

**IN THE MATTER OF THE PETITION OF**

**"A" , INC.**

**AND**

**"B" , INC.**

**FOR A DECLARATORY RULING**

**Doc# 5664, Eff. July 9, 1993**

Pursuant to RSA 541-A:1, IV., 541-A:14, and Rev 209 New Hampshire Code of Administrative Rules, "A" , Inc. ("A") EIN: ..... and "C" , Inc. ("C") EIN: ....., a subsidiary of "A" , manufacturers of xxxx having their principle offices in ....., NY, and ....., DE, respectfully, and "B" ("B") EIN: not determined, a manufacturer and seller of xxxx and xxxx products at a location yet to be determined have petitioned the Department of Revenue Administration for a declaratory ruling in order to determine if "A" , Inc. or any of its subsidiaries will be required to file business profits tax returns as a unitary business with "B" , Inc. should "B" decide to operate in the State of New Hampshire. The Petitioners represent the following:

- 1) "A" will form "B" as either a wholly owned Subsidiary corporation of "A" or as a wholly owned subsidiary corporation of "C".
- 2) "B" will be incorporated in the State of Delaware.
- 3) "A" is a manufacturer of xxxx . "B" will be a manufacturer of xxxx and xxxx products. "B" will market its products through new market channels that will be created and developed independent of "A" or any of "A"'s subsidiaries.
- 4) Any "B" products sold by "A"'s direct sales force in the future will be on an arms length basis (whether through a buy/sell or commission arrangement).
- 5) Intercompany transactions, if any, will be at arms length.
- 6) "B" will be managed and administered autonomously of "A", or other affiliates, with completely separate management personnel.
- 7) "A" and "B" will have separate and independent incentive compensation plans for their own key personnel.
- 8) "A" may perform the following services for "B" without compensation to "A" from "B".
  - a) Tax return preparation
  - b) Accounts receivable functions
  - c) Cash and debit management
  - d) Insurance/risk management
  - e) Legal support

- f) Engineering support and testing
- g) Data processing and information systems support
- h) Internal audit services

In connection with the above proposed formation of "B" by "A", the Petitioners request a declaratory ruling that the multistate business operations, operating as represented, will be held by the Department of Revenue Administration to be separate and discrete business organizations. New Hampshire Revised Statutes Annotated 77-A: 6 provides "A business organization which is part of a water's edge combined group and required to report under this chapter shall file a return containing the combined net income of the water's edge combined group and such other informational returns as the commissioner shall require by rules adopted under RSA 541-A. The Commissioner is authorized to impose the tax as though the entire combined net income of the water's edge combined group was that of one business organization or he may adjust the tax or income in such a manner as he shall determine to be equitable if he determines it to be necessary in order to clearly reflect the net income earned by such organization from such business done in this state."

In applying this provision, the Department looks to New Hampshire Revised Annotated 77-A: 1 Definition XIV "Unitary Business" and Administrative Rules Rev 301.28 "Unity of Operation", Rev 301.29 "Unity of Ownership" and Rev 301.30 "Unity of Use".

a) "Unitary Business" means one or more related business organizations engaged in business activity both within and without this state among which there exists a unity of ownership, operation and use; or an interdependence in their functions.

b) "Unity of Ownership", as used in RSA 77-A:1, XIV, means that the activities outside the taxing jurisdiction, together with the in-state activities are owned either directly or indirectly by the same economic entity or group of economic entities.

c) "Unity of Operation" as used in RSA 77-A:1, XIV, means there is a centralized executive structure evidenced by general, though not necessarily continuous or regularly repetitive, enterprise activities directing common functions including, but not limited to purchasing, advertising, personnel action, industrial relation, accounting, legal, research, insurance, and retirement planning.

d) "Unity of Use" as used in RSA 77-A:1, XIV, means that there is an executive authority which oversees or performs any or all of the following activities for the group or business organization:

- 1) defines and controls the general system for producing profit;
- 2) establishes professional standards to enhance or promote public perception of the business;
- 3) imposes and enforces procedures to implement compliance of business activities with public law and regulations;
- 4) sets standards of ethical performance;
- 5) controls major policy issues;
- 6) makes budgetary allocations;
- 7) approves major capital expenditures and expansions;

- 8) appoints, assigns or transfers personnel for combined group members;
- 9) coordinates the activities of the affiliated entities within the general system of operations;
- 10) prepares the financial reports;
- 11) determines and defines required intercompany transactions including sales, financing, and transfers of goods or services; or
- 12) determines combined group decisions in matters involving intercompany conflicts or problems.

The United States Supreme Court in its *Container Corp.* decision held that they, the Court, ". . . need not decide whether any one factor would be sufficient as a constitutional matter to prove the existence of a unitary business. Taken in combination. . . ." an aggregate of factors clearly demonstrate that a state in reaching a unitary determination is "within the realm of permissible judgment." The Court rejected the appellant's request for a "bright-line rule" as a prerequisite to a unitary finding that it be characterized by a "substantial flow of goods."

In order not to be required to file a combined return "B" and the other affiliated companies must be maintained as discrete business organizations. To that end "B" must be a passive investment of "A" and that there be no sharing or exchange of value beyond the mere flow of funds arising out of a passive investment. The Court caution regarding investment in similar industries is restated here to insure that the petitioner has a clear understanding that the ruling is contingent upon a separate and distinct relationship.

"When a corporation invests in a subsidiary that engages in the same line of work as itself, it becomes more likely that one function of the investment is to make better use--either through economies of scale or through operational integration or sharing of expertise--of the parent's existing business-related resources."

The caveat that the Department makes, and which is inherent

in this quotation, is that unreimbursed items (or even reimbursed) such as those listed as (a) through (h) under number 8 above (Item 5 in the original petition) can lead to a unitary finding depending on the frequency and nature of the services. Further, with respect to the representations renumbered in this ruling as items #4 and #5, unitary findings are not excluded by the maintenance of an "arms-length" relationship. Intercompany transactions, sales, and the use of intercompany sales personnel, have proven in the past to be of sufficient frequency and level to be considered adequate indicia for a unitary business.

If these activities are restricted within the bounds generally described herein and considered immaterial, then in view of these representations, and based upon an analysis thereof, the Department of Revenue Administration finds that "A", "C", and "B" do not satisfy the test: (a) unitary of operation and (b) unity of use, or (c) interdependence in their functions, and will not be required to file a combined return under RSA 77-A, the New Hampshire Business Profits Tax.

Stanley R. Arnold, Commissioner