



**Echelbarger, Himebaugh, Tamm & Co., P.C.**  
**STATE AND LOCAL TAX NEWSLETTER**

*Business Strategists & Certified Public Accountants*

2008-15

*The power to make a difference.*

*The people to make it count.*

5136 Cascade Rd. SE #2A • Grand Rapids, MI 49546 • Phone: 616-575-3482 • Fax: 616-575-3481



**Ed Kisscorni,**  
**CPA/MBA**

[edk@ehtc.com](mailto:edk@ehtc.com)

**Ed's Blog**

[www.MichiganState  
andLocalTax.com](http://www.MichiganStateandLocalTax.com)

**EHTC STATE  
AND LOCAL TAX  
SERVICES**

**INCOME &  
FRANCHISE TAX**

[Tax  
Minimization  
Studies](#)

[Business  
Structure  
Reviews](#)

[Allocation and  
Apportionment  
Planning](#)

[Combined,  
Consolidated, &  
Unitary Planning](#)

[Nexus Studies](#)

[Amended State  
Tax Returns  
from IRS Audits](#)

[Single Business  
Tax Training](#)

**Flow of Value – Economies of Scale: The Relationship Test of a Unitary Business Group**

GRAND RAPIDS, MI – Monday, April 21, 2008 – Last week, this newsletter discussed the "centralized management" aspect of *Flow of Value* for the relationship test of a "unitary business group." Today we will discuss the third and final aspect of *Flow of Value*, "centralized management." A *Flow of Value* exists when one of the aspects is present. "Flow of value" is established when members of the group demonstrate one or more of functional integration, centralized management, and economies of scale. [Treasury FAQ U8]

The term "flow of value" implies something more than intercompany sales.

**"... and that has business activities or operations which result in a flow of value between or among persons included in the unitary business group ..." [MCL 208.1117(6)]**

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)**

In *Container Corp. of America v. Franchise Tax Board*, 463 US 159 (1983), a Delaware corporation domiciled in Chicago owned controlling interest in Latin America and Western Europe, the Subsidiaries, all in the same business as Container. Container sold no products to the Subsidiaries and purchased no raw materials or finished products from them. The management of each Subsidiary had complete authority and control for all day to day operations of the Subsidiary. Container helped Subsidiaries buy equipment and raw materials, guaranteed loans, and made direct loans.

In *Container*, the Supreme Court held that worldwide combined reporting is one

## **SALES & USE TAX**

[Reverse Audits](#)

[Compliance System Review](#)

[Direct Pay & Compliance Agreements](#)

[Exemption Certificate](#)

[Documentation](#)

[Industrial Processing / Manufacturing Exemption Utility Studies](#)

[Nexus Studies](#)

[Sales & Use Tax Training](#)

[Transportation Company](#)

[Procurement Company](#)

## **PROPERTY (AD VOLOREM) TAX**

[Real Property Tax Reviews](#)

[Personal Property Tax Reviews](#)

## **TAX AUDIT & APPEALS**

[Sales & Use Tax Audit Defense & Appeals](#)

[Single Business Tax Audit Defense & Appeals](#)

[Property Tax Audit Defense & Appeals](#)

[State and Local Tax Litigation Support](#)

appropriate method of measuring in-state income and that it will defer to judgment of state courts on whether there is a unitary business relationship. It stated: "out-of-state activities ... must be related in some concrete way to in-state activities ... ." There must be "some sharing or exchange or value not capable of precise identification – beyond the mere flow of funds arising out of a passive investment or a distinct business operation."

The unitary business concept, like the "unit rule" upon which it is based, "rejects geographical or transactional accounting, and instead calculates the local tax base by first defining the scope of the "unitary business" between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction."

## **Economies of Scale**

Examples of economies of scale include centralized business functions and pooled benefits or insurance.

"Economies of scale" relate to executive forces and operational systems that take advantage of the pooled size of the group as opposed to the individual entities. The presence of "economies of scale" is reflected in the integration of executive control over the major policy matters of the business. A centralized executive force will control the direction of the various activities and will ensure that they are operated in a manner that will be most advantageous to the unitary business as a whole. The development of vertical (e.g., manufacturer/distributor) or horizontal (same type of business) relationships in order to maximize the profitability of the group is an example of how common executive control binds the operational systems of the business and achieves "economies of scale." Substantial intercompany sales or product flow, or the intercompany transfer of knowledge and know-how also contribute to "economies of scale."

The general operation of a group of affiliates for the benefit of the group as a whole may be contrasted with a situation where common officers and directors are concerned only with maximizing the profitability of each individual entity but without regard to each entity's role in the group as a whole. "Economies of scale" use the power and size of the group for the advantage of the entire group as a whole.

In order to determine where the major policy matters for each entity in the group are decided, it is necessary to look beyond the organization charts. Although the organization charts will identify the chain of command and show the reporting lines from the president down through the business segments, it is necessary to gain an understanding of the involvement and control that takes place at each level of management.

The most common examples of "economies of scale" may include centralized information systems, centralized human resources, or centralized purchasing of employee benefits including insurance and retirement benefits.

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.

[Merger & Acquisition Due Diligence Reviews](#)

[Voluntary Disclosure](#)

**BUSINESS INCENTIVE SERVICES**

[Business Relocation & Expansion Services](#)

[Tax Credits, Exemptions, & Abatements](#)

[Grants, Financing, & Infrastructure Assistance](#)

Sincerely,

Ed Kisscorni, CPA/MBA



**Echelbarger, Himebaugh, Tamm & Co., P.C.**  
**5136 Cascade Rd. SE #2A**  
**Grand Rapids, MI 49546**

[\(616\)575-3482](tel:(616)575-3482) / [ehtc@ehtc.com](mailto:ehtc@ehtc.com) / [www.ehtc.com/](http://www.ehtc.com/)

[www.MichiganStateandLocalTax.com](http://www.MichiganStateandLocalTax.com)

Notice:

To ensure compliance with Treasury Department regulations, we inform you that any tax advice that may be contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or applicable state or local tax law provisions or (ii) promoting, marketing, or recommending to another party any tax-related matters addressed herein.

The contents of this email and any attachments to it contain privileged and confidential information from Echelbarger, Himebaugh, Tamm & Co., P.C. This information is only for the viewing or use of the intended recipient. If you are not the intended recipient, you are hereby notified that any disclosure, copying, distribution or use of, or the taking of any action in reliance upon, the information contained in this email, or any of the attachments to this email, is strictly prohibited and that this email and all of the attachments to this email, if any, must be immediately returned to Echelbarger, Himebaugh, Tamm & Co., P.C. or destroyed and, in either case, this email and all attachments to this email must be immediately deleted from your computer without making any copies hereof. If you have received this email in error, please notify Echelbarger, Himebaugh, Tamm & Co., P.C. by email immediately.