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October 31, 1989

FTB Notice 89-713  
410:TLC:DN-89-713

Re: PROPOSED UNITARY BUSINESS REGULATIONS

At its meeting on October 4, 1989, in Sacramento, the Franchise Tax Board was presented with two staff proposals to amend Regulation 25120(b).

The first proposal dealt with the determination of whether businesses are to be treated as unitary or separate accounting entities. It is a revision of the earlier draft released to the public for comment on July 9, 1987.

The second proposal dealt with holding companies in the context of combination/decombination.

After discussion, the Franchise Tax Board requested that additional material be developed by the Department's legal staff before proceeding with the regulation projects. The material is to be presented at a Franchise Tax Board meeting to be held in early 1990.

The proposed amendments to Regulation 25120(b) are not yet part of the formal regulation adoption process governed by the Administrative Procedure Act (Govt. Code §§ 11340-11356). Consequently, pending final formal adoption and approval under this Act, the proposed amendments have no legal force or effect (~~see~~ Govt. Code § 11347.5), and should ~~not~~ be cited or otherwise applied or followed by taxpayers or the Department.

California courts have established two basic tests for determining the existence of a unitary business: the three unities test (~~Butler Brothers v. McColgan~~ (1941) 17 Cal.2d 664) and the contribution or dependency test (~~Edison California Stores, Inc. v. McColgan~~ (1947) 30 Cal.2d 472).

The United States Supreme Court has adopted its own test of what constitutes a unitary business, most notably, the ~~Mobil~~ test of "contributions to income result[ing] from functional integration, centralization of management, and economies of scale." ~~Mobil Oil Corp. v. Vermont~~ (1980) 445 U.S. 425 at 438.

The three unities and contribution or dependency tests continue to be valid standards for determining the existence of a unitary business, but the ~~Mobil~~ statement of what constitutes a unitary business is perceived by many to provide a better analytical framework and to be the most easily applied. Recent State Board of Equalization decisions cite

NOTE: ((---)) = Indicates obsolete information.

all three standards but premise their analysis upon the Mobil standard. Therefore, the Mobil test, as applied in recent Board of Equalization opinions, will be the primary standard relied upon by the Franchise Tax Board in analyzing whether a unitary business exists.

The Franchise Tax Board will continue to administer the law with respect to what constitutes a unitary business on a case-by-case basis. The appropriate weight to be given factual elements in various contexts, as well as their potential interactive significance, will be determined by the trends established by court decisions and opinions of the California State Board of Equalization. Adjustments will be made for new trends or principles evolving from future cases and/or opinions.

#### DRAFTING INFORMATION

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