



(“Unitary Affiliates”).

3. There is no dispute that the Unitary Affiliates are unitary among each other.
4. On or about [redacted], the Unitary Affiliates submitted amended corporate income tax returns for CYE [redacted] through [redacted] under [redacted] Inc. & Unitary Affiliates.
5. The amended returns filed on or about [redacted] included all of the Unitary Affiliates but excluded Parent.
6. The exclusion of Parent resulted in requested Arizona tax reductions in the total amount of \$[redacted] for CYE [redacted] through [redacted]. The amended returns for CYE [redacted], CYE [redacted] and CYE [redacted] also reported certain adjustments based on federal changes that are not at issue here. Overall, the amended returns for CYE [redacted] through [redacted] requested refunds of \$[redacted], exclusive of statutory interest.
7. The Section denied Taxpayer’s requested refunds insofar as they pertained to the exclusion of Parent and issued a refund denial of Taxpayer’s CYE [redacted] through CYE [redacted] refund requests for a total amount of \$[redacted].
8. The difference of \$[redacted] between the Section’s refund denial and Taxpayer’s requested reductions may have been calculation or rounding differences. At issue for CYE [redacted] through [redacted] are requested refunds of \$[redacted], exclusive of statutory interest.
9. Taxpayer timely appealed the Section’s refund denial.
10. On or about [redacted], Taxpayer submitted an amended return for [redacted] Inc. & Unitary Affiliates for CYE [redacted].

11. The amended return filed on or about [redacted] included [redacted] Unitary Affiliates, but excluded Parent, resulting in a request for refund of \$[redacted], exclusive of statutory interest.
12. On or about [redacted], the Section issued a refund denial of Taxpayer's CYE [redacted] refund request, pending the final resolution of the CYE [redacted] through [redacted] protests.
13. Taxpayer timely appealed the Section's refund denial of CYE [redacted], requesting that the protest for the refund denial for CYE [redacted] be consolidated with the CYE [redacted] through [redacted] protest.
14. The only contested issue is whether Parent should be included or excluded from the combined Arizona corporate income tax returns filed for the Protest Period.

Taxpayer's Business Structure

15. Parent owns 100% voting stock of the Unitary Affiliates, either directly or indirectly.
16. Parent and the Unitary Affiliates share common officers and directors who provide common management services.
17. Parent and the Unitary Affiliates use the same accounting systems and have reconciled accounting.
18. The [redacted] Group files a single federal consolidated return.

Taxpayer's Business

19. Certain of the Unitary Affiliates provide home oxygen equipment and other respiratory therapy services ("Respiratory Therapy Entities"), home infusion therapy and home medical equipment.
20. The contribution of oxygen and other respiratory therapy products by the Respiratory Therapy Entities to the [redacted] Group's net revenues was 90.2%, 91.7% and 92.1% for 2009, 2008 and 2007.

21. The balance of the [redacted] Group's net revenues were from a product category identified as "home medical equipment and other".
22. The Respiratory Therapy Entities served approximately 750,000 customers in 48 states through [redacted] operating centers.
23. Since reimbursement levels are established by fee schedules, healthcare service providers, such as the [redacted] Group, compete primarily on the basis of quality of service, nature of accreditation, and ability to comply with Medicare rules and regulations.

#### Parent

24. Parent is responsible for the development and execution of strategic management activities to grow the [redacted] Group's business, including strategic acquisitions; development, deployment, and maintenance of information systems; development and deployment of service offerings and customer education programs; as well as being responsible for other operational support activities that enable the [redacted] Group to grow its customer base and to maintain its accreditation status.
25. Parent develops the programs, provides training, coaching and other administrative support services to the Unitary Affiliates. Parents also provides sales and marketing tools and databases used by the Affiliates to qualify leads and track service delivery.
26. Parent personnel perform the following essential functions on behalf of other entities within the [redacted] Group: human resources management, including benefits and mailroom activities; finance, including general ledger and financial reporting; legal; tax, financial accounting, treasury; and payroll administration.
27. Parent also develops specific programs for the [redacted] Group's employees, including a leadership training program, which is designed to train and prepare

promising staff of the Respiratory Therapy Entities for more challenging roles and responsibilities. (e.g., to assume center manager or district manager roles).

28. The executives of Parent are responsible for developing the business model and for identifying promising talent from within the ranks of Unitary Affiliates who can continue to refine, enhance and propagate the core philosophy of the [redacted] Group.
29. The CEO, CFO, Chief Counsel, Director of Human Resources, Director of Information Technology, Director of Tax, and Compliance Officer are employed by Parent. These executive personnel oversee all of the [redacted] Group's operations, building leadership and reward systems that result in growth and profitability.
30. The [redacted] Group's strategy is to increase its market share through internal growth and through strategic acquisitions.

#### Operating Centers

31. Regional managers for the Respiratory Therapy Entities' operating centers monitor the performance and activities of the centers in their region. The managers receive direction and training from parent.
32. Typically, each operating center is comprised of a manager, two customer service representatives, two or three service representatives, a respiratory therapist and a sales representative.
33. A customer service representative obtains the necessary medical and insurance coverage information and assignment of benefits to the Respiratory Therapy Entities and coordinates the delivery of patient care.
34. The prescribed therapy is delivered by one of the service representatives or clinicians to the customer's home where instruction and training are provided to the customer and the customer's family regarding appropriate equipment use

and maintenance and compliance with the prescribed therapy. All services and equipment provided are coordinated with the prescribing physician.

35. The Respiratory Therapy Entities primarily acquire new customers through referrals. The principal source of referrals are physicians, hospital discharge planners, prepaid health plans, and clinical case managers. The Respiratory Therapy Entities' sales representatives maintain continual contact with these medical professionals.

#### Trademark Licensing

36. [redacted] Licensing, Inc. ("Licensor") granted to each entity that it has an agreement with, including Parent, the permission to use certain trademarks owned by Licensing (the "Trademarks") within the United States, on signs, stationery, business cards, and advertising in connection with the sale of products and services.

#### Property and Vehicle Leases

37. Parent personnel coordinate property leases for the company's nearly [redacted] separate locations nationwide.
38. The Respiratory Therapy Entities' regional managers are involved in the selection of each new operating center location.
39. Once the site has been determined, Parent's employees negotiate the property lease. All leases for the locations are held in the name of the respective entity using that location.
40. Parent's fleet management personnel negotiate and monitor fleet leases for the [redacted] Group.
41. Parent examines equipment needs of the Respiratory Therapy Entities and relocates vehicles to various locations to meet center needs.

## Marketing

42. Parent's' Marketing personnel develop all of the promotional materials and content utilized by the Respiratory Therapy Entities. Marketing personnel write, maintain and revise all manuals, such as the clinical protocol manual and the facility manual. The only manual not written by Marketing is the safety manual, which is developed and revised by the Safety Department.
43. Parent also designs some of the disease management programs utilized by the Respiratory Therapy Entities, including [redacted], the [redacted] Program, [redacted] Education, [redacted] and Asthma [redacted].
44. The [redacted] Program is an example of a successful program used by Respiratory Therapy Entities' sales representatives in their interactions with physicians. Programs of this nature are designed to enhance patient care and distinguish the Respiratory Therapy Entities from their competitors in the eyes of the referral community.
45. Parent's' Marketing personnel designed the Company's website through which patients can register to receive information and educational materials quarterly.

## Information Systems

46. The information system ("IS") owned by Parent is a strategic asset, which consists of technical know-how, proprietary programs and methods, and databases.
47. These systems are conveyed, in part, to the Respiratory Therapy Entities through the following software modules: (a) center operations management, sales tracking and referral databases, patient information databases, and related services; (b) billing, reimbursement, claims processing, claims collection software and related services; and (c) financial reporting and financial management software and related services.

48. The center operations software module consists of databases, including sales and tracking databases, is used for referral and sales tracking, patient information databases, center operating procedures, and communication packages.
49. The IS enables the Respiratory Therapy Entities to operate a center efficiently by being able to instantaneously access any necessary information relating to customers, sales opportunities, practice and procedures, and billing and reimbursement.
50. [redacted].
51. A single platform operation facilitates sharing critical information across the enterprise.
52. The IS personnel, employed by Parent, support all of the [redacted] Group's hardware and software needs, including the creation of custom programs (i.e., center operations, billing, sales and referral databases.)

#### Ensuring Compliance

53. Parent employs approximately [redacted] compliance personnel who are responsible for HIPPA compliance; Medicare, Medicaid and private payor audits; review, revision and distribution of training materials; investigations and ALJ hearings; application oversight and provider numbers; and compliance record management.
54. Parent develops all programs and controls the operational processes that enable the [redacted] Group to comply with healthcare laws that govern provider participation in the Medicare and Medicaid programs.

#### Transfer Pricing

55. All of Parent's gross receipts [redacted] are fees from affiliates for the various corporate management services provided. Specifically, during the [redacted] to [redacted] tax years,

Parent received funds from the Unitary Affiliates for the following lines of service: management and administration services, marketing and product development, information systems, and strategic management services (paid by [redacted] and [redacted]).

56. [Redacted] and Parent entered in a Residual Profit Participation Agreement in which [redacted] was required to pay to Parent a service fee equal to 55% of the residual profits earned by [redacted] during the term of this agreement. During each successive year for which this agreement was in force, the parties would review the fee to ensure that it is arm's length.
57. The [redacted] Group hired [redacted] to perform an analysis of the [redacted] Group's transfer pricing practices for the fiscal year ended [redacted] ("FY [redacted]") for state and local tax purposes which may be applied to FY [redacted] and FY [redacted] to the extent the intercompany transactions don't change materially.
58. The Transfer Pricing Analysis ("TPA") concluded that for every \$100 of profits, the Parent is responsible for 55%.
59. [redacted] paid Parent approximately \$[redacted] in residual profit for the CYE [redacted].
60. Parent's income is generated from its operating subsidiaries pursuant to an arm's-length agreement.
61. Parent does not provide services to any unrelated their parties.

#### CONCLUSIONS OF LAW

1. It is the intent of the Arizona legislature to impose on "each corporation with a business situs in this state a tax measured by taxable income which is the result of activity within or derived from sources within this state." Arizona Revised Statutes (A.R.S) § 43-102(A)(5).

2. A.R.S. § 43-1111 requires the filing of a corporate tax return and imposes, for each taxable year, a tax on every corporation's entire Arizona taxable income.
3. A.R.S. § 43-942 states
  - A. In any case of two or more corporations owned or controlled directly or indirectly by the same interests, the department may distribute, apportion or allocate gross income, deductions, credits or allowances between or among such taxpayers, if it determines that such distributions, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such taxpayer.
  - B. For the purpose of enforcing this section, the department may require the filing of a combined report and such other information as it deems necessary unless the taxpayer has elected or is required to file a consolidated return pursuant to section 43-947.
4. Arizona Administrative Code (A.A.C.) R15-2D-401(C) states:

The main reason for defining a business as unitary is that its components in various states are so tied together at the basic operational level that it is difficult to determine the state in which profits are earned. Centralized top-level management, financing, accounting, insurance and benefit programs, or overhead functions by a home office are not sufficient for a business to be unitary without further analysis of the basic operations of the components.
5. A.A.C. R15-2D-401(A) provides:

An entity, group of entities, or components of an entity is not a unitary business for apportionment purposes unless there is actual substantial interdependence and integration of the basic operations of the business

carried on in more than one taxing jurisdiction. The potential to operate an entity or a component as part of the unitary business is not dispositive.

6. The following are necessary threshold characteristics for components of an entity, an entity, or a group of entities to be considered a unitary business:
  1. The entities comprising the unitary business are owned or controlled, directly or indirectly, by the same interests that collectively own more than 50 percent of the voting stock,
  2. The entities or components share common management, and
  3. The entities or components have reconciled accounting systems.

A.A.C. R15-2D-401(D).

7. The presence of the three characteristics listed in subsection (D) is not sufficient for a business to be considered unitary without evidence of substantial operational integration. Factors that indicate operational integration include the following:
  1. The same or similar business conducted by components;
  2. Vertical development of a product by components, such as manufacturing, distribution, and sales;
  3. Horizontal development of a product by components, such as sales, service, repair, and financing;
  4. Transfer of materials, goods, products, and technological data and processes between components;
  5. Sharing of assets by components;
  6. Sharing or exchanging of operational employees by components;
  7. Centralized training of operational employees;
  8. Centralized mass purchasing of inventory, materials, equipment, and technology;

9. Centralized development and distribution of technology relating to the day-to-day operations of the components;
10. Use of common trademark or logo at the basic operational level;
11. Centralized advertising with impact at the basic operational level;
12. Exclusive sale-purchase agreements between components;
13. Price differentials between components as compared to unrelated businesses;
14. Sales or leases between components;
15. Any other integration between components at the basic operational level.

A.A.C. R-2D-401(E).

8. A.A.C. R15-2D-401(H) states:

In a unitary service business, the operations of the various components or entities of the business are integrated and interrelated by their involvement with the central office or parent in delivering substantially the same service. The day-to-day operations of the components or entities use the same procedures and technologies that are developed, organized, purchased, or prescribed by the central office or parent. There usually is an exchange of employees among the components or entities and centralized training of employees.

9. “[The] fundamental question . . . is whether combined reporting over overall net income by the Talley group was necessary to clearly reflect the taxable income earned by those subsidiaries with Arizona income factors.” *Arizona Department of Revenue v. Talley Industries, Inc.*, 182 Ariz. 17, 25 (App. 1994).
10. “We hold that because no substantial interrelationship or interdependence of basic operations exists among the various subsidiaries, the fact that the Talley group is an integrated business does not justify combining all net income or

losses of its subsidiaries into a single net income or loss figure for apportionment to Arizona.” *Id.* at 18.

11. “The unitary business rule, then, essentially rests on the difficulty of determining the amount of income attributable to various stages of producing, refining, manufacturing, transporting, buying, selling, and the like conducted in different states. This consideration does not exist, at least to the same extent, to centralized management or control, financing, research, legal, accounting, or other internal services rendered by one branch or affiliate to another. Such services are not contained in the product or its delivery to the customer and may be considered as an accessory to the operation of the business.” *Id.* at 25 (internal citations omitted).
12. “A key factor in the *Talley* analysis is the distinction between “basic operations” and “accessory” functions” *R.R. Donnelley & Sons Co. v. Arizona Dept. of Revenue*, 224 Ariz. 254, 258 (2010).
13. The court explained “suffice it to say that to be consistent with *Talley* such services and intangibles must be operational components of the core business contained in the product or its delivery, as opposed to mere accessories such as “centralized management and control, financing, research, legal, accounting, and other internal services.” *Id.* at 260 (internal citations omitted).
14. The Section properly denied Taxpayer’s claim for refund.

## DISCUSSION

The question presented is whether the Section properly denied Taxpayer’s claim for refund. In particular, whether Taxpayer must include the parent company, [redacted] (Parent), within the combined Arizona corporate income tax returns filed for tax years ending [redacted] through [redacted] and therefore, whether the Section properly denied Taxpayer’s refund request.

The [redacted] Group is in the business of in-home oxygen and respiratory therapy products and services to end customers throughout the United States. Certain of the Unitary Affiliates provide home oxygen equipment and other respiratory therapy services, home infusion therapy and home medical equipment. Other Unitary Affiliates perform functions such as procurement of medical supplies and equipment and holding intellectual property. Parent is responsible for the development and execution of strategic management activities to grow the [redacted] Group's business.<sup>2</sup>

Section 43-942 provides the following:

- 1) In any case of two or more corporations owned or controlled directly or indirectly by the same interests, the department may distribute, apportion or allocate gross income, deductions, credits or allowances between or among such taxpayers, if it determines that such distributions, apportionment or allocation is *necessary in order to prevent evasion of taxes or clearly to reflect the income of any such taxpayer*.
- 2) For the purpose of enforcing this section, *the department may require the filing of a combined report* and such other information as it deems necessary unless the taxpayer has elected or is required to file a consolidated return pursuant to section 43-947.

*(emphasis added)*.

The following are necessary threshold characteristics for components of an entity, an entity, or a group of entities to be considered a unitary business:

1. The entities comprising the unitary business are owned or controlled, directly or indirectly, by the same interests that collectively own more than 50 percent of the voting stock,
2. The entities or components share common management, and
3. The entities or components have reconciled accounting systems.

A.A.C. R15-2D-401(D).

Parent and Unitary Affiliates plainly meet the threshold requirements to be deemed a unitary business. Namely, Parent owns 100% of the voting stock of Unitary

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<sup>2</sup> Joint Listing of Facts 19 and 24.

Affiliates, either directly or indirectly. Parent and Unitary Affiliates share common officers and directors who provide common management services. And, Parent and Unitary Affiliates use the same accounting systems and have reconciled accounting.<sup>3</sup> There is also no dispute that Unitary Affiliates are unitary among each other.<sup>4</sup>

In this case, we must answer the fundamental question, as in *Talley*, whether combined reporting of overall net income by Parent and Unitary Affiliates is necessary to clearly reflect the taxable income earned by those subsidiaries with Arizona income factors. Based on the court's decision in *Talley*, we must determine whether Parent's activities constitute accessory functions or basic operational activities. As stated by the Arizona Court of Appeals in *Donnelley*, "suffice it to say that to be consistent with *Talley* such services and intangibles must be operational components of the core business "contained in the product or its delivery," as opposed to mere accessories such as "centralized management and control, financing, research, legal, accounting, and other internal services." *Donnelley*, 224 Ariz. at 260 (internal citations omitted).

#### Whether Parent Performs Accessory Functions or Basic Operational Activities

Taxpayer argues in its Pre-Hearing Memorandum that "[a]lso like the parent in *Talley*, the services [Parent] provides are entirely accessory in nature in that they are not embodied in the products and services provided by the [Unitary Affiliates]".<sup>5</sup> This is evident, Taxpayer states, by the parallels that exist when comparing the services provided by Parent and the services provided by the parent in *Talley*. Taxpayer argues that the functions performed by Parent are not embodied in the services rendered to nonaffiliated customers of Unitary Affiliates; namely, Parent does not provide or deliver respiratory services or products. Moreover, it does not insert itself in the operational process involved in providing respiratory services or products such as procuring oxygen

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<sup>3</sup> Joint Listing of Facts 15-17.

<sup>4</sup> Joint Listing of Facts 3.

<sup>5</sup> Taxpayer's Pre-Hearing Memorandum dated [redacted], page 5.

and other equipment, maintaining contacts with doctors and patients, or administering therapies.<sup>6</sup>

The Section, on the other hand, maintains that Parent and Unitary Affiliates, together, provide healthcare products and services such as oxygen and respiratory therapy to patients in the patient's home in the context of various disease management programs. Parent's key functions, the Section argues, are operational and not accessory. The Section argues that Taxpayer has too narrowly defined what constitutes operational services. The services that Taxpayer's customers receive embody Parent's service contributions. The Section maintains that

Just as the trademarks in *Donnelley* were "a core part of Taxpayer's operations in delivering the commercial printing materials it produced" and "fully and completely operationally integrated with the delivery and distribution of the product itself," even though the subsidiary that held and managed the trademarks never had direct contact or interactions with the customers who purchased the product, the services that Parent performs are fully integrated with the therapy and other services Taxpayer's customers receive.<sup>7</sup>

Although some of the services provided by Parent are accessory and not related to basic operations, such as tax reporting, payroll administration or financial accounting services, there is a substantial flow of operational services and thereby operational interdependence between Parent and Unitary Affiliates. Parent develops the programs used by Unitary Affiliates such as the "[redacted] Program." As provided in the Joint Statement of Facts,

[t]he [redacted] Program is an example of a successful program used by Respiratory Therapy Entities' sales representatives in their interactions with physicians. Programs of this nature are designed to enhance patient care and distinguish the Respiratory Therapy Entities from their competitors in the eyes of the referral community.<sup>8</sup>

These programs are more than activities that an unaffiliated marketing company might be contracted to undertake, as argued by Taxpayer. Rather than tools used for marketing, these programs are the "product" that is sold to physicians and their patients.

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<sup>6</sup> Taxpayer's Pre-Hearing Memorandum dated [redacted], page 6.

<sup>7</sup> Section's Response Memorandum dated [redacted], page 9.

<sup>8</sup> Joint Listing of Facts 57.

These programs are designed by Parent and implemented by Unitary Affiliates and are clearly operational in nature and not accessory.

Parent also creates the facilities and protocol manuals used by Unitary Affiliates.

As stated by Taxpayer,

The procedures contained in the manuals are the specific methods employed to express policies and action in the day-to-day functioning of the [redacted] Unitary Affiliates. Together, the protocol and facilities manual are aimed at ensuring that the point of view held by the executive management function in [redacted] is translated into steps that result in an outcome compatible with that review. Importantly, the facilities and protocol manuals do not direct the [redacted] Unitary Affiliates' operating center employees on the provision of respiratory therapy services, only on the manner in which they conduct themselves.<sup>9</sup>

These manuals, created by Parent, allow it to control the day-to-day operations of Unitary Affiliates. Taxpayer narrowly defines the services or "product" it provides as respiratory therapy services. The respiratory therapy services are only one part of the services packaged and sold to the customer. As reimbursement levels are established by fee schedules, healthcare providers "compete primarily on the basis of quality of service, nature of accreditation, and ability to comply with Medicare rules and regulations."<sup>10</sup> Parent ensures the quality of service by directing Unitary Affiliates day- to-day operations and thereby maintains a positive brand image.

As another example of operational interdependence, the information system, owned by parent,

enables the Respiratory Therapy Entities to operate a center efficiently by being able to instantaneously access any necessary information relating to customers, sales opportunities, practice and procedures, and billing and reimbursement. The IS personnel, employed by Parent, support all of the [redacted] Group's hardware and software needs, including the creation of custom programs (i.e., center operations, billing, sales and referral databases.)<sup>11</sup>

Taxpayer argues that Parent's database administration is focused on the administrative aspects of the business as opposed to "the core operational objective of providing

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<sup>9</sup> Post-Hearing Memorandum dated [redacted], page 4.

<sup>10</sup> Joint Listing of Facts 23.

<sup>11</sup> Joint Listing of Facts 65 and 78.

respiratory services.”<sup>12</sup> However, as explained above, Taxpayer too narrowly defines the service provided by Unitary Affiliates. Parent has designed and developed software programs and databases specifically to address the needs of Unitary Affiliates to operate efficiently. Without these systems and related services, Unitary Affiliates would have no capability to operate as more than a “mom and pop” operation.<sup>13</sup> In other words, Taxpayer’s information technology systems and continued support are contained in the services provided to Unitary Affiliate’s customers including communication with customers on the website, billing and reimbursement, and patient referrals. The service received by customers is more than merely the respiratory therapy provided.

#### Whether Parents’ Services are Capable of Separate Measurement

The second part of the *Talley* test is whether the services provided by Parent are capable of separate measurement. Taxpayer argues that the agreement between Parent and Unitary Affiliates establishes arms-length fees for Parent’s services under a transfer pricing methodology accepted under federal regulations. If parent’s services are at arms-length, then it follows that such services are capable of separate measurement. Taxpayer argues that the agreement does not support a unitary finding. However, as the court in *Donnelley* explained,

We caution, however, that the ability to determine income (and whether an arm’s-length negotiation took place) is not the *entire* test to determine whether a business is unitary. *Talley* emphasized that the “fundamental question . . . is whether combined reporting . . . [is] *necessary to clearly reflect the taxable income earned* by those subsidiaries with Arizona income factors.”  
*Donnelley* at 260 (emphasis added in *Donnelley*).

The decision in *Talley* does not preclude a finding that a business is unitary if transactions occur between the entities at arms-length. Rather, the Section maintains that whether Taxpayer complied with federal transfer pricing rules does not determine if it is a single unitary business.

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<sup>12</sup> Post-Hearing Memorandum dated [redacted], page 5.

<sup>13</sup> Section’s Response Memorandum, page 8, quoting Transfer Pricing Analysis submitted by Taxpayer.

The “Residual Profit Participation Agreement” of [redacted] between Parent and [redacted] is explained in the Taxpayer’s Transfer Pricing Analysis:

In this case, any excess profit available in the enterprise after each of the related entities to the transactions have earned arm’s length economic returns can be attributed to the combined activities of all the parties to the controlled transactions.<sup>14</sup>

The combined activities of all the parties contribute to the profits and compel a unitary determination. Combined reporting, in this case, is necessary to clearly reflect the taxable income earned by those subsidiaries with Arizona income factors.

#### Arizona Administrative Code Regulations

Having met the test in *Talley* for a unitary business, we must consider the fifteen factors provided in A.A.C. R15-2D-401(E) and (H) in determining whether operational integration exists.

A.A.C. R15-2D-401(H) states,

In a unitary service business, the operations of the various components or entities of the business are integrated and interrelated by their involvement with the central office or parent in delivering substantially the same service. The day- to-day operations of the components or entities use the same procedures and technologies that are developed, organized, purchased, or prescribed by the central office or parent. There usually is an exchange of employees among the components or entities and centralized training of employees.

The day-to-day operations of the Unitary Affiliates, as explained above, “use the same procedures and technologies that are developed organized, purchased, or prescribed by the central office or parent.” The procedures contained in the facilities and protocol manuals used by the Unitary Affiliates, and created by Parent, “are the specific methods employed to express policies and action in the day-to-day functioning of the [Unitary Affiliates]”.<sup>15</sup> Programs such as the [redacted] program are developed by Parent and sold to physicians and their patients by Unitary Affiliates. Parent’s information technology system, developed and maintained by Parent, is used by Unitary Affiliates in their day-to-day operations from providing information on their website for customers, to billing, to patient referrals.

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<sup>14</sup> Section’s Response Memorandum, page 12, quoting Transfer Pricing Analysis submitted by Taxpayer.

<sup>15</sup> Post-Hearing Memorandum dated [redacted], page 4.

Parent's services also meet the factors provided in A.A.C. R15-2D-401(E). Namely, transfer of materials, goods, products, and technological data and processes between components; sharing of assets by components; centralized training of operational employees; centralized development and distribution of technology relating to day-to-day operations of the components; and centralized advertising with impact at the basic operational level.

Therefore, the services provided by Parent are operational components of the core business embodied in the products and services provided by Unitary Affiliates. Combined reporting of overall net income by Parent and Unitary Affiliates is necessary to clearly reflect the taxable income earned by those subsidiaries with Arizona income factors. The Section correctly included Parent within the combined Arizona corporate income tax returns filed for calendar years ending [redacted] through [redacted].

Based on the foregoing, the Section's denial of Taxpayer's refund request is upheld.

DATED this 5<sup>th</sup> day of May, 2020.

ARIZONA DEPARTMENT OF REVENUE  
HEARING OFFICE

[Redacted]

Chief Hearing Officer

Original of the foregoing sent by  
certified mail to:

[Redacted]

[Redacted]

Copy of the foregoing delivered to:

Arizona Department of Revenue  
Corporate Audit Tax Section