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**I'm Skiing the Sierra Mountains this week in the State of California,
Home of the "Unitary" Theory of Multistate Taxation**

GRAND RAPIDS, MI – Monday, January 14, 2008 –I've escaped from all of the turmoil surrounding the imposition of the Michigan Business Tax to ten feet of snow in the Sierra Mountains of California. It's strictly pleasure; six days of skiing and a cruise on Lake Tahoe.

While in California, I'm prone to think about the 60 plus year history California has with the "unitary" theory of state taxation. Michigan is now starting on its journey down the "unitary" path..

The picture below is what it looks like from 10,000 feet above sea level overlooking the blue waters of Lake Tahoe from the top of Heavenly Ski Resort. This picture, taken on my last ski trip to California, was published in CPA Magazine. They wanted to know what CPAs do out of the office.



California is a big state that is known for a lot of things including great wine, sun, surf, movies, Arnold, and "unitary". Yes, "unitary". California has been a "unitary" state for more than 60 years. It would seem logical as we look for guidance on how to comply with the new Michigan "unitary" statute that we look to California.

Following is a brief summary of the development of the unitary theory.

Development of the Unitary Theory

The theory underlying the unitary business principle has its roots in real property tax law, where it arose in the context of railroad taxation. In *Union Pacific Railway Co. v. Ryan* ((1884) 113 U.S. 516), the United States Supreme Court recognized that the value of a railroad could not be measured merely by looking to the value of the property located within a specific geographic area. The Court found that the value of a railroad depends upon the whole line as a unit, to be used as a thoroughfare and means of transportation. A separate mile or two of its length is almost valueless.

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The Court approved a method enacted by the city of Cheyenne that taxed the value of the track within its city limits as a percentage of the value of the entire railroad line. In 1897, this concept of "unit" taxation was expanded to apply to a non-rail business that was operated in several states (*Adams Express Co. v. Ohio* (1897) 165 U.S. 194).

The next landmark in the development of unitary theory was the 1920 Supreme Court decision in *Underwood Typewriter Co. v. Chamberlain*, (1920) 254 U.S. 113, 65 L.Ed. 165, 17 S.Ct. 305. This was the first case in which the use of an apportionment formula for income tax purposes was approved. In approving the formula used by Connecticut to determine the amount of income from a multistate business that was attributable to that state, the court commented that the profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other states. At no time, however, did the Court refer to the operation as being "unitary."

The first express classification of a unitary business for state income tax purposes was made by the court in the case of *Bass, Ratcliff & Gretton, Ltd v. State Tax Commission* (1924), 266 U.S. 271, 69 L. Ed. 282, 45 S.Ct. 82. In that case, the Court stated:

"So in the present case we are of the opinion that, as the Company carried on the unitary business of manufacturing and selling ale, in which its profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places – the process of manufacturing resulting in no profits until it ends in sales – the state was justified in attributing to New York a just proportion of the profits earned by the Company from such unitary business. "

Edison California Stores v. McColgan ((1947) 30 Cal.2d 472) was the first case to extend the unitary concept to multiple entities. In that case, the business activity was carried on by a group of corporations rather than by divisions of a single corporation. The Court validated the use of the unitary business concept to allow apportionment of the combined income of a multi-corporate group. The constitutionality of applying this concept to multiple corporations was later confirmed in *Container Corporation v. Franchise Tax Board* (1983) 463 U.S. 159, affg 117 Cal. App.3d 988 (1981).)

The Department of Treasury has stated that they will rely on the guidance provided by the United States Supreme Court in *Container Corporation v Franchise Tax Board* (1983) 463 U.S. 159, affg 117 Cal. App. 3d 988.

The prerequisite to a constitutionally acceptable finding of unitary business is a flow of value, not a flow of goods.

A relevant question in the unitary business inquiry is whether contributions to income resulted from functional integration, centralization of management, and economies of scale.

Substantial mutual interdependence can arise in any number of ways; a substantial flow of goods is clearly one but just as clearly not the only one. (Edited from opinion)

Please stay tuned for more news and follow the [MichiganStateAndLocalTax Blog](#) for information as it becomes available.

If you have questions please feel free to contact me. I would be happy to be of assistance.

Sincerely,

Ed Kisscorni, CPA/MBA

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