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Multistate Tax
EXTERNAL ALERT

New York - combined reporting permitted under unitary business analysis

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Overview

On May 19, 2015, the New York State Tax Appeals Tribunal (Tribunal) overturned an administrative law judge's (ALJ) decision and granted SunGard Capital Corp. and Subsidiaries and SunGard Data Systems and Subsidiaries (hereinafter referred to collectively as SunGard) permission to file New York combined franchise tax returns for tax years 2005 and 2006.[1] For both years, the New York State Division of Taxation (Division) had originally refused to accept SunGard's combined return, which then prevented SunGard from collecting an underlying combined group claimed refund. SunGard appealed the Division's decision to an ALJ, who then determined that there was insufficient evidence to demonstrate the conduct of a unitary business among the affiliated entities. The ALJ further held that SunGard had failed to demonstrate that distortion of its business income or capital resulted from filing separate franchise tax reports. In reversing the ALJ, the Tribunal has now concluded that the factual record demonstrated both a unitary business among certain SunGard affiliates and distortion from filing separate franchise tax reports. This Tribunal decision is now final and non-appealable.[2]

In this Tax Alert we summarize this New York Tax Appeals Tribunal decision and provide some taxpayer considerations.

Background

For tax years beginning prior to 2015, under the General Corporation Franchise Tax (Article 9-A), New York may permit or require a related group of corporations to file a combined report if certain conditions are met.[3] More specifically, during the period at issue, these conditions include the satisfaction of an ownership standard, the unitary business requirement, and the "distortion" requirement.[4] While the existence of substantial intercorporate transactions between or among the related corporations created the presumption of distortion under state administrative regulations at that time,[5] no such claim of substantial intercorporate transactions was made in this case.

New York case law provides that a unitary business is defined using the "flow of value" concept as described in various US Supreme Court decisions,[6] determining this ''flow of value'' to exist in cases where there is centralized management, functional integration, and economies of scale resulting from coordinated business operations.[7] Distortion, which is not specifically defined in New York's administrative regulations, has generally been described as conducting intercompany transactions at

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[1] *SunGard Capital Corp. and Subsidiaries, et al.,* N. Y. Tax Appeals Tribunal, Decision DTA Nos. 823631, 823632, 823680, 824167 and 824256 (May 19, 2015).
[2] N.Y. Tax Law § 2016.
[3] [Former] N.Y. Tax Law Sec. 211.4, for tax years beginning on or before Dec. 31, 2006, New York's combined reporting rules were changed for tax years beginning on or after January 1, 2007 pursuant to Laws of 2007, ch. 60, §§ 1-3 (Part J) and then again changed for tax years beginning on or after January 1, 2015, pursuant to Laws of 2014, ch. 59, §§ 18 and 19 (Part A). This case involves the law in effect prior to the 2007 law change.
[4] N.Y. Comp. Codes R. & Regs. tit. 20, § 6-2.2(a); [Former] N.Y. Comp. Codes R. & Regs. tit. 20, § 6-2.2(b); and [Former] N.Y. Comp. Codes R. & Regs. tit. 20, § 6-2.
[5] [Former] N.Y. Comp. Codes R. & Regs. tit. 20, § 6-2.3(b).
[6] *See generally*, *Container Corp. of America v. California Franch. Tax Bd.*, 463 U.S. 159 (1983); *Allied Signal Corp. v. New Jersey Dir., Div. of Taxn.*, 504 U.S. 768 (1992).
[7] *British Land (Maryland) Inc. v. Tax Appeals Tribunal*, 85 N.Y.2d 139 (1995); *Heidelberg Eastern Inc.*, DTA Nos. 806890 and 807829 (N.Y. Tax App. Trib., May 5, 1994); and *Sears, Roebuck and CO.*, DTA No. 801732 (N.Y. Tax App. Trib., April 28, 1994).

prices that do not meet the "arms-length" standard set forth in the federal regulations issued under IRC Section 482.[8]

New York State Tax Appeals Tribunal decision

In reversing the ALJ's determination, the Tribunal noted that there is no single test for determining whether a unitary business exists, but that each case must be considered on its own unique facts. [9] The Tribunal also noted that the Division's administrative regulation provides factors to be considered, such as whether a corporation engages in related activities with other affiliates, including manufacturing or acquiring goods or providing services, selling goods on an affiliate's behalf or financing its sales, as well as whether the affiliates are engaged in related lines of business.[10] The Tribunal additionally referenced the federal unitary business doctrine, which is "in harmony" with the Division's applicable regulations.[11] Finally, citing established unitary business case law, the Tribunal noted that a unitary business can be demonstrated by the following: i) a flow of value between the subject entities; ii) functional integration, centralized management, and economies of scale; and/or iii) "transactions not undertaken at arm's length, a management role by the parent which is grounded in its own operational expertise and operational strategy, and the fact that the corporations are engaged in the same line of business."[12]

Applying these unitary business principles, the Tribunal concluded that many of SunGard's entities were engaged in the same or related lines of business.[13] More specifically, under the facts, these affiliates were engaged in the related businesses of providing information technology sales and services, information availability, software solutions, and software licensing through four main business segments: financial systems, public sector, higher education, and availability services. [14] Additionally, these affiliates collaborated with each other by providing products and expertise to other members of the group, as well as externally as part of broad cross-selling strategies. [15] The Tribunal reasoned that SunGard's brokerage businesses—although obviously in a different line of business than the information technology and data processing affiliates—nevertheless complemented other SunGard businesses that provided software and processing solutions, finding it significant that many of the brokerage customers were also customers of other SunGard entities. [16] Given the collaboration and complementary lines of business among the SunGard entities, the Tribunal found that the entities should be regarded as a unitary group, in line with existing Tribunal precedent.[11]

The Tribunal also noted that the facts demonstrated centralized management—specifically that the SunGard group of companies was run as a single business enterprise from a corporate planning perspective by corporate officers with responsibilities for multiple entities within the group. [17] This single business enterprise approach was also found to be shown by SunGard's strategic initiatives for improving the operating, marketing, and financial performance of the SunGard group as a whole.[18] The Tribunal then noted its prior decision deeming such a "clear centralization of basic business decisions" consistent with a unitary business.[12] The Tribunal explained that further evidence of central management was displayed via the fact that SunGard's cash management system disbursed cash amongst group members as needed, and without an interest charge, resulting in a flow of value among the SunGard entities.[13] Additionally, the Tribunal explained that the provision of central office functions such as accounting, tax,

[8] *In re Heidelberg Eastern, Inc.*, DTA Nos. 806890 and 807829 (N.Y. Tax. App. Trib. May 5, 1994).
[9] *SunGard Capital Corp. and Subsidiaries, et al.,* at 29.
[10] N.Y. Comp. Codes R. & Regs. tit. 20, former § 6-2.2(b), renumbered N.Y. Comp. Codes R. & Regs. tit. 20, § 6-2.3(e) eff. Jan. 2, 2013.
[11] *SunGard Capital Corp. and Subsidiaries, et al.,* at 28, citing *Matter of IT USA*, N.Y. Tax Appeals Tribunal, April 16, 2014.
[12] *Id.,* citing *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, (1983); *MeadWestvaco Corp. v. Illinois Dept. of Revenue*, 553 U.S. 16 (2008); *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768 (1992).
[13] *Id.* at 29.
[14] *Id.* at 29.
[15] *Id.* at 30.
[16] *Id.* at 30.
[11] *Id.* at 29-30, citing *In re Heidelberg Eastern, Inc.*, N.Y. Tax. App. Trib., May 5, 1994.
[17] *Id.* at 31.
[18] *Id.* at 31.
[12] *Id.* at 32, citing *Matter of Sears, Roebuck and Co.*, N.Y. Tax App. Trib., April 28, 1994.
[13] *Id.* at 30, 31. The Tribunal cited other cases describing similar cash management systems as characteristic of a centrally managed unitary business. S*ee Matter of IT USA, Inc.*; *Matter of Heidelberg Eastern*, and, [in a different court], *In re Envirodyne Industries*, 354 F 3d 646, 650 (7th Cir 2004).

legal, insurance, human resources and benefits, as well as group-wide purchasing, budgeting, marketing, and technology services by the parent corporation, resulted in a flow of value. [19] The Tribunal also noted that the parent's provision of these centralized corporate level functions without reimbursement was an indication of a unitary business as such an arrangement results in an obvious flow of value. [20]

In addressing the combined reporting requirement to show distortion of a taxpayer's business income or capital resulting from filing separate franchise tax reports, the Tribunal agreed with the ALJ's determination that the concept of a unitary business and distortion are related such that a flow of value can cause distortion of income computed on a separate company basis.[14] The Tribunal identified several activities or transactions involving members of the SunGard group which, when taken together, would give rise to a level of distortion sufficient to permit combined filing.[21] First, the Tribunal found the prevalence of uncompensated finance, purchasing, marketing, and general central office services provided by the parent to group members to be distortive because of the resulting reduction in costs that would not have been available if each member of the group were engaged in discrete, standalone operations.[22] Second, the Tribunal noted that SunGard's centralized cash management system, which allowed group members access to funds generated by other members on an as-needed basis without interest charges, resulted in distortion due to the reduced borrowing costs inherent in such an arrangement. [23] Finally, the Tribunal concluded that SunGard's securitization arrangement also contributed to distortion as it decreased the parent's interest cost incurred on its leveraged buyout debt. [24] More specifically, such interest costs were reduced due to an arrangement wherein all group members sold their receivables to a third-party conduit entity, and SunGard's parent entity did not compensate the other group members for this benefit—thus resulting in distortion on separately filed returns.

Note that the Tribunal did uphold the ALJ's decision of excluding from the New York combined franchise tax returns certain holding companies (*i.e.*, except those specific parent entities shown to be performing group functions) and inactive companies within the SunGard group—as well as one entity whose only asset was an interest in a partnership as no evidence was presented to support a conclusion that the partnership's activities were unitary with SunGard. This ruling is consistent with the Division's administrative regulation stating that a holding company is not necessarily unitary with its operating subsidiaries.[25]

Considerations

This Tribunal decision is important as it offers a comprehensive and rigorous analysis of both the unitary business principle and the distortion elements for combined reporting in New York for tax years beginning before January 1, 2015, as well as reinforces the strong degree of correlation between the two concepts. Further, the unitary business analysis set forth in this case arguably may have continued importance under New York's current mandatory unitary combined reporting statute, which does not specifically define a "unitary business." Accordingly, a critical review of the unique facts of each taxpayer circumstance may still be required, and thus the conceptual guideposts set forth in this decision may prove useful to both taxpayers and the Division. Finally, the exclusion of the pure holding companies and inactive companies in this case is noteworthy, as there is arguably nothing in New York's current unitary combined reporting statute that would dictate a different result—although, it should be noted that if desirable, the inclusion of such entities that satisfy the stock ownership requirement can be assured via New York's new common group election mechanism.[26]

[19] *Id.* at 31.
[20] *Id.* at 32.
[14] *Id.* at 35, citing *Matter of Autotote Limited*, Tax App. Trib., April 12, 1990.
[21] *Id.* at 35.
[22] *Id.* at 35-36.
[23] *Id.* at 36.
[24] *Id.* at 36.
[25] N.Y. Comp. Codes R. & Regs. tit. 20, § 6-2.3(e)(3).
[26] N.Y. Tax Law § 210-C.3.

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