

Minnesota Attorney General: Administrative Rules Proceedings

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STATE OF MINNESOTA
DEPARTMENT OF REVENUE
CENTENNIAL OFFICE BUILDING
SAINT PAUL, MINNESOTA 55145
PHONE: (612) 296-3439

June 15, 1983

Office of Attorney General-Rules
Administration Building
St. Paul, Minnesota 55155

Re: Review of Rule Relating to the Taxation of a Unitary Business and Formula Apportionment.

Deaer Sir or Madam:

In accordance with Minnesota Statutes, Section 14.16 and 1 MCAR Section 1.202, I enclose the following documents for your review:

1. Rule as Adopted (original and three copies).
2. Rule as Adopted showing the changes that were made to the rule after it was published.
3. Order Adopting including Findings of Fact and Conclusions (two copies).
4. Notice of Intent to Solicit Outside Opinion.
5. Written material received pursuant to that Notice by this agency prior to publication of proposed rule.
6. Order for Hearing.
7. Notice of Hearing.
8. Affidavit of Mailing (Notice of Hearing).
9. Certificate of Completeness and Accuracy (Mailing List Certificate).
10. Rule as Proposed and as published in the February 28, 1983 State Register.
11. Hearing Examiner's report dated May 5, 1983.
12. Statement of Need and Reasonableness.
13. A tape recording prepared by hearing examiner of the April 8, 1983 hearing.
14. Certificate of Compliance with Rulemaking Procedure.

June 15, 1983

The rule as adopted has already been approved by the Revisor.

Please contact the undersigned if there are any questions.

Sincerely,

Dale H. Busacker

Dale H. Busacker
Division Attorney
Income Tax Division

DHB/ml

Enclosures

Our File No. 4926

RULE REVIEW CHECKLIST

DATE RULE RECEIVED 6-16
DATE FOR REVIEW 6-27
DATE DUE 7-6

Adopted w/a hearing ✓
Adopted w/o hearing
Temporary rule

Approved _____ Disapproved _____ Returned to Agency _____

Resubmitted _____ Due _____
Approved _____ Disapproved _____ Returned to Agency _____

Date filed w/Secretary of State _____ Revisor approved 6/5/83
disapproved _____

✓ Rule as Adopted

✓ Rule as Proposed see SR

✓ Order Adopting 6.16.83 Date combined w/ FoF

✓ Notice of Intent to Solicit Outside Opinion + comments copies not submitted but see SONR for publication dates 1.29.79 and 7.6.81

✓ Order for rulemaking
4.8.83 date of Hearing

N/A Certificate of Board's Authorizing Resolution

✓ Notice of rulemaking
✓ Sufficiency

✓ Affidavits of Mailing Notice or rulemaking
2.24.83 At least 30 days prior to hearing/~~adoption~~

✓ Mailing list Certificate

✓ Publication in State Register
2.28.83 At least 30/~~20~~ days prior to hearing/~~adoption~~

✓ Hearing Examiner's Report

N/A Chief Hearing Examiner's Report(s)
_____ Approving H.E.'s Report
_____ Approving agency action

✓ Agency's Findings of Fact combined with Order Adopting

N/A LCRAR Report or agency Affidavit

N/A Certificate of Board's Resolution Adopting Rules

N/A Order Approving Incorporation by Reference

✓ Statement of Need and Reasonableness

N/A Petition for Adoption of a Rule

✓ Record (includes transcript or tape, exhibits, comments received by agency, requests for a hearing, and other relevant materials)

✓ Certificate of Compliance w/Rulemaking Procedures

N/A Affidavit of Mailing Notice of Submission to Attorney General

✓ Notice of Submission to the Attorney General

no requests

SF-00006-02

STATE OF MINNESOTA

DEPARTMENT ATTORNEY GENERAL

Office Memorandum

TO : Arthur C. Roemer, Commissioner

DATE: July 6, 1983

Attn: DALE H. BUSACKER
Income Tax Division Attorney

FROM : LARRY D. STARNS
Special Assistant
Attorney General
LDS

PHONE: 297-3493

SUBJECT: Proposed Adoption of New and Amended Rules and the Repeal of a Rule of the Department of Revenue Relating to the Taxation of a Unitary Business and Formula Approtionment (13 MCAR Section 1.6501 to 1.6503, 1.6004, Minnesota Income Tax Rule 2019 and Repealing Rule 2017(3)).

Enclosed herewith are the rules you have submitted for approval. These rules have been approved by this office and filed with the Secretary of State. Please note that they have not been filed with the State Register. This must be done promptly by your agency.

Upon receipt and before transmittal to your agency, however, it is important that you recheck these rules as to:

1. Affixation of stamps of the Attorney General and Secretary of State;

2. Coverage by these stamps of all rules submitted; and

3. Inclusion of all pages to the rules in the approved set.

If you have any questions in this regard, please contact me.

Encs:
LDS/las

cc: Ms. Kathy Burek
Mr. Duane Harves

AG copy

Department of Revenue

Income Tax Division

Adoption of New and Amended Rules and the Repeal of a Rule of the Department of Revenue Relating to the Taxation of a Unitary Business and Formula Apportionment

Rules as Adopted

13 MCAR S 1.6501 Definition of unitary business.

A. Definitions. The term "corporation" does not include an S corporation. The term "United States" includes any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any possession of the United States, or any political subdivision of any of the foregoing.

B. Unitary business defined. Business activities or operations carried on by more than one corporation are unitary in nature when the corporations are related through common ownership and when the trade or business activities of each of the corporations are of mutual benefit, dependent upon, or contributory to one another, individually or as a group. Unity is presumed whenever there is the unity of common ownership, the unity of operation evidenced generally by staff functions such as centralized advertising, accounting, financing, management, or centralized, group, or committee purchasing, and the unity of use evidenced generally by line functions, centralized executive force, and general system of operation. All of the examples are not needed to show the unity of operation or unity of use. The unitary nature of the business activities or operations is also evidenced by contributions to income resulting from functional integration, centralized management, and economies of scale. Examples of functional integration are centralized manufacturing, warehousing, accounting, legal staff, personnel training, financing, or centralized, group, or committee purchasing. Examples of centralized management are common officers or directors, exchange of personnel, frequent communication between management of the corporations, or where

the parent must approve of major financial decisions. All of the examples are not needed to show functional integration or centralized management. The term "unitary business" for purposes of filing a combined report includes only those corporations created or organized in the United States or under the laws of the United States or any state. The mere ownership of as much as 100 percent of the stock of another corporation does not, in the absence of other indicia of a unitary business, mean that the business of the group is unitary in nature. The presence of any one of the factors contained in C.-E. below creates a strong presumption that the activities of the corporations constitute a unitary trade or business.

C. Horizontal type of business. Business activities or operations carried on by more than one corporation, related through common ownership, are generally unitary when the activities of the corporations are in the same general line of business and exhibit functional integration and economies of scale. For example, separately incorporated grocery stores, related through common ownership, will usually be engaged in a unitary trade or business if they are functionally integrated, and have centralized management and economies of scale.

D. Steps in a vertical process. Business activities or operations carried on by more than one corporation, related through common ownership, are unitary in nature when the various members are engaged in a vertically structured enterprise. For example, assuming that the common ownership requirement is met, a trade or business that is functionally integrated and which benefits from centralized management and controlled interaction which involves the exploration and mining of copper ore by one of the related corporations; the smelting and refining of the copper ore by another of the related corporations; and the fabrication of the refined copper into consumer products by another of the related corporations, is unitary in nature.

E. Strong centralized management. A group of corporations, related through common ownership, which might otherwise be considered to be carrying on separate trades or businesses are

considered engaged in a unitary trade or business when there is strong centralized management in determining the policies of each corporation respecting its primary business activities, coupled with the existence of centralized offices for such functions as financing, advertising, research, or purchasing. Thus, some groups of corporations are considered as carrying on a unitary trade or business when the executive officers of one of the corporations in the group are normally involved in determining the policies respecting the primary business activities of the other corporations in the group, and there are centralized units which perform for some or all of the corporations functions which truly independent corporations would perform for themselves, such as accounting, personnel, insurance, legal, purchasing, advertising, or financing. A finding of "strong centralized management" is not supported merely by showing that the requisite ownership percentage exists or that there is incidental economic benefit accruing to a group because such ownership improves its financial position. Both elements of strong centralized management, that is strong centralized management authority and the exercise of that authority through centralized operations, must exist in order to justify a conclusion that the operations of otherwise seemingly separate trades or businesses are significantly integrated so as to constitute a unitary business.

F. Common ownership. Common ownership does not exist unless the corporation is one which is a member of a group of two or more corporations and more than 50 percent of the voting stock of each member is directly or indirectly owned by a common owner or by common owners, either corporate or noncorporate, or by one or more of the member corporations of the group. The term "common owner" includes the constructive ownership of stock by related taxpayers as provided in Minnesota Statutes, section 290.10, clause (6). Examples of common ownership are:

1. Corporation P owns 51 percent of the voting stock of corporation R1 and corporation R1 owns 51 percent of the voting stock of each of corporations R2 and R3. Common ownership

exists among P, R1, R2, and R3.

2. Corporation P owns 51 percent of the voting stock of corporation R1, corporation R1 owns 49 percent of the voting stock of corporation R2 and corporation R2 owns 51 percent of the voting stock of R3. Common ownership exists among P and R1 and will be identified as group A. Common ownership exists among R2 and R3 and will be identified as group B. There is no common ownership between group A and group B.

G. Examples. The provisions of A.-F. may be illustrated by examples 1.-3.

1. Sales corporation owns 51 percent of the outstanding voting stock in each of four subsidiaries - refining corporation, drilling corporation, transport corporation, and research corporation. Sales corporation markets and sells petroleum products in the United States and abroad. Some of the petroleum products are obtained from refining corporation which acquires some of the crude oil from drilling corporation. Transport corporation operates pipeline facilities to transport crude oil from drilling corporation's storage facilities to refining corporation's refineries. Research corporation conducts research and development for both sales and refining corporations. Since the corporations are operating a vertically integrated business and since there is common ownership, the five corporations are conducting a unitary business.

2. Corporation A owns 60 percent of the outstanding voting stock in each of three corporations; B, C, and D. Corporation B, in turn, owns 100 percent of the outstanding voting stock in corporation E. Corporation A is primarily engaged in operating multiline department stores in Minnesota and other midwestern states. Corporation B operates a chain of department stores in the northwestern portion of the United States. B's stores sell only high quality, top grade consumer items. Corporation C operates a chain of discount stores throughout the southwestern portion of the United States. Corporation D is a finance company, handling all of the consumer credit and financing arrangements of purchases at the stores

owned by corporations A, B, and C. Corporation E is the purchasing agent for corporations A, B, and C and maintains warehouses for the stores' inventories. Corporation A provides management services for all of the other corporations and maintains overall control in determining the policies respecting the primary business activities of the other corporations, including their budgetary and financial affairs. All of these corporations are engaged in the conduct of a unitary business since they are operating a horizontally integrated business and since they have common ownership.

3. Corporation K was incorporated in 1945 and thereafter was engaged primarily in activities connected with the manufacture and sale of canned goods. In 1960, K embarked upon a diversification campaign designed to insulate its profits from fluctuations in the demand for canned goods. One hundred percent of the voting stock of corporation L was acquired. Corporation L operated a chain of department stores throughout the United States. In 1961, K purchased 80 percent of the voting stock of corporation M which was engaged primarily in the manufacture and sale of household goods. In 1962, K acquired 75 percent of the voting stock of corporation N which developed and marketed computer software and programs. There was no significant flow of goods between any of the corporations. While these subsidiaries were relatively autonomous in their day-to-day operations, each subsidiary did not operate as a distinct business enterprise at the level of full time management. Corporation K involved itself in policy determinations respecting the primary business activities of all the corporations. The subsidiaries were required to submit annual budgets to K for approval. Capital expenditures in excess of $500,000 needed approval from K. All of the financing arrangements for the subsidiaries were made by or with the approval of K's management team which authorized and directed intercompany loans when feasible. Tax matters were supervised by K's tax department which prepared the subsidiaries' federal income tax returns. Corporation K also performed centralized

warehousing and accounting functions for itself and its subsidiaries. A uniform system of inventory control for corporation K and the subsidiaries was developed and managed by corporation N. Due to the control that corporation K exerted over policy determinations respecting the primary business activities of the subsidiaries and the integration and interdependence occasioned by the centralization of various business functions, all of the corporations are engaged in a unitary business.

13 MCAR S 1.6502 Intercompany transfers within unitary business.

Elimination of income, loss, expense, or deduction items arising from transactions between members of a unitary group must be made to avoid distortion of:

1. the group's income, loss, expenses, or deductions;

2. the denominator used by all members of the group in calculating apportionment factors; or

3. the numerator used by any particular member of the group in calculating its apportionment factors.

Where a corporation can show that no distortion of income, loss, expense, or deduction will result where intercompany transactions are not eliminated, a corporation may elect to not eliminate intercompany transactions for 1. only. All intercompany transactions must be eliminated when calculating the factors as provided in 2. and 3.

13 MCAR S 1.6503 Unitary business, reporting.

A. Minnesota business. A unitary business which conducts its entire business within Minnesota may file a combined report for each corporation. The income or loss must be allocated among the corporations on the report by use of the equally weighted arithmetic average of the property, payroll, and sales factors. Each corporation on the report is entitled to have its first $25,000 of income taxed at the lower tax rate as provided in Minnesota Statutes, section 290.06, subdivision 1. These provisions also apply to banks and bank holding companies.

B. Required if Minnesota nexus. Except as provided in this

rule, a combined report is required from every corporation that has a nexus with Minnesota and is part of a unitary business as defined in 13 MCAR S 1.6501 other than insurance companies subject to the provisions of Minnesota Statutes, section 290.35, investment companies subject to the provisions of Minnesota Statutes, section 290.36, or mining companies as provided in Minnesota Statutes, section 290.05, subdivision 1.

C. Farm income. Farm income is specifically excluded from combined reporting. Therefore, a unitary business must exclude farm income when figuring its combined income or loss and assign that income or loss to the state in which the farm is located. Where a Minnesota farm is a part of a unitary farming business which is located within and without Minnesota, the product from the Minnesota farm which is transferred outside of Minnesota for use in the unitary farming business must be treated as if it was sold at fair market value on the day of the transfer. Expenses connected with the farm are allowed under separate accounting.

D. Deductions. A corporation is allowed a charitable deduction which is subtracted from that corporation's apportioned unitary business income as determined on that corporation's combined report. The charitable contribution deduction is only allowed to a corporation which has a nexus with Minnesota and is determined as follows. The corporation is allowed to deduct:

1. those contributions it makes to an entity carrying on substantially all of its activities in Minnesota; and

2. a percentage of the charitable contributions made by the entire unitary group after reduction for all contributions qualifying under 1. made by a corporation with a Minnesota nexus. The percentage to be used is the ratio of Minnesota taxable net income of the corporation to the total net income of the unitary group.

E. Credits. Any refundable or nonrefundable credits allowed on the Minnesota return are allowed only to a corporation that has a nexus with Minnesota and must be based on that corporation's expenditures. These credits must be taken into

consideration after computing the income or loss of a unitary business on the combined report.

F. Minimum tax. The minimum tax liability must be determined by using 40 percent of the corporation's federal minimum tax liability as computed on its federal return, multiplied by a fraction the numerator of which is the taxpayer's preference item income allocated to this state and the denominator of which is the taxpayer's total preference item income for federal purposes. If the corporation filed a separate federal return the minimum tax must be based on that, or if a federal consolidated return was filed the minimum tax must be based on that to the extent all corporations on the consolidated return are also on the combined return.

G. Business acquisition. When a corporation acquires another corporation and starts a unitary business with that corporation, the new corporation must be included on the combined report and its income or loss reported starting with the first taxable year of the acquiring corporation that begins on or after the date of acquisition. Acquiring another corporation does not include creating the corporation from a part of a corporation's unitary business group as it previously existed.

H. Unitary banking business. When a bank, including a bank holding company, is part of a unitary business that is doing business within and without Minnesota, a combined report must be filed for that bank as part of the unitary business. Receipts from intangible personal property must be included in the sales factor as follows:

1. Interest and other receipts from assets in the nature of loans, including federal funds sold, and installment obligations must be attributed to the state where the office is located at which the customer applied for the loan except in cases where the loan is recognized by appropriate banking regulatory authority as being made from and as an asset of an office located in another state, in which case it must be attributed to the state where that office is located. For

purposes of this paragraph the word "applied" means initial inquiry, including customer assistance in preparing the loan application, or submission of a completed loan application, whichever occurs first in time.

2. Interest or service charges from bank, travel, and entertainment credit card receivables and credit card holders' fees must be attributed to the state in which the credit card holder resides in the case of an individual or, if a corporation, to the state of the corporation's commercial domicile provided the taxpayer is taxable in that state. If the taxpayer is not taxable in the state of the individual card holder's residence or commercial domicile of the corporate card holder, the receipts must be attributed to the state of the taxpayer's commercial domicile.

3. Merchant discount income derived from bank and financial corporation credit card holder transactions with a merchant must be attributed to the state in which the merchant is located, provided the taxpayer is taxable in that state. If the taxpayer is not taxable in the state in which the merchant is located, the merchant discount income must be attributed to the state in which the taxpayer's commercial domicile is located.

4. Receipts from investments of a bank in securities must be attributed to its commercial domicile with the following two exceptions. Receipts from securities used to maintain reserves against deposits to meet federal and state reserve deposit requirements must be attributed to each state based upon the ratio that total deposits in the state bear to total deposits everywhere. Receipts from securities owned by a bank but held by a state treasurer or other public official or pledged to secure public or trust funds deposited in such bank must be attributed to the banking office at which such secured deposit is maintained.

5. Receipts (fees or charges) from the issuance of travelers checks and money orders must be attributed to the state where the taxpayer's office is located that issued the travelers checks. If the travelers checks are issued by an

independent representative or agent of the taxpayer, the following rules apply. If the taxpayer is taxable in the state in which the independent representative or agent issues the travelers checks or money orders, the receipts (fees or charges) must be attributed to that state. If the taxpayer is not taxable in the state in which the independent representative or agent issues the travelers checks or money orders, the receipts (fees or charges) must be attributed to the state of commercial domicile of the taxpayer.

6. Receipts from investments of a financial corporation must be attributed to its commercial domicile unless the securities have acquired a business situs elsewhere.

I. Accounting periods. Where members of the unitary group employ different accounting periods, the income must be reported on the combined report using one of the following methods. The income or loss and factors of all the corporations involved are those amounts for the same common months contained in the accounting period of the parent corporation, or the corporation filing the Minnesota return. If there is no parent corporation, the members of the unitary group may select one corporation to be the parent corporation for purposes of this part. Once a method is selected, it must not be changed without the consent of the commissioner. For the first taxable year beginning after June 30, 1981, income or loss and the factors attributable to a month or months which were previously reflected on the corporation's separate income tax return shall not be again reflected on the corporation's combined report. For the first taxable year beginning after June 30, 1981, if all the months are not included on a combined report or on a separate return, a separate return shall be filed reflecting the income or loss and factors for those months which are omitted. The due date of the return continues to be determined with reference to the actual accounting period of the corporation.

J. Net operating loss. The provisions of Minnesota Statutes, section 290.095, subdivision 3, clause (c) must be applied as if the corporation was not included on a combined

report for that year when a corporation is included on a combined report for that year, and it is carrying over a net operating loss from a taxable year which began before July 1, 1981. This provision shall apply only if the corporation was a member of the unitary group prior to July 1, 1981.

K. Factors. Where members of a unitary business employ different methods of apportioning their income to Minnesota, the method used by the predominant business activity shall be used by all members of the unitary group.

2019 Apportionment of net income of business conducted partly within Minnesota.

(a) Applicability of Minnesota Statutes, section 290.19. The formulae prescribed by the provisions of Minnesota Statutes, section 290.19 shall be applied to the apportionable net income of a trade or business where the business carried on within this state is a part of a unitary business carried on both within and without this state.

(b) Apportionment of net income under Minnesota Statutes, section 290.19, subdivision 1, clause (1). If the business consists of the manufacture of personal property and sale of said property within and without Minnesota the formula shall be as follows:

(1) Under Minnesota Statutes, section 290.19, subdivision 1, clause (1)(a), (b), (c).

$$\frac{\text{Minn. Sales}}{\text{Total Sales}} + \frac{\text{Minn. Payroll}}{\text{Total Payroll}} + \frac{\text{Minn. Tangible Prop.}}{\text{Total Tangible Prop.}} \div 3 = \% \text{ to Minn.}$$

Using hypothetical percentages we secure a percent to Minnesota thus:

	Within Minn.	Without Minn.	Total Percent
Sales	40%	60%	100%
Payroll	50%	50%	100%
Tangible Property	70%	30%	100%
Divide by Three	160%/3		
Percent to Minnesota ..	53-1/3%		

(2) Under Minnesota Statutes, section 290.19, subdivision 1, clause (1)(d). ~~In the alternative~~ The following alternative HE 20 formula ~~may be~~ is employed if a lesser percentage to Minnesota results by its use:

$$70\% \text{ of } \frac{\text{Minn. Sales}}{\text{Total Sales}} + 15\% \text{ of } \frac{\text{Minn. Payroll}}{\text{Total Payroll}} + 15\% \text{ of } \frac{\text{Minn. Tang. Prop.}}{\text{Total Tang. Prop.}} = \% \text{ to Minn.}$$

An illustration of the weighing of the factors in the alternative formula as provided in Minnesota Statutes, section 290.19, subdivision 1, clause (1)(d) appears thus:

	Within Minn.	Weighted	Weighted Percentage
Sales	40%	70%	28.
Payroll	50%	15%	7.5
Tangible Property ...	70%	15%	10.5
Weighted averages percentage to Minnesota			46.0%

Since under the fact situation used in this illustration, the weighted average formula determines a lesser Minnesota percentage ratio, the weighted ratio ~~may be~~ is HE 20 used.

(c) Apportionment of net income under Minnesota Statutes, section 290.19, subdivision 1, clause (2). If the business does

not consist of the manufacture and sale of personal property within and without the state, the taxable net income from such business shall be assigned to Minnesota on the basis of the percentage obtained by taking the arithmetic average of the three factors of (1) tangible property, (2) payroll, and (3) sales, gross earnings, or receipts, or on the basis of the percentage obtained by taking the weighted average of these three factors (15 percent of the Minnesota property percentage, 15 percent of the Minnesota payroll percentage, and 70 percent of the Minnesota sales, gross earnings, or receipts percentage), whichever is the lesser. The methods prescribed in this paragraph are presumed to properly reflect the taxable net income assignable to this state.

The single factor of sales, gross earnings, or receipts may be used only if (1) the use of the arithmetic average of the three factors or the use of the weighted average of those factors, whichever is the lesser, will not properly reflect the taxable net income assignable to this state, and (2) the use of the single factor of sales, gross earnings, or receipts will properly and fairly reflect such income.

The separate or segregated accounting method may be used only where the business carried on within this state is not a part of a unitary business carried on both within and without this state. If this method is used, it is subject to the same limitations as those set forth in the preceding paragraph.

(d) Definition of terms.

(1) Manufacture. Generally, the word "manufacture" is defined as the production of an article for use from raw or prepared materials by giving such materials new forms, qualities, or combinations, whether by hand labor or machine. Whether a taxpayer's business consists of manufacture of personal property is a question of fact to be determined in each individual case.

(2) The property element of the apportionment formula considered above shall include land, buildings, machinery, and equipment, inventories, and other tangible personal property

actually used by the taxpayer during the taxable year in carrying on the business activities of the taxpayer. Tangible property which is to be separately allocated under Minnesota Statutes, sections 290.17 and 290.18 may not be considered as property includible in the apportionment factor. Cash on hand or in banks, shares of stock, notes, bonds, accounts receivable, or other evidences of indebtedness, special privileges, franchises, and good will, are specifically excluded from the property factor. The value of tangible property which is owned by the taxpayer and which is to be used in the apportionment fraction shall be the original cost adjusted for any subsequent capital additions or improvements and partial disposition by reason of sale, exchange, or abandonment. Property which is rented by the taxpayer is valued at eight times the net annual rental ~~rate~~. Net annual rental ~~rate~~ is the annual rental ~~rate~~ paid by the taxpayer less any annual rental ~~rate~~ received by the taxpayer from subrentals. If the subrents taken into account in determining the net annual rental produce a negative or clearly inaccurate value for any item of property, another method which will properly reflect the value of rented property may be required by the Department of Revenue or requested by the taxpayer. In no case however shall such value be less than an amount which bears the same ratio to the annual rental paid by the taxpayer for such property as the fair market value of that portion of the property used by the taxpayer bears to the total fair market value of the rented property. The valuations of property both within and without Minnesota shall be the averages during the year and must be on a commensurate basis. Rents paid during the year must not be averaged. The changes made in this paragraph concerning the property factor are effective for taxable years beginning after December 31, 1982. A person filing a combined report shall use this method of calculating the property factor for all members of the group.

HE 22

(3) The payroll element of the apportionment formula considered above shall be the payrolls paid or incurred by the taxpayer for the taxable year under review and wages or salaries

paid or incurred in Minnesota shall be determined to be paid or incurred in Minnesota provided the individual with respect to whom such wages or salaries are paid is either employed within this state or is actually engaged in work in the territorial confines of this state or, if working without this state, is identified with or accountable to an office within this state.

The wages or salaries paid to officers and employees working from Minnesota offices are considered as Minnesota payroll even though their employment requires them to spend working time without this state. Officers and employees whose employment requires them to work without the state entirely and who are assigned to an office without Minnesota, are not considered Minnesota employees for the purpose of apportionment even though their salaries are paid from the taxpayer's general offices in Minnesota.

13 MCAR S 1.6004 Minnesota gross income for individuals who are part-year residents or nonresidents of Minnesota (Federal Adjusted Gross Income).

A. Gross income.

1.-2. [Unchanged.]

3. The following types of income received by a nonresident in Minnesota are to be included in that individual's Minnesota gross income and are assignable to Minnesota:

a.-c. [Unchanged.]

d. Business income or losses.

(1) [Unchanged.]

(2) Business conducted within Minnesota and which has a nexus within Minnesota so that the business is subject to Minnesota income tax would include income or losses from sales whose destination is within Minnesota and a business dealing in personal and professional services where such services were performed in this state. Trade or business income or loss assignable to Minnesota and earned by a nonresident individual as a proprietorship or partnership which was carried on partly within and partly without Minnesota is subject to the three-factor apportionment formula contained in Minnesota

Statutes, section 290.19 or apportionment under Minnesota Statutes, section 290.20 , except for farm income or income from personal or professional services.

B.-H. [Unchanged.]

Repealer. Income tax rule 2017 (3) is repealed.

Effective date. The repeal of the last paragraph of income tax rule 2017 (3) relating to construction projects is effective for taxable years beginning after June 30, 1981.

APPROVED AS TO LEGALITY

July 6, 1983

HUBERT H. HUMPHREY, III
ATTORNEY GENERAL

BY _____
SPECIAL ASSISTANT ATTORNEY GENERAL

STATE OF MINNESOTA
DEPARTMENT OF STATE
FILED
JUL 7 - 1983
Joan Anderson Growe
Secretary of State
2:40 PM

STATE OF MINNESOTA
DEPARTMENT OF REVENUE
INCOME TAX DIVISION

PROPOSED ADOPTION OF NEW AND AMENDED RULES AND THE REPEAL OF A RULE OF THE DEPARTMENT OF REVENUE RELATING TO THE TAXATION OF A UNITARY BUSINESS AND FORMULA APPORTIONMENT (13 MCAR SECTION 1.6501 TO 1.6503, 1.6004, MINNESOTA INCOME TAX RULE 2019 AND REPEALING RULE 2017(3)).

ORDER ADOPTING RULES
FINDINGS OF FACT
AND CONCLUSION

The above entitled matter came on for hearing before George Beck, a hearing examiner from the Office of Administrative Hearings, on April 8, 1983 at 9 a.m. in the 5th Floor Conference Room, Veterans Building, 20 West 12th Street and Columbus Avenue, St. Paul, Minnesota, after proper notice required by Minnesota Statutes, Section 14.14, subdivision 1 was served upon all persons, associations and other interested groups registered with the Department of Revenue for that purpose.

After affording interested persons an opportunity to present written and oral data, statements and arguments, hearing all of the testimony, considering all of the evidence adduced and upon the records, files, and proceedings herein and applicable statutory standards or criteria, and confirming the need for and reasonableness of the above-captioned rules, and having now, therefore, reviewed the record of the hearing, including the exhibits and written materials submitted before the close of the record, the report of the hearing examiner, I do now adopt as my findings of fact in this matter, the findings of fact of the hearing examiner with the following exceptions:

1. In his report, on page 5, at the end of finding of fact 11.d. he suggests some additional changes to the rule. I feel that the change the hearing examiner is requesting is dealt with very clearly in part E. of the rule and so isn't needed here. Part B. of the rule only lists some examples of centralized management while part E. of the rule explains this provision more in depth.

2. I have considered but not adopted the suggestions contained on page 7, finding of fact 11.g., since I feel that the 80 percent test is contrary to the law and that there has not been enough evidence produced to make an informed judgment on the issue that was raised concerning the removal of regulated companies from a combined report.

3. I feel that the rule already adequately covers the concerns mentioned by the examiner on page 8, finding of fact 14.c., and page 9, finding of fact 17., and that the changes he proposes in these areas are not needed.

4. On pages 10 and 11, in finding of fact 21., the hearing examiner suggests that the Department consider defining the sales factor. Since this was not done in the rule as proposed, it should be done at some future time as a separate rule. This area has been subject to litigation as recently as November 24, 1982 when the Minnesota Supreme Court decided Olympia Brewing Company v. Commissioner of Revenue, 326 N.W.2d 642.

Now, Therefore, it is ordered that these rules identified as Rules of the Department of Revenue Relating to the Taxation of a Unitary Business and Formula Apportionment as published at State Register Volume 7, Number 35, pages 1226 through 1234, February 28, 1983 (7 S.R. 1226-1234) and as amended are adopted this 16th day of June, 1983 pursuant to authority vested in me by Minnesota Statutes, Section 290.52.

State of Minnesota
Department of Revenue

Arthur C. Roemer

ARTHUR C. ROEMER
Commissioner

Exhibit No. C

File No.

Date

STATE OF MINNESOTA

DEPARTMENT OF REVENUE

INCOME TAX DIVISION

RECEIVED
MAR 11 1983
ADMINISTRATIVE HEARINGS

IN THE MATTER OF THE PROPOSED ADOPTION
OF NEW AND AMENDED RULES AND THE
REPEAL OF A RULE OF THE DEPARTMENT OF REVENUE
RELATING TO THE TAXATION OF A UNITARY
BUSINESS AND FORMULA APPORTIONMENT.
(13 MCAR SECTIONS 1.6501 to 1.6503, 1.6004,
MINNESOTA INCOME TAX RULE 2019
AND REPEALING RULE 2017(3))

NOTICE OF HEARING

A public hearing concerning the adoption of the proposed new and amended rules and the repeal of a rule will be held in the 5th Floor Conference Room, Veterans Building, 20 West 12th Street and Columbus Avenue, St. Paul, Minnesota (south end of the Capitol Mall) on Friday, April 8, 1983, commencing at 9 a.m. The proposed new and amended rules and the repeal of a rule may be modified as a result of the hearing process. Therefore, if you are affected in any manner by the proposed rule changes, you are urged to participate in the rule hearing process.

Following the agency's presentation at the hearing, all interested (or affected) persons will have an opportunity to ask questions and make comments. Statements may be made orally and written material may be submitted. In addition, whether or not an appearance is made at the hearing, written statements or materials may be submitted to George Beck, Office of Administrative Hearings, 400 Summit Bank Building, 310 Fourth Avenue South, Minneapolis, Minnesota 55415, 612-341-7601, either before the hearing or

within five working days after the close of the hearing. The Hearing Examiner may, at the hearing, order that the record be kept open for a longer period not to exceed 20 calendar days. The rule hearing procedure is covered by Minn. Stat. Sections 14.01 to 14.20 and by 9 MCAR Sections 2.101-2.112 (Minnesota Code of Agency Rules). If you have any questions about the procedure, call or write the Hearing Examiner.

Twenty-five days prior to the hearing a statement of need and reasonableness will be available for review at the agency and at the Office of Administrative Hearings. This statement of need and reasonableness will include a summary of all the evidence which will be presented by the agency at the hearing justifying both the need for and the reasonableness of the proposed rule. Copies of this statement of need and reasonableness may be obtained from the Office of Administrative Hearings at a minimal charge.

The proposed new and amended rules and repealed rule (13 MCAR Sections 1.6501 to 1.6503, 1.6004 and Minnesota Income Tax Rules 2019 and 2017(3)) are summarized as follows:

1. 13 MCAR Section 1.6501 defines a unitary business. The rule explains that examples of a unitary business are a horizontal or vertical business or one with strong centralized management. Other examples are also provided. The rule defines what common ownership is and also the term "United States."
2. 13 MCAR Section 1.6502 provides the treatment of intercompany transfers within a unitary business.
3. 13 MCAR Section 1.6503 provides many special rules on how a unitary business is to report to Minnesota. Specifically, the rule deals with 100 percent Minnesota corporations, farm income, charitable contributions, credits, minimum tax, banks, new acquisitions, different accounting periods and factors, and net operating loss.

4. Minnesota Income Tax Rule 2019 sets out how a business which conducts business partly within Minnesota apportions its net income. The property factor is changed to use original cost and rented property is valued at eight times the rental rate. Obsolete language is removed.

5. 13 MCAR Section 1.6004 defines Minnesota gross income for individuals who are part-year residents or non-residents. The changes conform the rule to changes made regarding construction companies and farms.

6. Minnesota Income Tax Rule 2017(3) is repealed. The main part of this rule had required that construction companies use separate accounting. The rest of the rule either copies the statute or is obsolete.

The agency's authority to adopt the proposed new and amended rules and to repeal the existing rule is contained in Minn. Stat. Section 290.52.

The agency estimates that there will be no cost to local public bodies in the state to implement the rule for the next two years immediately following its adoption within the meaning of Minn. Stat. Section 14.11, subd. 1.

Any person may request notification of the date on which the Hearing Examiner's report will be available, after which date the agency may not take any final action on the rules for a period of five working days. Any person may request notification of the date on which the hearing record has been submitted or resubmitted to the Attorney General by the agency. If you desire to be so notified, you may so indicate at the hearing. After the hearing you may request notification by sending a written request to the Hearing Examiner in the case of the Hearing Examiner's report or to the agency in the case of the agency's submission or re-submission to the Attorney General.

Copies of the proposed rule are now available. Persons with questions about the rule or who desire a free copy of the rule should contact:

Mr. Dale H. Busacker
Attorney, Income Tax Division
Minnesota Department of Revenue
Centennial Office Building
St. Paul, Minnesota 55145
(612) 296-3439

Minn. Stat. Chapter 10A requires each lobbyist to register with the State Ethical Practices Board within five says after he or she commences lobbying. A lobbyist is defined in Minn. Stat. Section 10A.01, subd. 11 (1982) as any individual:

(a) Engaged for pay or other consideration, or authorized by another individual or association to spend money, who spends more than five hours in any month or more than $250, not including his own travel expenses and membership dues, in any year, for the purpose of attempting to influence legislative or administrative action by communicating or urging others to communicate with public officials; or

(b) Who spends more than $250, not including his own traveling expenses and membership dues, in any year for the purpose of attempting to influence legislative or administrative action by communicating or urging others to communicate with public officials.

The statute provides certain exceptions. Questions should be directed to the Ethical Practices Board, 41 State Office Building, St. Paul, Minnesota 55155, telephone 612-296-5615.

February 9, 1983

Arthur C. Roemer

Arthur C. Roemer
Commissioner of Revenue

Exhibit No. B

File No.

Date

STATE OF MINNESOTA

DEPARTMENT OF REVENUE

INCOME TAX DIVISION

RECEIVED
MAR 11 1983
ADMINISTRATIVE HEARINGS

IN THE MATTER OF THE PROPOSED ADOPTION
OF NEW AND AMENDED RULES AND THE
REPEAL OF A RULE OF THE DEPARTMENT OF REVENUE
RELATING TO THE TAXATION OF A UNITARY
BUSINESS AND FORMULA APPORTIONMENT.
(13 MCAR SECTIONS 1.6501 TO 1.6503, 1.6004,
MINNESOTA INCOME TAX RULE 2019
AND REPEALING RULE 2017(3))

ORDER FOR HEARING

It is hereby ordered that a public hearing on the above captioned rules be held in the 5th Floor Conference Room, Veterans Building, 20 West 12th Street and Columbus Avenue, St. Paul, Minnesota (south end of the Capitol Mall) on Friday, April 8, 1983, commencing at 9 a.m. and continuing until all persons have had an opportunity to be heard.

It is further ordered that a Notice of Hearing be mailed to all persons or representatives of associations or other interested groups who have registered their names with the Department of Revenue for that purpose.

It is further ordered that the Notice of Hearing be published in the State Register.

Arthur C. Roemer

February 7, 1983

Arthur C. Roemer

Commissioner of Revenue

Exhibit No. E

File No.

Date

STATE OF MINNESOTA

DEPARTMENT OF REVENUE

INCOME TAX DIVISION

RECEIVED
MAR 11 1983
ADMINISTRATIVE HEARINGS

IN THE MATTER OF THE PROPOSED ADOPTION OF NEW AND AMENDED RULES AND THE REPEAL OF A RULE OF THE DEPARTMENT OF REVENUE RELATING TO THE TAXATION OF A UNITARY BUSINESS AND FORMULA APPORTIONMENT. (13 MCAR SECTIONS 1.6501 TO 1.6503, 1.6004, MINNESOTA INCOME TAX RULE 2019 AND REPEALING RULE 2017(3)).

AFFIDAVIT

Mary Lacho, being first duly sworn, deposes and says:

That on the 24th day of February, 1983, at the City of St. Paul, County of Ramsey, State of Minnesota, she served the Notice of Hearing in the matter of the proposed adoption of a new rule relating to taxation of a unitary business and formula apportionment by depositing in the United States mail at the City of St. Paul, a true and correct copy of the Notice, properly enveloped, with postage prepaid, to all persons and associations at the address listed on the attached list received from the Department of Revenue.

Mary Lacho

Subscribed and sworn to before me
this 24th day of February, 1983.

Kathryn A. Kenney

KATHRYN A. KENNEY
NOTARY PUBLIC-MINNESOTA
RAMSEY COUNTY
MY COMMISSION EXPIRES NOVEMBER 8, 1988

STATE OF MINNESOTA

DEPARTMENT OF REVENUE

INCOME TAX DIVISION

IN THE MATTER OF THE PROPOSED ADOPTION
OF NEW AND AMENDED RULES AND THE REPEAL
OF A RULE OF THE DEPARTMENT OF REVENUE
RELATING TO THE TAXATION OF A UNITARY
BUSINESS AND FORMULA APPORTIONMENT.
(13 MCAR SECTIONS 1.6501 TO 1.6503,
1.6004, MINNESOTA INCOME TAX RULE 2019
AND REPEALING RULE 2017(3)).

AFFIDAVIT

Dale H. Busacker, being first duly sworn, deposes and says:

That on the 18th day of February, 1983 at the city of St. Paul, County of Ramsey, State of Minnesota, he personally received the list of persons, associations and other interested groups who had registered with the Department of Revenue for the purpose of receiving notice of public hearing on proposed rules. A copy of this list is attached.

Dale H. Busacker

Subscribed and sworn to before me
this 24th day of February, 1983.

Diane C. Walsh

DIANE C. WALSH
NOTARY PUBLIC MINNESOTA
My Commission Expires July 27, 1985
RAMSEY COUNTY

STATE OF MINNESOTA

DEPARTMENT OF REVENUE

IN THE MATTER OF THE PROPOSED ADOPTION OF NEW AND AMENDED RULES AND THE REPEAL OF A RULE OF THE DEPARTMENT OF REVENUE RELATING TO THE TAXATION OF A UNITARY BUSINESS AND FORMULA APPORTIONMENT. (13 MCAR SECTIONS 1.6501 TO 1.6503, 1.6004, MINNESOTA INCOME TAX RULE 2019 AND REPEALING RULE 2017(3)).

CERTIFICATE
COMPLETENESS AND ACCURACY

I hereby certify that the attached 28 sheets constitute the complete list of persons, associations and other interested groups who, as of 8:00 a.m., this 16th day of February, 1983, have requested, pursuant to Minn. Stat. Section 14.14, subd. 1 that their names be placed on file with the Department of Revenue for the purpose of receiving notice of public hearing on proposed rules on the subject captioned above.

STATE OF MINNESOTA
ARTHUR C. ROEMER
COMMISSIONER OF REVENUE

By Dorothy A. McClung
Dorothy McClung, Attorney
Commissioner's Staff

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1821 University Avenue, Rm. 389S
St. Paul, MN 55104

Mr. Bruce Akerman
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Minneapolis, MN 55402

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Licensed Public Accountants
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300 Third Avenue Southeast
Rochester, MN 55901

American Legion Club
Box 183
Hill City, MN 55748

Anderson & Peterson, LPAs
Dodge Professional Building
Moose Lake, MN 55767

David J. Anderson
Certified Public Accountant
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Fargo, ND 58108

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Certified Public Accountants
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Forest Lake, MN 55025

Anderson, Keszler & Associates
Accountants and Auditors
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Fargo, ND 58108

Arrowhead Accounting Service
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Coleraine, MN 55722

Arsenal Sand & Gravel Co., Inc.
P. O. Box 12707
New Brighton, MN 55112

Arthur Treacher's Fish & Chips, Inc.
5501 Tabor Road
Philadelphia, PA 19120
Attn: J. A. Altomare

Association of MN Counties
2305 Ford Parkway
St. Paul, MN 55116
Attn: James C. Shipman
Executive Director

Ausmus Furniture & Carpet
Hinckley,
MN 55037

Auto-Soler Co.
5101 Fulton Industrial Blvd. SW
Atlanta, GA 30336
Attn: H. Ensign, General Accountant

Wesley L. Bahl
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Faribault, MN 55021

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Attorney at Law
306 Minnesota Federal Bldg.
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George R. Ballenger, Finance Dir.
City of Apple Valley
14200 Cedar Avenue South
Apple Valley, MN 55124

Bankers Service Company
1918 W. County Rd. C.
Roseville, MN 55113
Attn: Glenn Thomasen

Bauer Built, Inc.
P. O. Box 248
Durand, WI 54736
Attn: Calvin Jacks, Jr.
Operations Manager

Bemidji Area Chamber of Commerce
P. O. Box 806
Bemidji, MN 56601
Attn: Bookkeeper

T. A. Bengtson
Rural Route 2, Box 90
Waterville, MN 56096

L. T. Bensen & Associates
5315 France Avenue North
Minneapolis, MN 55429

Benson Tax Service
3109 Bloomington Ave. S.
Minneapolis, MN 55407
Attn: Peter J. Benson

Benusa T.V. & Appliance, Inc.
109 7th Avenue South
St. Cloud, MN 56301

Best & Flanagan
4040 IDS Center
Minneapolis, MN 55402
Attn: James C. Diracles

Lyle L. Boehlke
Boehlke & Son, Inc.
Box 86
Buffalo Lake, MN 55314

Oscar J. Boldt Construction Co.
P. O. Box 419
Appleton, WI 54912
Attn: Kathy L. Baumann

Borowicz, Holmgren, Loberg & Co.
Certified Public Accountants
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Boulay, Heutmaker, Zibell & Co.
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Briggs & Morgan, P.A.
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Attn: Jerome A. Geis, Esq.

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R. W. Brust, Vice Pres., Taxes
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3M Center - 220 - 13W
St. Paul, MN 55144

Business and Financial Services
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Cannon Falls, MN 55009

Byerly's
7171 France Avenue So.
Edina, MN 55435
Attn: Don Hoekstra, Accts. Mgr.

C.A.P. Cooperative Oil Ass'n.
P. O. Box 38
Kettle River, MN 55757

Caldwell, Taylor & Brown, Ltd.
540 Shelard Plaza North
300 South County Road 18
Minneapolis, MN 55426

Carlisle Accounting Service
14645 Cameo Avenue
Rosemount, MN 55068

Daniel R. Cartier
Post Office Box 41245
10601 Olson Memorial Highway
Plymouth, MN 55441

Casey & Casey
Certified Public Accountants
7400 Metro Boulevard
Edina, MN 55435

CCH Computax Inc.
P. O. Box 92938
Worldway Postal Center
Los Angeles, CA 90009
Attn: John Koffroth, Tax Specialist

Chicago, Milwaukee, St. Paul
and Pacific Railroad Company
516 W. Jackson Blvd.
Chicago, IL 60608
Attn: Manager-Tax Accounting

Christian Preparation Network
P. O. Box 628
Grand Rapids, MN 55744
Attn: Dominick Fenovese, Ed/Pub

Commercial Tally, Inc.
E K Williams & Co.
WestGate Mall
St. Cloud, MN 56301

Computer Techniques Inc.
7801 East Bush Lake Road
Minneapolis, MN 55435
Attn: Office Manager

Concrete Sectional Culvert Company
P. O. Box 1429
Fargo, ND 58102

Corp. Law Dept.
The St. Paul Co., Inc.
385 Washington Street
St. Paul, MN 55102
Attn: Claudia Smith

Corporate Tax Division/3M
Attention: W. R. Spangler
Director of Tax Compliance
P. O. Box 33441
St. Paul, MN 55133

County Flower Shop
Audrey Van Klompenburg
Route 3, Box 218
Montevideo, MN 56265

Country Furniture
D. J. Meyer Inc.
Lake Park, MN 56554

Crest Electronics
Simon at Third
Dassel, MN 55325
Attn: Carol A. Chap, Office Manager

Custom Printing, Inc.
P. O. Box 1010
1913 2nd Street S.W.
Rochester, MN 55901

Dacotah Paper Co.
1401 - 5th Avenue North
P. O. Box 2727
Fargo, ND 58108

Dan Blank Accounting
213 N. 1st Street
P. O. Box 530
Montevideo, MN 56265

Dayton's
700 on the Mall
Minneapolis, MN 55402
Attn: J.E. Wahl, Property Accounting

Dayton's - Advertising
700 Nicollet Mall
Minneapolis, MN 55402
Attn: Mr. Edward Hannasch

DDD Motel Corporation
111 Range Street
North Mankato, MN 56001
Attn: Shirley Miller, Bookkeeper

Dean's Towing & Auto Parks
P. O. Box 157
Brainerd, MN 56401

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3945 Zarthan Avenue
St. Louis Park, MN 55416

Lorraine DeMill
1414 13th Avenue E.
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The Denesen Company, Inc.
2836 Colfax Avenue South
Minneapolis, MN 55408
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Denny's North Star
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Hill City, MN 55748

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Director Staff Services
2215 W. Old Shakopee Road
Bloomington, MN 55431
Attn: Lyle R. Olson

Distributors Novelty House, Inc.
119 North 4th Street
Minneapolis, MN 55401
Attn: Lois Mann, Bookkeeper

Dome Pipeline Corporation
P. O. Box 2608, Station M
Calgary, Canada T2P 2M7
Attn: K. D. Olstad

Dome Pipeline Corporation
P. O. Box 200
Calgary, Alberta
Canada T2P 2H8

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& Halladay
2300 First National Bank Building
Minneapolis, MN 55402
Attn: Philip M. Chen

Drug Fair, Inc.-Sta Drug-Witte Drug
Industrial Park Road
Iowa City, IA 52240

E.A.T. Inc.
K-Bob Cafe & Riverside Deli
109 South 5th Avenue
Princeton, MN 55371

E. I. du Pont de Nemours & Co.
State, Excise & Employment Taxes Sec.
Room 1346 Farmers Bank Bldg.
1007 Market Street
Wilmington, DE 19898

Mary Lou Eltgroth
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Morris, MN 56267

The Estenson Company
101 East Main
Luverne, MN 56156

Ernst & Whinney
1400 Pillsbury Center
Minneapolis, MN 55402

Ernst & Whinney
1400 Pillsbury Center
Minneapolis, MN 55402
Attn: Anthony M. Schelonka

FAB Pipe, Inc.
701 County Road 83
Shakopee, MN 55379

Fabri-Centers of America, Inc.
23550 Commerce Park Road
Beachwood, OH 44122
Attn: David Essi, Jr.
Tax Department

Donald M. Fahrenkamp
P. O. Box 305
4769 Dakota Street
Prior Lake, MN 55372

Farmers Exchange Cooperative
Lake Park
IA 51347

First Northwestern Bank
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Firstbank Financial Corporation
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Flight Transportation Corporation
9960 Flying Cloud Drive
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The Flintkote Company
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Attn: Tax Department
Account No. 8665376

John Henry Foster Co., Inc.
3748 Minnehaha Ave.
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John Henry Foster Co., Inc.
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Gavin, Olson & Conkel, Ltd.
Gavin Law Building
Glencoe, MN 55336

General Business Services
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Cannon Falls, MN 55009

General Business Service
1827 No. St. Paul Road
Maplewood, MN 55109

General Mills, Inc.
c/o R. D. Mueller, Tax Manager
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Minneapolis, MN 55440

Gildner Stores, Inc.
15½ N. Federal
Mason City, IA 50401

Goering Fire Suppression, Inc.
9803 Logan Avenue South
Bloomington, MN 55431

Goodall Rubber Company
P. O. Box 8237
Trenton, NJ 08650
Attn: G. E. Hamilton, Tax Manager

Elmer A. Goodman
Route 2, Box 276
Rockford, MN 55373

Grace Home, Inc.
Graceville, MN 56240

Richard J. Graf
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Minneapolis, MN 55438

Graves, McKenna, Lundeen & Almquist
6800 France Avenue South
Minneapolis, MN 55435
Attn: Mary Olmscheid

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Attn: Richard Fretland

Haack Tax Service
1506 3rd Avenue N.W.
Rochester, MN 55901

Habert Accounting
2127 West Superior St.
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Attn: Karen Habert

Hackbarth Auto & Tractor Supply, Inc.
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Attn: Betty Jane Hackbarth

Mathew Hall Lumber Co.
127 6th Avenue North
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Golden Valley, MN 55422

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333 Central Avenue
Long Prairie, MN 56347
Attn: John L. Larson, Accountant

Alfred L. Haugud
Box 49
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Havemeier's Accounting
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Attn: Jim Drahos

Hayssen Manufacturing Company
P. O. Box 571
Sheboygan, WI 53081
Attn: L. H. Volz

HBE Leasing Corporation
717 Office Parkway
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St. Louis MO 63141

Heart of America
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Minneapolis, MN 55447
Attn: Ms. Sonya H. Stenulson

Perry and Jane Hendricks
Route 1
Millville, MN 55957

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West St. Paul, MN 55118

Erwin Hill, CPA
P. O. Box B
Austin, MN 55912

Brad Hoffman
City of Brooklyn Center
6301 Shingle Creek Parkway
Brooklyn Center, MN 55430

Holcomb, Knudson & Co.
407 - 2nd Street N.W.
East Grand Forks, MN 56721

Holcomb, Knudson & Co.
P. O. Box 1043
Grand Forks, ND 58201
Attn: Gerald C. Knudson

Honeywell Inc.
Honeywell Plaza, MN 12-4184
Minneapolis, MN 55408
Attn: Robert H. Dillon
Director, Tax Admin.

Honeywell Inc.
Honeywell Plaza
Minneapolis, MN 55408
Attn: Mr. W. C. Viitala
Dir. of Public Affairs

Hopkins Lodge No. 2221
30 - 8th Avenue South
P. O. Box 106
Hopkins, MN 55343

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Certified Public Accountants
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St. Paul, MN 55104

Hudrlik Furniture
125-133 W. Bridge St.
Owatonna, MN 55060

Human Service Agency
Wright Co. Courthouse
Buffalo, MN 55313
Attn: Janice M. Devens, Director

INDEP. BANKERS OF MN
327 Plymouth Building
12 South 6th Street
Minneapolis, MN 55402
Attn: Norbert McCrady, Exec. V.P.

Inryco, Inc.
Tax Division
P. O. Box 8237
Chicago, IL 60680

Inter-City Gas Corporation
Inter-City Gas Building
444 St. Mary Avenue
Winnepeg Manitoba Canada
R3C3T7

International Business Machines Corp.
Armonk, NY 10504
Attention: J. J. Nash

International Research & Evaluation
Research Publication Division
21098 IRE Control Center
Eagan, MN 55121

Interstate Power Company
President
1000 Main Street
Dubuque, IA 52001

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Spokane, WA 99206

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Minneapolis, MN 55403

Barbara Johnson
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St. Paul, MN 55104

Johnson Engineering
Grandy, MN 55029

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Harley Y. Karvonen
Public Accountant
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Perham, MN 56573

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Mankato, MN 56001
Attn: Linda Miller

Kelco Supply Company
311 East 14th Street
Minneapolis, MN 55404

Mr. Jay B. Kelly
Suite W-1294
First National Bank Building
St. Paul, MN 55101

Kern, Paganski, Hirschfeld & Company
c/o Don Meyer
1400 St. Germain
St. Cloud, MN 56301

L. A. Klepperich
Space Center, Inc.
444 Lafayette Road
St. Paul, MN 55101

Maurice Klingsporn, CPA
1022 Mill
Zumbrota, MN 55992

R. L. Kuehmichel & Co.
2437 Park Avenue South
Minneapolis, MN 55404

Kuhlman Corporation
P. O. Box 288
Birmingham, MI 48012
Attn: Walter Meissner

Mr. George J. Kurvers
1010 London Road
St. Paul, MN 55118

Laclede Steel Company
Equitable Building
St. Louis, MO 63102
Attn. D. K. Shipley

Lake City Gas, Inc.
211 East Lyon Avenue
Lake City, MN 55041

Lake Superior Industrial Bureau
828 First National Bank Building
Duluth, MN 55802
Attention: Alfred E. France, President

Lakeland Federal Savings & Loan Ass'n.
P. O. Box 646
928 Lake Avenue
Detroit Lakes, MN 56501

LANCO Data Proc. Serv., Inc.
219 Little Canada Road
St. Paul, MN 55117
Attn: Harold R. Johnson

Land O'Lakes, Inc.
P. O. Box 116
Minneapolis, MN 55440
Attn: Tom Jordan, Tax Dept.

Lapp, Lazar, Laurie & Smith
1800 First Bank Place West
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Attn: Mr. Gerald W. Poppe

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Attn: Mark A. Sellner

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Attn: Don McNally

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Exhibit No. F

File No.

Date

STATE OF MINNESOTA

DEPARTMENT OF REVENUE

INCOME TAX DIVISION

RECEIVED
MAR 11 1983
ADMINISTRATIVE HEARINGS

IN THE MATTER OF THE PROPOSED ADOPTION OF NEW AND AMENDED RULES AND THE REPEAL OF A RULE OF THE DEPARTMENT OF REVENUE RELATING TO THE TAXATION OF A UNITARY BUSINESS AND FORMULA APPORTIONMENT. (13 MCAR SECTIONS 1.6501 TO 1.6503, 1.6004, MINNESOTA INCOME TAX RULE 2019 AND REPEALING RULE 2017(3)).

AFFIDAVIT

Mary Lacho, being first duly sworn, deposes and says:

That on the 24th day of February, 1983, at the City of St. Paul, County of Ramsey, State of Minnesota, she served the Notice of Hearing in the matter of the proposed adoption of a new rule relating to taxation of a unitary business and formula apportionment by depositing in the United States mail at the City of St. Paul or in State of Minnesota interoffice mail, where appropriate, a true and correct copy of the Notice, properly enveloped, with postage prepaid, to all persons and associations at the address listed on the attached list.

Mary Lacho

Subscribed and sworn to before me
this 24th day of February, 1983.

Kathryn A. Kenney

KATHRYN A. KENNEY
NOTARY PUBLIC-MINNESOTA
RAMSEY COUNTY
MY COMMISSION EXPIRES NOVEMBER 8, 1988

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Exhibit No. I

File No.

Date

STATE REGISTER

STATE OF MINNESOTA



VOLUME 7, NUMBER 35

February 28, 1983

Pages 1221-1248

STATE REGISTER

Printing Schedule for Agencies

Issue Number	*Submission deadline for Executive Orders, Adopted Rules and **Proposed Rules	*Submission deadline for State Contract Notices and other **Official Notices	Issue Date
	SCHEDULE FOR VOLUME 7		
36	Friday Feb 18	Monday Feb 28	Monday Mar 7
37	Monday Feb 28	Monday Mar 7	Monday Mar 14
38	Monday Mar 7	Monday Mar 14	Monday Mar 21
39	Monday Mar 14	Monday Mar 21	Monday Mar 28

*Deadline extensions may be possible at the editor's discretion; however, none will be made beyond the second Wednesday (12 calendar days) preceding the issue date for rules, proposed rules and executive orders, or beyond the Wednesday (5 calendar days) preceding the issue date for official notices. Requests for deadline extensions should be made only in valid emergency situations.

**Notices of public hearings on proposed rules and notices of intent to adopt rules without a public hearing are published in the Proposed Rules section and must be submitted two weeks prior to the issue date.

Instructions for submission of documents may be obtained from the Office of the State Register, 506 Rice Street, St. Paul, Minnesota 55103, (612) 296-0930.

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The *State Register* is the official publication of the State of Minnesota, containing executive orders of the governor, proposed and adopted rules of state agencies, and official notices to the public. Judicial notice shall be taken of material published in the *State Register*.

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How to Follow State Agency Rulemaking Action in the *State Register*

State agencies must publish notice of their rulemaking action in the *State Register*. If an agency seeks outside opinion before promulgating new rules or rule amendments, it must publish a NOTICE OF INTENT TO SOLICIT OUTSIDE OPINION. Such notices are published in the OFFICIAL NOTICES section. Proposed rules and adopted rules are published in separate sections of the magazine.

The PROPOSED RULES section contains:

- Calendar of Public Hearings on Proposed Rules.
- Proposed new rules (including Notice of Hearing and/or Notice of Intent to Adopt Rules without A Hearing).
- Proposed amendments to rules already in existence in the Minnesota Code of Agency Rules (MCAR).
- Proposed temporary rules.

The ADOPTED RULES section contains:

- Notice of adoption of new rules and rule amendments (those which were adopted without change from the proposed version previously published).
- Adopted amendments to new rules or rule amendments (changes made since the proposed version was published).
- Notice of adoption of temporary rules.
- Adopted amendments to temporary rules (changes made since the proposed version was published).

ALL ADOPTED RULES and ADOPTED AMENDMENTS TO EXISTING RULES published in the *State Register* and filed with the Secretary of State before September 15, 1982, are published in the *Minnesota Code of Agency Rules 1982 Reprint*. ADOPTED RULES and ADOPTED AMENDMENTS TO EXISTING RULES filed after September 15, 1982, will be included in a new publication, *Minnesota Rules*, scheduled for publication in late summer 1983. In the MCAR AMENDMENT AND ADDITIONS listing below, the rules published in the *MCAR 1982 Reprint* are identified with an asterisk. Proposed and adopted TEMPORARY RULES appear in the *State Register* but are not published in the *1982 Reprint* due to the short-term nature of their legal effectiveness.

The *State Register* publishes partial and cumulative listings of rule action in the MCAR AMENDMENTS AND ADDITIONS list on the following schedule:

Issues 1-13, inclusive
Issues 14-25, inclusive
Issue 26, cumulative for 1-26
Issue 27-38, inclusive
Issue 39, cumulative for 1-39
Issues 40-51, inclusive
Issue 52, cumulative for 1-52

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PROPOSED RULES

Pursuant to Minn. Laws of 1980, § 15.0412, subd. 4h, an agency may propose to adopt, amend, suspend or repeal rules without first holding a public hearing, as long as the agency determines that the rules will be noncontroversial in nature. The agency must first publish a notice of intent to adopt rules without a public hearing, together with the proposed rules, in the *State Register*. The notice must advise the public:

1. that they have 30 days in which to submit comment on the proposed rules;
2. that no public hearing will be held unless seven or more persons make a written request for a hearing within the 30-day comment period;
3. of the manner in which persons shall request a hearing on the proposed rules;

and

4. that the rule may be modified if modifications are supported by the data and views submitted.

If, during the 30-day comment period, seven or more persons submit to the agency a written request for a hearing of the proposed rules, the agency must proceed under the provisions of § 15.0412, subds. 4 through 4g, which state that if an agency decides to hold a public hearing, it must publish in the *State Register* a notice of its intent to do so. This notice must appear at least 30 days prior to the date set for the hearing, along with the full text of the proposed rules. (If the agency has followed the provisions of subd. 4h and has already published the proposed rules, a citation to the prior publication may be substituted for republication.)

Pursuant to Minn. Stat. § 15.0412, subd. 5, when a statute, federal law or court order to adopt, suspend or repeal a rule does not allow time for the usual rulemaking process, temporary rules may be proposed. Proposed temporary rules are published in the *State Register*, and for at least 20 days thereafter, interested persons may submit data and views in writing to the proposing agency.

Department of Revenue
Income Tax Division

Proposed Adoption of New and Amended Rules and the Repeal of a Rule of the Department of Revenue Relating to the Taxation of a Unitary Business and Formula Apportionment (13 MCAR §§ 1.6501 to 1.6503, 1.6004, Minnesota Income Tax Rule 2019 and Repealing Rule 2017(3))

Notice of Hearing

A public hearing concerning the adoption of the proposed new and amended rules and the repeal of a rule will be held in the 5th Floor Conference Room, Veterans Building, 20 West 12th Street and Columbus Avenue, St. Paul, Minnesota (south end of the Capitol Mall) on Friday, April 8, 1983, commencing at 9 a.m. The proposed new and amended rules and the repeal of a rule may be modified as a result of the hearing process. Therefore, if you are affected in any manner by the proposed rule changes, you are urged to participate in the rule hearing process.

Following the agency's presentation at the hearing, all interested (or affected) persons will have an opportunity to ask questions and make comments. Statements may be made orally and written material may be submitted. In addition, whether or not an appearance is made at the hearing, written statements or materials may be submitted to George Beck, Office of Administrative Hearings, 400 Summit Bank Building, 310 Fourth Avenue South, Minneapolis, Minnesota 55415, (612) 341-7601, either before the hearing or within five working days after the close of the hearing. The hearing examiner may, at the hearing, order that the record be kept open for a longer period not to exceed 20 calendar days. The rule hearing procedure is covered by Minn. Stat. §§ 14.01 to 14.20 and by 9 MCAR §§ 2.101-2.112 (Minnesota Code of Agency Rules). If you have any questions about the procedure, call or write the hearing examiner.

Twenty-five days prior to the hearing a statement of need and reasonableness will be available for review at the agency and at the Office of Administrative Hearings. This statement of need and reasonableness will include a summary of all the evidence which will be presented by the agency at the hearing justifying both the need for and the reasonableness of the proposed rule. Copies of this statement of need and reasonableness may be obtained from the Office of Administrative Hearings at a minimal charge.

The proposed new and amended rules and repealed rule (13 MCAR §§ 1.6501 to 1.6503, 1.6004 and Minnesota Income Tax Rules 2019 and 2017(3)) are summarized as follows:

1. 13 MCAR § 1.6501 defines a unitary business. The rule explains that examples of a unitary business are a horizontal or vertical business or one with strong centralized management. Other examples are also provided. The rule defines what common ownership is and also the term "United States."

2. 13 MCAR § 1.6502 provides the treatment of intercompany transfers within a unitary business.

3. 13 MCAR § 1.6503 provides many special rules on how a unitary business is to report to Minnesota. Specifically, the rule deals with 100 percent Minnesota corporations, farm income, charitable contributions, credits, minimum tax, banks, new acquisitions, different accounting periods and factors, and net operating loss.

4. Minnesota Income Tax Rule 2019 sets out how a business which conducts business partly within Minnesota apportions its net income. The property factor is changed to use original cost and rented property is valued at eight times the rental rate. Obsolete language is removed.

5. 13 MCAR § 1.6004 defines Minnesota gross income for individuals who are part-year residents or non-residents. The changes conform the rule to changes made regarding construction companies and farms.

6. Minnesota Income Tax Rule 2017(3) is repealed. The main part of this rule had required that construction companies use separate accounting. The rest of the rule either copies the statute or is obsolete.

The agency's authority to adopt the proposed new and amended rules and to repeal the existing rule is contained in Minn. Stat. § 290.52.

The agency estimates that there will be no cost to local public bodies in the state to implement the rule for the next two years immediately following its adoption within the meaning of Minn. Stat. § 14.11, subd. 1.

Any person may request notification of the date on which the hearing examiner's report will be available, after which date the agency may not take any final action on the rules for a period of five working days. Any person may request notification of the date on which the hearing record has been submitted or resubmitted to the Attorney General by the agency. If you desire to be so notified, you may so indicate at the hearing. After the hearing you may request notification by sending a written request to the hearing examiner in the case of the hearing examiner's report or to the agency in the case of the agency's submission or re-submission to the Attorney General.

Copies of the proposed rule are now available. Persons with questions about the rule or who desire a free copy of the rule should contact:

Mr. Dale H. Busacker
Attorney, Income Tax Division
Minnesota Department of Revenue
Centennial Office Building
St. Paul, Minnesota 55145
(612) 296-3439

Minn. Stat. chapter 10A requires each lobbyist to register with the State Ethical Practices Board within five days after he or she commences lobbying. A lobbyist is defined in Minn. Stat. § 10A.01, subd. 11 (1982) as any individual:

(a) Engaged for pay or other consideration, or authorized by another individual or association to spend money, who spends more than five hours in any month or more than $250, not including his own travel expenses and membership dues, in any year, for the purpose of attempting to influence legislative or administrative action by communicating or urging others to communicate with public officials; or

(b) Who spends more than $250, not including his own traveling expenses and membership dues, in any year for the purpose of attempting to influence legislative or administrative action by communicating or urging others to communicate with public officials.

The statute provides certain exceptions. Questions should be directed to the Ethical Practices Board, 41 State Office Building, St. Paul, Minnesota 55155, telephone 612-296-5615.

February 9, 1983

Arthur C. Roemer
Commissioner of Revenue

Rules as Proposed (all new material)

13 MCAR § 1.6501 Definition of unitary business.

A. Definitions. The term "corporation" does not include an S corporation. The term "United States" includes any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any possession of the United States, or any political subdivision of any of the foregoing.

KEY: PROPOSED RULES SECTION — Underlining indicates additions to existing rule language. ~~Strike outs~~ indicate deletions from existing rule language. If a proposed rule is totally new, it is designated "all new material." ADOPTED RULES SECTION — Underlining indicates additions to proposed rule language. ~~Strike outs~~ indicate deletions from proposed rule language.

B. Unitary business defined. Business activities or operations carried on by more than one corporation are unitary in nature when the corporations are related through common ownership and when the trade or business activities of each of the corporations are of mutual benefit, dependent upon, or contributory to one another, individually or as a group. Unity is presumed whenever there is the unity of common ownership, the unity of operation evidenced generally by staff functions such as centralized advertising, accounting, financing, management, or centralized, group, or committee purchasing, and the unity of use evidenced generally by line functions, centralized executive force, and general system of operation. All of the examples are not needed to show the unity of operation or unity of use. The unitary nature of the business activities or operations is also evidenced by contributions to income resulting from functional integration, centralized management, and economies of scale. Examples of functional integration are centralized manufacturing, warehousing, accounting, legal staff, personnel training, financing, or centralized, group, or committee purchasing. Examples of centralized management are common officers or directors, exchange of personnel, frequent communication between management of the corporations, or where the parent must approve of major financial decisions. All of the examples are not needed to show functional integration or centralized management. The term "unitary business" for purposes of filing a combined report includes only those corporations created or organized in the United States or under the laws of the United States or any state. The mere ownership of as much as 100 percent of the stock of another corporation does not, in the absence of other indicia of a unitary business, mean that the business of the group is unitary in nature. The presence of any one of the factors contained in C.-E. below creates a strong presumption that the activities of the corporations constitute a unitary trade or business.

C. Horizontal type of business. Business activities or operations carried on by more than one corporation, related through common ownership, are generally unitary when the activities of the corporations are in the same general line of business and exhibit functional integration and economies of scale. For example, separately incorporated grocery stores, related through common ownership, will usually be engaged in a unitary trade or business if they are functionally integrated, and have centralized management and economies of scale.

D. Steps in a vertical process. Business activities or operations carried on by more than one corporation, related through common ownership, are unitary in nature when the various members are engaged in a vertically structured enterprise. For example, assuming that the common ownership requirement is met, a trade or business that is functionally integrated and which benefits from centralized management and controlled interaction which involves the exploration and mining of copper ore by one of the related corporations; the smelting and refining of the copper ore by another of the related corporations; and the fabrication of the refined copper into consumer products by another of the related corporations, is unitary in nature.

E. Strong centralized management. A group of corporations, related through common ownership, which might otherwise be considered to be carrying on separate trades or businesses are considered engaged in a unitary trade or business when there is strong centralized management in determining the policies of each corporation respecting its primary business activities, coupled with the existence of centralized offices for such functions as financing, advertising, research, or purchasing. Thus, some groups of corporations are considered as carrying on a unitary trade or business when the executive officers of one of the corporations in the group are normally involved in determining the policies respecting the primary business activities of the other corporations in the group, and there are centralized units which perform for some or all of the corporations functions which truly independent corporations would perform for themselves, such as accounting, personnel, insurance, legal, purchasing, advertising, or financing. A finding of "strong centralized management" is not supported merely by showing that the requisite ownership percentage exists or that there is incidental economic benefit accruing to a group because such ownership improves its financial position. Both elements of strong centralized management, that is strong centralized management authority and the exercise of that authority through centralized operations, must exist in order to justify a conclusion that the operations of otherwise seemingly separate trades or businesses are significantly integrated so as to constitute a unitary business.

F. Common ownership. Common ownership does not exist unless the corporation is one which is a member of a group of two or more corporations and more than 50 percent of the voting stock of each member is directly or indirectly owned by a common owner or by common owners, either corporate or noncorporate, or by one or more of the member corporations of the group. The term "common owner" includes the constructive ownership of stock by related taxpayers as provided in Minnesota Statutes, section 290.10, clause (6). Examples of common ownership are:

1. Corporation P owns 51 percent of the voting stock of corporation R1 and corporation R1 owns 51 percent of the voting stock of each of corporations R2 and R3. Common ownership exists among P, R1, R2, and R3.

2. Corporation P owns 51 percent of the voting stock of corporation R1, corporation R1 owns 49 percent of the voting stock of corporation R2 and corporation R2 owns 51 percent of the voting stock of R3. Common ownership exists among P and R1 and will be identified as group A. Common ownership exists among R2 and R3 and will be identified as group B. There is no common ownership between group A and group B.

G. Examples. The provisions of A.-F. may be illustrated by examples 1.-3.

1. Sales corporation owns 51 percent of the outstanding voting stock in each of four subsidiaries—refining corporation, drilling corporation, transport corporation, and research corporation. Sales corporation markets and sells petroleum products in the United States and abroad. Some of the petroleum products are obtained from refining corporation which acquires some of the crude oil from drilling corporation. Transport corporation operates pipeline facilities to transport crude oil from drilling corporation's storage facilities to refining corporation's refineries. Research corporation conducts research and development for both sales and refining corporations. Since the corporations are operating a vertically integrated business and since there is common ownership, the five corporations are conducting a unitary business.

2. Corporation A owns 60 percent of the outstanding voting stock in each of three corporations; B, C, and D. Corporation B, in turn, owns 100 percent of the outstanding voting stock in corporation E. Corporation A is primarily engaged in operating multiline department stores in Minnesota and other midwestern states. Corporation B operates a chain of department stores in the northwestern portion of the United States. B's stores sell only high quality, top grade consumer items. Corporation C operates a chain of discount stores throughout the southwestern portion of the United States. Corporation D is a finance company, handling all of the consumer credit and financing arrangements of purchases at the stores owned by corporations A, B, and C. Corporation E is the purchasing agent for corporations A, B, and C and maintains warehouses for the stores' inventories. Corporation A provides management services for all of the other corporations and maintains overall control in determining the policies respecting the primary business activities of the other corporations, including their budgetary and financial affairs. All of these corporations are engaged in the conduct of a unitary business since they are operating a horizontally integrated business and since they have common ownership.

3. Corporation K was incorporated in 1945 and thereafter was engaged primarily in activities connected with the manufacture and sale of canned goods. In 1960, K embarked upon a diversification campaign designed to insulate its profits from fluctuations in the demand for canned goods. One hundred percent of the voting stock of corporation L was acquired. Corporation L operated a chain of department stores throughout the United States. In 1961, K purchased 80 percent of the voting stock of corporation M which was engaged primarily in the manufacture and sale of household goods. In 1962, K acquired 75 percent of the voting stock of corporation N which developed and marketed computer software and programs. There was no significant flow of goods between any of the corporations. While these subsidiaries were relatively autonomous in their day-to-day operations, each subsidiary did not operate as a distinct business enterprise at the level of full time management. Corporation K involved itself in policy determinations respecting the primary business activities of all the corporations. The subsidiaries were required to submit annual budgets to K for approval. Capital expenditures in excess of $500,000 needed approval from K. All of the financing arrangements for the subsidiaries were made by or with the approval of K's management team which authorized and directed intercompany loans when feasible. Tax matters were supervised by K's tax department which prepared the subsidiaries' federal income tax returns. Corporation K also performed centralized warehousing and accounting functions for itself and its subsidiaries. A uniform system of inventory control for corporation K and the subsidiaries was developed and managed by corporation N. Due to the control that corporation K exerted over policy determinations respecting the primary business activities of the subsidiaries and the integration and interdependence occasioned by the centralization of various business functions, all of the corporations are engaged in a unitary business.

13 MCAR § 1.6502 Intercompany transfers within unitary business.

Elimination of income, loss, expense, or deduction items arising from transactions between members of a unitary group must be made to avoid distortion of:

1. the group's income, loss, expenses, or deductions;
2. the denominator used by all members of the group in calculating apportionment factors; or
3. the numerator used by any particular member of the group in calculating its apportionment factors.

Where a corporation can show that no distortion of income, loss, expense, or deduction will result where intercompany transactions are not eliminated, a corporation may elect to not eliminate intercompany transactions for 1. only. All intercompany transactions must be eliminated when calculating the factors as provided in 2. and 3.

13 MCAR § 1.6503 Unitary business, reporting.

A. Minnesota business. A unitary business which conducts its entire business within Minnesota may file a combined report for each corporation. The income or loss must be allocated among the corporations on the report by use of the equally weighted

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arithmetic average of the property, payroll, and sales factors. Each corporation on the report is entitled to have its first $25,000 of income taxed at the lower tax rate as provided in Minnesota Statutes, section 290.06, subdivision 1. These provisions also apply to banks and bank holding companies.

B. Required if Minnesota nexus. Except as provided in this rule, a combined report is required from every corporation that has a nexus with Minnesota and is part of a unitary business as defined in 13 MCAR § 1.6501 other than insurance companies subject to the provisions of Minnesota Statutes, section 290.35, investment companies subject to the provisions of Minnesota Statutes, section 290.36, or mining companies as provided in Minnesota Statutes, section 290.05, subdivision 1.

C. Farm income. Farm income is specifically excluded from combined reporting. Therefore, a unitary business must exclude farm income when figuring its combined income or loss and assign that income or loss to the state in which the farm is located. Where a Minnesota farm is a part of a unitary farming business which is located within and without Minnesota, the product from the Minnesota farm which is transferred outside of Minnesota for use in the unitary farming business must be treated as if it was sold at fair market value on the day of the transfer. Expenses connected with the farm are allowed under separate accounting.

D. Deductions. A corporation is allowed a charitable deduction which is subtracted from that corporation's apportioned unitary business income as determined on that corporation's combined report. The charitable contribution deduction is only allowed to a corporation which has a nexus with Minnesota and is determined as follows. The corporation is allowed to deduct:

1. those contributions it makes to an entity carrying on substantially all of its activities in Minnesota; and

2. a percentage of the charitable contributions made by the entire unitary group after reduction for all contributions qualifying under 1. made by a corporation with a Minnesota nexus. The percentage to be used is the ratio of Minnesota taxable net income of the corporation to the total net income of the unitary group.

E. Credits. Any refundable or nonrefundable credits allowed on the Minnesota return are allowed only to a corporation that has a nexus with Minnesota and must be based on that corporation's expenditures. These credits must be taken into consideration after computing the income or loss of a unitary business on the combined report.

F. Minimum tax. The minimum tax liability must be determined by using 40 percent of the corporation's federal minimum tax liability as computed on its federal return, multiplied by a fraction the numerator of which is the taxpayer's preference item income allocated to this state and the denominator of which is the taxpayer's total preference item income for federal purposes. If the corporation filed a separate federal return the minimum tax must be based on that, or if a federal consolidated return was filed the minimum tax must be based on that to the extent all corporations on the consolidated return are also on the combined return.

G. Business acquisition. When a corporation acquires another corporation and starts a unitary business with that corporation, the new corporation must be included on the combined report and its income or loss reported starting with the first taxable year of the acquiring corporation that begins on or after the date of acquisition. Acquiring another corporation does not include creating the corporation from a part of a corporation's unitary business group as it previously existed.

H. Unitary banking business. When a bank, including a bank holding company, is part of a unitary business that is doing business within and without Minnesota, a combined report must be filed for that bank as part of the unitary business. Receipts from intangible personal property must be included in the sales factor as follows:

1. Interest and other receipts from assets in the nature of loans, including federal funds sold, and installment obligations must be attributed to the state where the office is located at which the customer applied for the loan except in cases where the loan is recognized by appropriate banking regulatory authority as being made from and as an asset of an office located in another state, in which case it must be attributed to the state where that office is located. For purposes of this paragraph the word "applied" means initial inquiry, including customer assistance in preparing the loan application, or submission of a completed loan application, whichever occurs first in time.

2. Interest or service charges from bank, travel, and entertainment credit card receivables and credit card holders' fees must be attributed to the state in which the credit card holder resides in the case of an individual or, if a corporation, to the state of the corporation's commercial domicile provided the taxpayer is taxable in that state. If the taxpayer is not taxable in the state of the individual card holder's residence or commercial domicile of the corporate card holder, the receipts must be attributed to the state of the taxpayer's commercial domicile.

3. Merchant discount income derived from bank and financial corporation credit card holder transactions with a merchant must be attributed to the state in which the merchant is located, provided the taxpayer is taxable in that state. If the taxpayer is not taxable in the state in which the merchant is located, the merchant discount income must be attributed to the state in which the taxpayer's commercial domicile is located.

4. Receipts from investments of a bank in securities must be attributed to its commercial domicile with the following two exceptions. Receipts from securities used to maintain reserves against deposits to meet federal and state reserve deposit

requirements must be attributed to each state based upon the ratio that total deposits in the state bear to total deposits everywhere. Receipts from securities owned by a bank but held by a state treasurer or other public official or pledged to secure public or trust funds deposited in such bank must be attributed to the banking office at which such secured deposit is maintained.

5. Receipts (fees or charges) from the issuance of travelers checks and money orders must be attributed to the state where the taxpayer's office is located that issued the travelers checks. If the travelers checks are issued by an independent representative or agent of the taxpayer, the following rules apply. If the taxpayer is taxable in the state in which the independent representative or agent issues the travelers checks or money orders, the receipts (fees or charges) must be attributed to that state. If the taxpayer is not taxable in the state in which the independent representative or agent issues the travelers checks or money orders, the receipts (fees or charges) must be attributed to the state of commercial domicile of the taxpayer.

6. Receipts from investments of a financial corporation must be attributed to its commercial domicile unless the securities have acquired a business situs elsewhere.

I. Accounting periods. Where members of the unitary group employ different accounting periods, the income must be reported on the combined report using one of the following methods. The income or loss and factors of all the corporations involved are those amounts for the same common months contained in the accounting period of the parent corporation, or the corporation filing the Minnesota return. If there is no parent corporation, the members of the unitary group may select one corporation to be the parent corporation for purposes of this part. Once a method is selected, it must not be changed without the consent of the commissioner. For the first taxable year beginning after June 30, 1981, income or loss and the factors attributable to a month or months which were previously reflected on the corporation's separate income tax return shall not be again reflected on the corporation's combined report. For the first taxable year beginning after June 30, 1981, if all the months are not included on a combined report or on a separate return, a separate return shall be filed reflecting the income or loss and factors for those months which are omitted. The due date of the return continues to be determined with reference to the actual accounting period of the corporation.

J. Net operating loss. The provisions of Minnesota Statutes, section 290.095, subdivision 3, clause (c) must be applied as if the corporation was not included on a combined report for that year when a corporation is included on a combined report for that year, and it is carrying over a net operating loss from a taxable year which began before July 1, 1981. This provision shall apply only if the corporation was a member of the unitary group prior to July 1, 1981.

K. Factors. Where members of a unitary business employ different methods of apportioning their income to Minnesota, the method used by the predominant business activity shall be used by all members of the unitary group.

Rules as Proposed.

2019 Apportionment of net income of business conducted partly within Minnesota.

(a) Applicability of Minnesota Statutes, section 290.19. The formulae prescribed by the provisions of Minnesota Statutes, section 290.19 shall be applied to the apportionable net income of a trade or business where the business carried on within this state is ~~an integral~~ a part of a unitary business carried on both within and without this state.

(b) Apportionment of net income under Minnesota Statutes, section 290.19, subdivision 1, clause (1). If the business consists of the manufacture ~~in Minnesota or within and without Minnesota~~ of personal property and sale of said property within and without Minnesota the formula shall be as follows:

(1) Under Minnesota Statutes, section 290.19, subdivision 1, clause (1)(a), (b), (c).

$$\frac{\text{Minn. Sales}}{\text{Total Sales}} + \frac{\text{Minn. Payroll}}{\text{Total Payroll}} + \frac{\text{Minn. Tangible Prop.}}{\text{Total Tangible Prop.}} \div 3 = \% \text{ to Minn.}$$

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Using hypothetical percentages we secure a percent to Minnesota thus:

	Within Minn.	Without Minn.	Total Percent
Sales	40%	60%	100%
Payroll	50%	50%	100%
Tangible Property	70%	30%	100%
Divide by Three	~~3/160%~~ 160%/3		
Percent to Minnesota	53-1/3%		

(2) Under Minnesota Statutes, section 290.19, subdivision 1, clause (1)(d). In the alternative the following formula may be employed if a lesser percentage to Minnesota results by its use:

$$70\% \frac{\text{Minn. Sales}}{\text{Total Sales}} + 15\% \text{ of } \frac{\text{Minn. Payroll}}{\text{Total Payroll}} + 15\% \text{ of } \frac{\text{Minn. Tang. Prop.}}{\text{Total Tang. Prop.}} = \% \text{ to Minn.}$$

An illustration of the weighing of the factors in the alternative formula as provided in Minnesota Statutes, section 290.19, subdivision 1, clause (1)(d) appears thus:

	Within Minn.	Weighted	Weighted Percentage
Sales	40%	70%	28.
Payroll	50%	15%	7.5
Tangible Property	70%	15%	10.5
Weighted averages percentage to Minnesota			46.0%

Since under the fact situation used in this illustration, the weighted average formula determines a lesser Minnesota percentage ratio, the ~~lesser~~ weighted ratio may be used.

(c) Apportionment of net income under Minnesota Statutes, section 290.19, subdivision 1, clause (2). If the business does not consist of the manufacture ~~within or within and without Minnesota~~ and ~~the~~ sale of personal property within and without the state, the taxable net income from such business shall be assigned to Minnesota on the basis of the percentage obtained by taking the arithmetic average of the three factors of (1) tangible property, (2) payroll, and (3) sales, gross earnings, or receipts, or on the basis of the percentage obtained by taking the weighted average of these three factors (15 percent of the Minnesota property percentage, 15 percent of the Minnesota payroll percentage, and 70 percent of the Minnesota sales, gross earnings, or receipts percentage), whichever is the lesser. The methods prescribed in this paragraph are presumed to properly reflect the taxable net income assignable to this state.

The single factor of sales, gross earnings, or receipts may be used only if (1) the use of the arithmetic average of the three factors or the use of the weighted average of those factors, whichever is the lesser, will not properly reflect the taxable net income assignable to this state, and (2) the use of the single factor of sales, gross earnings, or receipts will properly and fairly reflect such income.

The separate or segregated accounting method may be used only where the business carried on within this state is not ~~an integral~~ a part of a unitary business carried on both within and without this state. If this method is used, it is subject to the same limitations as those set forth in the preceding paragraph.

~~Those taxpayers who apportion a part of their income to Minnesota are required to complete Schedules T and U and attach them to their returns when filed.~~

(d) Definition of terms.

(1) Manufacture. Generally, the word "manufacture" is defined as the production of an article for use from raw or prepared materials by giving such materials new forms, qualities, or combinations, whether by hand labor or machine. Whether a taxpayer's business consists of manufacture of personal property is a question of fact to be determined in each individual case.

~~In order for a business to consist of the manufacture in Minnesota of personal property within the purview of Minnesota~~

~~Statutes, section 290.19, subdivision 1, clause (1), the operations of "manufacture" must occur within the geographical territory of this state.~~

(2) The property element of the apportionment formula considered above shall include land, buildings, machinery, and equipment, inventories, and other tangible personal property actually used by the taxpayer during the taxable year in ~~producing income subject to apportionment by formula~~ carrying on the business activities of the taxpayer. Tangible property ~~from which income is derived~~ which is to be separately allocated under Minnesota Statutes, sections 290.17 and 290.18 may not be considered as property includible in the apportionment factor. Cash on hand or in banks, shares of stock, notes, bonds, accounts receivable, or other evidences of indebtedness, special privileges, franchises, and good will, are specifically excluded from the property factor. The value of tangible property which is owned by the taxpayer and which is to be used in the apportionment fraction shall be the original cost ~~or other allowable income tax basis adjusted for allowable depreciation~~ adjusted for any subsequent capital additions or improvements and partial disposition by reason of sale, exchange, or abandonment. Property which is rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals. The valuations of property both within and without Minnesota shall be the averages during the year and must be on a commensurate basis. Rents paid during the year must not be averaged. The changes made in this paragraph concerning the property factor are effective for taxable years beginning after December 31, 1982. A person filing a combined report shall use this method of calculating the property factor for all members of the group.

(3) The payroll element of the apportionment formula considered above shall be the payrolls paid or incurred by the taxpayer for the taxable year under review and wages or salaries paid or incurred in Minnesota shall be determined to be paid or incurred in Minnesota provided the individual with respect to whom such wages or salaries are paid is either employed within this state or is actually engaged in work in the territorial confines of this state or, if working without this state, is identified with or accountable to an office within this state.

The wages or salaries paid to officers and employees working from Minnesota offices are considered as Minnesota payroll even though their employment requires them to spend working time without this state. Officers and employees whose employment requires them to work without the state entirely and who are assigned to an office without Minnesota, are not considered Minnesota employees for the purpose of apportionment even though their salaries are paid from the taxpayer's general offices in Minnesota.

~~(4) Sales assignable to this state shall include sales made within Minnesota and sales made through, from or by offices, agencies, branches or stores located within Minnesota. All sales shall be deemed allocable to Minnesota unless it can be shown to the satisfaction of the commissioner that such sales were negotiated or effected by agents of the taxpayer chiefly situated at, connected with, or sent out from premises for the transaction of business, owned or rented by the taxpayer or by his agents or agencies outside the state. Minnesota sales are not restricted to acts or activities that result immediately in a sales transaction, but include preliminary negotiations of a transaction which may later be completed either in Minnesota or outside of Minnesota, including interstate business.~~

~~(e) Allocation of federal income taxes paid. See regulation 2018 (1).~~

13 MCAR § 1.6004 Minnesota gross income for individuals who are part-year residents or nonresidents of Minnesota (Federal Adjusted Gross Income).

A. Gross income.

1.-2. [Unchanged.]

3. The following types of income received by a nonresident in Minnesota are to be included in that individual's Minnesota gross income and are assignable to Minnesota:

a.-c. [Unchanged.]

d. Business income or losses.

(1) [Unchanged.]

(2) Business conducted within Minnesota and which has a nexus within Minnesota so that the business is subject to Minnesota income tax would include income or losses from sales whose destination is within Minnesota and a business

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dealing in personal and professional services where such services were performed in this state. Trade or business income or loss assignable to Minnesota and earned by a nonresident individual as a proprietorship or partnership which was carried on partly within and partly without Minnesota is subject to the three-factor apportionment formula contained in Minnesota Statutes, section 290.19 or apportionment under Minnesota Statutes, section 290.20 ~~except for construction business on which the three-factor formula is not permitted. A nonresident individual who has farm income from within Minnesota and from outside of Minnesota may also use the apportionment formulas contained in Minnesota Statutes, sections 290.19 and 290.20~~, except for farm income or income from personal or professional services.

B.-H. [Unchanged.]

Repealer. Income tax rule 2017 (3) is repealed.

Effective date. The repeal of the last paragraph of income tax rule 2017 (3) relating to construction projects is effective for taxable years beginning after June 30, 1981.

ADOPTED RULES

The adoption of a rule becomes effective after the requirements of Minn. Stat. § 15.0412, subd. 4, have been met and five working days after the rule is published in the *State Register*, unless a later date is required by statutes or specified in the rule.

If an adopted rule is identical to its proposed form as previously published, a notice of adoption and a citation to its previous *State Register* publication will be printed.

If an adopted rule differs from its proposed form, language which has been deleted will be printed with strike outs and new language will be underlined, and the rule's previous *State Register* publication will be cited.

A temporary rule becomes effective upon the approval of the Attorney General as specified in Minn. Stat. § 15.0412, subd. 5. Notice of his decision will be published as soon as practicable, and the adopted temporary rule will be published in the manner provided for adopted rules under subd. 4.

Department of Health Minnesota Merit System

Adopted Amendments to Existing Rules Governing the Compensation Plan; Leaves of Absence and Inter-Agency Operations

The rules proposed and published at *State Register*, Volume 7, Number 15, pages 517-528, October 11, 1982 (7 S.R. 517) are adopted as proposed.

Department of Public Safety

Adopted Amendments of Existing Rules Governing the Compensation Plan; Leaves of Absence and Inter-Agency Operations

The rules proposed and published at *State Register*, Volume 7, Number 15, pages 528-536, October 11, 1982 (7 S.R. 528) are adopted as proposed.

Department of Public Welfare

Adopted Amendments to Existing Rules Governing the Compensation Plan; Leaves of Absence and Inter-Agency Operations

The rules proposed and published at *State Register*, Volume 7, Number 15, pages 536-561, October 11, 1982 (7 S.R. 536) are adopted as proposed.

TAX COURT

Pursuant to Minn. Stat. § 271.06, subd. 1, an appeal to the tax court may be taken from any official order of the Commissioner of Revenue regarding any tax, fee or assessment, or any matter concerning the tax laws listed in § 271.01, subd. 5, by an interested or affected person, by any political subdivision of the state, by the Attorney General in behalf of the state, or by any resident taxpayer of the state in behalf of the state in case the Attorney General, upon request, shall refuse to appeal. Decisions of the tax court are printed in the *State Register*, except in the case of appeals dealing with property valuation, assessment, or taxation for property tax purposes.

State of Minnesota
County of Clay

Tax Court
Regular Division

Leon A. and Muriel Simon,

Appellants,

v.

Commissioner of Revenue,

Appellee.

Docket No. 3549

FINDINGS OF FACT, CONCLUSIONS OF LAW, ORDER FOR JUDGMENT AND MEMORANDUM

Order dated: February 10, 1983

This is an appeal from an Order of the Commissioner of Revenue dated December 28, 1981, revised March 29, 1982, relating to the income tax liability of the Appellants for the year 1978. The matter has been submitted to the Honorable John Knapp, Chief Judge of the Tax Court, on a Stipulation of Facts and written briefs.

Edward F. Klinger, attorney at law, appeared for Appellants. Paul R. Kempainen, Special Assistant Attorney General, appeared for Appellee.

From the Stipulation of Facts and the files and records herein, the Court makes the following:

Findings of Fact

1. The Appellants, Leon A. and Muriel Simon, are cash basis, calendar year taxpayers who were, during 1978 (the taxable year at issue herein), residents and domiciliaries of Minnesota for state income tax purposes.

2. During the taxable year 1978, the Appellant Leon Simon was a shareholder in Simon's Home Furnishings, Inc. (hereinafter, "Simon's, Inc."). Simon's, Inc. was a Nevada corporation doing business entirely within the State of Nevada. During the taxable year at issue herein, Simon's, Inc. also was an electing small business corporation for federal income purposes. At no time during the year in question was an election filed by Simon's, Inc. to be a small business corporation for Minnesota income tax purposes under section 290.972 of the Minnesota Statutes.

3. During the taxable year in question Simon's, Inc. incurred losses for federal income tax purposes, and on his Form K-1 the Appellant Leon Simon received his proportionate share of such losses from Simon's, Inc. in the amount of $77,898.00.

4. For the taxable year 1978, the loss from Simon's, Inc. was reported on the Appellant's federal income tax return in arriving at their federal adjusted gross income, and was carried over by Appellants to their 1978 Minnesota Income Tax Return for the purpose of arriving at their Minnesota gross income.

5. Upon examination of the Appellants' return by the Minnesota Department of Revenue an Audit Report of Individual Income Tax Changes was issued, adding back into Minnesota gross income the amount of the loss reported from Simon's, Inc. A proposed tax liability based upon said audit report was issued on November 20, 1981. From this proposal a written administrative protest was made by the Appellants on December 21, 1981. No resolution of the issues was arrived at and the Commissioner of Revenue issued his Order assessing additional income tax on March 29, 1982.

6. The Appellants have taken a timely appeal to this Court from the Commissioner's Order dated March 29, 1982.

Conclusion of Law

1. The Order of the Commissioner must be affirmed.

LET JUDGMENT BE ENTERED ACCORDINGLY. A STAY OF 15 DAYS IS HEREBY ORDERED.

February 10, 1983.

John Knapp, Chief Judge
Minnesota Tax Court

Memorandum

The issue in this case is the use by a Minnesota resident on his individual income tax return of losses incurred by a foreign

(Nevada) corporation in which he held stock ownership. The Nevada corporation was an electing small business corporation for federal income tax purposes. However, this Nevada corporation made no election for Minnesota income tax purposes.

Under Minnesota Law, the calculation of an individual income tax liability begins with federal adjusted gross income, but with certain modifications spelled out in Minnesota Statutes, section 290.01, subd. 20. The basic error of Appellant's argument is that they begin and end solely with reference to federal adjusted gross income, without ever taking into account the specific statutory modifications required by Minnesota Statutes, section 290.01, subd. 20, one of which expressly controls the facts in issue in this case.

Although Minnesota gross income is defined as federal adjusted gross income, the Minnesota Commissioner of Revenue may adjust a taxpayer's gross income based on his own investigation of the taxpayer notwithstanding the federal government's failure to make a similar adjustment. *Specktor, et al. vs. Commissioner of Revenue,* 308 N.W. 2d 806.

The Appellant contends that Simon's, Inc. did not make an election to be treated as a small business corporation for Minnesota income tax purposes because at the time the election had to be filed, August 1977, there was no reason to make such an election. At that time Minnesota Law did not allow a deduction of losses incurred by foreign small business corporations. On April 5, 1978, the Minnesota Legislature passed a law effective December 31, 1977, which allowed out-of-state losses in determining Minnesota taxable income. Laws of Minnesota for 1978, Chapter 767, Section 18, amends Minn. Stat. section 290.17, subd. 1, to read as follows:

290.17 GROSS INCOME, ALLOCATION TO STATE. Subdivision 1. INCOME OF RESIDENT INDIVIDUALS, ESTATES AND TRUSTS. (a) The gross income of individuals during the period of time when they are residents of Minnesota and the gross income of resident estates and trusts shall be their gross income as defined in section 290.01, subdivision 20.

(b) Deductions for losses incurred in connection with income derived from sources outside the state which is included in an individual's gross income pursuant to section 290.17, subdivision 1, may be taken only to the extent of the amount of income derived from sources outside the state in the taxable year during which the loss was incurred.

(c) Any deductions for losses which could not be taken in the three immediately preceding taxable years because of the provisions of clause (b), may be taken to reduce any net income derived from sources outside the state which remain after application of clause (b) for income earned and deductions for the current taxable year; provided, however, that any deductions allowable pursuant to this clause (c) may be taken only to the extent of the amount of net income remaining after the application of clause (b).

The Appellant contends that the foregoing amendment gave him the right to deduct the losses from the small business corporation. We cannot agree with that contention. The statute makes it clear that the losses may be deducted only as provided for in section 290.01, subd. 20(c) as applied to calendar year 1978 read as follows:

(c) Modifications affecting shareholders of electing small business corporations under section 1372 of the Internal Revenue Code of 1954, or section 290.972 of this chapter.

(1) Shareholders in a small business corporation, which has elected to be so taxed under the Internal Revenue Code of 1954, but has not made an election under section 290.972 of this chapter, shall deduct from federal adjusted gross income the amount of any imputed income from such corporation and shall add to federal adjusted gross income the amount of any loss claimed as a result of such stock ownership. Also there shall be added to federal adjusted gross income the amount of any distributions in cash or property made by said corporation to its shareholders during the taxable year.

The above statute is directly applicable to the facts of this case, and is dispositive of the issue herein. The Appellant, Leon Simon, was a shareholder in a foreign corporation which had elected to be taxed as a small business corporation under Section 1372 of the Internal Revenue Code, but had not made a similar election under Minn. Stat. § 290.972. Accordingly, Leon Simon was expressly required to add back into his federal adjusted gross income, for Minnesota tax purposes, the amount of his pro rata loss which he received from Simon's Inc. as a result of his stock ownership.

Under Minnesota Statutes as they existed in 1978, corporate losses such as the ones at issue herein, are to be treated in exactly the same manner as a loss by any other corporation, unless an election is properly made under Minnesota Statutes Section 290.972. Because there was no election by Simon's, Inc., its losses may not be passed through the individual shareholders. *Bernard M. Hilton v. Commissioner of Taxation*, Minnesota Tax Court Docket No. 1379, *Benny & Iola Peterson v. Commissioner of Revenue*, Minnesota Tax Court Docket No. 2668.

The Appellant contends that this Court should exercise equity jurisdiction to grant relief because failure to do so will lead to an inequitable result. Even if the Court were to agree that the result is inequitable the Tax Court is a creature of statute and has not been granted equity powers. The Court can grant equity relief only when such authority has been granted to the Commissioner and he has failed to exercise it. In the instant case the statute does not give the Commissioner equity powers so the Court is without jurisdiction to grant relief.

The statutes in effect for calendar year 1978 are so clear that the Court has no alternative but to affirm the Commissioner's Order. The statute has since been changed so that any corporation having a valid election in effect under Section 1372 of the Internal Revenue Code is no longer subject to taxes. Minnesota Statutes, section 290.9725. That change, however, was effective only for taxable years of corporations beginning after December 31, 1980.

Appellant's Reply Brief was filed December 13, 1982. Since that date, i.e. January 19, 1983, this Court has rendered a decision in *Arnold A. Carlson, Anna C. Carlson, Fred Fredrickson, D/B/A/ Laura-Lynn, Inc. v. Commissioner of Revenue*, Docket No. 3483, which also deals with losses sustained by a small business corporation, however, that case is distinguishable from the instant case. In Carlson the corporation was a domestic corporation and a bona fide attempt was made to comply with the statute requiring the filing of an election. In the instant case we have a foreign corporation and no election was filed.

J.K.

SUPREME COURT

Decisions Filed Friday, February 18, 1983

Compiled by Wayne Tschimperle, Clerk

C6-81-448 James D. Hubbard v. United Press International, Inc., *et al.*, Appellants. Hennepin County.

We recognize the separate and independent tort of intentional infliction of emotional distress, and thereby discard the "parasitic" theory which restricted recovery to cases involving contemporaneous physical injury or the allegation of malicious conduct sufficient to constitute an underlying tort.

Our recognition of this independent tort does not signal an appreciable expansion in the scope of conduct actionable under this theory of recovery.

Hubbard failed to satisfy his burden of production in his claim of intentional infliction of emotional distress, and the trial court erred in submitting that claim to the jury.

In a claim of discriminatory discharge in violation of the Minnesota Human Rights Act, the employee has the burden of proof throughout the proceedings, and carries the initial burden of production in establishing a prima facie case. The employer may rebut the plaintiff's prima facie showing by producing evidence of nondiscriminatory purpose. The employee then has an opportunity to prove that the employer's proffered reasons are a pretext for discrimination, and to otherwise meet its overall burden of persuasion.

Assuming, without deciding, that Hubbard made out a prima facie case of discriminatory discharge, it is clear that UPI met its burden of production in establishing legitimate, nondiscriminatory reasons for its actions and that Hubbard failed to rebut these reasons or to otherwise carry his overall burden of proof.

In a claim of retaliatory discharge under the Minnesota Human Rights Act, the three part procedure of shifting production burdens, set out in *McDonnell-Douglas* and applied to Human Rights Act claims generally, is applicable.

Although Hubbard established a prima facie case of retaliatory discharge, it is clear that UPI met its burden of production in establishing legitimate, nondiscriminatory reasons for its actions and that Hubbard failed to rebut these reasons or to otherwise carry his overall burden of proof.

Reversed. Amdahl, C. J.

C6-82-492 Kurt R. Nordby and Illinois Farmers Insurance Company v. Atlantic Mutual Insurance Company, Appellants. Hennepin County.

Where an insurance policy automobile liability endorsement was not ambiguous, and clearly stated that an executive driving his own automobile was not an insured, there was no personal coverage for such employee under the policy; coverage was provided only under a theory of vicarious liability.

Proration was properly denied where one policy provided coverage for the employee's own negligence and the other policy, clearly designated as excess insurance, provided vicarious liability coverage.

An insurer has no right of action against another insurer to recover the cost of defending the insured or the cost of bringing a declaratory judgment action, since there is no contractual obligation between insurers.

Affirmed in part and reversed in part. Amdahl, C. J.

C5-82-192 Truck Crane Service Co. v. Barr-Nelson, Inc., Appellant. Hennepin County.

Employee lacked apparent authority to sign a payment guarantee agreement on behalf of employer where employer had specifically denied liability, and there was no affirmative course of conduct by employer that would constitute holding out or knowingly permitting employee to contract for company.

Reversed and remanded. Amdahl, C. J.

C8-82-882 State of Minnesota, Appellant, v. Larry Michael Nelson. Ramsey County.

A defendant's willingness to succeed in treatment is a ground for a dispositional departure in the form of a stay of execution of sentence but is not a justification for a downward durational departure.

Remanded for resentencing. Amdahl, C. J.

C4-82-135 State of Minnesota v. Daniel H. Vazquez, Appellant. Hennepin County.

Evidence was sufficient to support conviction of criminal sexual conduct in the first degree.

Fact that accomplice received a more lenient sentence does not mandate reduction of defendant's sentence under the circumstances of this case.

Affirmed. Peterson, J. Conc. in part; dis. in part, Wahl, J. Took no part, Simonett, J.

C0-82-231 In Re the Marriage of: JoAnn Joy Smoot, petitioner, Appellant, v. John Patrick Smoot. Hennepin County.

The trial court did not abuse its discretion in its award of maintenance or its division of marital and nonmarital property. The case is remanded, however, for a re-evaluation of the maintenance award, in view of appellant's changed medical condition, which arose after entry of the judgment and decree.

The order finding appellant in willful contempt of court is valid.

Remanded. Peterson, J.

C0-82-441 State of Minnesota v. Robert A. Jones, Appellant. Hennepin County.

Defendant received a fair trial on the charge of criminal sexual conduct in the first degree, and evidence was sufficient to support the jury verdict finding him guilty of that charge.

Affirmed. Peterson, J.

C7-81-1043 State of Minnesota v. James Michael Patch, Appellant. Mower County.

Evidence was adequate to support convictions of kidnapping and criminal sexual conduct in the first degree.

Trial court was not biased against defendant and did not commit prejudicial error in denying a motion for a change of venue, in ordering defendant shackled, in refusing to submit the lesser offense of criminal sexual conduct in the third degree, and in refusing to instruct the jury on the defense of involuntary intoxication.

Pursuant to Minn. Stat. § 609.04 (1982), defendant's second conviction of kidnapping, based on the same act as the other kidnapping conviction, must be vacated.

Pursuant to Minn. Stat. § 609.035 (1982) and Minnesota Sentencing Guidelines and Commentary (1982), defendant's sentence for the kidnapping conviction is vacated and defendant's sentence for the sexual assault is reduced from 240 months to 140 months or two times the maximum presumptive sentence duration.

Affirmed in part; reversed in part. Yetka, J.

C4-82-572 State of Minnesota v. Arnold R. Williams, Appellant, Hennepin County.

Evidence was sufficient to support defendant's conviction of aggravated robbery, however, case is remanded for resentencing in light of *State v. Olson*, 325 N.W. 2d 13 (Minn. 1982).

Remanded for resentencing. Yetka, J.

C4-81-1145 State of Minnesota v. Michael Dean Dornack, Appellant. Ramsey County.

Evidence was sufficient to establish that sexual penetration was nonconsensual, and trial court did not err in excluding evidence concerning the victim's previous sexual conduct.

Affirmed. Wahl, J.

C2-81-1211 State of Minnesota v. Charles Patterson, Appellant. Hennepin County.

Defendant received a fair trial on charges of criminal sexual conduct and soliciting a person under age 16 to practice prostitution, and evidence was sufficient to support his convictions on those charges.

Affirmed. Wahl, J.

STATE CONTRACTS

Pursuant to the provisions of Minn. Stat. § 16.098, subd. 3, an agency must make reasonable effort to publicize the availability of any consultant services contract or professional and technical services contract which has an estimated cost of over $2,000.

Department of Administration procedures require that notice of any consultant services contract or professional and technical services contract which has an estimated cost of over $10,000 be printed in the *State Register*. These procedures also require that the following information be included in the notice: name of contact person, agency name and address, description of project and tasks, cost estimate, and final submission date of completed contract proposal.

Minnesota Housing Finance Agency

Cancellation of Bid Request for Installation of Meters in 48 Minnesota Homes

This is to notify that the Bid Request for Installation of Meters in 48 Minnesota Homes, published in the *State Register*, pp. 1179-1180, Monday, February 14, 1983 is being withdrawn in its entirety.

A modified bid request is being processed by the Procurement Division of the Minnesota Department of Administration. Please contact the Procurement Division (Information (612) 296-6152) for the modified bid request.

Department of Natural Resources

Notice of Request for Proposals to Operate Summer Work/Learn Camp

The Department of Natural Resources requests proposals to staff, manage and provide food for two residential and several non-residential Youth Conservation Corps (YCC) camps throughout the state. YCC is a work/learn program for high school aged youth.

A copy of the RFP may be obtained between February 28th and March 21st from John F. Grix, Office of Youth Programs, Centennial Office Building, Box 4, St. Paul, MN 55155. (612) 296-2144.

Proposals must be received by 2:00 p.m. on March 22, 1983. The approximate amount of funds available for this contract is $80,000.

OFFICIAL NOTICES

Pursuant to the provisions of Minn. Stat. § 15.0412, subd. 6, an agency, in preparing proposed rules, may seek information or opinion from sources outside the agency. Notices of intent to solicit outside opinion must be published in the *State Register* and all interested persons afforded the opportunity to submit data or views on the subject, either orally or in writing.

The *State Register* also publishes other official notices of state agencies, notices of meetings, and matters of public interest.

Department of Agriculture
Agronomy Services Division

Notice of Special Local Need (SLN) Registration for: "Copper Sulfate" EPA Registration Number 1278-5

Pursuant to Minnesota Statutes § 18A.23, and 3 MCAR § 1.0338 B., the Minnesota Department of Agriculture (MDA), on February 17, 1983, issued a Special Local Need (SLN) Registration for Copper Sulfate, manufactured by Phelps Dodge Refining Corporation, New York, New York 10022.

The Commissioner of Agriculture, based upon information in the application, has deemed it in the public interest to issue such a registration, and has deemed that the information in the application indicates that the pesticide does not have the potential for unreasonable adverse environmental effects.

In addition to the uses prescribed on the product label, this Special Local Need (SLN) Registration permits the use of this product in an aquatic environment to control snails and leeches.

The application and other data required under Minnesota Statutes §§ 18A.22, subdivision 2(a-d), 18A.23, and 40 CFR 162.150-162.158, subpart B., relative to this registration (identified as SLN No. MN83-0006) is on file for inspection at:

Minnesota Department of Agriculture
Agronomy Services Division
Pesticide Control Section
90 West Plato Boulevard
St. Paul, Minnesota 55107
Telephone: (612) 296-8547

A federal or state agency, a local unit of government, or any person or group of persons filing with the Commissioner a petition that contains the signatures and addresses of 500 or more individuals of legal voting age has thirty (30) days to file written objections with the Commissioner of Agriculture regarding the issuance of this Special Local Need Registration. Upon receipt of such objections and when it is deemed in the best interest of the environment or the health, welfare, and safety of the public, the Commissioner of Agriculture shall order a hearing pursuant to Minnesota Statutes, Chapter 15, for the purpose of revoking, amending, or upholding this registration.

February 17, 1983

Jim Nichols, Commissioner
Department of Agriculture

Department of Agriculture
Agronomy Services Division

Notice of Special Local Need (SLN) Registration for: "Overtime 25% Wettable Powder"

Pursuant to Minnesota Statutes § 18A.23, and 3 MCAR § 1.0338 B., the Minnesota Department of Agriculture (MDA), on February 14, 1983, issued a Special Local Need (SLN) Registration for "Overtime 25% Wettable Powder," manufactured by Philips Roxane, Inc., St. Joseph, Missouri.

The Commissioner of Agriculture, based upon information in the application, has deemed it in the public interest to issue such a registration, and has deemed that the information in the application indicates that the pesticide does not have the potential for unreasonable adverse environmental effects.

This Special Local Need (SLN) Registration permits the use of this product as a farm and kennel premise spray for control of house flies, stable flies or dog flies, and false stable flies or sand flies.

The application and other data required under Minnesota Statutes §§ 18A.22, subdivision 2(a-d), 18A.23, and 40 CFR 162.150-162.158, subpart B, relative to this registration (identified as SLN No. MN83-0004) is on file for inspection at:

Minnesota Department of Agriculture
Agronomy Services Division
Pesticide Control Section
90 West Plato Boulevard
Saint Paul, Minnesota 55107
Telephone: (612) 297-2530

A federal or state agency, a local unit of government, or any person or group of persons filing with the commissioner a petition that contains the signatures and addresses of 500 or more individuals of legal voting age has thirty (30) days to file written objections with the Commissioner of Agriculture regarding the issuance of this Special Local Need Registration. Upon receipt of such objections and when it is deemed in the best interest of the environment or the health, welfare, and safety of the public, the Commissioner of Agriculture shall order a hearing pursuant to Minnesota Statutes, chapter 15, for the purpose of revoking, amending, or upholding this registration.

February 14, 1983

James Nichols, Commissioner
Department of Agriculture

Department of Education
Instruction Division

Notice of Availability of Federal Funds for Adult Education

The Minnesota Department of Education announces the availability of funds to conduct Adult Education under Public Law 91-230, as amended.

The purpose of Public Law 91-230 is to expand educational opportunities for adults and to encourage the establishment of programs of adult education that will:

"(1) enable all adults to acquire basic skills necessary to function in society,

(2) enable adults who so desire to continue their education to at least the level of completion of secondary school, and

(3) to make available to adults the means to secure training that will enable them to become more employable, productive, and responsible citizens."

Applications for grants to carry out the purposes of this Act may be submitted by local educational agencies and by public or private non-profit agencies, organizations and institutions.

Application procedures and forms may be obtained after March 1, 1983, by writing to: Robert O. Gramstad, Supervisor, Community and Adult Education, State of Minnesota, 639 Capitol Square Building, 550 Cedar St., St. Paul, MN 55101.

All applications must be delivered to the Department of Education, Community Education Section on or before June 1, 1983.

Department of Education Instruction Division

Notice of Availability of Federal Funds for Adult Education Special Experimental Demonstration Projects and Teacher Training

The Minnesota Department of Education announces the availability of funds to conduct Special Experimental Demonstration Projects and Teacher Training under Section 310 of Public Law 91-230, whose purpose is to provide funds for:

"(1) Special projects which will be carried out in furtherance of the title and which:

(A) Involve the use of innovative methods, including methods of teaching persons of limited English speaking ability, systems, materials, or programs which may have national significance or be of special value in promoting effective programs under this title; or,

(B) Involve programs of adult education, including education of persons of limited English speaking ability, which are part of community school programs, carried out in cooperation with other federal, federally assisted, state, or local programs which have unusual promise in promoting a comprehensive or coordinated approach to the problems or people with educational deficiencies; and

(2) Training persons engaged, or preparing to engage, as personnel in programs designed to carry out the purpose of this title."

Applications for grants to carry out the purposes of this Act may be submitted by local education agencies and by public or private non-profit agencies, organizations and institutions.

Application procedures and forms may be obtained after March 1, 1983, by writing to: Robert O. Gramstad, Supervisor, Community and Adult Education, State of Minnesota, 639 Capitol Square Building, 550 Cedar St., St. Paul, MN 55101.

All applications must be delivered to the Department of Eduction, Community Education Section on or before June 1, 1983.

State Board of Education Department of Education Instruction Division

Notice of Public Hearings before Department of Education Staff on the Minnesota State Plan for Fiscal Years 1984 through 1986 for Meeting the Requirements of Public Law 94-142, the Education of All Handicapped Children Act (45 C.F.R. 300a.)

Three public hearings on the proposed Minnesota State Plan for Fiscal Years 1984 through 1986 will be conducted by Department of Education staff during the week of April 4-7, 1983. Each hearing will begin at 9:00 a.m. and continue until all parties have had ample opportunity to participate. The hearings will be held on the following dates:

(1) April 4, 1983: Mankato, MN

Mankato State University
Room 101 Centennial Student Union
Mankato, MN
(Parking in ramp lot #4 on the southside of the Student Union)

(2) April 5, 1983: St. Paul, MN

Sheraton-Midway Auditorium
Highway I 94 and Hamline Ave.
St. Paul, MN

(3) April 7, 1983: Grand Rapids, MN

Holiday Inn
Blandin Hall
Grand Rapids, MN

The State Plan is a grant application for Minnesota's P.L. 94-142 Education for All Handicapped Children Act entitlement funds. It outlines Minnesota's policies and procedures to insure that all eligible handicapped children and youth in Minnesota receive a free appropriate public education. The proposed State Plan is essentially similar to the current plan but has been reviewed and updated.

The State Plan may be modified as a result of the hearing process. Therefore, if you are affected by the activities included in the proposed State Plan, you are urged to participate in the hearing process. An interpreter for the hearing impaired will be present upon request.

Following the agency's brief overview of the plan, all interested persons will have an opportunity to ask questions and make comments. Statements may be made orally and written material may be submitted. In addition, whether or not an appearance is made at the hearing, written comments may be submitted through April 14, 1983 to Barbara S. Burke, State Department of Education, Instruction Division, Special Education Section, 550 Cedar Street, St. Paul, MN 55101.

Copies of the plan will be available upon request from the Special Education Section by March 14, 1983. Additional copies will be available at the hearings. If you have any questions on the content of the plan, contact Barbara Burke, (612) 296-8588.

State Board of Investment Investment Advisory Council

Notice of Regular Meetings

The State Board of Investment will meet on Wednesday, March 9, 1983 at 1:00 p.m. in the Conference Room, Veterans Service Building, 20 West 12th Street, Saint Paul.

The Investment Advisory Council will meet at 7:30 a.m. on Wednesday, March 9, 1983 in the MEA Building Conference Room, 41 Sherburne, Saint Paul.

Public Utilities Commission

Notice of Intent to Solicit Outside Opinion Concerning Intrastate Telephone Access Charges for Intrastate Toll Telecommunications

Notice is hereby given that the Minnesota Public Utilities Commission (the commission) is seeking information or opinions from sources outside the commission in preparation to promulgate rules governing the appropriate methods to determine the rates interexchange carriers (long-distance telephone companies) and end users (telephone customers) will pay for access to local telephone company facilities used to complete intrastate service offerings within the State of Minnesota.

The promulgation of these rules is authorized by Minnesota Statutes section 237.10, which requires the commission to prescribe uniform rules and classifications pertaining to the conduct of intrastate telephone business; and by Minnesota Statutes sections 237.06, 237.07, 237.081 and 237.12, under which the commission may inquire into the rates and regulations for service.

On December 23, 1982, the Federal Communications Commission (the FCC) adopted rules that will determine the rates long-distance telephone companies and telephone customers will pay for access to local telepyone company facilities used to complete interstate toll calls. The new FCC rules will become effective on January 1, 1984.

It now becomes the responsibility of state regulatory commissions to determine the rates interexchange carriers and telephone customers will pay for access to local telephone company facilities used to complete intrastate toll calls.

BACKGROUND

The Modified Final Judgement (MFJ) which settled the U.S. Department of Justice's antitrust suit against the American Telephone and Telegraph Company (AT&T) requires the use of interstate and intrastate access charges to recover the costs incurred by the local Bell Operating Companies (the BOCs) in providing local access to interstate and intrastate long distance telecommunications carriers.

The FCC's access charge plan establishes a method to recover the costs of the local telephone plant devoted to interstate access. In its plan, the FCC seeks to carefully balance four basic goals, namely: (1) the continued assurance of universal service; (2) the elimination of unjust discrimination or unlawful preferential rates; (3) the encouragement of network efficiency; and, (4) the prevention of uneconomic bypass.

The FCC's access charge plan provides for the recovery of both the traffic-sensitive and non-traffic-sensitive (NTS) telephone plant devoted to interstate service.

Interstate traffic-sensitive costs will be recovered from the interconnecting long-distance carriers and will not be collected directly from telephone customers. During a five-year transition period, interstate NTS costs will be recovered, in part, from each telephone customer and, in part, from each interexchange carrier. Each telephone customer will pay an increasing share of the interstate NTS costs in each succeeding year of the transition period. At the end of the five year period, each telephone customer will pay all of the interstate NTS costs directly.

In 1982, nationwide interstate NTS costs approached $8.4 billion. During the first year that the FCC's access charge plan is in place (1984), all telephone customers will be required to directly pay for half of the $8.4 billion through a $4.00 monthly access charge per customer line, whether or not they make long-distance telephone calls. This charge will be collected from telephone customers through a combination of flat and usage based charges. The discretion of local telephone companies in setting these charges is limited by two rules. First, there must be a minimum monthly flat rate charge of $2.00 per residential customer line and a $4.00 flat rate charge per business customer line. Second, the maximum charge that may be recovered from any individual customer may not exceed the local telephone company's rate for an equivalent dedicated interstate private line. Interstate NTS costs in excess of the amount covered by the $4.00 charge will be collected from the long distance companies in the form of "carrier's carrier" charges. Part of this carrier's carrier charge will also go into a "Universal Service Fund." The Universal Service Fund is designed to ensure the continued availability of quality telephone service in high cost and rural areas.

The FCC has set up the five-year transition period to gradually require telephone customers to pay the entire interstate NTS costs directly. Thus, after the fifth year of the plan, telephone customers will be paying the entire $8.4 billion of interstate NTS costs via a flat rate interstate access charge of approximately $7.75 per month.

In addition to paying for the interstate NTS costs through an interstate access charge, telephone customers may also have to pay for a portion or all of the intrastate NTS costs through an intrastate access charge or through an increase in their local service access charge. It is the goal of the commission in this proceeding to determine a method for calculating intrastate access charges to be collected by local telephone companies serving telephone customers in the State of Minnesota and also to determine who will pay the intrastate access charges (the long-distance companies, the telephone customer, or both).

The commission encourages telephone customers, telephone companies, interested state agencies, and any other interested or affected parties to comment on the appropriate method for recovering the intrastate NTS and traffic sensitive costs associated with the provision of intrastate long distance service. The commission has not formulated its final opinions on the matter. The attached Staff Discussion Paper is exactly that and should not be understood to reflect any commission decisions. The Staff Discussion Paper is provided to focus comments on specific issues and ideas that the Commission may wish to consider in developing its intrastate access charge plan.

The commission requests information and comments concerning the subject matter of these rules. Interested or affected persons or groups may submit statements of information or comment orally or in writing. Written statements should be addressed to:

Randall D. Young
Executive Secretary
Minnesota Public Utilities Commission
780 American Center Building
160 East Kellogg Boulevard
St. Paul, Minnesota 55101
Reference: Docket No. P-999/R-83-101

Oral statements will be received during the regular business hours by Karin F. Leonard over the telephone at (612) 296-8994 and in person at the above address.

All statements of information or comment shall be accepted until March 31, 1983. Any written material received by the Commission will become part of the record in the event that the rules are promulgated.

INTRASTATE ACCESS CHARGE PLAN
STAFF DISCUSSION PAPER

After an extensive proceeding in Docket 78-72, the Federal Communications Commission (the FCC) adopted an interstate access charge plan on December 23, 1983. State regulatory commissions are now faced with the task of developing an intrastate access charge plan and having it in place by January 1, 1984 in order to conform with the requirements of the Modified Final Judgement (MFJ). The MFJ, in Appendix B discusses the obligation of each divested Bell Operating Company (BOC) to provide non-discriminatory access to interexchange carriers on an unbundled, tariffed basis. The MFJ is only directed at the divested BOCs; it imposes no requirements on independent telephone companies. The FCC, however, contemplates that its interstate access charge plan will apply equally to the divested BOCs as well as independent telephone companies.

This means that within less than one year's time, each state regulatory commission must develop a detailed and complete mechanism for allocating, between users, the traffic-sensitive and non-traffic sensitive (NTS) costs of the local telephone plant devoted to the provision of intrastate access between the divested BOC Local Access and Transport Areas (LATAs) and within LATAs. Each state commission must also ensure that the tariffs, under which such costs are recovered, are established by local telephone carriers (BOCs and Independent telephone companies) according to the access charge plan adopted by each State commission.

It is reasonable to begin the development of an intrastate access charge plan by asking and addressing questions such as, what are the intrastate NTS costs of providing interexchange access, what objectives should an intrastate access charge plan achieve, how should the plan be structured, how it should be administered, which telephone companies should file access charge tariffs, and finally, who should pay what charges. The following questions and brief responses are intended only to generate discussion and comment. They should not be interpreted to be the position of the commission or its staff.

Questions to be Addressed:

1) What portion of the total NTS costs are recovered by the FCC's interstate access charge plan and what portion of the total NTS costs will be recovered through the Minnesota Commission's intrastate access charge plan?

The Minnesota commission finds that at this point in this proceeding there is not enough information available to determine the answer to this question. The commission, however, believes that a final decision in the current Joint Board separations proceeding in FCC Docket No. 80-286 may provide some answers.

2) What objectives should an intrastate access charge plan achieve?

First and foremost, an intrastate access charge plan should balance the goals of economic efficiency with customer equity. To address concerns regarding local exchange bypass on an intrastate-interLATA basis and on an intrastate-intraLATA basis, if the plan achieves economic efficiency by modeling cost causation as closely as possible it will most likely relegate the potential for local exchange bypass to future market conditions.

In addition to balancing economic efficiency and customer equity, an intrastate access charge plan must meet the requirements of the MFJ. That is, it must fulfill the equal access requirements imposed on the BOC's by the MFJ and it must account for the scope and operation of the Local Access and Transport Areas (LATAs).

Although it must fulfill the requirements of the MFJ, an intrastate access charge plan must also be flexible in allowing for unequal access arrangements and differing costs among local telephone companies.

Finally, an intrastate access charge plan must exercise firm control over access charges in order to minimize controversy between local carriers, interexchange carriers, and telephone customers.

3) How should an intrastate access charge plan be structured?

The answer to the question of how an intrastate access charge plan should be structured should begin with an examination of what types of access services exist today. The cost associated with each service could then be recovered through various function-specific rate categories.

Basically, there are three types of access services, namely, switched access (such as local telephone service), dedicated access (such as private line service), and ancilliary access (such as billing services).

An intrastate access charge plan should be structured such that the costs associated with the access services provided to interexchange carriers and telephone customers are recovered on an unbundled basis by rate category. In other words, the access charge plan should be structured such that exchange-related investments assigned to intrastate services are distributed

into several generic access pricing and cost allocation categories. The following rate category division may be reasonably applied to the switched and dedicated access services in an intrastate access charge plan:

a) Access Connections—These charges would be traffic-sensitive and would recover the costs associated with connecting the interexchange carriers' point of presence in the LATA or independent exchange to the serving wire center. This charge could be billed monthly and be based on average busy day/busy hour units of traffic capacity.

b) Local Transport—These charges would be traffic-sensitive and would recover the cost of transporting the intrastate, interexchange call from the switching center serving the interexchange carrier to the end office exchange switch. The charge could be usage and/or distance sensitive.

c) End Office Switching and Features—This charge would recover the costs of using office switching equipment to originate and terminate an interexchange carrier's traffic and to provide certain features.

d) End User Connections—This charge would be NTS and would recover the costs associated with the use of the Subscriber Plant between the End Office and the End User (customer) premises.

Ancilliary services are functions such as billing, message recording, directory assistance and testing. The costs of these services could be recovered through a recurring or non-recurring charge.

To subsidize high cost areas and possibly help telephone customers with the transition to paying access charges, it may be necessary to establish a Universal Service Fund on an intrastate basis. Interexchange carriers would be required to contribute to this fund.

4) How should an intrastate access charge plan be administered?

The Minnesota Public Utilities Commission will be responsible for the regulation of access charge tariffs that are submitted in compliance with the commission's intrastate access charge plan.

The question of who would administer an intrastate Universal Service Fund requires outside comment prior to a final commission decision.

5) Which telephone companies are legally required to file access charge tariffs?

All telephone companies serving telephone customers in the State of Minnesota will file access charge tariffs with the Minnesota Public Utilities Commission, but only the access charge tariff rates of all telephone companies organized as corporations and serving more than 2,500 telephone customers in the State of Minnesota will be regulated by the Minnesota Public Utilities Commission.

6) Who should pay what?

The interexchange carriers will most likely be required to directly pay the access connection charge, the local transport charge, and the end office switching and features charge.

Telephone customers may be required to pay all or a portion of the end user connection charge.

In conclusion, the commission staff realizes that many issues may not have been mentioned in this paper (such as what happens to Extended Area Service and Community Calling arrangements under an access charge system). Therefore, the reader of this paper is encouraged to provide additional comment on any issue that may have been neglected.

Errata

The Notice of Intent to Amend Rules without a Public Hearing which was published by the Securities and Real Estate Division of the Department of Commerce on February 14, 1983 at 7 S.R. 1170 should be amended to correct a typographical error in the third paragraph.

The first sentence of that paragraph should read: "Unless seven or more persons submit written requests for a public hearing on the proposed amendments within the 30-day comment period, a public hearing will not be held."

The 30-day comment period shall commence February 29, 1983.

STATE OF MINNESOTA

State Register and Public Documents Division
117 University Avenue
St. Paul, Minnesota 55155

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FOR LEGISLATIVE NEWS

Publications containing news and information from the Minnesota Senate and House of Representatives are available free to concerned citizens and the news media. To be placed on the mailing list, write or call the offices listed below:

Briefly/Preview—Senate news and committee calendar; published weekly during legislative sessions. Contact Senate Public Information Office, Room B29 State Capitol, St. Paul MN 55155, (612) 296-0504.

Perspectives—Publication about the Senate. Contact Senate Information Office.

Weekly Wrap-Up—House committees, committee assignments of individual representatives, news on committee meetings and action, House action and bill introductions. Contact House Information Office, Room 8 State Capitol, St. Paul, MN, (612) 296-2146.

This Week—weekly interim bulletin of the House. Contact House Information Office.

DR-83-047-GB

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE DEPARTMENT OF REVENUE
INCOME TAX DIVISION

In the Matter of the Proposed Adoption of New and Amended Rules and the Repeal of a Rule of the Department of Revenue Relating to the Taxation of a Unitary Business and Formula Apportionment (13 MCAR §§ 1.6501 to 1.6503, 1.6004, Minnesota Income Tax Rule 2019 and Repealing Rule 2017(3)).

REPORT OF THE HEARING EXAMINER

The above-entitled matter came on for hearing before State Hearing Examiner George A. Beck on Friday, April 8, 1983, at 9:00 a.m. in the Fifth Floor Conference Room of the Veterans Building, 20 West 12th Street and Columbus Avenue in the City of Saint Paul, Minnesota.

This Report is a part of a controversial rule hearing proceeding held pursuant to Minn. Stat. §§ 14.13 through 14.20, to determine whether the agency has fulfilled all relevant substantive and procedural requirements, whether the proposed rules are needed and reasonable, and whether or not the rules, if modified, are substantially different from those originally proposed.

Members of the agency panel appearing at the hearing included Dale Busacker, John Malach and Jerome Caufield.

Twenty people signed the hearing register. Three people appeared and offered oral comments at the hearing. The Department submitted 11 written exhibits. Six written comments were received from the public.

This Report shall be available for review to all affected individuals upon request for at least five working days before the agency takes any further action on the rule(s). Pursuant to Minn. Stat. § 14.16 (1982), the Commissioner of Revenue shall, if he proposes to adopt the rule as recommended herein, submit the rule, together with the complete hearing record to the Attorney General and shall be responsible for notifying persons who have indicated that they wish to be notified of such filing. If the Commissioner makes changes in the rule other than those recommended herein, he shall submit the rule with the complete hearing record to the Chief Hearing Examiner for a review of the changes prior to submitting it to the Attorney General for review.

Based upon all the testimony, exhibits, and written comments, the Hearing Examiner makes the following:

FINDINGS OF FACT

Procedural Requirements

1. On February 7, 1983, the Department filed the following documents with the Chief Hearing Examiner:

(a) A copy of the proposed rules.
(b) The Order for Hearing.
(c) The Notice of Hearing proposed to be issued.
(d) A Statement of the number of persons expected to attend the hearing and estimated length of the Agency's presentation.

2. On February 28, 1983, a Notice of Hearing and a copy of the proposed rules were published at 7 State Register 1226.

3. On February 24, 1983, the Department mailed the Notice of Hearing to all persons and associations who had registered their names with the Department for the purpose of receiving such notice.

4. On March 11, 1983, the Department filed the following documents with the Hearing Examiner:

(a) The Notice of Hearing as mailed.
(b) The Agency's certification that its mailing list was accurate and complete.
(c) The Affidavit of Mailing the Notice to all persons on the Agency's list.
(d) The Statement of Need and Reasonableness.
(e) The names of Department personnel who will represent the Agency at the hearing together with the names of any other witnesses solicited by the Agency to appear on its behalf.
(f) A copy of the State Register for March 7, 1983.
(g) An Affidavit of Additional Notice.
(h) All materials received following a Notice of Intent to Solicit Outside Opinion published on January 29, 1979 and July 6, 1981, in the State Register.

The documents were available for inspection at the Office of Administrative Hearings from the date of filing to the date of the hearing.

5. The record remained open through April 18, 1983, for the receipt of written comments and statements, the period having been extended by order of the Hearing Examiner to 10 calendar days following the hearing.

6. The submission by the Department of Revenue to the Office of Administrative Hearings on March 11, 1983 included a copy of the State Register for March 7, 1983. At the hearing, the February 28, 1983 State Register was substituted, which is the issue containing the proposed rules. No person asked to review the prefiled documents prior to the rule hearing and therefore no one has been prejudiced by the initial filing of the wrong copy of the State Register. Accordingly, the original misfiling does not constitute a defect in this proceeding. See, City of Minneapolis v. Wurtele, 291 N.W.2d 386, 391 (Minn. 1980) and Auerbach, Administrative Rulemaking in Minnesota, 63 Minn. L. Rev. 151, 215 (1979).

7. In addition to the publication of a Notice of Intent to Solicit Outside Opinion as noted in Finding 4(h), a draft of the proposed rules were submitted to interested persons on September 7 and November 19 of 1982. Public meetings were held on September 29 and December 8 of 1982, at which the proposed rules were discussed.

Nature of the Rules and Statutory Authority

8. The general nature of the proposed rules, rule amendments and repeal relates to the method of taxation of multi-state businesses. The rules provide a definition of a "unitary business" which is a concept devised in order to permit states to tax multi-state or multi-corporate business based upon the profit generated by the unitary business in the state rather than taxing simply according to the geographical location of the corporations. By the application of an apportionment formula, the state may tax business activities carried on geographically outside the taxing state but which make a contribution to the profitability of the business within the taxing state.

9. The Department cites Minn. Stat. § 290.52 as statutory authority for the adoption of the proposed rules and rule amendments. That section provides in part as follows:

> The commissioner shall administer and enforce the assessment and collection of taxes imposed by this chapter. He may, from time to time, make, publish, and distribute rules and regulations in enforcing its provisions.

Chapter 290 deals generally with income and excise taxes. The chapter also deals with corporate taxation. The unitary business test is described at Minn. Stat. § 290.17, subd. 2(4). Combined reporting of a unitary business is described at Minn. Stat. § 290.34, subd. 2. The Department has demonstrated its statutory authority to adopt the proposed rules and rule amendments.

10. Proposed rules, rule amendments, or repeals which are not specifically discussed in this Report were not the subject of public comment. Those provisions are found to be needed and reasonable based upon the Department's Statement of Need and Reasonableness. (Ex. G).

13 MCAR § 1.6501 B. - Definition of Unitary Business

11a. Section 1.6501 B. defines unitary business. The proposed definition includes the statutory definitions set out at Minn. Stat. § 290.17, subd. 2(4), which states that a unitary business includes operations which are of mutual benefit, dependent upon or contributory to one another. The statute also provides that unity can be presumed where there is a unity of ownership, operation and use evidenced by centralized management or executive force, centralized purchasing, advertising, accounting or other controlled interaction. The proposed rule then goes on to list examples of factors which will generally evidence the three unities listed. The rule also provides that all examples listed need not be present to show functional integration or centralized management. The rule makes it clear that ownership of even 100% of the stock of another corporation does not mean that the two corporations are unitary in the absence of other listed characteristics.

b. The tests, examples and other language of the proposed definition are drawn in large part from Minnesota and U.S. Supreme Court decisions which examine state taxation of multi-state corporations. A state can constitutionally tax only corporate income that is reasonably attributable to activities within the taxing state. The problem faced by state taxing authorities is that separate geographical accounting for individual but related corporations may distort corporate net income because it fails to account for contributions to that income from functional integration, centralization of management and economies of scale which may exist between a corporation within the taxing state and other corporations located outside of the taxing state. Exxon Corporation v. Department of Revenue of Wisconsin, 447 U.S. 207, 222 (1980). The judicial response to state attempts to avoid geographical reporting was the unitary business test which holds that where the three unities cited in the proposed definition are present, the state can deem several corporations to be a single business and require combined reporting for the corporations. The states commonly apply a three-factor apportionment formula to unitary corporate net income to reflect the reality that business activities

outside of the state contribute to profitability within the state. In Mobil Oil Corporation v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980), the Court stated that the "lynchpin of apportionability in the field of state income taxation is the unitary business principle". 445 U.S. at 439. The Court stated that a prerequisite to combined reporting by several corporations was finding a functionally integrated enterprise or underlying unitary business.

c. Two more recent cases cited by both the Department and the corporations offering comments in this rule hearing proceeding are F.W. Woolworth Company v. Taxation and Revenue Department of New Mexico, 102 S.Ct. 3128 (1982) and Asarco, Inc. v. Idaho State Tax Commission, 103 S.Ct. 3103 (1982). Both of these decisions apply the principles set out in Exxon and Mobil. In Woolworth, New Mexico had attempted to tax dividend income received by Woolworth from four foreign (located outside the United States) subsidiaries. The Court found no underlying unity of enterprise since there was no centralized purchasing, manufacturing, warehousing or financing. The Court, therefore, concluded that there was no functional integration, centralization of management or economies of scale. The Court made it plain that the receipt of dividends or economic benefit alone was not enough to conclude that a unitary business existed. The Court also noted that there was no flow of trade among the corporations nor interchange of personnel or substantial mutual interdependence. 102 S.Ct. at 3139. In Asarco, the Court did not permit Idaho to include income received by the parent corporation from subsidiaries even though one subsidiary was more than 50% owned by Asarco. The Court reaffirmed its conclusion that mere investments in other corporations are not enough to support a finding of a unitary business. It emphasized that because there was no direction or approval from Asarco on the operational or other management decisions by the subsidiaries, there was no actual management control and therefore no unitary business. The proposed rules must be tested against the constitutional principle announced by the Supreme Court which provides that where business acitivites of an outstate corporation have nothing to do with the activities of a related corporation in the taxing state, due process may preclude apportionability since there is no underlying unitary business. Mobil, supra, 445 U.S at 441-42.

d. Dayton Hudson Corporation suggested that the proposed definition was not consistent with Woolworth and Asarco because the rule does not require evidence of a substantial contribution to the income of the instate corporation by outstate activities resulting from functional integration, centralized management and economies of scale. (Ex. 3, p. 2). The decisions do not however mention either "significant" or "substantial" contributions as being a singular prerequisite of the finding of a unitary business. The proposed rule does accurately restate the holding of the cases that unity is "evidenced by contributions to income resulting from functional integration, centralized management, and economies of scale". Dayton Hudson and Shell Oil (Ex. 6) also expressed concern that both the Woolworth and Asarco factual situations would be presumed to be unitary under the proposed definition. However, in Woolworth, the Court noted that there was no centralized accounting, purchasing, manufacturing, warehousing or personnel training. The management decisions

were made separately between the corporations and the legal staffs were separate. Each corporation obtained its own financing. The Court noted that there was no exchange of personnel between the corporations. 102 S.Ct. at 3135-36. All of these factors are cited in the proposed rule as examples of the unities necessary to a presumption of a unitary business. Unless a number of them can be found to exist, unity cannot be concluded. In Asarco, the Court noted that the corporations operated independently with no common officers or directors and that there was no direction or approval from Asarco on operational or other management decisions. 102 S.Ct. at 3113. The examples listed in the proposed rule include centralized management and a centralized executive force. The proposed rule states that examples of centralized management are "common officers or directors, exchange of personnel, frequent communication between management of the corporations, or where the parent must approve of major financial decisions". Dayton Hudson accurately points out that some of these examples may exist even in the absence of a unitary business. In Woolworth, there were a few common directors and there were mail and telephone communications between the very highest management levels. Additionally, major financial decisions such as the amount of dividends to be declared or debt to be assumed were made in consultation with the parent corporation. 102 S.Ct. at 3137. The proposed rule does not, however, presume a unitary business exists simply where there are common directors, frequent communication and approval of major financial decisions such as in Woolworth. These are merely examples of centralized management, which the rule states may evidence the unitary nature of a business. In order to create a presumption, all three unities must be identified, including unity of use evidenced by line functions, centralized executive force and the general system of operation. Additionally, the rule requires evidence of functional integration and economies of scale. It appears unlikely that it could be concluded that unity of use or functional integration as defined in the rule existed based upon the facts of the Woolworth case. The facts of Woolworth indicated no centralized executive force and discrete, rather than functionally integrated, enterprises. In order to avoid a misinterpretation, however, it is recommended that the Department include another example of centralized management within § 1.6501 B. which reflects the idea that centralized management exists when one corporation determines the primary business policies of another. This concept is set out in § 1.6501 E. and is also noted in the Asarco case which emphasized actual management control of subsidiaries as a factor in finding a unitary business. Such a modification would make it clear that something more than mere stewardship of an investment must be shown before a unitary business can be found.

no change see FofF 1.

e. Shell Oil Company (Ex. 1) and others expressed concern that the creation of a presumption would lessen the Department's burden in demonstrating a unitary business. Presumptions can be reasonably created where the existence of certain facts renders the inference of a particular conclusion so probable that it is sensible to assume the truth of the conclusion until the adversary disproves it. The effect of the creation of the presumption is that, where certain facts appear, the burden of proof shifts to the other party to disprove the presumption. This is reasonably done where, as here, the burden is

shifted to the party who has superior means of access to the facts. See, McCormick Law of Evidence, § 309. Multi-state corporations have superior access to the facts concerning the structure and operation of their corporate enterprise. The creation of a presumption is within the legislative rule-making authority of an agency. It must be tested, however, to ensure that there is a rational connection between the facts proved and the conclusion presumed. McCormick Law of Evidence, § 313. The Statement of Need and Reasonableness together with the Supreme Court cases cited demonstrate that the presumption created is reasonable; that is to say when the factors and examples cited in the proposed rule are present, there is commonly a unitary business.

f. General Mills objected to one portion of the proposed definition based upon their belief that centralized staff functions such as accounting, legal or personnel do not generally evidence unity of operation. General Mills believes that the cost of staff functions can be allocated among the benefiting entities so as to eliminate any distortion of income which might otherwise result. (Ex. 4). The Department's position is that the staff functions listed in the proposed rule demonstrate unity of operation when they are being performed for several corporations by the same group of people and those functions would not occur if the separate corporations were in fact conducting their business as separate entities. (Ex. G, p. 10). It would appear however that the critical question is not whether the staff functions can be allocated to avoid distortion of income, but whether or not it can reasonably be said that the centralization of staff functions indicates an underlying unitary business. The Court in Woolworth mentioned separate accounting functions, separate purchasing, manufacturing, warehousing, legal and personnel functions as an indication of no functional integration and, therefore, no unitary business. 102 S.Ct. at 3135. The proposed rule does state that ownership of 100% of the stock of another corporation will not in the absence of other factors render the business of the group unitary. It must be remembered that the finding of one centralized staff function does not compel a conclusion of a unitary business under the proposed rule. As the Asarco Court noted, the application of the unitary business principle requires in each case a careful examination of the way in which a corporate enterprise is structured and operates and of its relationship with the taxing state. Asarco, 102 S.Ct. at 3115, n. 22; see also, Dexter, Unitary Concept of State Income Taxation of Multi-State - Multi-National Businesses, 10 Urb. L. 181, 211 (1978). The proposed rule, therefore, lists only examples of unity of operation. The Department is still obligated to examine all of the factual data concerning the operation of the business before coming to a conclusion.

g. Mobil Oil Corporation suggested that another factor be added to the proposed definition, namely, the existence of a "substantial flow of goods or services" as a unity factor. This suggestion is based upon a decision of the California State Board of Equalization. (Ex. 5). The case law developed by the United States Supreme Court would not appear to compel inclusion of this factor. Recent state case law subsequent to Asarco and Woolworth has found a unitary business in the absence of a flow of business between related corporations but where the other factors set out in Woolworth were present.

Earth Resources Co. of Alaska v. State of Alaska, Department of Revenue, ___ P.2d ___ (Alaska 1983) CCH Alaska Tax Reports ¶220-285, Feb. 10, 1983. United States Steel Corporation suggested that the Department exempt from the definition corporations organized in the United States which conduct 80% or more of their business outside of the United States. It also requested that regulated companies not be treated as being unitary with nonregulated companies. (Ex. 2). The Department may consider these suggestions.

no change see FoF 2

h. Section 1.6501 B. has been demonstrated to be needed and reasonable as proposed. The proposed definition is consistent with the decisions of the Minnesota and United States Supreme Court and, therefore, it does not constitute a substantive violation of law. The Department is encouraged to consider the modifications suggested, however.

13 MCAR § 6501 C. - Horizontal Type of Business

12. This subsection contains an example of a horizontal type of business which will usually be concluded to be unitary. Shell Oil suggested that the word "all" be reinserted in line 2 in front of the words "the activities". (Ex. 1). Shell Oil also suggested that under this subsection the subsidiaries in the Woolworth case would be presumed to be unitary. (Ex. 6). A prerequisite of a unitary finding under this subsection requires however that the corporations be functionally integrated and have centralized management. As the Court's discussion demonstrates, that clearly was not the case in Woolworth. The example described in this subsection is similar to the business described in Edison California Stores, Inc. v. McColgan, 183 P.2d 16 (Cal. 1947). That case involved a multi-state retail shoe business comprised of 15 wholly-owned subsidiary corporations where the parent provided centralized management, purchasing, advertising and other centralized administrative functions. General Mills also felt that the conclusion was reached too easily because of the all-inclusive definition of functional integration in the prior rule subsection. (Ex. 4, p. 2). The proposed subsection is, however, consistent with the existing case law and has been demonstrated to be needed and reasonable.

13 MCAR § 1.6501 D. - Steps in a Vertical Process

13. This subsection describes an example of a vertically structured enterprise which is unitary in nature. Shell Oil commented that the enterprises in Asarco would be presumed to be unitary under this subsection. (Ex. 6). That would not necessarily appear to be the case, however. In Asarco, the Court's description of the business would seem to preclude a finding of functional integration or centralized management. There was no direction or approval of operational or other management decisions between Asarco and its subsidiaries. 102 S.Ct. at 3113. Another obvious difference is that in the example the business of each corporation is copper ore, while in Asarco, the Idaho business was silver mining while the company of which Asarco owned 51.5% was involved in copper mining. (See, Floyd, The Unitary Business in State Taxation: Confusion at the Supreme Court?, 3 BYUL Rev. 465 (1982)). The subsection is needed and reasonable as proposed and does not constitute a violation of substantive law.

13 MCAR § 1.6501 E. - Strong Centralized Management

14a. This proposed subsection describes when certain indications of a strong centralized management among related corporations will be presumed to constitute a unitary business. General Mills objected to the concept that policy determinations could result in a business being unitary. (Ex. 4, p. 2). Dayton Hudson stated that the proposed rule subsection overstates the importance of centralization of management and asked that the rule be modified to mentioned all three factors, namely, functional integration, centralized management and economies of scale. It also suggests that the phrase "primary business activities" be clarified to indicate that day-to-day business operations are referred to. Dayton Hudson points out that Asarco and Woolworth indicate that some managerial links may exist without the determination of a unitary business such as common directors, frequent communication between upper echelons of management and major financial decisions by the parent. Woolworth, 102 S.Ct. at 3137. (Ex. 4).

b. The Department relies primarily on the Woolworth case to support this subsection. One of the factors mentioned in Woolworth was the management decentralization reflected by the fact that each subsidiary possessed autonomy to determine its own policies respecting its primary activity which was retailing. The Court contrasted the situation with that in Exxon, where the parent provided long-range planning, development of financial policy, financing itself, accounting, legal, public relations and the purchase and sale of raw materials. Exxon, 447 U.S. at 207. (Ex. G, p. 25-26). The proposed definition does reflect the holdings of Woolworth and Asarco that a mere investment does not constitute a unitary business and that strong centralized management authority must be exercised in order to produce a unitary business.

c. It is concluded that the proposed subsection is needed and reasonable and is not inconsistent with the Supreme Court decisions. However, it is recommended that the subsection be modified so that its consistency with Woolworth and Asarco is more obvious. Although the last sentence of the subsection mentions integration as a prerequisite of a unitary business, language should be added which makes it clear that a unitary business is not presumed in the absence of functional integration. Although the language "primary business activities" is language actually employed by the Court in Woolworth, the proposed subsection should be amended to explicitly recognize Woolworth's holding that some management communication between separate corporations is permissible without creating a unitary business for tax purposes.

no change
see FoFF 3

13 MCAR § 1.6501 G. - Examples

15. Section 1.6501 G.1. is the first example of a unitary business. General Mills stated that this example was based upon a too-sweeping definition of functional integration. (Ex. 4, p. 2). Shell Oil stated that the use of the language "some of" in regard to the movement of products was not sufficient to constitute a unitary business. It suggested that a more substantial flow of goods must be demonstrated to constitute a unitary business. (Ex. 1). It would appear as the Department suggests that example is consistent with the Court's finding in Exxon. The example would not preclude an argument

by a taxpayer to the effect that the flow of goods or services was so insubstantial as to preclude a finding of a unitary business. The case law does not compel inclusion of this factor, however. The subsection is needed and reasonable as proposed and is consistent with case law.

16. Section 1.6501 G.2. sets out an example of a horizontally integrated business which constitutes a unitary enterprise. General Mills again believes that the example rests upon a too-sweeping definition of function integration. (Ex. 4, p. 2). Shell Oil commented that the integration appeared more vertical than horizontal. (Ex. 1). Dayton Hudson Corporation asked that the management services provided by corporation A be further defined in the example. It also stated that the phrase "primary business activities" should be expanded to focus on day-to-day business operations. (Ex. 3, p. 3). The Department may consider these suggestions; however, the proposed subsection is needed and reasonable as proposed. It is recommended that any modification of the phrase "primary business activities" in § 1.6501 E. be carried over to this proposed subsection.

no change see ¶ 14c

17. It should be noted that the concluding sentence of both § 1.6501 G.1. and 2. are somewhat misleading in that they suggest that a unitary business can be found based solely upon the factors mentioned. They should be modified to reflect utilization of all the tests set out in § 1.6501.

no change see ¶ of F 3

18. Section 1.6501 G.3. sets out an example of what the Department believes is a unitary business reflecting strong centralized management. Dayton Hudson commented that the example should be modified to make it clear that "stewardship" investor activities such as budget and capital expenditure controls and financing activities are permissible. (Ex. 3, p. 3). General Mills felt that the example failed to indicate which characteristics conclusively resulted in the business being unitary. (Ex. 4, p. 2). Shell Oil questioned whether or not the minority shareholders in M and N would permit such management control. (Ex. 1). Shell Oil also suggested that this example was close to the Asarco situation. (Ex. 6). It appears, however, that the functions performed by corporation K such as approval of capital expenditures, financing arrangements, loans, tax matters, centralized warehousing, accounting and inventory control are substantially different from the Asarco case. Although the subsection is needed and reasonable as proposed, it is suggested that any modification of § 1.6501 E. be carried over into this example.

no change see ¶ 14c

13 MCAR § 1.6502 - Intercompany Transfers Within Unitary Business

19a. This subsection requires elimination of income, loss, expense or deduction items between members of a unitary group in order to avoid distortion. Shell Oil Company states that this rule incorrectly interprets the statutory language upon which the rule is based. The statute at Minn. Stat. § 290.34, subd. 2, provides in part that: "All intercompany transactions between companies which are contained on the combined report shall be eliminated." Shell Oil Company contends that the statutory language does not authorize any elimination of intercompany transactions in regard to the apportionment factors. It interprets the statutory directive to relate only to refer to taxation of income on the combined return and suggest that the Department's interpretation in effect creates a "consolidated" return contrary

to legislative intent. (Ex. 1, p. 2; Ex. 6, p. 2). It cites a speech given by the Commissioner which suggests that the effect of the statutory language is that all intercorporate transactions which affect taxable income are disregarded.

b. The Department points out that intercompany transactions must be eliminated in order to accomplish the objective, which is to treat more than one corporation as a unitary business for tax purposes. The Department suggests that a multi-corporate enterprise can distort its activities within and without the State of Minnesota by manipulating intercompany transactions. Its states that the transactions must be eliminated for the determination of the apportionment factors because these factors, especially the sales factor, can be easily inflated by intercompany transactions which will result in a distortion. (Ex. G, p. 35-37). The Department suggests that its rule will be uniform with other states, such as Illinois. As Shell Oil points out, the Illinois regulation is somewhat different in that it eliminates transactions "whenever necessary to avoid distortion of the group's income". Shell Oil states that it would have no problem with the Illinois regulation; however, the Illinois regulation does require modification of the apportionment factors similar to the proposed Minnesota rule. The only significant difference between the two is that in Illinois the Department must prove that the elimination of intercompany transfers is necessary to avoid distortion while under the Minnesota proposed rule the taxpayer would have to show that no distortion would result in order to avoid the effect of the rule.

c. It is concluded that the proposed rule is consistent with the statute. The Department points out that the current language, which was enacted in 1982, replaced language which eliminated only intercompany dividends within a unitary business. The broader language enacted in 1982 would seem to signal a legislative intent to expand the effect of the statute. It would not seem logical to require elimination of intercompany transfers to avoid distortion in the reporting of income on the combined report and yet permit it to create a distortion in the apportionment factors. It appears that the legislative intent is to treat several corporations as one for the purpose of the imposition of the corporate tax. The rule is needed and reasonable as proposed.

Amendment of Minn. Rule 2019 - Apportionment of Net Income of Business Conducted Partly Within Minnesota

20. At the hearing, the Department proposed an amendment of Minn. Rule 2019(b)(2) which would amend the second sentence of the rule to read as follows: "The following alternative formula is employed if a lesser percentage to Minnesota results by its use:". Additionally, the words "may be" in the last sentence of this subsection would be replaced with the word "is". There was no objection to the suggested modification and the modification does not result in a rule amendment substantially different from that which was published in the state register. The amendment is needed and reasonable as modified.

21. Minn. Rule 2019 D. contains several definitions of terms. Shell Oil requested that the terms "sales" and "sales, gross earnings, or receipts" be

defined in this subsection. (Exs. 1, 6). The Department may consider this suggestion.

22. Minn. Rule 2019 D.2. is proposed for amendment. At the hearing, Shell Oil suggested that the word "rate" should be deleted wherever used since a cents per gallons or percent of revenue rate can be translated into an annual rental but not an annual rental rate. (Ex. 6, p. 3). The Department accepted this suggestion in its post-hearing comments. (Ex. K). Shell Oil also suggested that the Department should not reduce the rent expense to be included in the property factor when the rental income is included in the apportionable net income. The Department agreed that distortions can take place where subrental income is subtracted from rental income in determining the property factor. In its post-hearing comments, the Department therefore suggested the adoption of additional language relating to subrental income, which is nearly identical to that contained in California regulations. The new language permits the Department to require, or the taxpayer to request, another method for determining the net annual rental where the rule produces a clearly inaccurate value for any item or property. The suggested modification would not result in a rule which is substantially different from that as published. The modification appears to permit sufficient flexibility to eliminate the harsh effect perceived by Shell Oil Company. The suggested modification appears to sufficiently contain the discretion to be exercised by the Commissioner since any other method chosen must properly reflect the value of the renter property. The last sentence of the additional language also contains a further limiting factor. The proposed amendments, together with the suggested modifications are needed and reasonable.

Based upon the foregoing Findings of Fact, the Hearing Examiner makes the following:

CONCLUSIONS

1. That the Department of Revenue gave proper notice of the hearing in this matter.

2. That, except as noted at Finding of Fact No. 6, the Department of Revenue has fulfilled the procedural requirements of Minn. Stat. § 14.14, subds. 1 and 2 (1982) and all other procedural requirements of law or rule. The misfiling noted at Finding of Fact No. 6 prejudiced no one and does not constitute a defect in this proceeding.

3. That the Department of Revenue has documented its statutory authority to adopt the proposed rules, and has fulfilled all other substantive requirements of law or rule within the meaning of Minn. Stat. §§ 14.05, subd. 1, 14.15, subd. 3 and 14.50 (i) and (ii) (1982).

4. That the Department of Revenue has demonstrated the need for and reasonableness of the proposed rules by an affirmative presentation of facts in the record within the meaning of Minn. Stat. §§ 14.14, subd. 2 and 14.50 (iii) (1982).

5. That the additions and amendments to the proposed rules which were suggested by the Department of Revenue after publication of the proposed rules in the State Register do not result in rules which are substantially different from the proposed rules as published in the State Register within the meaning

of Minn. Stat. § 14.15, subd. 3 (1982) and 9 MCAR §§ 2.110 A. and 2.111 (1980 Ed.).

6. That any Findings which might properly be termed Conclusions and any Conclusions which might properly be termed Findings are hereby adopted as such.

7. That a finding or conclusion of need and reasonableness in regard to any particular rule subsection does not preclude and should not discourage the Department from further modification of the rules based upon an examination of the public comments, provided that no substantial change is made from the proposed rules as originally published, and provided that the rule finally adopted is based upon facts appearing in this rule hearing record.

Based upon the foregoing Conclusions, the Hearing Examiner makes the following:

RECOMMENDATION

It is hereby recommended that the proposed rules be adopted consistent with the Findings and Conclusions and Recommendations made above.

Dated: May 5 , 1983.

George A. Beck

GEORGE A. BECK
State Hearing Examiner

Exhibit No. G

File No.

Date

STATE OF MINNESOTA

DEPARTMENT OF REVENUE

RECEIVED
MAR 11 1983
ADMINISTRATIVE HEARINGS

IN THE MATTER OF THE PROPOSED ADOPTION OF NEW AND AMENDED RULES AND THE REPEAL OF A RULE OF THE DEPARTMENT OF REVENUE RELATING TO THE TAXATION OF A UNITARY BUSINESS AND FORMULA APPORTIONMENT. (13 MCAR SECTIONS 1.6501 TO 1.6503, 1.6004, MINNESOTA INCOME TAX RULE 2019 AND REPEALING RULE 2017(3)).

STATEMENT OF NEED AND REASONABLENESS

This document has been prepared as a verbatim affirmative presentation of the facts necessary to establish the statutory authority, need for and reasonableness of the proposed new and amended rules and repeal of a rule. It is submitted pursuant to 9 MCAR Section 2.104 requiring a Statement of Need and Reasonableness. The Statement of Need and Reasonableness for each rule has been typed separately for ease in understanding and to reduce the cost for a person who is interested only in one rule.

A Notice of Intent to Solicit Outside Opinion regarding income tax rules including corporate income taxes was published in the State Register on January 29, 1979 and again on July 6, 1981. These proposed new and amended rules and repeal of a rule were submitted to those people who contacted us, for their comment on September 7 and on November 19, 1982. Public meetings were held on September 29, 1982 and on December 8, 1982, at which time these rules were discussed with interested people. All interested parties were allowed time to submit comments orally or in writing. Suggestions and comments that were received have been duly considered.

Authority to Adopt Rules

Minn. Stat. Section 290.52 grants the Commissioner statutory authority to promulgate rules concerning the income tax law. Implicit in the authority to establish rules is the ability to amend and repeal rules. The unitary business rules are caused by the law changes made in Laws 1981, Third Special Session, Chapter 2, Article 3, Sections 13-15, and as amended by Laws 1982, Chapter 523, Article 29.

Rule 13 MCAR Section 1.6501 - Definition of Unitary Business.

Statement of Need and Reasonableness

A. The first sentence of this paragraph excludes an S corporation from the definition of a corporation for purposes of a unitary business. In the federal Subchapter S Revision Act of 1982, P.L. 97-354, the designation of a Subchapter S corporation was changed to an S corporation effective for taxable years beginning after December 31, 1982. In order to qualify as an S corporation under federal law, Internal Revenue Code Section 1361 provides that all shareholders must be individuals or, in certain situations, an estate or trust. Minn. Stat. Section 290.9725 provides that if an S corporation has a valid federal election it will be accorded the same treatment for Minnesota purposes. Minn. Stat. Section 290.9726, subd. 1 states that the provisions of Section 290.01, subd. 20 to 20f shall govern the treatment of this income to the shareholder. Minn. Stat. Section 290.01, subd. 20 provides that Minnesota will use federal adjusted gross income as its starting point for the taxation of individuals, estates and trusts. Minnesota taxes all of the income of its resident individuals. Since no provision is made to increase or decrease an individual resident's income if the individual is part of a unitary business, the rule provides that the S corporation would not be a part of a unitary business. The statute does provide modifications for part-year and nonresidents so that Minnesota will tax only their Minnesota income. For federal and Minnesota purposes, the S corporate entity is disregarded and the tax consequences of the operations are passed on directly to the individual shareholders of the S corporation. This is why the term corporation would not include an S corporation for purposes of a unitary business and the combined income approach. The exclusion of an S corporation from unitary tax treatment is reasonable since no provision is made in the law to modify an individual's income.

The second sentence of this paragraph contains the definition for the term United States. The term United States as used in Minn. Stat. Section 290.34, subd. 2 is read broadly by the Department and is considered to include not only all the states but also the District of Columbia and the Commonwealth of Puerto Rico. It also includes any possession of the United States or political subdivision of any of the foregoing. It is the Department's position that since the Commonwealth of Puerto Rico and the possessions of the United States are granted protection by the United States and are governed by the Constitution of the United States, these areas should be included within the definition. These areas are granted substantial benefits by the United States Government. Laws enacted by the Congress and decisions of the U.S. Supreme Court apply to these areas. For these reasons, the Department has included these areas within the definition of United States for purposes of the unitary business concept and the combined income approach.

B. The first sentence of this paragraph defines the unitary business. It is a restatement of the definition contained in Minn. Stat. Section 290.17, subd. 2, clause (4), 2nd paragraph, 2nd sentence. The rule states that more than one corporation must be involved in order to find a unitary business. In addition, those corporations involved in a unitary business must be related through common ownership and the business activities of the corporations must be of mutual benefit, dependent upon or contributory to the activities of one or more of the other corporations in the unitary group. The rule does provide that common ownership, as defined in this rule, must be found before the test of mutual benefit, dependent upon, or contributory to is applied. This is a clarification of the application of the test.

The concept of the unitary business and resulting formula apportionment were developed by the states in order to serve as an expedient and rational means by which to define the income of a multistate business for tax purposes. The

concern that many states have had was that many corporations which were deriving profits from a particular state were able to immunize themselves from tax on those profits by organizing themselves in such a way as to eliminate or substantially reduce their tax liability to that state based on their form of conducting business. The unitary business concept was devised in order to protect each state's tax base on the amount of profit generated by that corporate entity in the state. When applied for corporate income tax purposes, the unitary business concept and combined reporting determine a corporation's tax liability to a state by looking at the entire (unitary) business of which the corporation is a part. That business consists of all units which are engaged in it, whether those units be divisions in the corporation, or corporate affiliates of a multicorporate enterprise. In a state which applies the unitary business concept with combined reporting, substance triumphs over mere form. The unitary business concept enables states to look beyond the immediate corporation to determine the true nature of the operations of a multicorporate business and to tax fairly the income derived from those operations. See, Corrigan, Mobil-izing Interstate Taxation, Tax Notes, October 12, 1981; Dexter, The Unitary Concept in State Taxation of Multistate-Multinational Businesses, 10 Urb. Law. 181 (1978); Chen, State Taxation of Unitary Businesses, 8 Fordham Urb. L.J. 819 (1979-1980).

The Minnesota legislature has enacted specific legislation in order to protect Minnesota's tax base and to fairly tax the operations of multistate and multinational corporations conducting part of their business within Minnesota. The unitary legislation and these rules are written in order to avoid protracted litigation which may otherwise be needed to establish Minnesota's right to utilize the combined income approach under the unitary business concept and to put all corporations on notice that the unitary business concept and combined reporting will be used by the State of Minnesota. It is the Department's

position that these rules on unitary taxation are necessary in order to inform the taxpayer as to the parameters and effects of the unitary business concept and combined reporting to its particular business.

The mutual benefit, dependent upon, or contributory to test was used by Minnesota courts prior to the passage of the new unitary tax law. In Western Auto Supply Company v. Commissioner of Taxation, 71 N.W.2d 797 (1955), the Minnesota Supreme Court stated this test in finding a taxpayer was conducting a unitary business partly within and partly without Minnesota. Western Auto was a Missouri corporation engaged in the retail and wholesale merchandising of automotive parts and accessories on a nationwide basis. During 1947 Western Auto operated 257 retail stores in 30 states. This included eight such stores in Minnesota. All general, executive, and management functions of Western Auto were performed at its home office in Kansas City, Missouri. The centralized purchasing was done by expertly trained personnel whose department was located in Kansas City. All the merchandise sold by Western Auto was purchased from manufacturers and jobbers by the company's central purchasing department and initially shipped from the manufacturing jobbers to warehouses of the taxpayer and from there to company stores, or sold and delivered to the dealer stores. Western Auto, in filing its 1947 Minnesota corporate income tax return, apportioned to Minnesota on the basis of separate accounting. The Commissioner, upon auditing the return for 1947, apportioned Western Auto's income under the statutory three factor formula of property, payroll, and sales. The issue in the case was whether the Commissioner of Taxation was correct in readjusting taxpayer's apportionable income to Minnesota. The Minnesota Supreme Court stated that the test to be applied in determining whether a business is a unitary one is based on whether the operation of the business within the state is dependent upon or contributory to the operation of the business outside the state. The court went on to state that the test of whether a business is

unitary is whether its various parts are interdependent and of mutual benefit so as to form one business unit rather than separate business entities and not whether the operating experience of the parts is the same in all places. The court stated that the profits that Western Auto realized through centralized purchasing and administration were not created solely by activities in the state of taxpayer's home office or in states where its warehouses were located. It was created by the operation of the entire business unit, through the coordinated and standardized activity of numerous stores throughout the country which made possible the central purchasing, the central management, the warehousing as carried on, and the advertising methods adopted. The Minnesota stores contributed in part to make all this possible, and the multiple formula methods simply allocated a fair share of the profits to Minnesota. Western Auto was found to be a unitary business under this test.

The second sentence of this paragraph restates the presumption of a unitary business where the three unities exist as provided in Minn. Stat. Section 290.17, subd. 2, clause (4), 2nd paragraph, 3rd sentence. The three unities test (unity of ownership, unity of operation and unity of use) has been utilized by the courts for several decades. The Supreme Court of the United States in Butler Brothers v. McColgan, 315 U.S. 501 (1942), utilized the three unities test in determining that the taxpayer was conducting a unitary business. Butler Brothers was an Illinois corporation engaged in the wholesale dry goods and merchandising business. It operated seven wholesale stores in seven states, including one in California. Each of the seven locations served as a separate territory. Each location had its own sales persons, handled its own collections and credit arrangements, and kept its own accounts. All of the sales in California were handled by a San Francisco office. All purchases made by the San Francisco office came from the company's home office in Chicago.

Charges for the goods were made to each location at cost plus transportation expenses. Operating and advertising costs by the central purchasing division were allocated among the several wholesale stores. Although the business as a whole realized a profit, the California operation showed a loss. This loss was computed by the taxpayer using the separate accounting method. California treated Butler Brothers as a unitary business and used a formula to allocate a portion of taxpayer's overall profit to the state. The United States Supreme Court found that Butler Brothers was conducting a unitary business. The critical factor in the court's holding was Butler Brothers' use of a central purchasing division. This system enabled it to obtain lower prices than would be possible from the individual branches. The court noted that this mode of operation alone would indicate that the branches' functions were closely integrated. The savings afforded by the lower purchasing prices were reflected in the lower cost to each branch and undoubtedly contributed to the net overall profit of the business.

In determining whether a presumption exists that taxpayer is conducting a unitary business based on the three unities test, the focus of the determination is whether, as a result of the unitary characteristics, the income (or loss) of the combined operations are materially different from what would have been in the absence of those unitary characteristics.

The rule sets out in the second sentence of paragraph B. what evidence or characteristics will be looked at in order to determine whether each of the three unities exist, thereby creating the presumption of a unitary business. The question of whether or not a business is unitary and what constitutes the income of that unitary business involves complex factual determinations concerning all phases of the operation of the business, particularly that data pertaining to the overall management of the business and interrelationship with

the various operating branches or departments of that business. Many of these characteristics or indicia of one of the three unities have been incorporated in numerous court cases over the years. Probably one of the most significant court cases is Edison California Stores, Inc. v. McColgan, 183 P.2d 16 (1947). In Edison California Stores, a multistate retail shoe business was operated through a Delaware parent corporation with its headquarters in St. Louis. The corporation was comprised of 15 wholly owned subsidiary corporations, each operating in its state of incorporation. The parent provided centralized management, purchasing, advertising, and other centralized administrative functions. The home office determined operating policies for the entire affiliated group and conducted the principal accounting work for all subsidiaries. Goods purchased by the central purchasing division were shipped to the various stores operated by the subsidiaries, which were charged with the cost and a portion of the general overhead expenses. Each subsidiary operated solely within the geographical confines of its particular state. The California Tax Commission regarded the entire business, comprising the parent and all the subsidiaries, as a unitary business. The taxpayer objected on the grounds that the unitary rule did not apply to separate corporate entities. The court rejected this argument and held that the corporate veil of each corporation could not cloak the existence of an integrated multistate unitary business enterprise. In finding a unitary business, the California Supreme Court stated:

> In the present case all the elements of a unitary business are present--unity of ownership, unity of operation by centralized purchasing, management, advertising and accounting, and unity of use, in the centralized executive force and general system of operation. The business of the parent and all of its subsidiaries is owned and managed under one centralized system, to the same extent as in the Butler Brothers case and other cases considered therein. Thus, the business is unitary regardless of the fact that in the Butler Brothers case there was but one corporation involved . . . and that in the present case there is a parent corporation owning and controlling as units of one system 15 different branches organized as corporations . . . . At page 21.

The third sentence in paragraph E. states that not all of the examples are needed to show unity of operation or unity of use. The Department wishes to

stress that the determination of whether a business is part of a unitary business is based on the particular facts in each case. The factual determination is undertaken in order to determine whether sufficient facts or indicia exist which evidence the conduct of a unitary business. It is the Department's position that not all of the factors mentioned in the rule which indicate a unitary business are necessary in order to prove that a unitary business exists. The determination of a unitary business must rest upon all the facts of that particular business. Therefore, all of the factors given in the rule are not necessary before a unitary business will be presumed to exist.

Unity of operation is generally shown to exist by showing staff functions such as the centralized advertising, accounting, financing, management, or centralized, group, or committee purchasing. Unity of operation exists where the staff functions for several corporations are being performed by the same group of people and which functions would not occur if the separate corporations were in fact conducting their business as separate entities. Unity of use is evidenced by the same group of people performing line functions such as a centralized executive force. Again, where the line functions are being performed for the different corporations by the same group of management, unity of use has been shown to exist. The same executive force would not be used for separate corporations if those corporations in fact were conducting separate independent businesses.

The rule sets out that in order to establish any of the unities it is not necessary that all factors as enumerated in both the rule and the law exist. It is sufficient that only some of the factors are shown to exist in order to demonstrate that the particular unity does exist for a group of corporations. Other cases that can be examined regarding the definition of a unitary business are: 1. Associated Dry Goods v. Commissioner of Revenue, Minn. Tax Ct. Docket

No. 2457, November 2, 1982; 2. Chase Brass & Copper Co. v. Franchise Tax Board, 10 Cal. App. 3rd 496 (1970); and 3. Container Corporation of America v. Franchise Tax Board, App. 173 Cal. Rptr. 121 (1981), cert. granted by U.S. Supreme Court on October 6, 1981, argued January 10, 1983.

The fourth sentence of this paragraph contains the test used by the United States Supreme Court in determining the unitary nature of a business. See, Mobil Oil Corporation v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980); Exxon Corporation v. Wisconsin Department of Revenue, 447 U.S. 207 (1980); ASARCO, Inc. v. Idaho State Tax Commission, 103 S.Ct. 3103 (1982); F. W. Woolworth Co. v. Taxation and Revenue Department of the State of New Mexico, 102 S.Ct. 3128 (1982).

The test enunciated by the United States Supreme Court to determine whether a unitary business exists is whether functional integration, centralization of management and economies of scale are present. In Mobil, the United States Supreme Court noted that while separate accounting purports to isolate portions of income received in various states, (it) may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. Mobil, 100 S.Ct., at 1232. See also, Butler Brothers v. McColgan, 315 U.S., at 508-509.

In ASARCO, the United States Supreme Court noted that "The Mobil Court explicated the limiting 'unitary business' principle by observing that geographic accounting, in purporting to isolate income received in various states, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale." ASARCO, S.Ct. at 3109.

The fifth sentence of this paragraph contains examples of functional integration. Examples of functional integration include centralized manufacturing, warehousing, accounting, legal staff, personnel training, financing or centralized, group, or committee purchasing. These examples are generally taken from the United States Supreme Court decision in Woolworth. In Woolworth, the United States Supreme Court looked at the factors of functional integration, centralization of management and economies of scale to determine whether certain subsidiaries were part of Woolworth's unitary business. The Court stated on pages 3135 to 3136 and 3138:

> In Mobil we emphasized, as relevant to the right of a State to tax dividends from foreign subsidiaries, the question whether "contributions to income [of the subsidiaries] result[ed] from functional integration, centralization of management, and economies of scale." 445 U.S., at 438, 100 S.Ct., at 1232. If such "factors of profitability" arising "from the operation of the business as a whole" exist and evidence the operation of a unitary business, a State can gain a justification for its tax consideration of value that has no other connection with that State. Ibid. We turn now to consider the extent, if any, to which these factors exist in this case.
>
> [5] There was little functional integration. Woolworth's subsidiaries engaged exclusively in the business of retailing--the purchase of wholesale goods for resale to final consumers. This type of business differs significantly from the "highly integrated business" of locating, processing, and marketing a resource (such as petroleum) that we previously have found to constitute a unitary business. Exxon, 447 U.S., at 224, 100 S.Ct., at 2120. See also id., at 226, 100 S.Ct., at 2121 (describing "a unitary stream of income, of which the income derived from internal transfers of raw materials from exploration and production to refining is a part"); Mobil, 445 U.S., at 428, 100 S.Ct., at 1227. Consistent with this distinction, the evidence in this case is that no phase of any subsidiary's business was integrated with the parent's. With respect to "who makes the decision for seeing to the merchandise, [store] site selection, advertising and accounting control," the undisputed testimony stated "[e]ach subsidiary performs these functions autonomously and independently of the parent company." App. 12. "Each subsidiary has a complete accounting department and a financial staff." Id., at 14. Each had its own outside counsel. App. to Juris. Statement 34. It further appears that Woolworth engaged in no centralized purchasing, manufacturing, or warehousing of merchandise. The parent had no central personnel training school for its foreign subsidiaries. Id., at 34. And each subsidiary was responsible for obtaining its own financing from sources other than the parent. In sum, the record is persuasive that Woolworth's operations were not functionally integrated with its subsidiaries.
>
> We now consider the extent to which there was centralization of management or achievement of other economies of scale. It appears that each subsidiary operated as a distinct business enterprise at the level of fulltime management. With one possible exception, none of the subsidiaries' officers during the year in question was a current or former employee of the parent.

> App. to Juris. Statement 34. The testimony was that the subsidiaries "figure their operations are independent, autonomous." App. 13. Woolworth did not "rotate or train personnel to operate stores in those countries. There is no exchange of personnel." Ibid. There was no "training program that is central to transmit the Woolworth idea of merchandising[,] such as it may be[,] to the foreign subsidiaries." Id., at 15. The subsidiaries "proceed . . . with their own programs, either formal or informal. They develop their own managers and instruct them in their methods of operation." Ibid.
>
> This management decentralization was reflected in the fact that each subsidiary possessed autonomy to determine its own policies respecting its primary activity--retailing . . . .
>
> We conclude, on the basis of undisputed facts, that the four subsidiaries in question are not a part of a unitary business under the principles articulated in Mobil and Exxon, and today reiterated in ASARCO. Except for the type of occasional oversight--with respect to capital structure, major debt, and dividends--that any parent gives to an investment in a subsidiary, there is little or no integration of the business activities or centralization of the management of these five corporations. Woolworth has proved that its situation differs from that in Exxon, where the corporation's Coordination and Services Management office was found to provide for the asserted unitary business.

The rule demonstrates that functional integration exists where centralized functions are being performed on behalf of all of the corporations in the unitary group by a management group and where said functions would not be performed by the management group if the corporations were in fact conducting separate distinct businesses which were totally unrelated to each other. Centralized management is demonstrated by common officers or directors, exchange of personnel, frequent communication between management of the corporations, or where the parent must approve of major financial decisions. These examples are generally taken from Woolworth. See examples on pages 3137 and 3138. Again, centralized management is demonstrated where a management group is performing functions on behalf of the unitary business which would not be performed if the separate corporations were in fact conducting separate and distinct businesses and were unrelated to each other.

As stated previously, since the determination of a unitary business is mainly a factual determination, it is not necessary that all the examples be shown in

order to establish functional integration or centralized management. Functional integration or centralized management is demonstrated where one or more of the factors listed is shown to exist.

The eighth sentence of this paragraph restates the restriction contained in Minn. Stat. Section 290.34, subd. 2 that combined reporting is limited in scope to domestic unitary groups only. As provided in paragraph A., the term United States includes the District of Columbia, the Commonwealth of Puerto Rico and any other possession of the United States. The rule makes it clear that combined reporting for Minnesota purposes does not mean worldwide reporting.

The ninth sentence of the paragraph provides that the ownership of as much as 100 percent of the stock of another corporation does not in and of itself establish a unitary business. It is essential that an interrelationship which demonstrates a mutual benefit, dependency upon, or contribution to one another be established in order to show that a unitary business exists for Minnesota purposes. Therefore, the mere ownership of the stock of another corporation does not prove unitary absent other indicia of a unitary relationship. This is consistent with the U.S. Supreme Court's decision in Woolworth where Woolworth owned 100 percent of the stock of three of the subsidiaries.

The last sentence in paragraph B. states that if the factors as enumerated in the examples C. through E. are shown to exist then a strong presumption is created that the corporations are conducting a unitary business. Again, it must be noted that not all the factors in the examples must be shown in order to prove a unitary relationship.

C. A horizontal type of business is unitary when the activities of the corporation are basically in the same general line of business and where there is common

ownership, functional integration and economies of scale. This paragraph gives as an example a chain of grocery stores where functional integration, centralized management and economies of scale are demonstrated. The focus of the determination is on the interrelationship between the corporations and on whether each separate corporation is conducting its business in a distinct and separate manner from the other corporations or whether centralized functions are being performed on behalf of all corporations by a management group or an entity on behalf of the whole group of corporations as a unitary business. The origin of the test of functional integration, centralized management and economies of scale was given under paragraph B. with citations to several United States Supreme Court decisions. Common ownership is provided as a minimal criteria in determining a unitary business. Examples of horizontal unitary businesses are contained in Edison California Stores; Western Auto; Butler Brothers; Associated Dry Goods; Valley Markets, Inc. v. Commissioner of Revenue, Minn. Tax Ct. Docket No. 2772, May 7, 1980; and Maurice L. Rothschild & Company v. Commissioner of Taxation, 270 Minn. 245, 133 N.W.2d 524 (1965).

In Edison California Stores, taxpayer was conducting a multistate horizontally integrated retail shoe business from its headquarters in St. Louis. The corporation was comprised of 15 wholly owned subsidiary corporations, each operating in its state of incorporation. The parent provided centralized management, purchasing, advertising, and other centralized administrative functions. The home office determined operating policies for the entire affiliated group and provided the principal accounting work for all subsidiaries. Goods purchased by the central purchasing division were shipped to the various stores operated by the subsidiaries, which were charged with the cost and a portion of the general overhead expenses. Each subsidiary operated solely within the geographical confines of its particular state. The California Tax Commission regarded the entire business, comprising the parent and all the

subsidiaries, as a unitary business. The taxpayer objected on the grounds that the unitary rule did not apply to separate corporate entities. The Court rejected this argument and held that the corporate veil of each corporation could not cloak the existence of an integrated multistate unitary business. In finding a unitary business, the California Supreme Court stated:

> In the present case all the elements of a unitary business are present--unity of ownership, unity of operation by centralized purchasing, management, advertising and accounting, and unity of use, in the centralized executive force and general system of operation. The business of the parent and all of its subsidiaries is owned and managed under one centralized system, to the same extent as in the Butler Brothers case and other cases considered therein. Thus, the business is unitary regardless of the fact that in the Butler Brothers case there was but one corporation involved . . . and that in the present case there is a parent corporation owning and controlling as units of one system 15 different branches organized as corporations . . . . At page 21.

In Western Auto, the Minnesota Supreme Court found that taxpayer was conducting a horizontally integrated unitary business partly within and partly without Minnesota. Western Auto was a Missouri corporation engaged in the retail and wholesale merchandising of automotive parts and accessories on a nationwide basis. During 1947 Western Auto operated 257 retail stores in 30 states. This included eight such stores in Minnesota. All general, executive, and management functions of Western Auto were performed at its home office in Kansas City, Missouri. The centralized purchasing was done by expertly trained personnel whose department was located in Kansas City. All the merchandise sold by Western Auto was purchased from manufacturers and jobbers by the company's central purchasing department and initially shipped from the manufacturing jobbers to warehouses of the taxpayer and from there to company stores, or sold and delivered to the dealer stores. Western Auto, in filing its 1947 Minnesota corporate income tax return, apportioned to Minnesota on the basis of separate accounting. The Commissioner, upon auditing the return for 1947, apportioned Western Auto's income under the statutory three factor formula of property, payroll, and sales. The issue in the case was whether the Commissioner of Taxation was correct in readjusting taxpayer's apportionable income to

Minnesota. The Court stated that the profits that Western Auto realized through centralized purchasing and administration were not created solely by activities in the state of taxpayer's home office or in states where its warehouses were located. It was created by the operation of the entire business unit, through the coordinated and standardized activity of numerous stores throughout the country which made possible the central purchasing, the central management, the warehousing as carried on, and the advertising methods adopted. The Minnesota stores contributed in part to make all this possible, and the multiple formula methods simply allocated a fair share of the profits to Minnesota. Western Auto was found to be a horizontally integrated unitary business.

In Butler Brothers, taxpayer was found to be conducting a unitary business based on horizontal integration and a centralization of management and purchasing. As noted earlier, Butler Brothers was an Illinois corporation engaged in the wholesale dry goods and merchandising business. It operated seven wholesale stores in seven states, including one in California. Each of the seven locations served as a separate territory. Each location had its own sales persons, handled its own collections and credit arrangements, and kept its own accounts. All of the sales in California were handled by a San Francisco office. All purchases made by the San Francisco office came from the company's home office in Chicago. Charges for the goods were made to each location at cost plus transportation expenses. Operating and advertising costs by the central purchasing division were allocated among the several wholesale stores. Although the business as a whole realized a profit, the California operation showed a loss. This loss was computed by the taxpayer using the separate accounting method. California treated Butler Brothers as a unitary business and used a formula to allocate a portion of taxpayer's overall profit to the state. The United States Supreme Court found that Butler Brothers was conducting a unitary business. The critical factor in the court's holding was Butler

Brothers' use of a central purchasing division. This system enabled it to obtain lower prices than would be possible or the individual branches. The Court noted that this mode of operation alone would indicate that the branches' functions were closely integrated. The savings afforded by the lower purchasing prices were reflected in the lower cost to each branch and undoubtedly contributed to the net overall profit of the business. Butler Brothers was functionally integrated and exhibited economies of scale. Butler Brothers was found to be a unitary business.

In Associated Dry Goods, taxpayer was found to be conducting a unitary business by the Minnesota Tax Court. Associated Dry Goods was a Virginia corporation that owned and operated 19 retail store divisions throughout the United States. In Minnesota, it operated a Powers division with seven stores in the Twin Cities metropolitan area. The Commissioner of Revenue considered Associated a unitary business that was horizontally integrated. The Department apportioned Associated's net taxable income to Minnesota by applying a three-factor statutory formula. Associated argued that it should be allowed to report its income to Minnesota on a separate accounting basis. In finding that Associated was conducting a unitary business, the Tax Court in its finding of facts pointed out that Associated's headquarters staff exercised overall control of store operations. There was exchange of key personnel and information within the unitary business. All of Associated's stores were financially interdependent. All borrowing was based on the combined assets of the entire unitary business. Associated's Market Research Division performed research for all of the divisions within the unitary group. Insurance policies were handled centrally by Associated for all the divisions. Associated had a common pension plan. The Minnesota Tax Court held that based on these facts, Associated was conducting a unitary business partly within and partly without Minnesota.

In Valley Markets, the Minnesota Tax Court found taxpayer was conducting a unitary business. Valley Markets was a North Dakota corporation doing business in Minnesota and North Dakota. Valley Market owned and operated a chain of four supermarket food stores. Valley Market argued that it was conducting two separate businesses, one wholly in Minnesota and the other wholly in North Dakota, and that its income from these two businesses should be apportioned by separate accounting. In determining that Valley Market was indeed conducting a unitary business, the Court pointed to the fact that the board of directors and corporate officers exercised centralized management control over the entire corporation. Moreover, there was but one corporate manager exercising centralized control over the ordinary and usual business operations of the entire corporation. Valley Market's centralized management exercised direct business control over numerous areas having to do with all four stores. For example, basic employee policies such as wages, terms of employment, promises of vacation time, were set for the entire corporation by the central management. The payroll was centrally computerized and the board of directors and corporate officers also set up a single profit sharing plan for all four stores, administered by a North Dakota bank. Insurance for all four stores was purchased in one package by central management from a single insurance agent. All expansion decisions were made solely by the board of directors. Finally, accounting and financial statements for the corporation were done by one accounting firm. The Minnesota Tax Court therefore concluded that Valley Markets was a horizontally integrated unitary business which exhibited strong centralized management and economies of scale.

In the Pothschild case, the taxpayer's business consisted entirely of the operation of six retail stores, three in the Twin Cities area and three in the Chicago area, all selling men's, boys', women's and girls' clothing. Its

officers were equally divided in both localities, the president, vice president and treasurer residing in Chicago, and four vice presidents residing in Minnesota. Each store in Rothschild operated to a large extent independently of the other stores. The Minnesota stores had their own purchasing office, their own merchandise managers and buyers, and their own buying office in New York. Separate decisions were made by each store with respect to quantity and type of merchandise to be purchased, although it could not change any brand name carried without the approval of all the officers. Each store maintained its own accounting records and handled its own accounts receivable and payable and had its own bank account. Each store also handled its own employment and personnel matters. However, the Board of Tax Appeals in Rothschild found, and the Supreme Court affirmed, that frequent consultations between the management of the Chicago and Minnesota stores were held concerning fast-moving items and overall policy; that slow-moving merchandise in one store or area would occasionally be shipped to other stores for possible better and faster disposition; that although many lines of merchandise carried in the Chicago stores differed from those carried in the Minnesota stores, the basic lines in men's and women's clothing and in men's shoes were the same; that because of this, price concessions resulted due to volume purchases and there was faster service on reorders and greater advertising allowances by the manufacturer. Based on these facts, the Minnesota Supreme Court found that Pothschild was conducting a unitary business partly within and partly without Minnesota.

D. This paragraph defines a unitary business as one which is vertically integrated and which is engaged in a vertically structured enterprise. Again, the focus is on the interrelationship between the corporations and whether there are any benefits or contributions being made by one or more of the corporations in the unitary group to one or more other corporations in the unitary group. The paragraph demonstrates a flow of goods from the exploration and mining of the copper as a raw material to the smelting, refining and eventual fabrication of

the refined copper into a finished product. The Department relies on the United States Supreme Court decisions in Mobil; Exxon; Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920); and Pass, Ratcliff & Gretton, Ltd. v. State Tax Commission, 266 U.S. 271 (1924) as its authority in demonstrating a vertically integrated unitary business. The paragraph shows a vertically structured enterprise in which the Mobil and Exxon tests of functional integration, centralized management and economies of scale are present.

In Mobil, the United States Supreme Court found that Mobil was engaged in an integrated petroleum business. Mobil was vertically integrated ranging from the exploration for petroleum reserves to the production, refining, transportation, distribution and the eventual sale of petroleum and petroleum products. Mobil's commercial domicile was located in New York at the time the case arose. During the years 1970, 1971, and 1972, Mobil's worldwide operations included $8,544,000.00, $9,176,000.00 and $9,589,000.00 in sales in Vermont; and it filed returns showing $1,082.00, $25.00 and $25.00 in income tax liability. During that period, it received some $739,000,000.00 in dividends from overseas affiliates and from ARAMCO, an American corporation in which it owned a 10 percent interest. Mobil attributed no portion of the dividends to Vermont. It applied the Vermont apportionment formula to only its nondividend income. In two of the years in question, Mobil showed negative nondividend income and paid the minimum $25.00 fee. The Vermont Department of Taxes recalculated Mobil's income by restoring the asserted nonapportionable items to the preapportionment tax base. It determined that Mobil's aggregate tax liability for the three years was $76,418.77, and deficiencies plus interest were assessed accordingly. The Supreme Court stated that the linchpin of apportionability in the field of state taxation is the unitary business principle. 100 S.Ct., at 1232. Mobil did not show, in order to establish that its dividend income was not subject to an apportioned tax in Vermont, that the income was earned in the course of

of activities unrelated to the sale of petroleum products in that state. The Court found that Mobil's foreign activities (the source of the dividend income) was part of Mobil's integrated petroleum enterprise. The dividends reflected profits derived from a functionally integrated enterprise. Vermont was therefore entitled to subject the income to an apportioned tax.

In Exxon, the United States Supreme Court found that Exxon was a vertically integrated petroleum company doing business in several states. The controversy in the Exxon case started in June of 1977 when Exxon (Humble) received a franchise tax assessment for the years 1965-68 in the amount of $316,470.95. Exxon had no exploration, production or refining operations in Wisconsin. Exxon carried on only marketing in the state. Exxon had prepared returns based on accounting methods reflecting only its Wisconsin marketing operation. Exxon used a nationwide uniform credit card system, which was administered out of the national headquarters in Houston. Uniform packaging and brand names were used, and the overall plan for distribution of products was developed in Houston. Wisconsin assessed the taxes on Exxon as a single unitary business and applied its three factor formula excluding only that income from the sale of crude oil and gas at the wellhead to third parties. The Wisconsin Supreme Court held that taxpayer's Wisconsin marketing operations were an integral part of one unitary business and that therefore its total corporate income was subject to the statutory apportionment formula. The Wisconsin Supreme Court concluded that the test for what constituted a unitary business was whether or not the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside the state. Reviewing the organizational structure and business operations' effects, the Court reasoned that Exxon's production and refining functions were dependent upon its marketing operations to provide an outlet for its products, and Wisconsin was part of that marketing system. In a high capital investment industry

such as the petroleum industry, the Court found, the existence of a stable marketing system was important for the full utilization of refining capacity. The U.S. Supreme Court affirmed the Wisconsin Supreme Court's decision. The United States Supreme Court found that Exxon's marketing operation in Wisconsin was an integral part of Exxon's unitary business. The Court stated that the important link among the three main operating departments of appellant was stated most clearly in the testimony of an Exxon senior vice president. This official testified that:

> [I]n any industry which is highly capital intensive, such as the petroleum industry, the fixed operating costs are highly relative to total operating costs, and for this reason the profitability of such an industry is very sensitive and directly related to the full utilization of the capacity of the facilities.
>
> So, in the case of the petroleum industry it is--where you have high capital investments in refineries, the existence of an assured supply of raw materials and crude is important and the assured and stable outlet for products is important, and therefore when there are--when these segments are under a single corporate entity, it provides for some assurance that the risk of disruptions in refining operations are minimized due to supply and demand imbalances that may occur from time to time.
>
> [T]he placing individual segments under one corporate entity does provide greater profits stability for the reason that . . . nonparallel and nonmutual economic factors which may affect one department may be offset by the factors existing in another department. App. 224-225. 100 S.Ct., at 2121.

The Court went on to find that there is indeed a unitary stream of income, of which the income from internal transfers of raw materials from exploration and production to refining was a part. Exxon was conducting a vertically integrated unitary business.

E. A unitary business may be established by showing that strong centralized management exists among the individual separate corporations and that strong centralized management is dictating the major policies of each corporation respecting its primary business activities. As the rule states, strong centralized management is evidenced by such functions as financing, advertising, research, or purchasing. The focus of the determination is on the interrelationship between the separate corporations to determine whether strong centralized management exists which is dictating the major business decisions and

activities of the separate corporations and which said corporations would not be subject to if they were in fact conducting separate distinct businesses independent of any outside control. Strong centralized management cannot be shown by simply showing that the requisite ownership percentage exists. As stated earlier, mere ownership alone is not sufficient to prove a unitary business. Other indicia of a unitary business must be demonstrated before a unitary business can be found to exist, such as strong centralized management. Strong centralized management is not shown where a mere incidental economic benefit accrues to a group of corporations because such ownership improves its financial position alone. As the example sets out, strong centralized management authority must be exercised in order for a unitary business to exist based on strong centralized management alone. See, Exxon; Mobil; ASARCO; Woolworth; Container Corporation of America v. Franchise Tax Board, 173 Cal. Rptr. 121 (1981); Associated Dry Goods; Butler Brothers.

In Exxon on pages 2120 and 2121, the United States Supreme Court emphasized the importance of centralized management when it stated:

> We agree with the Wisconsin Supreme Court that Exxon is such a unitary business and that Exxon has not carried its burden of showing that its functional departments are "discrete business enterprises" whose income is beyond the apportionment statute of the State. While Exxon may treat its operational departments as independent profit centers, it is nonetheless true that this case involves a highly integrated business which benefits from an umbrella of centralized management and controlled interaction.
>
> As has already been noted, Exxon's Coordination and Service Management provided many essential corporate services for the entire company, including the coordination of the refining and other operational functions "to obtain an optimum short range operating program." App. 189. Many of the items sold by appellant in Wisconsin were obtained through a centralized purchasing office in Houston whose obvious purpose was to increase overall corporate profits through bulk purchases and efficient allocation of supplies among retailers. Cf. Butler Brothers v. McColgan, 315 U.S., at 508, 62 S.Ct. at 705 ("the operation of the central buying division alone demonstrates that functionally the various branches are closely integrated").

The concept of centralized management was discussed in greater detail by the United States Supreme Court in Woolworth at pages 3135 through 3137 where it stated:

> In Mobil we emphasized, as relevant to the right of a State to tax dividends from foreign subsidiaries, the question whether "contributions to income [of the subsidiaries] result[ed] from functional integration, centralization of management, and economies of scale." 445 U.S., at 438. If such "factors of profitability" arising "from the operation of the business as a whole" exist and evidence the operation of a unitary business, a State can gain a justification for its tax consideration of value that has no other connection with that State. Ibid. We turn now to consider the extent, if any, to which these factors exist in this case . . . .
>
> We now consider the extent to which there was centralization of management or achievement of other economies of scale. It appears that each subsidiary operated as a distinct business enterprise at the level of fulltime management. With one possible exception, none of the subsidiaries' officers during the year in question was a current or former employee of the parent. App. to Juris. Statement 34. The testimony was that the subsidiaries "figure their operations are independent, autonomous." App. 13. Woolworth did not "rotate or train personnel to operate stores in those countries. There is no exchange of personnel." Ibid. There was no "training program that is central to transmit the Woolworth idea of merchandising[,] such as it may be[,] to the foreign subsidiaries." Id., at 15. The subsidiaries "proceed . . . with their own programs, either formal or informal. They develop their own managers and instruct them in their methods of operation." Ibid.
>
> This management decentralization was reflected in the fact that each subsidiary possessed autonomy to determine its own policies respecting its primary activity--retailing . . . .
>
> Importantly, the Department's hearing officer found that Woolworth had "no department or section, as such, devoted to overseeing the foreign subsidiary operations." App. to Juris. Statement 34. Neither the parent corporation nor any of the subsidiaries consolidates its tax return with any of the other companies. App. 37-38. The tax manager for Woolworth stated that he did not review the subsidiaries' tax returns or consult with them on decisions affecting taxes. Id., at 14. There was no "policy of the parent that all of the managers of all the operations get together periodically to discuss the overall Woolworth operations." Id., at 35.

The Court concluded that based on the undisputed facts, that the four subsidiaries in question were not part of Woolworth's unitary business. The Court on page 3138 distinguished Woolworth and Exxon and stated that:

> Woolworth has proved that its situation differs from that in Exxon, where the corporation's Coordination and Services Management office was found to provide for the asserted unitary business

> "long-range planning for the company, maximization of overall company operations, development of financial policy and procedures, financing of corporate activities, maintenance of the accounting system, legal advice, public relations, purchase and sale of raw crude oil and raw materials, and coordination between the refining and other operating functions so as to obtain an optimum short range operating program." 447 U.S., at 207.
>
> In this case the parent company's operations are not interrelated with those of its subsidiaries so that one's "stable" operation is important to the other's "full utilization" of capacity. 447 U.S., at 218. See also id., at 225. The Woolworth parent did not provide "many essential corporate services" for the subsidiaries, and there was no "centralized purchasing office . . . whose obvious purpose was to increase overall corporate profits through bulk purchases and efficient allocation of supplies among retailers." Id., at 224.

Woolworth demonstrated that strong centralized management was not present. Woolworth was able to demonstrate that it did not exert an active centralized management over the four subsidiaries. Woolworth was therefore found not to be conducting a unitary business with its four subsidiaries.

In ASARCO, the United States Supreme Court found that ASARCO did have a potential to control the subsidiaries. However, the Court found that ASARCO had not asserted its control over the subsidiaries. Strong centralized management was not present.

In Container, the California Court of Appeals found taxpayer to be conducting a unitary business based in part on strong centralized management. Container Corporation was a Delaware corporation headquartered in Chicago and engaged in the production and distribution of paperboard packaging materials. Container Corporation was subject to corporate franchise taxes on its activities in California. Container Corporation argued that its California and out-of-state operations did not compromise a unitary enterprise to which the Franchise Tax Board could properly apply its formula for apportionment of income. The Court of appeals found that Container Corporation was indeed a unitary business and

allowed the Franchise Tax Board to apply its apportionment formula to Container Corporation's total income in order to establish tax liability. The Court stated that there was unity of ownership since the parent corporation owned the subsidiaries. Unity of operation was established based on the intercorporate loans. Finally, the Court found unity of use based on centralized management and technical assistance. Significantly, the Court went on to state that the flow of goods is only a factor and is not in and of itself determinative in finding a unitary business. The Court stated:

> Because a substantial flow of goods between the parent and its subsidiaries is not requisite to unitary status, the operational interrelationship of the corporate entities must be evaluated. The integration of major executive functions is a factor of great importance pointing toward unity. (See Chase Brass & Copper Co. v. Franchise Tax Bd., supra, 10 Cal.App.3d 496, 504, 95 Cal.Rptr. 805.) Although the everyday operations of the subsidiaries were handled by local employees, major policy decisions of the subsidiaries were subject to review by appellant. "The 'major policy matters' are what count in our estimation of integration." (Chase Brass & Copper Co. v. Franchise Bd., supra, 10 Cal.App.3d 496, 504, 95 Cal.Rptr. 805.) High officials of appellant gave directions to subsidiaries for compliance with the parent's standard of professionalism, profitability and ethical practices. Appellant constantly reviewed the financial reports of its subsidiaries; if those reports had not given sufficient information of a subsidiary's condition, appellant would have intervened. The submission of financial reports on a monthly basis from the subsidiary to the parent corporation is of some significance. (See Standard Register Co. v. Franchise Tax Board, supra, 259 Cal.App.2d 125, 136, 66 Cal.Rptr. 803.) Appellant's officials served on boards of directors of most of the subsidiaries. Thus, control on the highest level was exerted by appellant. Appellant also employed a "foreign operations staff" to oversee the subsidiaries, to prepare studies regarding the subsidiaries' activities and to give directions to the management of the subsidiaries.
>
> Appellant's policy of regional decentralization was followed by the subsidiaries. The parent corporation was involved with the training of local nationals for management positions. Appellant provided important personnel, equipment and financing to assist its first foreign subsidiary to enter the paperboard packaging industry. Such assistance in the initial stages of operation was crucial to the success of the subsidiary. Appellant continued to provide technical assistance to its subsidiaries. The subsidiaries had ready access to appellant's expertise. The subsidiaries were only charged costs and an apportionment of overhead; in some cases the charges were not recovered. The extent of the technical assistance provided by appellant was substantial; it included design work, sample packaging, marketing research, formula methods used in packaging and cost accounting. Appellant did not provide extensive technical service to any nonaffiliated corporations. The subsidiaries were prohibited from transferring information received from appellant to third parties. 173 Cal.Rptr. at 127-128.

Container was therefore found to be conducting a unitary business with its subsidiaries based on strong centralized management.

Finally, in Chase Brass the Court placed considerable significance on the centralized executive force of the parent to determine that the parent and its subsidiary corporations conducted a unitary business.

> The integration of executive forces is an element of exceeding importance. It is top level management which is credited (or, in the case of failure or indifferent results, debited) with the effects of corporate enterprises. Chief executives of large organizations are regarded as highly prized acquisitions. They are induced to join a corporation, or to remain with it, and to exert their best efforts, not only by generous salaries, but also in many cases by incentive plans of various kinds. For a subsidiary corporation to have the assistance and direction of high executive authority of such a corporation as Kennecott is an invaluable resource. The stipulation of facts reads: "The day to day operations of the subsidiaries were the concern of the executives of the subsidiaries and were handled by various subordinate employees of the subsidiaries. The Board of Directors of Kennecott was primarily interested in, and devoted the majority of its time to, the larger problems facing the copper industry in general, including the development and maintenance of its fabricating subsidiaries. The President of Kennecott was concerned with basic problems and policies of the subsidiaries. The executives of the subsidiaries reported to the President of Kennecott with respect to major policy matters." The "major policy matters" are what count in our estimation of integration. Day to day operations are made at various levels by many executives in any organization. They are made, no doubt, by a multitude of officials of Kennecott and its subsidiaries. Major policy is another thing. This was the main concern of Kennecott. 10 Cal.App.3d, at 504.

A group of companies which are engaged in separate operations but which are functionally integrated and where strong centralized management is exercised regarding its primary business functions are part of a unitary business. See, Dexter, The Unitary Concept in State Taxation of Multistate-Multinational Businesses, 10 Urb. Law. 191 (1978).

F. The 50 percent ownership test is set out in Minn. Stat. Section 290.17, subd. 2, clause (4), 2nd paragraph. Under the statute, the test to determine a unitary business is the "mutual benefit, dependent upon, or contributory to" test. In order to clarify this test, the rule does include a common ownership threshold before the test applies. This rule charifies that threshold.

The statute also provides that a unitary business will be presumed if the unity of ownership, operation and use are present. The unity of ownership is then defined. The statute needs to be clarified by this rule to provide for indirect ownership. Clearly the statute must be read to find the unity of ownership present when the corporate parent owns 100 percent of the stock of the first tier subsidiary, which in turn owns 100 percent of the stock of the second tier subsidiary.

The three unities test cannot be read to be more restrictive than the statutory test. The three unities test is merely a statutory example of a unitary business. The rule states that there must be two or more corporations involved in order to find a unitary business. In determining a common owner, the Department will look not only at direct ownership but also constructive ownership of voting stock to determine who has effective control of the corporation. The 50 percent ownership test focuses on who has effective control of the enterprise. The test is applied by the Department to pierce through mere form or appearances and ascertain who, in substance, has ownership and therefore control. The definition of common ownership is intended to circumvent any attempt at changing the nature of a taxpayer or taxpayer's form in order to avoid the application of the unitary tax treatment to a group of corporations where common ownership does exist. Therefore, the Department will look at the stock ownership by a corporate taxpayer, the stock ownership by partnerships and individuals, the relationship between the taxpayers and whether any constructive ownership exists so as to establish common ownership for purposes of implementing the unitary business concept and combined reporting. For this reason the Department will look at the total ownership structure. It should be noted that the indirect ownership test is the same as that used by the Internal Revenue Code to determine related parties.

Example 1. sets out the situation where common ownership is shown to exist between all four corporations through effective control based on ownership. Indirect and constructive ownership exist for the entire group. Corporation P directly owns 51 percent of the voting stock of Corporation R1 only. Corporation P does not directly own any of the stock of either Corporation R2 or R3. However, Corporation R1 directly owns 51 percent of the voting stock of both Corporations R2 and R3. Common ownership exists because P1 controls R2 and P3, and P controls R1.

Example 2. demonstrates that there must be over 50 percent ownership in order to establish sufficient ownership and implement the unitary business and combined reporting requirements. Common ownership exists between Coprporation P and Corporation R1. Common ownership also exists between Corporation R2 and Corporation R3. Common ownership does not exist between Corporation R1 and Corporation R2 since Corporation R1 owns only 49 percent of Corporation R2. Since R1 does not have control over R2, the rule states that there is no common ownership between Group A and Group B.

C. The first example sets out a unitary business which is vertically integrated. The four subsidiaries and parent in the example are all highly interrelated from the research and drilling for oil to the transport, refining and selling of the finished product. Flow of goods is established within the unitary group. Selling corporation owns 51 percent of the outstanding voting stock in each of the four subsidiaries. Common ownership is established. The parent corporation and four subsidiaries are conducting a unitary business.

In Exxon, which has previously been discussed, the Court found that there was in fact a flow of goods. Exxon was found to be a vertically integrated unitary business from its exploration, drilling, research and production functions to its refining, storage, transportation and sale to the ultimate consumer. The

benefits from this vertical integration to Exxon were substantial and have been previously discussed.

Example 2. demonstrates a unitary business which is horizontally integrated. Corporation A is in the primary business of operating multiline department stores. The other subsidiaries, B and C, operate retail department stores in other areas of the country. Subsidiary D provides the financing in order to facilitate the sale of the goods by the parent and two subsidiary corporations. Corporation E acts as the purchasing agent for Corporations A, B and C and maintains the warehouses for these corporations' inventories. Corporation A is providing the management and maintains the overall control in determining the primary business policies respecting the primary business activities of the other corporations. All five corporations are of mutual benefit, dependent upon and contributory to each other. Common ownership has been established. The corporations are engaged in a horizontally integrated business. The corporations are conducting a unitary business. See, generally, Edison California Stores; Western Auto; Butler Brothers; Associated Dry Goods; Valley Markets; Rothschild. The example sets out that centralized purchasing was done on behalf of the unitary group. See, Edison California Stores; Western Auto; Butler Brothers. Centralized management regarding the primary business activities of the unitary group is set out in the example. See, Woolworth; Edison California Stores; Western Auto; Associated Dry Goods; Valley Markets; Rothschild. All corporations in the example are engaged in the retail business or in supportive functions to the retail business. See, Edison California Stores; Western Auto; Butler Brothers; Associated Dry Goods; Valley Markets; Rothschild.

Example 3. demonstrates a unitary business which has strong centralized management. As noted in example 3., there is no significant flow of goods between any of the corporations. Furthermore, each of the individual corporations are

autonomous as to their daily operations. The example includes corporations which are engaged in the manufacturing and sale of canned goods, the operations of a chain of department stores, the manufacture and sale of household goods, and the development and marketing of computer software and programs. However, the subsidiaries do not operate as distinct and discrete business enterprises. See, Mobil. Corporation E is involved not only in the major policy determinations but in the approval of annual budgets, approval of capital expenditures, approval of financing arrangements, preparation of tax matters, performing of centralized warehousing and accounting functions for the subsidiaries. Corporation E and its subsidiaries form a diverse and multifaceted corporate conglomerate. The exercise of strong centralized management as enumerated in the example establishes a unitary business. See, Woolworth; ASARCO; Mobil; Container; Superior Oil Company v. Franchise Tax Board, 386 P.2d 33 (1963); Honolulu Oil Corporation v. Franchise Tax Board, 386 P.2d 40 (1963).

The presence of strong centralized management has already been discussed in Woolworth, ASARCO, Container, Exxon, and Chase Brass. As Woolworth points out, the central inquiry is whether there is centralized control of the primary business activities of the unitary group. If centralized control exists, then the corporations are conducting a unitary business.

Please note that the preparation of tax matters was specifically mentioned in Woolworth. The Department wishes to point out that it will not bootstrap a taxpayer into unitary by demanding a unitary combined return and then use the return as an element in proving that taxpayer is conducting a unitary business. The Department will therefore only look at the preparation of the federal return as an element in proving or disproving unitary.

Two additional cases which have not been discussed which show strong centralized management are Superior Oil and Honolulu Oil. Superior Oil was not a vertically integrated oil company, as it did not engage in refining and processing. It engaged only in producing and selling petroleum and petroleum products in California and seven other states. Typically, Superior Oil sold its crude petroleum at the well site to other companies. All of its California crude oil was sold within the state and all of its crude oil produced outside the state was sold outside of California. Its executive office was in Los Angeles, which handled accounting, insurance, and the purchasing of equipment for the entire enterprise. Personnel were moved frequently throughout the several states where Superior Oil operated. Superior sought unitary business treatment in order to apply losses incurred in Arkansas and Louisiana to offset its California income. California, on the other hand, wanted to tax Superior as a separate business. The court rejected the state's position and found that Superior was a unitary business. The court's decision was based on the centralized performance of certain supporting functions by Superior's executive office, and its contribution to out-of-state business. The court declared on page 39 that:

> It is only through a multitude of individual operations which precede and make possible the outflow of petroleum at a producing well that Superior is able to obtain possession of a product which it can market. While the actual recovery and sale of the crude oil are, perhaps, local activities, nevertheless very extensive interstate transactions are involved in the other individual operations which make such production possible. The evidence here reveals that such essential factors as land acquisition, exploration, technology, testing, availability of equipment and personnel, financing, and many others are definitely interstate in character. It must also be considered that each producing well in a particular state is the end product of interstate activities which may involve many other unproductive wells in many other states. Superior's products are thus acquired for the local market only as a result of interstate transactions . . . .

The factual situation in Honolulu Oil is substantially the same as in Superior Oil. The issue before the court was whether Honolulu Oil's business was unitary in nature entitling it to report its California income by the employment of an allocation formula. The court quoted Butler Brothers which held that the unitary nature of a business was definitely established by the presence of the

following factors: 1. unity of ownership, 2. unity of operation as evidenced by central purchasing, advertising, accounting and management division, and 3. unity of use in its centralized executive force and general system of operation. The court in Honolulu Oil felt that unity of ownership and unity of use were manifestly present in the case. Also, unity of operation which the California Franchise Tax Board apparently directed its contentions against appeared to be also satisfied. As stated, unity of operation is evidenced by central purchasing, advertising, accounting and management, all of which except for advertising appears as a matter of record to have been centrally controlled in the instant case. The court stated that exploration and development are not an end in and of themselves, but are only the forerunners of production and processing in Honolulu's scheme to create revenue. The court went on to find that where the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state, the operations are unitary. See, Edison Stores. Both Superior Oil and Honolulu Oil were found to be unitary based on strong centralized management.

13 MCAR Section 1.6502 - Intercompany Transfers Within the Unitary Business.

Statement of Need and Reasonableness

The authority for this rule is contained in Minn. Stat. Section 290.34, subd. 2. Minn. Stat. Section 290.34, subd. 2 states in relevant part that "All intercompany transactions between companies which are contained in a combined report shall be eliminated." The rule sets out that intercompany transactions which are eliminated include income, loss, expense or deduction items and items used to compute the apportionment factors.

The elimination of intercompany transactions within a unitary business is both reasonable and necessary for the following reasons:

1. Intercompany eliminations are necessary in order to eliminate double counting. An example is the taxation of the operating income of a subsidiary on the combined report and then the taxation of the dividend income received by the parent corporation. In ASARCO, the United States Supreme Court approved at page 3107 this elimination of the intercompany transaction. Double counting must be eliminated to prevent a distortion of the factors and income reportable to Minnesota.
2. By eliminating intercompany transactions, a unitary business is treated as one corporation conducting its business activities both within and without the State of Minnesota. This is in conformity with the basic concept behind unitary tax treatment and combined reporting of multicorporate and multinational corporations. The tax consequences for a multicorporate or multinational corporation should be the same as they are for one corporation where both conduct business both within and without the State of Minnesota. By eliminating intercompany transactions, this equality is achieved.

3. By eliminating intercompany transactions, a multicorporate enterprise cannot distort the amount of its activities, both within and without the State of Minnesota. The distortion becomes especially important when attempting to determine both the amount of taxable income of that entity to Minnesota and the factors used in apportioning income of the entity between Minnesota and the other states.

4. The elimination of intercompany transactions, as required by Minnesota, would be uniform with other states which impose combined reporting under the unitary business concept. Therefore, a company in determining its proportionate share of taxable income to Minnesota would be following the same rules as in other states. The Department has adopted this procedure which is similar to that used by Illinois. See, Illinois Regulation Section 304-1(F)(4), Illinois CCH State Tax Rptr., Vol. 1, p. 1327. It is therefore extremely important to remove intercompany transactions which would distort the amount of income reportable by the unitary group or which would distort the factors used to apportion the income among the members of the unitary group. This is consistent in allowing the unitary business to be treated as one entity. The purpose of eliminating intercompany transactions is to see the unitary business entity as one whole. Therefore, intercompany transactions cannot be allowed since it would allow a unitary business to generate artificial expenses and sales. These expenses and sales would prevent seeing the total unitary entity as one.

Finally, the Minnesota legislature has recognized the importance of eliminating intercompany transactions. Originally the law was changed by the Minnesota Legislature, 1981 Laws, Third Special Session, Chapter 2, Article 3, Section 14 to eliminate intercompany dividends only within a unitary business. The law was later changed by the Minnesota Legislature, 1982 Laws, Chapter 523, Article 20, Section 4 to state that all intercompany transactions between companies

which are contained on the combined report shall be eliminated. All intercompany transactions must therefore be eliminated. The only exception, as provided in the rule, is where a corporation can demonstrate an unusual situation and where it can demonstrate that, in fact, no distortion of income results. For purposes of reporting income or deduction items, if a taxpayer has filed a federal consolidated return and totaled the items, the Department could accept the combined return without the elimination of intercompany transactions. This exception is contingent on taxpayer having the same companies included on both its federal consolidated return and its combined report. It is also contingent on taxpayer showing the Department that no distortion would result by allowing taxpayer to file in this manner. The Department will allow taxpayer to file under this exception in order to ease taxpayer's burden in reporting to Minnesota. However, for purposes of determining the factors, in all cases, all intercompany transactions must be eliminated. This is necessary since the factors, especially the sales factor, can be easily inflated by intercompany transactions. Since the unitary business is seen as one unit, for purposes of the factors, all intercompany transactions must be eliminated to prevent distortions.

13 MCAR Section 1.6503 - Unitary Business, Reporting.

Statement of Need and Reasonableness

A. The first sentence in this paragraph allows a 100 percent Minnesota unitary business to file a combined report for each corporation. The authority for paragraph A. of this rule is contained in Minn. Stat. 290.17, subd. 2(4). Minn. Stat. 290.17, subd. 2(4) states in relevant part that "If the trade or business carried on wholly or partly in Minnesota is part of a unitary business, the entire income of that unitary business shall be subject to apportionment under Section 290.19." It is the Department's position that based on this authority, a 100 percent Minnesota corporation would be allowed to file a combined report. This provision is reasonable for the following reasons:

1. It is the Department's position that all corporations which are part of a unitary business shall be treated equally. Therefore, no distinction should be made between a unitary business which conducts its business both within and without Minnesota and a unitary business which conducts 100 percent of its business within Minnesota.
2. The provision is inserted so that a unitary business which is conducting 100 percent of its business within Minnesota is not penalized because of different reporting methods, for conducting all of its business within Minnesota.
3. The Department does not want to encourage a unitary business which is conducting 100 percent of its business in Minnesota to begin to transact business outside the state merely to qualify for combined reporting.

The second sentence states that should the Minnesota corporation elect to file a combined report that it must use the equally weighted arithmetic average of the factors. The authority for this provision is contained in Minn. Stat. Sections 290.17, subd. 2(3) and 290.19, subd. 3. Minn. Stat. Section 290.17, subd. 2(3) states that:

> Income derived from carrying on a trade or business, including in the case of a business owned by natural persons the income imputable to the owner for his services and the use of his property therein, shall be assigned to this state if the trade or business is conducted wholly within this state, and to other states if conducted wholly without this state.

Minn. Stat. Section 290.19, subd. 3 states that "Nothing in this section shall prevent the application of Sections 290.17 and 290.18 to that portion of a taxpayer's income which is not from a trade or business carried on partly within and partly without this state." The use of the equally weighted arithmetic average is reasonable as a familiar means of dividing up corporate income. To do otherwise would be doing a consolidated return which is not permitted under Minn. Stat. Section 290.34, subds. 2 and 3. This provision is necessary so that a distortion does not take place in allowing a Minnesota unitary business to elect either the arithmetic or weighted averages among the individual members of the unitary group. Under certain circumstances, a distortion of income can occur resulting in the underreporting of taxable income to Minnesota even though all the income was earned in Minnesota. This provision corrects this distortion by requiring all corporations within the unitary business which conducts 100 percent of its business within Minnesota to use the arithmetic average in reporting its income to Minnesota.

The third sentence in the paragraph entitles each member of the unitary group to have its first $25,000 of income taxed at the lower tax rate. The authority for this provision is contained in Minn. Stat. Section 290.06, subd. 1. The provision is reasonable since it treats all corporations equally, regardless of whether a corporation is part of a unitary business. No corporation is excluded from this provision based on its unitary or non-unitary status. The Department feels this provision is mandatory based on Minn. Stat. Section 290.06, subd. 1.

The last sentence in this paragraph states that banks and bank holding companies are subject to all the provisions contained in paragraph A. The authority for this provision is contained in Minn. Stat. Section 290.34, subd. 2 which specifically excludes insurance companies from combined reporting. All other companies which are not specifically excluded are thereby included for combined reporting. Minn. Stat. Section 290.17, subd. 2(4) is therefore applicable to banks and bank holding companies. This provision is reasonable in that it subjects banks and bank holding companies to the same requirements as all other companies which are part of a unitary business and are subject to Minn. Stat. Section 290.17, subd. 2. All companies are treated equally under combined reporting. It is the Department's position that banks and bank holding companies are subject to the provisions of a unitary business under Minn. Stat. Section 290.17, subd. 2(4) and that they are required to file using the combined income approach.

B. Every corporation that is part of a unitary business and has nexus with Minnesota is required to file a combined report. The authority for this statement is found in Minn. Stat. Section 290.17, subd. 2(4). This provision of the rule implements the Commissioner's authority to require combined reporting under Minn. Stat. Section 290.34, subd. 2. Minn. Stat. Section 290.17, subd. 2(4) states in relevant part that "If the trade or business carried on wholly or partly in Minnesota is part of a unitary business, the entire income of that unitary business shall be subject to apportionment under Section 290.19."

Minn. Stat. Section 290.17, subd. 2(4) states that "when a trade or business is carried on partly within and partly without this state, the entire income derived from such trade or business . . . shall be governed, except as otherwise provided in Sections 290.35 and 290.36 by the provisions of Section 290.19 notwithstanding any provisions of this section to the contrary." Minn. Stat.

Sections 290.35 and 290.36 provide that insurance companies and investment companies are to be taxed by Minnesota based on a single factor formula. Insurance companies are specifically exempted from the combined reporting requirements under Minn. Stat. Section 290.34, subd. 2. Since investment companies allocate income by use of a single factor and not the normal corporate three factor formula, it is reasonable to treat investment companies like insurance companies. These companies are therefore excluded from unitary tax treatment and the combined income approach. It is the Department's position that because of the unique character of these corporations the unitary tax treatment and combined reporting requirements would not accurately reflect these corporations' taxable income to Minnesota.

C. The first sentence in paragraph C. states that farm income is specifically excluded from combined reporting. The authority for this provision and paragraph is found in Minn. Stat. Section 290.17, subd. 2, clause (4), first paragraph, and the law change made by the Minnesota Legislature in Laws 1981, Third Special Session, Chapter 2, Article 3, Section 13. Minn. Stat. Section 290.17, subd. 2(2) states that "the income from the operation of a farm shall be assigned to this state if the farm is located within this state and to other states only if the farm is not located in this state." Minn. Stat. Section 290.17, subd. 2(4) goes on to state that the specific clause is not applicable to income from the operation of a farm.

The second sentence sets out that to the extent a farm is part of a unitary business, that unitary business must exclude the farm income when figuring its combined income or loss under the combined income approach. In a situation where the Minnesota farm as part of a unitary business makes sales to another member of the unitary business outside the state, that sale must be treated as if made at fair market value. This is necessary so that transactions between the unitary business and the farm business stay separate and distinct for

purposes of reporting income and loss to Minnesota. Farm income is to be reported on a separate accounting basis. Minnesota law specifically sets out that the unitary tax treatment is not applicable to farming. In order to assure full accountability, the income and operations of the farm must remain separate from the unitary business. Therefore, any sales between the farm and the unitary business where the farm is part of that unitary business must be treated as being made at fair market value to prevent any distortions of income and to insure full accountability of the farm income to Minnesota. The last sentence in paragraph C. allows expenses connected with a farm to be taken under separate accounting. This provision is consistent with the provision of Minn. Stat. Section 290.17, subd. 2(2) and the other provisions in this paragraph since it allows a corporation to report income and expense items using a uniform method which adequately reflects taxpayer's farming operations.

D. This paragraph allows each corporation having nexus with Minnesota and which is part of a unitary business to subtract its charitable deduction from its apportioned unitary income. The authority for this paragraph is contained in Minn. Stat. Section 290.21, subd. 3 which allows corporations a deduction for charitable contributions. Each separate corporation will be allowed to subtract from that corporation's apportioned income based on the combined income approach its charitable deduction. In order to utilize the charitable contribution deduction, the corporation itself must have nexus with the State of Minnesota. It is not sufficient that nexus is established for the corporation based on the unitary concept. Sufficient contact must be present for each separate corporation with the State of Minnesota in order for the corporation to use the charitable contribution deduction. The corporation's charitable contribution deduction is computed in the following manner: all charitable contributions made by the separate entity are allowable as deductions on that corporation's Minnesota income tax return. Furthermore, the rules provide that a percentage of the charitable contributions made by the unitary group after deducting

contributions made by the separate corporation are also allowable based on the ratio of taxable net income of the individual corporation to the total net income of the unitary group. The authority for this allocation is contained in Minn. Stat. Section 290.21, subd. 3(d). Therefore, each separate corporation which has nexus with Minnesota would be allowed to deduct in full its contributions made within Minnesota. In addition, for corporations which are part of a unitary group, a charitable contribution deduction is allowed based on the ratio of Minnesota's taxable net income of that particular corporation to the total net income of the entire unitary group. This ratio computation is used only after all contributions made by the separate corporate entity to Minnesota are first deducted. In this way, the law maximizes the advantage to any corporation which desires to make charitable contributions within the State of Minnesota. This provision is reasonable for the following reasons:

1. The provision allows each separate corporation having nexus with Minnesota to deduct its Minnesota charitable contributions in full. In certain situations, a corporation having nexus with Minnesota which is part of a unitary business might not be allowed to take its full deduction for charitable contributions made within Minnesota. This provision prevents a corporation having nexus with Minnesota which is part of a unitary business from being penalized.
2. The provision treats equitably both separate corporate taxpayers and corporations which are part of a unitary business.

E. This paragraph sets out Minnesota's treatment of credits. Basically, the rule states that any refundable or nonrefundable credits which are allowed under Minnesota law must be taken by the corporation based on that individual corporation's expenditures within the state. The separate corporation claiming the credits must have established a nexus with the state for the taxable year based on its own activities within the state. It is not sufficient that nexus has been established for the unitary group of which the separate corporation is a

member. The separate corporation must in and of itself have sufficient contacts with the State of Minnesota in order to establish nexus for purposes of claiming any credits on the Minnesota tax return. The nonrefundable credits are granted as a matter of legislative grace to corporations based on that corporation's activities within the state. These nonrefundable credits are designed to encourage expenditures by corporations in specified areas in Minnesota. Minnesota credits include Minnesota Statute Sections:

290.06, subd. 9 - Pollution Control Credit

290.06, subd. 9a - Feedlot Pollution Control Credit

290.06, subd. 14(c) - Energy Credit

290.068 - Research Credit

290.06, subd. 13 - Gas Tax Credit

290.936 - Estimated Tax Credit

The first four credits are nonrefundable while the last two credits are refundable.

These laws provide that these credits belong only to a corporation that makes payments or incurs expenses. There is no authority for a consolidated return in which all expenses or payments would be consolidated. The combined report is only a method of reporting income. Credit amounts aren't combined. Minn. Stat. Section 290.34, subd. 2 provides only for combining income. That also is the only effect of Minn. Stat. Section 290.17, subd. 2(4). The rule is reasonable for the following reasons:

1. Credits taken by a corporation which is a member of a unitary business are based only on that corporation's expenditures which create the credits. This treatment is uniform with the treatment afforded corporations which have nexus with Minnesota and which are not a part of a unitary business.
2. Where a corporation having nexus with Minnesota is part of a unitary business, it is allowed to take its Minnesota credit against its proportionate income from the entire unitary business.

F. This paragraph sets out Minnesota's position regarding the computation of a corporation's minimum tax under Minn. Stat. Section 290.091. For purposes of determining a corporation's minimum tax to Minnesota where the corporation is a member of a unitary group, said corporation must determine its tax liability by using 40 percent of the federal minimum tax liability as computed on its federal return. The separate computation of the minimum tax is consistent with the computations of the credits. However, where a consolidated federal return was filed, the minimum tax must be based on the consolidated return where the same corporations are on the federal consolidated return as appear on the combined report. The reason for this special treatment is that this is the method used for federal purposes and it is consistent with the method of reporting to Minnesota. This is seen as a convenience to the taxpayer. The minimum tax liability for said corporation is then multiplied by the statutory ratio, the numerator of which is the taxpayer's preference item income allocated to Minnesota and the denominator of which is the taxpayer's total preference items for federal purposes. The authority for this provision is contained in Minn. Stat. Section 290.091 which imposes a Minnesota minimum tax of forty percent (40%) of a taxpayer's federal minimum tax with certain modifications. A separate corporation which is part of a unitary group and which has a nexus with Minnesota computes its minimum tax based on its proportionate tax preference income to the tax preference income of the entire unitary group.

G. Paragraph G. relates to the acquisition by a unitary business of another corporation. The paragraph sets out when the newly acquired corporation must be included in the unitary business's combined report. The inclusion of the newly acquired corporation in the unitary business is necessary in order for the unitary business to accurately reflect both its taxable income and business operations to Minnesota. The authority for this provision is contained in Minn. Stat. Section 290.17, subd. 2(4). Minn. Stat. Section 290.17, subd. 2(4) states in relevant part that "If the trade or business carried on wholly or

partly in Minnesota is part of a unitary business, the entire income of that unitary business shall be subject to apportionment . . . ." Taxpayer is allowed to exclude a new corporation in its combined report until the first taxable year of the acquiring corporation which begins after the date of acquisition. This provision is proposed in order to allow sufficient time to make the necessary adjustments to assimilate the newly acquired corporation into the unitary business and in order to allow for the necessary changeover of internal procedures, both functional and staff, within the unitary business group. As has been stated earlier in the rule, mere ownership alone is not sufficient to demonstrate a unitary business. Additional factors must be found to establish that a unitary business does exist between the original unitary business and the newly acquired corporation. Whether the factors demonstrate vertical integration, horizontal integration, or strong centralized management, such additional factors must be found to establish that a unitary business exists. It would, therefore, not be possible to classify a newly acquired corporation as part of a unitary business until sufficient time has elapsed in order to demonstrate that such additional factors do indeed exist. It is the Department's position, therefore, that taxpayer should not be required to immediately include the newly acquired corporation on the combined return of the unitary business. However, this exception does not apply to a corporation created from a part of the previous unitary business. The reason is that this business was part of the unitary group originally. Therefore, the unitary attributes are already established.

H. The unitary business concept and combined income approach is applicable to banks and bank holding companies. The statutory authority for their inclusion within the unitary business concept is contained in Minn. Stat. Section 290.17, subd. 2(4). Minn. Stat. Section 290.17, subd. 2(4) states in relevant part that "when a trade or business is carried on partly within and partly without the state, the entire income derived from such trade or business . . . shall be governed,

except as otherwise provided in Sections 290.35 and 290.36 by the provisions of Section 290.19 notwithstanding any provisions of this section to the contrary." Minn. Stat. Sections 290.35 and 290.36 set out how insurance companies and investment companies are to be taxed by the state. These companies are excluded from unitary tax treatment and the combined income approach. The statute does not specifically exclude banks and bank holding companies from the application of the unitary business and combined reporting. It is the Department's position that there is nothing inherently different in the business of banking than is found in other businesses which are subject to the unitary business concept and combined reporting. Absent specific statutory authority granting banks and bank holding companies an exception from unitary tax treatment, banks and bank holding companies are subject to Minn. Stat. Sections 290.17, subd. 2(4) and 290.34, subd. 2.

The inclusion of banks and bank holding companies within the unitary tax treatment is reasonable for the following reasons:

1. The inclusion of banks and bank holding companies is mandated by Minn. Stat. Section 290.17, subd. 2(4).
2. There is nothing inherently different between the business of banking and other businesses subject to combined reporting.
3. The application of combined reporting to banks and bank holding companies helps prevent distortions in reporting income to Minnesota and
4. Finally, unitary tax treatment encourages full accountability of a bank's activities within all the states.

Receipts from intangible personal property are included in the sales factor of banks for purposes of determining the apportionment factor and the banks' unitary business conducted within Minnesota. Normally, receipts from intangible personal property would not be included in a unitary business's sales factor in order to determine the amount of taxable income to Minnesota. However, banks

are in the general business of making loans and therefore intangible personal property becomes the key asset for these institutions. It is the Department's position therefore that intangible personal property must be used as a component of the sales factor to properly determine apportionable income. Minn. Stat. Section 290.19, subd. 1(2)(a)(1) states that the sales factor is determined by "The percentage which the sales, gross earnings, or receipts from business operations, in whole or in part, within this state bear to the total sales, gross earnings, or receipts from business operations wherever conducted." The rule therefore provides how a bank computes its sales factor under this provision since banks have few if any merchandise sales. This position is consistent with California, which taxes banks in like manner. See, Guideline for Apportionment of Income of Banks and Financial Corporations, California CCH State Tax Rptr., Vol. 1, p. 1309 and 1310.

1. Interest and other receipts from assets in the nature of loans and installment obligations are attributed to the state where the office is located at which the customer applied for the loan. The only exception to this is where the loan is recognized by appropriate banking regulatory authority as being made from and is an asset of an office located in another state, in which case it is attributed to that state. It is the Department's position that by attributing the income to the state where the office is located and the loan originated, or was at least applied for, that this is the most efficient and effective manner in allocating said income among the different states. It is also the most acceptable and efficient approach as concerns the taxpayer and his methodology to determine and apportion said income. Basically, this means that the "sale" was made from that office and so should be allocated to that state. The second sentence in this paragraph defines the word "applied" to mean initial inquiry, including customer assistance in preparing the loan application or submission of a completed loan application, whichever occurs first in time. The initial point of

contact is treated as determinative for purposes of determining accountability of income and loss resulting from business transacted within the state. Again, this order of priority is established in order to make the computation of apportionable income as easy and efficient as possible for both the taxpayer and Minnesota. This approach is in conformity with the approach taken in California. See, Guideline for Apportionment of Income of Banks and Financial Corporations, California CCH State Tax Rptr., Vol. 1, p. 1308.

2. In addition, interest and service charges on credit cards including holders' fees must all be attributed to the state in which the credit card holder resides in the case of an individual. In the case of a corporation, said income must be attributed to the state of the corporation card holder's commercial domicile.

This treatment is reasonable since:

1. Taxpayer knows the address of the card holder and can most easily allocate the receipts on this basis.
2. Allocating based on taxpayer's office would make no sense. Allocating based on taxpayer's office would not only be difficult to determine but would be extremely difficult to substantiate and verify.
3. The approach adopted in the rule is the most reasonable since the state of residence or commercial domicile is the source of the loan since the customer is drawing on the loan.

If the taxpayer is found not to be taxable in the state of the individual card holder's residence or commercial domicile of the corporation card holder, the receipts are then attributed to the state of the taxpayer's commercial domicile. This approach to interest, service charges and credit card holder fees is in conformity with California's treatment. See, Guideline for Apportionment of Income of Banks and Financial Corporations, California CCH State Tax Rptr., Vol. 1, p. 1308.

The rule is reasonable because:

1. Minn. Stat. Section 290.19, subd. 1a states in relevant part that

> For purposes of this section the following rules shall apply in determining whether or not sales are made within this state.
>
> Sales of tangible personal property are made within this state if the property is delivered or shipped to a purchaser within this state, and the taxpayer is taxable in this state, regardless of the F.O.B. point or other conditions of the sale.

Minn. Stat. Section 290.19, subd. 1a only applies to tangible personal property. It does not apply to intangible personal property.

2. The rule provides for a complete accounting of all receipts in the sales factor. A distortion in the sales factor would result if this provision was not incorporated into the rule.

3. Finally, if a taxpayer has a mere isolated contact with a state, there is no reason why the receipts from the transactions should not go back to the main office.

It is the Department's position that this approach is the most effective and efficient manner in which to tax this income. This approach simplifies the determination of where the income is attributable to and therefore taxable by any given state. This is seen as the best possible approach. It should be pointed out that Minnesota's approach conforms with California. See, generally, Guideline for Apportionment of Income of Banks and Financial Corporations, California CCH State Tax Rptr., Vol. 1, p. 1307-1310. It is the Department's position that conformity is both desirable and advisable in order to create uniformity among the states in taxing unitary businesses.

3. Merchant discount income is attributed to the state in which the merchant is located. This is contingent on the fact that taxpayer is taxable in that state. If the taxpayer is not taxable in the state, the merchant discount income is then attributed to the state in which the taxpayer's

commercial domicile is located. This provision is justifiable for the reasons provided in the preceding paragraph.

4. Generally, receipts from investments of a bank in securities are attributable to the bank's commercial domicile. There are two exceptions: (1) receipts from securities used to maintain reserves against deposits to meet federal and state reserve deposit requirements must be attributed to each state based upon the ratio the total deposits in the state bear to the total deposits everywhere, and (2) receipts from securities owned by a bank but held by a state treasurer or other public official or pledged to secure public or trust funds deposited in such bank must be attributed to the banking office at which such secured deposit is maintained. The approach outlined in the rule is the same taken by California in administering its tax laws allocating the receipts from a bank's investments in securities. Minnesota's approach as outlined in the rule attempts to adopt a uniform approach in this area consistent with other states. This approach is highly desirable in order to minimize differences between the states in administering their tax laws affecting a unitary business which is engaged in banking and bank related matters. Securities are intangibles. Intangibles have no geographic situs. Income from intangibles, which is part of a unitary business, is subject to three factor apportionment. It is generally said that the situs of intangibles is the bank's commercial domicile. See, Graves v. Schmidlapp, 315 U.S. 657 (1942); Hillstrom v. Commissioner of Revenue, 270 N.W.2d 265 (1978). In this situation, it would be unreasonable to say that the situs of the intangibles is in an office. Under this rule, the sales factor would follow the location of the intangibles. The rule provides for two exceptions. The two exceptions are allowed when the securities are identified and pledged and so have a geographical situs. The securities under the two exceptions are therefore allowed to be assigned to an office.

5. Receipts from the issuance of traveler's checks and money orders must be attributed to the state where the taxpayer's office is located that issued the traveler's checks or money orders. This general rule is consistent with the Department's approach to taxing the income and receipts of a unitary business engaged in banking. The Department therefore attributes said income to the location where the business was transacted. This is where the "sale" occurred. The taxpayer's records would reflect this. It really shows what specific business activities occurred in the particular state for sales factor purposes. In this case, that would be where the traveler's checks or money orders were issued. The remainder of the paragraph deals with situations where the traveler's checks or money orders are issued by an independent representative or agent. The receipts are attributable to the state in which the independent representative or agent issues the traveler's checks or money orders if the taxpayer is taxable in that state. Where the taxpayer is not taxable in the state, the receipts must be attributable to the state of commercial domicile of the taxpayer. This approach is consistent with the treatment of interest, service charges and credit card holder fees. This method is the most efficient approach in dealing with income generated by such transactions. Again, this method is consistent with that adopted by California in its treatment of unitary businesses which are conducting banking operations. See, Guideline for Apportionment of Income of Banks and Financial Corporations, California CCH Tax Rptr., Vol. 1, p. 1310.

6. This provision attributes receipts from investments of a financial corporation to its commercial domicile unless the securities have acquired a business situs elsewhere. This provision is very similar to paragraph 4 and is in keeping with the uniform treatment of a bank which is conducting a unitary business. This approach is also consistent with California.

I. Paragraph I. sets out Minnesota's reporting requirements regarding members of unitary group who have the same or different accounting periods. Members of a unitary business are treated as one entity and so the same common period must be used. The unitary business must therefore report to Minnesota using one common period of twelve (12) months. A common reporting period among the unitary members is necessary in order to correctly determine the income, factors and unitary attributes of the group. The second sentence of paragraph I. allows the unitary members to report to Minnesota using the parent corporation's accounting period. This treatment is identical to Illinois which also allows unitary members to report based on the parent corporation's accounting period. See, Illinois Regulation Section 304-1(B)(3), Illinois CCH State Tax Rptr., Vol. 1, p. 1327. California also uses this procedure as set out in their corporate tax instructions. See, California Franchise Tax Board, Instructions For Corporations Filing A Combined Report (1981) which states at page (8) that "In filing a combined report, it is necessary that the income of all corporations be determined on the basis of the same accounting period. Where there is a parent subsidiary relationship, the income of all corporations should be determined generally on the basis of the parent's income year." The Department relies on Minn. Stat. Section 290.07, subd. 1 as its authority to require members of a unitary group to reconcile their accounting periods to the accounting period of a member of the unitary group conducting business in Minnesota. The rule goes on to provide that where no parent corporation exists, the unitary members may select one corporation to be the parent corporation for purposes of a common accounting period. This provision was requested by an outside party. The justification for the provision is that it allows accountants to reconcile all the records of a unitary group to one corporation where no parent corporation exists. This allows the accountant to make just one visit to the client in order to do the tax returns.

The rule goes on to state that once a method is selected, it may not be changed without the permission of the Commissioner of Revenue. The authority for this provision is contained in Minn. Stat. Section 290.07. subd. 2 which requires a taxpayer to stay consistent for fair and proper income reporting.

The fifth and sixth sentences in paragraph I. set out how the income and factors for corporations should be treated for the first taxable year beginning after June 30, 1981. The rule sets out that no double counting of income or factors is allowed. The rule prevents overlap of income and factors during the transition period from filing on other than a combined return to now, as a unitary business, filing a combined return. The provision helps assure fairness, no distortions, and full accountability in reporting income to Minnesota. The authority for this provision is contained in Minn. Stat. Section 290.07, subd. 3(1)(b).

The seventh sentence in paragraph I. states that the due date of the corporate return is still based on the actual accounting period of the corporation. The authority for this provision is contained in Minn. Stat. Sections 290.07, subd. 1 and 290.42 (1) and (2). Minn. Stat. Section 290.07, subd. 1 requires taxpayer to employ the same accounting period as for federal. Minn. Stat. Section 290.42, (1) and (2) imposes basically the same rules for filing as is required for filing taxpayer's federal returns.

J. This provision was inserted into the rules in order to avoid penalizing corporations as a result of the transition period from reporting their income on other than a combined report to reporting their income as a unitary business under the combined income approach. Initially what would happen to numerous corporations if this provision had not been inserted was that net operating losses which they incurred prior to the law change would have been drastically reduced in carryforward years because of Minn. Stat. Section 290.095, subd. 3(c). Minn.

Stat. 290.095, subd. 3(c) allows the loss based on the apportionment ratio of the loss year or the year to which the loss was carried, whichever is smaller. Numerous corporations would have had a much smaller apportionment ratio to Minnesota as a unitary business under the combined income approach than they would have had in prior years where they were using a reporting approach different from the combined income approach. It is the Department's position that this was neither intended to occur based on the legislation that was passed, nor is it equitable to penalize corporations based solely on a change in Minnesota's tax law. This provision is therefore inserted so that said corporations are equitably treated regarding the carryforwards of their net operating losses into unitary tax years. It must be noted, however, that the rule would apply the statutory provision as it relates to the corporation's apportionment on a separate return basis. Therefore, if the corporation's apportionment ratio in the carryover year was smaller than in the loss year after computing it on a separate accounting basis, the statutory provision would apply. The result is that if the corporation (on a separate accounting basis) is leaving Minnesota, it must bear the statutory consequences of its action. The rule merely prevents the corporation from being unduly penalized based on a law change requiring the corporation to switch from a separate accounting basis to combined reporting.

The last sentence of paragraph J. restricts this provision to the situation where the corporation was part of a unitary group on the effective date of the combined reporting law. Only in these situations could it truly be said that the only thing that changed was the passage of the new law.

K. The rule sets out in paragraph K. that where any members of the unitary business employ different methods of apportioning their income to Minnesota, all members

must use the method used by the predominant business activity conducted. It was requested that this provision be inserted in the rule to clarify what happens when a combination is required between a corporation reporting on three factor and a corporation reporting using a single factor, separate accounting or some other method. The rule states that the method used by the predominant business activity must be used by all the members of the unitary group.

Minnesota Income Tax Rule 2019 - Apportionment of Net Income of Business Conducted Partly Within Minnesota.

Statement of Need and Reasonableness

Minnesota Income Tax Rule 2019 is amended in order to help clarify the rule as it applies to a business conducted both within and without Minnesota. The most important change is the change in the property factor.

The first change occurs in paragraph (a) which strikes out "an integral" and replaces it with "a part of a unitary business." The reason for this change is for clarification purposes. The Department is attempting to eliminate any confusion in this area as it relates to a unitary business. The Department wishes to stress that the trade or business must be a unitary trade or business conducted both within and without Minnesota in order for the formula to apply. By replacing the word "integral" with "unitary," the Department is attempting to eliminate any confusion as to just what is intended.

The next change occurs in paragraph (b) and is the deletion of "in Minnesota or within and without Minnesota." The deleted words were removed from the law in Laws 1969, Chapter 978 and they should also be removed from the rule.

The next change in the rule is in paragraph (b) and is a technical correction in the example. It merely corrects an oversight in the original rule relating to the calculation. The next change in paragraph (b) is made in order to eliminate any confusion regarding the example. The word "lesser" is eliminated and replaced with the word "weighted" in order to make the example more clear. The Department is attempting to eliminate any confusion that the previous language may have caused. No change in the meaning of the example is either intended or accomplished by the word change.

The first change in paragraph (c) is a deletion of the words "within or within and without Minnesota." The words are deleted based on the change made in Laws 1969, Chapter 978. The second change is the insertion of certain punctuation in order to make the rule grammatically correct. No change in the meaning of the rule is either intended or accomplished by these changes. The third change inserts "Minnesota" before property, payroll or sales percentage. This is for clarification. There is no change in the meaning of the rule. The fourth change replaces "integral" with "unitary." This change was explained under paragraph (a). The next change in the paragraph relates to the use of Schedules T and U. Since new forms have been developed for apportioning income and these schedules are no longer used, the sentence is obsolete and has no effect. It has therefore been deleted from this paragraph.

The change in paragraph (d)(1) eliminates the requirement in the old rule that in order for a business to consist of the manufacture of personal property in Minnesota that the operations of "manufacture" must occur within the geographical territory of Minnesota. The deleted words add nothing in describing the manufacture of personal property. The law was amended by the Legislature in Laws 1969, Chapter 978, which deleted provisions from subd. 1(1) limiting manufacture to "in Minnesota or within and without Minnesota." The deletion of this provision from the rule is necessary in order to correspond with the 1969 law change.

The first change in paragraph (d)(2) deals with the property factor and clarifies which property used by the taxpayer can be considered. Minn. Stat. Section 290.19, subd. 1(1)(b) and (2)(a)(2) requires that the property be used in connection with the taxpayer's trade or business. This change was made in Laws 1939, Chapter 146, Section 22. The law does not specifically require that the property, which is used by the taxpayer in the taxpayer's business, produce income. For this reason, the requirement is being dropped. The next change in paragaraph (d)(2) relates to

valuing tangible property which is owned by the taxpayer. The rule proposes to use the property's original cost and not its adjusted basis. There are several reasons for this change. The most important reason is that the change brings Minnesota's property factor calculation in conformity with other states which value property based on original cost. Section 11 of the Uniform Division of Income For Tax Purposes Act (UDITPA), as drafted by the National Conference of Commissioners on Uniform State Laws in 1957, provides for the valuation of property at original cost. It is the Department's desire to eliminate as many inconsistencies between the different states as possible in determining the property factor for a unitary business. The change is also necessitated by the fact that Minnesota has not adopted the full Federal Accelerated Cost Recovery System (ACRS) depreciation. Therefore, the calculations that will have to be made by both the taxpayer and the Department in order to determine the correct property factors would be extremely burdensome if the current adjusted basis system was used. This change is in the taxpayer's best interest since it allows a far easier calculation of the property factor. It also takes Minnesota a step closer to being uniform with the other states. It must be remembered that the law does not now nor has it ever required that the property factor be computed based on either adjusted basis or original cost. This has always been a subject the Department has dealt with by rule. The rule has provided for the use of adjusted basis since 1939 (see, 1939 Income Tax Rule Article 25-1). However, the Department feels a change should be made now to conform with the uniform law, methods of other states, and since the law requires a modification to ACRS depreciation.

The paragraph also incorporates the change in valuation based on any subsequent capital additions or improvements and partial dispositions by reason of sale, exchange or abandonment. This provision is seen as beneficial in accurately reflecting the true cost to the taxpayer not only at the time of original purchase but subsequently, where substantial changes are made to the property or where partial

dispositions are made of the same property. The provision is identical with the adjustments allowed in Regulation IV.11.(a) of the Multistate Tax Compact. The next change relates to the valuation of property which is rented by the taxpayer. The change would value rented property at eight times the annual rental rate, instead of the previous seven and one-half times. The rule had never provided for the method. It is current administrative practice to use seven and one-half times. Again, the Department is trying to conform with other states in determining the property factor. Specifically, this change and other changes concerning the rental calculation are copied from Section 11 of UDITPA. This change is in the taxpayer's best interest since it allows a more uniform calculation and avoids a difference among the states in determining the property factor. The definition of the net annual rental rate is also taken from UDITPA. The result of the provision is that only the rental expense that the taxpayer incurs can be considered. Expenses, which are paid by another as a sub-rental, are not considered. The next change states that rents during the year must not be averaged. The purpose of this provision is to disallow distortions in the factor based on the use of averages in the rents. This provision codifies current administrative practice (see, instructions for Form M-5). The rule provides an effective date for the property factor changes to eliminate any retroactive effect. The last provision states that all members of the unitary group must use this method in calculating their property factors. Again, the Department is inserting this provision to make sure that there are no distortions in reporting. The provision prevents members of the same unitary group from using different reporting methods in determining their property factor and their taxable income to Minnesota. It is the Department's position that this uniformity and equitable treatment of all members of the unitary group is the proper method for determining a corporation's true proportionate share of business done in Minnesota.

The entire paragraph (d)(4) has been eliminated since it in no way clarifies or adds to the rule relating to the sales factor. The authority for the deletion is

based on Laws 1973, Chapter 650, Article VII, Section 2, in which Minn. Stat. Section 290.19, subd. 1(4) was deleted in full. The deletion of this provision from the rule is necessary, therefore, in order to correspond with this 1973 law change.

The provision of paragraph (e) which references the allocation of federal income taxes paid, Rule 2018(1), has been deleted since it adds nothing to the rule.

13 MCAR Section 1.6004 - Minnesota Gross Income For Individuals Who Are Part Year Residents or Nonresidents of Minnesota (Federal Adjusted Gross Income).

Statement of Need and Reasonableness

The first change in this rule occurs in paragraph A.3.d.(2) and states that business conducted within Minnesota and which has nexus within Minnesota so that the business is subject to Minnesota income tax includes income or losses from sales whose destination is within Minnesota. The destination wording is considered necessary in light of the Minnesota Supreme Court decision relating to destination sales. See, Olympia Brewing Company v. Commissioner of Revenue, 326 N.W.2d 642 (1982). In Olympia, the Minnesota Supreme Court held that beer picked up at taxpayer's Minnesota brewery by out-of-state distributor-purchasers in their own trucks for transportation and resale outside Minnesota did not constitute a sale within the state for income tax apportionment. The insertion of the words "whose destination is" in the rule is therefore necessary to clarify which sales are includable within the rule.

The deletion in the same paragraph relates to construction businesses which had been required to report on the separate accounting basis. It is the Department's position that construction businesses should be subject to the normal three factor apportionment of income including the unitary tax treatment and combined reporting. Therefore, this provision is being stricken and eliminated from the rule. The authority for the inclusion of a construction business within those businesses subject to three factor apportionment and the unitary tax treatment and combined reporting is Minn. Stat. Section 290.17, subd. 2(4). Three factor apportionment is applicable to all corporations unless it can be shown that it does not properly reflect income. See, Minn. Stat. Section 290.19, subd. 1(2)(b). In light of the new unitary tax law, the Department feels that construction companies should be

treated like any other business and use the normal three factor formula. The additional provision stricken and the additional language inserted specifically excludes farm income and income from personal or professional services from three factor apportionment as business income. The authority for this deletion and insertion of additional language is Laws 1981, Third Special Session, Chapter 2, Article 3, Section 13 which amended Minn. Stat. Section 290.17, subd. 2(4) to specifically exempt farm income from three factor apportionment. Personal service income had previously been exempted. The changes in the rule are therefore necessary in order to comply with applicable law.

Minnesota Income Tax Rule 2017(3) - Assignment of Income to Minnesota - Income From A Trade or Business Conducted Wholly Within or Wholly Without the State.

Statement of Need and Reasonableness

As mentioned earlier, it is the Department's position that construction businesses should no longer be required to report on a separate accounting basis. Construction businesses are considered a unitary business for purposes of reporting their income to Minnesota and are required to file on a combined income approach. Therefore, Minnesota Income Tax Rule 2017(3) is no longer applicable and should be repealed. The authority for the repeal of Minnesota Income Tax Rule 2017(3) is Minn. Stat. Section 290.17, subd. 2(4). Unitary tax treatment is applicable to all businesses unless specifically excluded by law. Minnesota law provides no exclusion for construction businesses. It is therefore subject to Minn. Stat. Section 290.17, subd. 2(4) and Minn. Stat. Section 290.19. Minnesota Income Tax Rule 2017(3) must therefore be repealed in order to comply with current law.

Paragraphs 1 and 2 are unnecessary since they add nothing to Minn. Stat. Section 290.17, subd. 2(3).

Paragraphs 3, 4, and 6 are obsolete in light of the law changes made in Laws 1973, Chapter 650, Article VII when the law was changed from an office basis to a destination basis.

Paragraph 5 is obsolete in light of Laws 1969, Chapter 978.

Paragraph 7 is not needed since it adds nothing to Minn. Stat. Section 290.05, subd. 1.

STATE OF MINNESOTA

DEPARTMENT OF REVENUE

INCOME TAX DIVISION

In the Matter of the Proposed Adoption of New and Amended Rules and the Repeal of a Rule of the Department of Revenue Relating to the Taxation of a Unitary Business and Formula Apportionment (13 MCAR Sections 1.6501 to 1.6503, 1.6004, Minnesota Income Tax Rule 2019 and Repealing Rule 2017(3)).

Statement of Compliance With Rulemaking Procedures

I, Dale H. Busacker, Income Tax Division Attorney, do hereby declare that I have examined the rules and all related documents and that, based on my examination and my personal familiarity with the applicable procedures, the Administrative Procedure Act, the rules of the Office of Administrative Hearings, and the rules of the Attorney General have been followed. There are no exceptions.

Dale H. Busacker

Dale H. Busacker

Dated: 16 June 1983