New York – Tax Appeal Tribunal concludes unitary business exists, supports combination

May 29, 2015

In brief
The New York State Tax Appeals Tribunal concluded that a corporate group was engaged in a unitary business, reversing an administrative law judge’s prior non-unitary determination. Guided by US Supreme Court cases and the Division of Taxation’s regulations, the tribunal noted that the members of the group were in the same line of business, the group’s centralized management and consolidated services created economies of scale and resulted in a flow of value, and that filing separate returns would be distorting. [SunGard Capital Corp. and Subsidiaries, et al., New York, Tax Appeals Tribunal, Decision DTA Nos. 823631, 823632, 823680, 824167 and 824256 (May 19, 2015).]

Although decided under prior law, with the adoption of a mandatory combined reporting system for unitary groups starting in 2015, the tribunal’s decision is instructive for purposes of determining the existence of a unitary business.

In detail
Facts and procedural history
At issue was whether SunGard Group (Group) should be allowed to file as a combined group for tax years 2005 and 2006. During those years, the Group’s primary line of business was providing information technology sales and services, information availability, software solutions, and software licensing through four main business segments: financial systems, public section, higher education, and availability services.

In 2005, SunGuard Data Systems, Inc. (SDS) was the corporate parent of the Group for federal corporate income tax purposes and was responsible for filing the Group’s consolidated federal income tax return. In 2006, this responsibility shifted to SunGuard Capital Corp. (SCC), which became the corporate parent. SDS and SCC owned at least 80% of the capital stock of all the entities in the Group in 2005 and 2006, respectively. SDS provided centralized corporate level function and services for all Group entities and segments, for which SDS was not reimbursed. SDS directed the Group’s cash flow management system, insurance matters and a variety of audit functions, prepared SEC and other public documents, and provided legal and employee management services. In addition, SDS financed a leveraged buyout in which many corporate subsidiaries were converted into disregarded entities.

For both 2005 and 2006, the parents (SDS and SCC) and their corporate subsidiaries filed separate returns for New York purposes. For both years,
the parents and the corporate subsidiaries filed amended returns, claiming refunds on the basis that the Group was a unitary business and that filing separate returns distorted the income of the Group. In both instances, the Division of Taxation (Division) denied the refund claims.

On appeal to an administrative law judge, the ALJ concluded that the Group was not engaged in a unitary business and that the Group failed to establish distortion. (View a summary of the ALJ decision.) Thus, the ALJ sustained the Division's decision that the Group members were required to report on a separate basis. The Group appealed the ALJ's decision to the Tax Appeals Tribunal.

**Standard for combination—prior law**

During the years at issue, combined reporting was required or permitted where corporations in a group met a substantial ownership requirement, a unitary business requirement, and an 'other' or 'distortion' requirement. There was no dispute regarding the substantial ownership requirement; at issue was whether the unitary business and distortion requirements were met.

**Unitary business requirements**

In determining whether a unitary business exists, the tribunal relied heavily upon US Supreme Court cases addressing the unitary business doctrine. The tribunal specifically noted that the “prerequisite to a constitutionally acceptable finding of unitary business is a flow of value” between the corporate entities (Container Corp. of America v. Franchise Tax Board, 463 U.S. 159, 178 (1983)) and that the “hallmarks of a unitary relationship...are functional integration, centralized management and economies of scale” (MeadWestvaco Corp. v. Illinois Dept. of Revenue, 553 U.S. 16, 30 (2008)).

The tribunal added that "[t]hese ‘essentials’ may be shown, respectively, by 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" (Allied-Signal, Inc. v Director, Div. of Taxation, 504 U.S. 768, 789 (1992)).

The tribunal was also guided by the Division's unitary business regulations, which require consideration of the following factors in determining whether a group of corporations is unitary: manufacturing or acquiring goods or property or performing services for one another; cross-selling or financing; and being in the same or similar lines of business, as evidenced by manufacturing or selling similar products, performing similar services, or performing services for the same customers. “Accordingly, a unitary business analysis necessarily depends on the facts of each case,” the tribunal explained.

**Unitary business standards met**

Rejecting the ALJ’s determination, the tribunal determined that the Group was engaged in a unitary business.

The tribunal concluded that all of the Group's entities and segments engaged in the Group’s primary line of business, which was selling software and processing services to institutional clients. Further, the tribunal noted that these segments provided complementary services that allowed for cross-selling opportunities, which was “indicative of a unitary business under the Division’s regulations.”

The tribunal also concluded that the Group had functionally integrated central management consistent with a finding of a unitary business. The tribunal noted that the Group’s cash management system, which included a non-arm’s length, interest-free component, and SDS’s unreimbursed support services resulted in a flow of value between the entities. The Group’s single ‘strategic corporate planning perspective’ as demonstrated by corporate officers who were responsible for management, direction and control for multiple and, in some cases, all the entities, was also evidence of the Group’s strong centralized management. Citing Allied-Signal, Inc., the tribunal added that the facts demonstrated ‘a management rule by the parent which is ground in the parent’s own operational expertise and operational strategy.” Unity was also supported by the Group’s consolidation of purchasing services, which provided the Group economies of scale, and the Group’s financing commitments and arrangements following the leveraged buyout, which gave rise to flows of value.

**Sufficient evidence of distortion**

Having found that the Group was unitary, the tribunal addressed whether filing separately would result in “a distortion of the taxpayer’s activities, business, income or capital.” Rejecting the ALJ’s determination, the tribunal identified several activities or transactions that created distortion. First, the tribunal found that SDS’s uncompensated support services were distortive since there was a reduction of costs that would not have otherwise been available. Second, the tribunal noted the distortive effect of the Group’s centralized cash management system that allowed the members access to funds generated by other Group members on an as-needed basis without being charged interest. Finally, the tribunal pointed to the Group’s securitization arrangement for the leveraged buyout as further
evidence of distortion, noting that had the members had to obtain third-party debt financing, their interest costs would have increased and that such costs would not be reflected on a separate filing basis.

**Certain entities not included in the unitary group**

Although the tribunal ultimately concluded that the Group was a unitary business and could file a combined report, it found that certain Group entities, including a holding company, two inactive corporations, and an entity that received all of its income from an unrelated partnership, were not engaged in a unitary business with the Group. Accordingly, the tribunal concluded that these entities should not be included in the combined report.

**The takeaway**

Although addressed under former New York Law, this decision is instructive for members of affiliated groups paying taxes in New York State and New York City. Both jurisdictions have adopted a unitary combined reporting system effective for tax years beginning on or after January 1, 2015. Absent any new Division of Taxation guidance or regulations defining a unitary business, taxpayers, the State, and the City will be guided by this tribunal decision in determining the proper composition of a combined group.

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**Let’s talk**

If you have any questions about the SunGard Capital case, please contact:

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