable exceptions].
3. "Segment" means a subdivision of an entity consisting of any grouping of business activities, functions or transactions.

B. Dependency/Contribution Test.

1. An entity or segment is part of a unitary business with (i) each other entity or segment upon which it is dependent or to which it contributes; and with (ii) each other entity or segment which is dependent upon or contributes to any other entity or segment which is part of the unitary business.
2. In order to satisfy this test, the entities and segments must be interdependent or of mutual benefit to one another; however, the operation of any one entity or segment need not (i) contribute to or depend upon the operation of all other entities or segments; *nor (ii) be*

essential or necessary to the operation of any other entity or segment.

C. Facts and Circumstances; Presumptions.

The determination under paragraph B. of whether an entity or segment forms part of a unitary business with another shall be determined by the facts and circumstances of each case. It shall be presumed, subject to rebuttal, that sufficient dependency or contribution exists between entities or segments under paragraph B. to form a unitary business when one or more of the following factors are present:

1. When the principal activities of the entities or segments are in the same general line of business. Illustrations of the same general line of business, but not limitations, are manufacturing, wholesaling, retailing of tangible personal property, insurance, transportation or finance.
 - a. In determining whether two entities or segments are in the same general line of business, consideration shall be given to the nature and character of the basic operations of each entity or segment, including, but not limited to, sources of supply, goods or services produced or sold, labor force and market.
 - b. Two entities or segments are in the same general line of business when their operations are sufficiently similar to reasonably conclude that the entities or segments are likely to depend upon or contribute to one another.
2. When the entities or segments are engaged in different steps of a vertically structured business. Illustrations of such different steps, but not limitations, are exploration, mining/drilling, production, refining, marketing, and/or transportation of natural resources.
3. When there exists a strong centralized management among the entities or segments. Illustrations of such management, but not limitations, are executive level policy decisions in the areas of purchasing, accounting, financing, tax compliance, legal services, human resources, health/retirement plans, product lines, capital investment, marketing and the like are determined by a

central person or persons or committee and not by each entity or segment.

4. When the business segments are in the same entity.

[Note: There was support expressed to eliminate this subparagraph 4. as possibly duplicative of the other three subparagraphs, especially subparagraph 3.]

D. Illustrations.

The above principles are illustrated by the following examples:

Example 1: Corporation A has an ownership interest in Corporations B, C, and D. Corporation A is dependent upon or contributes to Corporation C. Corporation C is dependent upon or contributes to Corporation D. Corporation B does not contribute to and is not dependent upon Corporations A, C, or D. In this example, Corporations A, C, and D constitute a unitary business. This is the result even though Corporation A is not directly dependent upon and does not directly contribute to Corporation D.

Example 2: Corporation A has an ownership interest in Corporations B, C, and D. Corporation A consists of Segments A1, A2, and A3. The presumption that A1, A2, and A3 are part of a unitary business has not been successfully rebutted. Segment A1 is dependent upon or contributes to Corporation C. Corporation C is dependent upon or contributes to Corporation D. Corporation B does not contribute to and is not dependent upon Corporations A (or any of its segments), C, or D. In this example, Corporations A (including each of its segments), C, and D constitute a unitary business.

Example 3: Same as Example 2, except that the presumption that Segment A3 is part of a unitary business with the other segments of Corporation A has been successfully rebutted. Furthermore, Segment A3 does not contribute to and is not dependent upon Corporations C or D. In this example, Corporations A (including Segments A1 and A2), C, and D constitute a unitary business.

