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Business Strategists & Certified Public Accountants

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Flow of Value – Centralized Management: The Relationship Test of a Unitary Business Group

GRAND RAPIDS, MI – Monday, April 14, 2008 – Last week, this newsletter discussed the "functional integration" aspect of *Flow of Value* for the relationship test of a "unitary business group." Today we will discuss the "centralized management" aspect of *Flow of Value*. A *Flow of Value* exists when one of the aspects is present.

Centralized Management

Examples of centralized management include common management or directors, shared staff functions, and business decisions made for the group rather than separately by each member.

A finding of unitary based on "centralized management" must consider such functions as financing, advertising, research or purchasing. "Central management" will depend, to a considerable extent, on the facts in the particular case. It requires more than the mere existence of 'common officers or directors' or an allegation that the various business segments were under the ultimate control of the same person or group of people. Centralized managers will, among other things, play a regular operational role in the business activities of the various divisions or affiliates. The significance of such a managerial role, in the constitutional context, was underscored by the Supreme Court in "*Container*."

"There is no question that the regulation does not contain an all-inclusive list of the services which might be centralized, and which might provide evidence of unitary integration. Similarly, it should be clear that proof of a 'centralized department' requires something weightier than merely alleging, for example, that there was a 'common accountant' who

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kept the books for each affiliate. Other trivialities like a 'common insurance agent' will likewise be insufficient."

The courts have not provided a precise definition of "centralized management." However, state court decisions appear to focus on involvement of managers in significant operational decisions with some regularity. This regular operational role may be distinguished from a lesser degree of management oversight over the results of a subsidiary's operations that are to be expected of any parent/subsidiary relationship.

In F.W. Woolworth v. Taxation & Revenue Dept., 458 U.S. 354 (1982), the U.S. Supreme Court, in finding that related retailing operations were not unitary, stated inter alia:

"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." (458 U.S. at 370)

In discussing the unitary significance to be attached to the fact that Woolworth's published financial statements, such as its annual reports, were prepared on a consolidated basis, the high court cited to the following passage from Keesling and Warren, The Unitary Concept in the Allocation of Income, 12 Hastings L.J. 43, 52 (1960):

"Central accounting, for instance, may result in some savings, but in most instances the amount is trifling in comparison with the income [involved]. Alone considered it is too weak a connecting link to bind into one business, what would otherwise, from an operational standpoint, be considered separate businesses." (458 U.S. at 368, fn.22)

In view of the above authorities, there is no single, universally applicable listing of "centralized management" duties or activities rising to unitary significance. Therefore, each case must turn on its particular facts.

As a general guide, the following list obtained, in part, from the California Internal Procedures Manual can assist the taxpayer in evaluating the "centralized management" issue. This list is not exhaustive; nor is the absence of any item cited in the list as generally significant or important conclusive of whether a particular case satisfies the element of centralized management.

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Centralized Management - Generally Insignificant:

- Preparation of audited financial statements
- Preparation of tax returns
- Common purchases of insurance
- Centralized purchasing of office supplies
- Group discounts on items such as rental cars
- Legal services for matters such as SEC filing, shareholder relations, and public relations

Centralized Management - Generally Significant:

- Government relations (e.g. representing businesses to government regulatory entities)
- Centralized bookkeeping
- Pension and profit sharing
- Cash management, centralized borrowing or treasury
- Personnel: hiring, EDP and payroll
- Employee benefits
- Legal services for contract review
- Common headquarters building
- Labor relations
- Marketing and common use of logo (unconnected to common sales efforts)
- Central advertising offices (providing separate advertising services to each member, without common advertising of a product relationship between products of different members)
- Real estate construction
- Self-insurance

Centralized Management - Generally Important:

- Research and development
- Central purchasing of raw materials
- Shared sales force
- Use of common trade name substantially affecting customer purchasing decisions
- Common distribution systems
- Common inventory control

Stay tuned for more news and follow the [MichiganStateAndLocalTaxBlog](#) for information as it becomes available.

If you have any questions, please go ahead and contact me. I would be happy to be of assistance.

Sincerely,

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