



October 25, 2021

## **LEGAL RULING – 2021-01**

### **SUBJECT: Unity of Apportioning Pass-through Entities**

#### **ISSUE**

Whether, in a series of differing situations, pass-through entity holding companies are unitary with other pass-through entities.

#### **LAW AND ANALYSIS**

##### **I. Unity**

The California Supreme Court has established two tests for determining when the activities of multiple business components are treated as parts of a single unitary business. In *Butler Brothers*, the court stated that a unitary enterprise is definitely established if “unity of ownership,”<sup>1</sup> “unity of operation,” and “unity of use” are present.<sup>2</sup> This has come to be known as the “three unities test.” In *Edison California Stores*, the court discussed another unity test, the “contribution or dependency” test, under which components of a business must be treated as parts of a single unitary enterprise if the business within the state is “*dependent upon or contributes to*” the operation of the business outside the state.<sup>3</sup> The three unities test is “[a] more particular statement of the [dependency or contribution] test.”<sup>4</sup>

The “two tests are alternative methods for determining unity.”<sup>5</sup> The U.S. Supreme Court has referred to *both* tests as being part of the settled jurisprudence concerning the unities test, and many of the same facts and factors are used in reaching a determination under either test.<sup>6</sup> But, the fact that separate businesses might not be viewed as unitary under the three unities test

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<sup>1</sup> Ownership requirements are disregarded for pass-through entities. (California Code of Regulations, title 18 (“Regulation”) section 25137-1(f); also see Regulation section 17951-4(d)(6).)

<sup>2</sup> *Butler Brothers v. McColgan* (1941) 17 Cal.2d 664, 678, *affd.* (1942) 315 U.S. 501 (“*Butler Brothers*”).

<sup>3</sup> *Edison California Stores, Inc. v. McColgan* (1947) 30 Cal.2d 472, 481, (emphasis added). “In general, the activities of the taxpayer will be considered a single business if there is evidence to indicate that the segments under consideration are integrated with, dependent upon or contribute to each other and the operation of the taxpayer as a whole.” (Regulation section 25120(b).)

<sup>4</sup> *Chase Brass and Copper Co. v. Franchise Tax Bd.* (1970) 10 Cal.App.3d 496, 501-502.

<sup>5</sup> *A.M. Castle & Co. v. Franchise Tax Bd.* (1995) 36 Cal.App.4th 1794, 1805-1806, (“*A.M. Castle*”).

<sup>6</sup> *A.M. Castle, supra*, 36 Cal.App.4th 1794, 1807, internal quotations omitted.

does *not* preclude those businesses from being treated as unitary under the dependency or contribution test.<sup>7</sup>

## II. Limited and General Partnerships

Control of a limited partnership generally rests with its general, not limited, partner.<sup>8</sup> Limited partners cannot generally take part in the control of the partnership and retain the limited liability of a limited partner.<sup>9</sup> The general partner's control demonstrates that contribution or dependency exists between the general partner and partnership. Thus, given their authority to control the business of the limited partnership, general partners are properly presumed to be unitary with the limited partnerships in which they participate, because the activities of the general partners evidence contribution or dependency between the general partner and the partnership.

By contrast, limited partners are not likely to be considered unitary with limited partnerships in which they have only limited interests.<sup>10</sup> In *Gasco*, where the taxpayer acquired limited partnership interests in a limited partnership operating in the same line of business as the taxpayer, California's State Board of Equalization ("SBE")<sup>11</sup> has concluded the limited partnership interests were not unitary with the Taxpayer:

Absent unusual circumstances, we believe that it would be extremely difficult to overcome the inherent passive investment nature of a limited partnership interest. In the present case, the evidence unequivocally reinforces the conclusion that these were acquired and maintained as passive investments.<sup>12</sup>

## III. Holding Companies and Unity

The SBE has opined on a series of cases involving the question of whether a holding company and its operating subsidiaries were unitary. It endeavored to reconcile the traditional unity factors with holding companies, which are not generally thought of as "operational" in nature.

In *PBS Building*,<sup>13</sup> the SBE rejected the notion that a different unity standard or test should be used for holding company situations. Instead, it reasoned that:

[I]n situations concerning corporations which are not vertically or horizontally integrated, the typical characteristics of unity may not exist. ...

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<sup>7</sup> See *id.* at pp. 1805-1806.

<sup>8</sup> *Otay Land Company, LLC v. U.E. Limited, L.P.*, (2017) 15 Cal. App. 5th 806, 859.

<sup>9</sup> *Jarvis v. Jarvis* (2019) 33 Cal. App. 5th 113, 136.

<sup>10</sup> *Appeal of Gasco Gasoline*, 88-SBE-017, June 1, 1988, ("*Gasco*").

<sup>11</sup> Title 18 of the California Code of Regulations, section 30504 provides that a precedential opinion of the State Board of Equalization that was adopted prior to January 1, 2018, may be cited as precedential authority to Office of Tax Appeals ("OTA") unless a Panel removes, in whole or in part, the precedential status of that opinion.

<sup>12</sup> *Ibid.*

<sup>13</sup> *Appeal of PBS Building Systems, Inc. and PKH Building Systems, Inc.*, 94-SBE-008, Nov. 17, 1994, ("*PBS Building*")."

"... (W)here there is no horizontal or vertical integration, some of the most significant unitary factors, such as intercompany product flow, often will not exist. Therefore, factors which might be considered relatively insignificant in a case of horizontal or vertical integration take on added importance because they are the only factors present to consider."

Thus, where pure or passive holding companies are involved, it is relevant to carefully inquire into the nature of the benefits accruing to both the holding company and the operating subsidiaries as a result of their corporate structure. For example, even in the most extreme circumstance, where a pure holding company lacks even acquisition debt, an operating company it holds may gain significant advantages, such as insulation from liability. Consequently, in the typical case where a group of corporations conduct only one unitary business, it would be expected that the requisite contribution or dependency would exist between the "ultimate parent" holding company and its operating subsidiary or subsidiaries. It is important to recognize that flows of value or contribution and dependency may take the form of shared tax benefits ..., intercompany financing (loans, loan guarantees and debt retirement) or improved credit worthiness (bond security, more favorable insurance rating or interest rates on borrowed capital).<sup>14</sup>

According to the SBE, because holding companies are not horizontally or vertically integrated, given their lack of operations, the typical characteristics of unity may not exist. Thus, factors which are traditionally insignificant become important, because they are the only factors that might exist. The SBE explained that the structure of the business and benefits of the holding company to the operating companies then become key factors to consider. In *PBS Building*, presence of additional factors – a complete overlap of officers and directors in the holding and operating companies, presence of intercompany financing between the entities, and entrance into a covenant not to compete by the holding company for the benefit of the operating subsidiary, were found determinative of a unitary relationship between the entities. Additionally, the SBE stated:

Consequently, in the typical case where a group of corporations conduct only one unitary business, it would be expected that the requisite contribution or dependency would exist between the "ultimate parent" holding company and its operating subsidiary or subsidiaries.<sup>15</sup>

As discussed above, in *PBS Building*, the SBE stated that the structure of a business and the role of the holding company within that business can support a finding of unity.<sup>16</sup> When a passive parent holding company holds one or more operating company subsidiaries engaged in a single unitary business, the holding company primarily functions as a conduit between its shareholders and the single unitary business that the shareholders also indirectly own.<sup>17</sup>

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<sup>14</sup> *PBS Building*, *supra*, internal citations omitted.

<sup>15</sup> *Ibid.*

<sup>16</sup> *Ibid.*

<sup>17</sup> FTB Legal Ruling 1995-7. Please note that FTB's legal rulings, while not controlling, are entitled to great weight. (See *Container Corp. of America v. Franchise Tax Bd.* (1981) 117 Cal. App. 3d 988, 1000 ["administrative

The unitary business gives the holding company value to shareholders by representing the unitary business and the shareholders in relationships with each other.<sup>18</sup> In addition, the holding company is the focal point for the unitary group and third parties, representing it in relationships with government (e.g., the Securities and Exchange Commission and other regulatory agencies) and third parties.<sup>19</sup> It dedicates all or virtually all of its activity, however minimal, to the unitary business.<sup>20</sup> In such situations, the holding company "is an integral part of a larger and unitary system," the parts of which contribute to and/or depend upon each other; i.e., unitary with the operating companies.<sup>21</sup>

Separating the holding company from its unitary operating company affiliates places too much emphasis on the form of corporate structure, when the substance is that the holding company and its operating company subsidiaries are engaged in one unitary business.<sup>22</sup> Thus, when the purpose of a holding company is to hold and control a single unitary business on behalf of its shareholders, the holding company will be treated as unitary with the operating subsidiaries which it holds.<sup>23</sup>

In *Fibreboard*, the SBE held that an appellant parent corporation's gain from the sale of a holding company, which held an operating company, was nonbusiness income.<sup>24</sup> There, the SBE held that gain from selling stock in a holding company that also held all stock in a lower tier operating company was nonbusiness because appellant failed to substantiate its arguments that the operating company was integral to or unitary with the appellant's business at the time of the decision to sell. As such, to determine whether gain from sale of the stock in holding company was business income, the SBE looked through the holding company, relied on a lack of evidence that the operating company was integrated with the parent company, and held that gain to the parent company from the sales of its interest in the holding company was nonbusiness income.

The look-through analysis of *Fibreboard*, used in context of a business income determination, can be applied to a unity analysis. The SBE looked through the holding company and held that gain on the sale of the stock of a holding company, which in turn held another corporation, was determined to be business or nonbusiness income by reference to the relationship between the seller and the ultimate corporation held. It reasoned that, if the entity held by the holding company was not integral to the holding shareholder's business had the shareholder held the entity directly, then the holding company stock was also a nonbusiness asset. Therefore, if the holding company serves essentially no purpose, other than to act as a holder of a nonunitary subsidiary, the holding company only furthers the investment objective of its parent and does not create a unitary business relationship between the parent and holding company. This investment

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construction of the California tax laws 'is entitled to great weight, and the courts will not depart from such construction unless it is clearly erroneous or unauthorized"'].)

<sup>18</sup> FTB Legal Ruling 1995-7.

<sup>19</sup> *Ibid.*

<sup>20</sup> *Ibid.*

<sup>21</sup> *Ibid.*, citing *Edison California Stores*, *supra*, 30 Cal.2d 472, 480-481.

<sup>22</sup> FTB Legal Ruling 1995-7.

<sup>23</sup> *PBS Building*, *supra*.

<sup>24</sup> *Appeal of Fibreboard Corporation*, 87-SBE-002, Jan. 6, 1987, "*Fibreboard*."

attribute attaches to the relationship between the parent and holding company, and between the holding company and its subsidiary.

The above analysis references the existing California decisional authority regarding unity with respect to holding companies. However, in 2011, in *Blue Bell*, the Tennessee Supreme Court addressed a situation where a holding company with operating subsidiaries underwent a reorganization to achieve certain tax and regulatory efficiencies.<sup>25</sup> As part of the reorganization, the holding company transferred assets of an operating subsidiary to a newly formed limited partnership, the taxpayer at issue. The holding company's shareholders then exchanged their shares for the interest in the limited partnership, which the holding company redeemed, resulting in gains to the taxpayer. The Tennessee Department of Revenue took the position that the capital gains generated from the reorganization were subject to Tennessee's excise tax. The taxpayer took the position that these gains were non-business earnings. As a result of the dispute, the question of unity was relevant.

The *Blue Bell* court acknowledged that holding companies present unique challenges to determinations of unity.<sup>26</sup> The court then reasoned the traditional unitary tests are ill-suited for holding company situations because the tests require a comparison of "business operations" while holding companies usually are passive entities.<sup>27</sup> However, the court also noted that, in considering unity, the U.S. Supreme Court reviews the "underlying activity" and considers whether the two business enterprises at issue represent "discrete business enterprises."<sup>28</sup> The Tennessee Supreme Court stated,

For Taxpayer and BBC USA, the only underlying activity generating income is the production, sale, and distribution of Blue Bell ice cream. BBC USA may be a separate business entity, but it is uncontested that BBC USA does not conduct any business operations of its own. Furthermore, BBC USA exists as a separate business entity to channel income from Taxpayer to BBC USA's stockholders without incurring a Texas franchise tax, according to William Rankin, the Chief Financial Officer of Taxpayer's general partner. Mr. Rankin also characterized BBC USA and BBC USA's subsidiaries as part of the singular ice cream business and characterized the stockholders of BBC USA as investors in the ice cream business. Because both entities derive their income from a single underlying activity, we hold that BBC USA is unitary with Taxpayer's Blue Bell ice cream business.<sup>29</sup>

Because the taxpayer did not meet its "burden to identify clear and cogent evidence demonstrating that Taxpayer and [its parent holding company] BBC USA are discrete business enterprises," the Tennessee Supreme Court held that the taxpayer and its holding company were unitary.<sup>30</sup>

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<sup>25</sup> *Blue Bell Creameries, LP v. Roberts* (2011) 333 S.W.3d 59, ("*Blue Bell*").

<sup>26</sup> *Ibid.*

<sup>27</sup> *Id.* at 72.

<sup>28</sup> *Id.* at 71, citing *Mobil Oil Corp. v. Comm'r of Taxes* (1980) 445 U.S. 425, 440-441; *Exxon Corp. v. Wisc. Dep't of Revenue* (1980) 447 U.S. 207, 223-224.

<sup>29</sup> *Ibid.*

<sup>30</sup> *Id.* at 71-72.

The *Blue Bell* opinion utilized very similar reasoning discussed in *PBS Building*. *PBS Building* held that, when there exists only one business with actual operations, it is "expected" that contribution or dependency would exist between the holding company and its operating subsidiary(ies).<sup>31</sup> Similarly to *PBS Building*, the lack of evidence establishing the holding company operated a discrete business enterprise separate from its operating subsidiaries in *Blue Bell* resulted in the conclusion that the holding and operating companies were unitary.

#### **IV. Analysis**

In synthesizing the above cases, it becomes apparent that a unity determination in the context of pass-through holding companies requires additional consideration, and may expand on a traditional unity analysis.

First, as discussed in *PBS Building*, the fact that holding companies have limited, if any, operations, means that other, non-traditional factors are more heavily weighted in determining unity. Those factors include:

- Insulation from liability,<sup>32</sup>
- Acting as the focal point or conduit for ownership of an operating business,<sup>33</sup>
- Intercompany financing,<sup>34</sup>
- Shared tax benefits,<sup>35</sup>
- Improved creditworthiness,<sup>36</sup>
- Covenants not to compete,<sup>37</sup>
- Holding company control of the operating company,<sup>38</sup>
- Any other benefits to the operating business from the holding company.

Second, the SBE emphasized that the purpose of the holding company in the structure of a business can also support a finding of contribution or dependency among the holding company and the operating subsidiaries, and therefore evidence unity.<sup>39</sup> The fact that the holding company functions as a conduit for its owners, or as a focal point for an operating business, also supports a finding of unity between the holding company and the operating business. By contrast, where the structure of ownership through a holding company evidences an investment purpose, e.g., where the holding company is not integral to the overall unitary business, the holding company will not be treated as unitary.<sup>40</sup>

As mentioned above, in *Fibreboard*, for example, the SBE looked through a holding company and held that gain to the parent company was nonbusiness income because the holding company

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<sup>31</sup> *PBS Building*, *supra*.

<sup>32</sup> *PBS Building*, *supra*.

<sup>33</sup> See *ibid*.

<sup>34</sup> *Ibid*.

<sup>35</sup> *Ibid*.

<sup>36</sup> *Ibid*.

<sup>37</sup> *Ibid*.

<sup>38</sup> See *ibid*.

<sup>39</sup> *Ibid*.

<sup>40</sup> See *ibid*.

held an interest in a company which was not integrated with the parent. Similarly, as to unity, given that unity and business income are related concepts,<sup>41</sup> if a parent company utilizes a holding company solely to hold an interest in a nonunitary subsidiary, the purpose of the holding company is to further an investment objective of its parent. The investment purpose of the holding company is relevant to a unity analysis and attaches to the relationship between the parent and holding company, and between the holding company and its subsidiary. The holding company is therefore not unitary with either the parent company, or the entity which it holds.

Third, the traditional unity tests focused on the combination of purported separate operating businesses or affiliates. For example, *Barclays* focused on purportedly separate banking operations in the United States and worldwide;<sup>42</sup> and *Chase Brass* addressed unity between a copper mining and copper product manufacturing company.<sup>43</sup> However, when there exists only a single business, as in the case with a holding company and one operating business, the case for unity becomes stronger. As a result, the SBE in *PBS Building* indicated that if there exists only one business among a group of entities, it becomes likely that the holding company is unitary with those entities.<sup>44</sup> Both *Blue Bell* and *PBS Building* have indicated that unity is very likely present when a holding company is affiliated with only one operating business.<sup>45</sup> This can be contrasted with a holding company that is affiliated with several, distinct businesses. When a holding company holds interests in several unrelated operating companies which lack unitary connections, it becomes likely that the holding company is merely holding interest in investments. Unless the holding and operating companies are engaged in discrete operations, the holding company is treated as part of the operating unitary business.<sup>46</sup>

While lack of majority ownership and control might be insufficient for a finding of unity between operating entities, unity could be found between a passive holding company and a single operating business. The fact that the holding company has majority ownership and control over the operating company, though not necessarily day-to-day control, is sufficient to support a finding of unity; it is "expected that the requisite contribution or dependency would exist between the 'ultimate parent' holding company and its operating subsidiary or subsidiaries."<sup>47</sup> As discussed in *PBS Building* and *Blue Bell*, lack of other factors in the holding company context, along with the involvement of only one business enterprise, supports a finding the holding company existed as a focal point and as a conduit for the ultimate owners of the business.<sup>48</sup> The very structure involving a holding company, used as means to control an operating business strongly supports a finding of unity.

Lastly, one must not forget that, as discussed above, traditional tests for unity are not an exact fit in the context of pass-through entity holding companies. The traditional unitary tests were concerned with the extent to which the income and factors of disparate corporate affiliates could

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<sup>41</sup> Business income is income arising from a unitary business. See *Appeal of Standard Oil Company of California*, 83-SBE-068, Mar. 2, 1983.

<sup>42</sup> *Barclays Bank PLC v. Franchise Tax Bd.* (1994) 512 U.S. 298, 304, ("*Barclays*").

<sup>43</sup> *Chase Brass and Copper Co. v. Franchise Tax Bd.* (1970) 10 Cal.App.3d 496 ("*Chase Brass*").

<sup>44</sup> *PBS Building*, *supra*.

<sup>45</sup> *PBS Building*, *supra*; *Blue Bell*, *supra*, 333 S.W.3d 59, 72.

<sup>46</sup> *Blue Bell*, *supra*, 333 S.W.3d 59, 72.

<sup>47</sup> *PBS Building*, *supra*.

<sup>48</sup> *PBS Building*, *supra*.

be combined and used to apportion income.<sup>49</sup> In the corporate context, all factors and income of unitary entities are combined. However, with pass-through interests, an entity is unitary only to the extent of its interest in the pass-through entity.<sup>50</sup> Therefore if a partner is unitary with a partnership and holds a 25 interest, the partner and 25 percent of the partnerships income and factors are combined.<sup>51</sup> Thus, since not all of the income and factors of a unitary holding company are includable, attributes normally considered insignificant become critical.<sup>52</sup>

Therefore, in instances where a pass-through entity holding company holds less than a controlling interest in an operating entity, the holding company can still be unitary with the operating entity, to the extent of its ownership interest in the entity. This is because pass-through entities need not hold more than fifty percent of an entity to be unitary with that entity.<sup>53</sup> As long as unitary indicia, as discussed above, exist, a pass-through entity holding company can be unitary with an operating entity. If a pass-through entity holding company provides value and support to the operating business, it will be properly treated as unitary with that business.

### **Situation 1**

Limited Liability Company 1 (LLC 1) is an operating entity doing business within and without California. LLC 1 is owned 20% by Partnership X (PSHP X), 60% by LLC A, and 20% by S Corp. All LLC 1 owners are holding companies with no operations or employees of their own and no assets other than an ownership interest in LLC1.

LLC A is not involved in the day-to-day operations of LLC 1. LLC A is 90% owned and managed by Nonresident Individual 1 (NR 1). The other direct or indirect owners of LLC A do not own an interest in PSHP X or engage in any activities related to LLC 1. LLC A has three of five votes (60%) on matters requiring member approval related to LLC 1, including approving and terminating managers and other major policy decisions, and NR 1 casts all votes on behalf of LLC A.

Partnership A (PSHP A) owns 90 percent of PSHP X. PSHP X is the managing member of LLC 1. The general partners and employees of PSHP A act on behalf of PSHP X to manage the day-to-day operations of LLC 1. PSHP X has one of five votes (20%) on matters requiring member approval, related to LLC 1.

S Corp is owned 100% by Nonresident Individual 2 (NR 2). Neither NR 2 nor S Corp is involved in the daily operations of LLC 1. S Corp has one of five votes (20%) on matters requiring member approval related to LLC 1. NR 2 does not own a direct or indirect interest in PSHP X, and does not engage in any activities, directly or indirectly related to LLC 1.

- A. Is LLC A unitary with LLC 1?
- B. Is PSHP X unitary with LLC 1?

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<sup>49</sup> *Blue Bell, supra*, 333 S.W.3d 59, 72.

<sup>50</sup> See Regulation section 25137-1(f).

<sup>51</sup> See *ibid.*

<sup>52</sup> See *PBS Building, supra*.

<sup>53</sup> See Regulation section 25137-1(f).



C. Is S Corp unitary with LLC 1?

**Situation 1 Holdings**

- A. LLC A is unitary with LLC 1, as the result of majority control granted to it by virtue of its majority ownership of LLC 1. LLC A exists as a means for NR 1 to exercise control over the management of LLC 1. Since LLC A controls the policy matters and hiring and firing of the managers of LLC 1, it does not exist to merely manage a passive investment. Given the reasoning of *PBS*, LLC A's limited activities and majority ownership and control of LLC 1 supports a finding the two comprise a unitary business.<sup>54</sup> Unless the taxpayer establishes otherwise, contribution and dependency exists between LLC A and LLC 1. LLC A's existence to hold a controlling interest in LLC 1 is therefore sufficient to treat LLC A and LLC 1 as unitary.
- B. PSHP X is unitary with LLC 1. The purpose of PSHP X is to allow PSHP A to maintain control of its interest in LLC 1. Through PSHP X, PSHP A has control over the day-to-day operations of LLC 1. Under a look-through approach utilized in *Fibreboard*, day-to-day control over LLC 1 by PSHP A, through PSHP X, demonstrates that PSHP X contributes to the operations of LLC 1, and LLC 1 depends of PSHP X for its daily operations. Unless established otherwise, it can be concluded that PSHP X and LLC 1 are unitary.
- C. S Corp is not unitary with LLC 1. S Corp's minority interest in LLC 1 and minority voting rights are not sufficient to support a finding of unity, and there is no evidence that it has any control over LLC 1, its managers, or its operations. S Corp therefore exists to hold a passive investment in LLC 1, and it is therefore not unitary with LLC 1.

**SITUATION 2**

Same fact pattern as Situation 1, above, except that PSHP X hired an unrelated third-party manager to manage the day-to-day operations of LLC 1.

Is PSHP X unitary with LLC 1?

**Situation 2 Holding**

- PSHP X is unitary with LLC 1. Though a third party controls the day-to-day operations of LLC 1, PSHP X has authority over the third party manager. The purpose of PSHP X is to allow PSHP A to maintain control of its interest in LLC 1. Through PSHP X, PSHP A has control over the third-party manager, which controls the day-to-day operations of LLC 1. Under a look-through approach, day-to-day control over LLC 1's operations by PSHP A, through PSHP X and the third-party manager, demonstrates that PSHP X contributes to the operations of LLC 1, and LLC 1 depends of PSHP X for its daily operations. PSHP X and LLC 1 are therefore unitary.

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<sup>54</sup> See *PBS Building*, *supra*.

### **SITUATION 3**

Same fact pattern as Situation 1, above, except that S Corp's owner, NR 2, is the co-founder and Chief Operating Officer of LLC 1, and regularly assists in the conduct of the day-to-day operations of LLC 1.

Is S Corp unitary with LLC 1?

#### **Situation 3 Holding**

- S Corp is unitary with LLC 1. NR 2 is a key officer of LLC 1 and is actively engaged in LLC 1's business activities. Since NR 2 is a key officer actively engaged in LLC 1's business, NR 2 is not a passive investor. Under a look-through approach, NR 2's interest in LLC 1, through S Corp, is not a passive investment. NR 2's active role as an officer of LLC 1, and NR 2's sole ownership of S Corp, evidences contribution and dependency between LLC 1 and S Corp, through which NR 2 maintains an interest in LLC 1.

### **SITUATION 4**

PSHP W, a real estate development company, owns 85% of PSHP Y, a holding company, which owns 10% of PSHP Z, a software development company. The remaining 90 percent of PSHP Z is held by an unrelated corporation. PSHP W and PSHP Z have distinct businesses with no operational integration. PSHP Y has no employees or activities or assets other than its interest in PSHP Z, and is not involved in PSHP Z's day to day operations or decisions.

- A. Is PSHP W unitary with PSHP Y?
- B. Is PSHP W unitary with PSHP Z?
- C. Is PSHP Y unitary with PSHP Z?

#### **Situation 4 Holdings**

- A. PSHP W is not unitary with PSHP Y. Based on the structure of ownership of PSHP Z through PSHP Y, PSHP Y is holding PSHP Z for investment purposes, given that PSHP W and PSHP Z are distinct businesses and share no operational integration. Since PSHP W and PSHP Z are in two distinct businesses, the "single business" analysis of *PBS Building* and *Blue Bell* is inapplicable. Moreover, the lack of any integration between PSHP W and PSHP Z demonstrates that PSHP Y's purpose is to hold an investment; the investment purpose attaches to the relationship between PSHP W and PSHP Y, and between PSHP Y and PSHP Z. Since the purpose of PSHP W's interest in PSHP Z, through PSHP Y, is that of an investment, PSHP W and PSHP Y are not unitary.
- B. PSHP W is not unitary with PSHP Z. For the reasons discussed above, PSHP W holds PSHP Z as an investment, as it has no operational integration with it. Therefore, PSHP W is not unitary with PSHP Z.
- C. PSHP Y is not unitary with PSHP Z. PSHP Y exists solely as a means for PSHP W to hold PSHP Z as an investment, and no indicia of unity are present. Since holding company PSHP Y holds PSHP Z as an investment and no other indicia of unity are present, PSHP Y is not unitary with PSHP Z.

## **SITUATION 5**

PSHP S is an operating limited partnership, with employees. PSHP S is owned 20% by S Corp 1, 60% by PSHP 1, 10% by a CA Resident 1 and 10% by Nonresident 1. S Corp 1 does not have any operations of its own but is the general partner of PSHP S. PSHP 1, a holding company, CA Resident 1 and Nonresident 1 are all limited partners of PSHP S. As general partner, S Corp 1, has the power and authority to make decisions and carry out the business of PSHP S, and its employees manage the day-to-day operations of PSHP S. PSHP 1, CA Resident 1, and Nonresident 1, as limited partners, do not take part in the management, operation or control of the business of PSHP S. The limited partners and their direct or indirect owners do not own an interest in the general partner or engage in any activities related to PSHP S, either directly or indirectly.

- A. Is S Corp 1 unitary with PSHP S?
- B. Is PSHP 1 unitary with PSHP S?

### **Situation 5 Holdings**

- A. S Corp 1 is unitary with PSHP S. Since S Corp 1 is a general partner, as described above, it has control over the operations of PSHP S. Control over PSHP S evidences contribution or dependency between PSHP S and S Corp 1, and they are therefore unitary.
- B. PSHP 1 is not unitary with PSHP S. Limited partners, as described above, are typically passive investors. PSHP 1 is a limited partner, and has no managerial, or operational control over the business of PSHP S. Thus, PSHP 1 is not unitary with PSHP S.

## **DRAFTING INFORMATION**

The principal author of this legal ruling is Rafael Zaychenko of the Franchise Tax Board, Legal Division. For further information regarding this ruling, contact Mr. Zaychenko at the Franchise Tax Board, Legal Division, P.O. Box 1720, Rancho Cordova, California 95741-1720.