

ARIZONA CORPORATE TAX RULING

CTR 00-2

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

ISSUE:

When are taxpayers united by a bond of direct or indirect ownership or control in order to file a combined return?

APPLICABLE LAW:

Arizona Revised Statute (A.R.S.) § 43-941(A) provides the Department of Revenue authority to combine two or more persons, organizations, trades or businesses, whether or not affiliated, that are owned or controlled directly or indirectly by the same interests.

A.R.S. § 43-941(B) provides the Department of Revenue authority to require combined returns unless the taxpayer has elected or is required to file a consolidated return pursuant to A.R.S. § 43-947.

A.R.S. § 43-942(A) states, "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."

A.R.S. § 43-942(B) provides the Department of Revenue authority to require the filing of a combined report unless the taxpayer has elected or is required to file a consolidated return pursuant to A.R.S. § 43-947.

Arizona Administrative Code (A.A.C.) R15-2-1131(E) provides that entities comprising a unitary business must be united by a bond of direct or indirect ownership or control of more than 50 percent of the voting stock of a subsidiary corporation.

A.A.C. R15-2-1132(E) states that, "[i]f a particular unitary trade or business is carried on by a

taxpayer and 1 or more affiliated taxpayers united by a bond of direct or indirect ownership or control of more than fifty percent (50%) and a part of the business is conducted in Arizona by 1 or more of the members of the group, the business income attributable to such member or members shall be apportioned by multiplying the group's unitary business income by the average of the property, payroll and sales factors."

DISCUSSION:

The Department of Revenue, under the authority of A.R.S. §§ 43-941(B) and 43-942(A), may require the filing of a combined return for a group of corporations comprising a unitary business. In addition, A.A.C. R15-2-1132(E) requires the taxpayer to file an Arizona combined return for a group of corporations comprising a unitary business if at least some part of the unitary business is conducted in Arizona. Pursuant to A.A.C. R15-2-1131(E), the entities comprising the unitary business must be united by a bond of direct or indirect ownership or control of more than 50 percent of the voting stock of a subsidiary company. The principle underlying the unity of ownership requirement is that in order for two entities to be unitary, there must be some bond of ownership or control uniting the entities. When unity of ownership exists, corporations can be commonly controlled in a manner in which the interests of a single corporation can be made subservient to the interests of the entire economic unit represented by all of the corporations in the unitary group. The unity of ownership (common ownership) requirement is only one aspect of determining when corporations are considered unitary. This ruling only examines the requirements for unity of ownership.

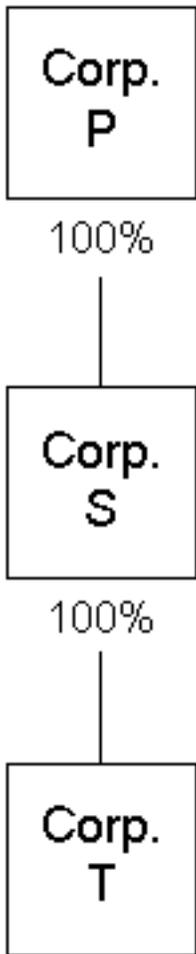
Most courts today have suggested that majority ownership does not need to rest with one individual or entity to satisfy the unity of ownership requirement. A few states are using a *bright-line* test to determine the 50 percent threshold for ownership. For example, Corporation A owns 60 percent of Corporation B's voting stock and 30 percent of Corporation C's voting stock, and Corporation B owns 30 percent of Corporation C's voting stock. Corporations A, B, and C can be combined. In another example, Corporation A owns 40 percent of Corporation B's voting stock and 30 percent of Corporation C's voting stock. Corporation B owns 60 percent of Corporation C's voting stock. Corporation A cannot be combined with B and C because Corporation A does not control the voting stock of Corporation B.

There are many different examples of controlled groups, such as parent-subsidary, brother-sister corporations, and combined groups. Below are examples of some of these controlled groups and whether they satisfy Arizona's unity of ownership requirement (more than 50 percent owned or controlled) for combining taxpayers.

Example 1: Indirect ownership

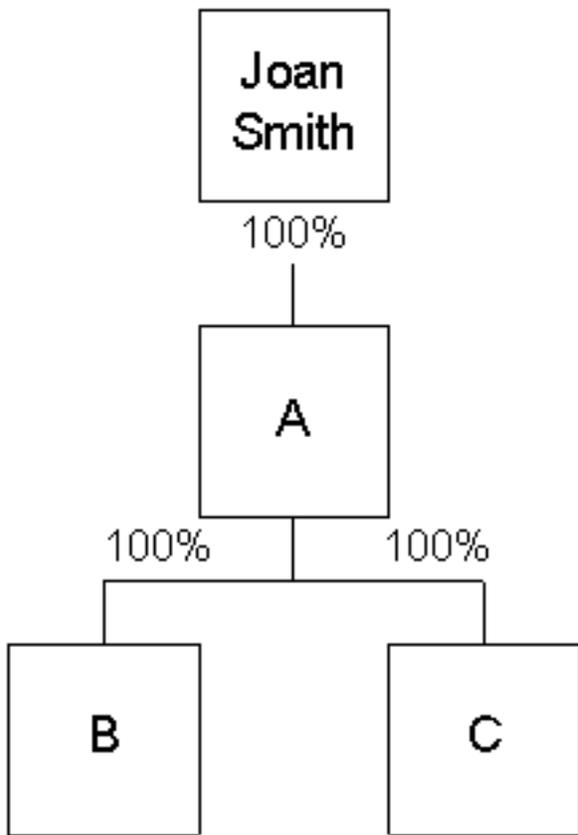
Corporation P owns 100 percent of Corporation S, and Corporation S owns 100 percent of Corporation T. Corporations P and T can be combined provided they meet the unitary

requirements because Corporation P can control (or indirectly owns) Corporation T through its ownership of Corporation S.



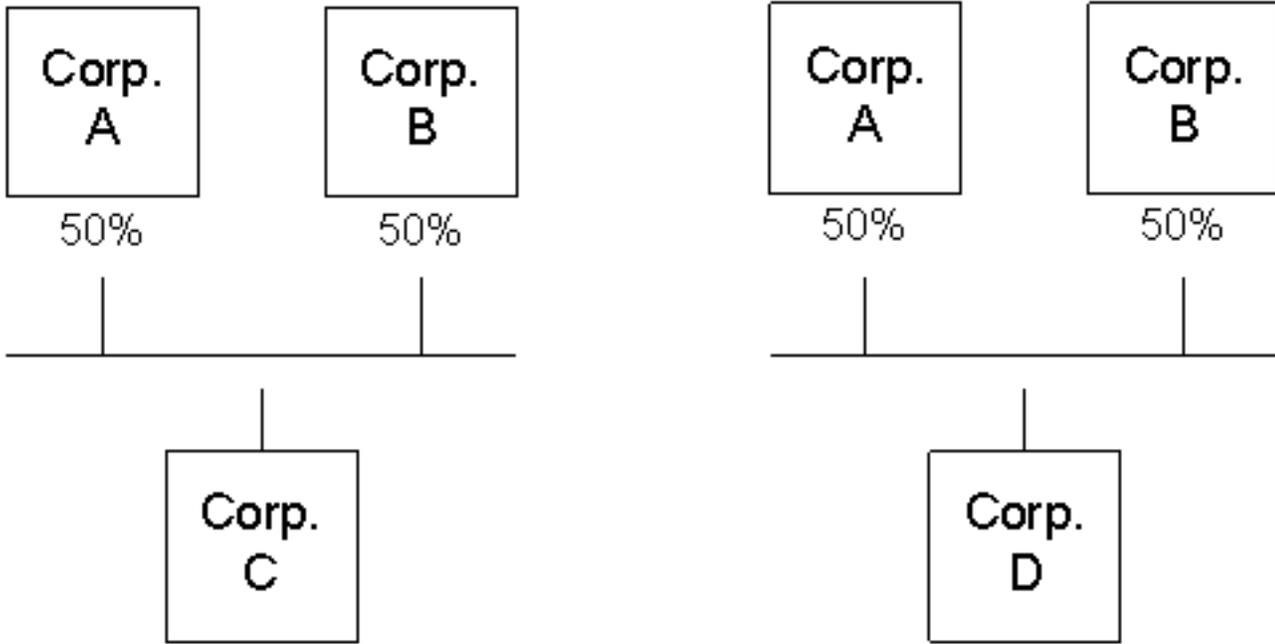
Example 2: Direct/indirect ownership

Joan Smith, an individual, owns 100 percent of the voting stock of Corporation A, which in turn owns 100 percent of the voting stock of Corporations B and C. If Corporations B and C are found to be unitary, they can be combined, because Corporation A controls both B and C by the more than 50 percent threshold. If Corporation A is unitary with Corporations B and C, then all three corporations would satisfy the more than 50 percent threshold test for ownership.

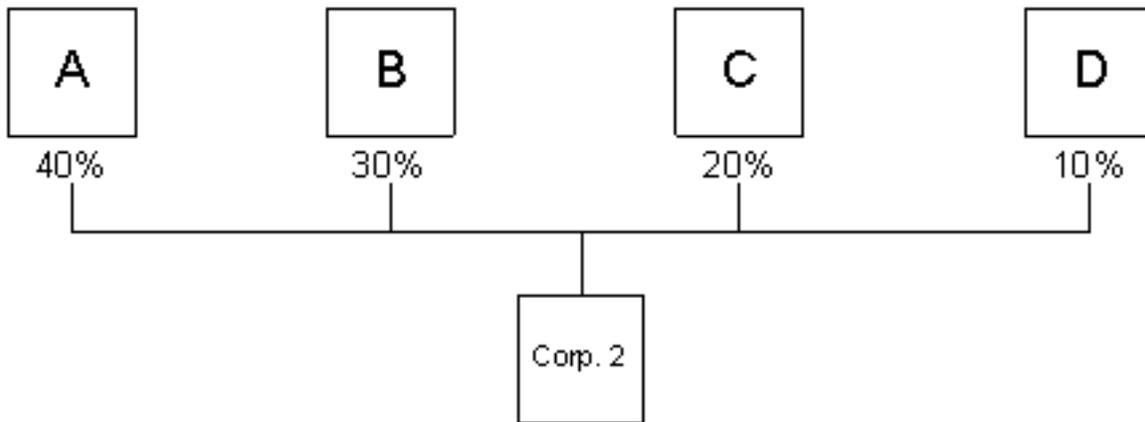
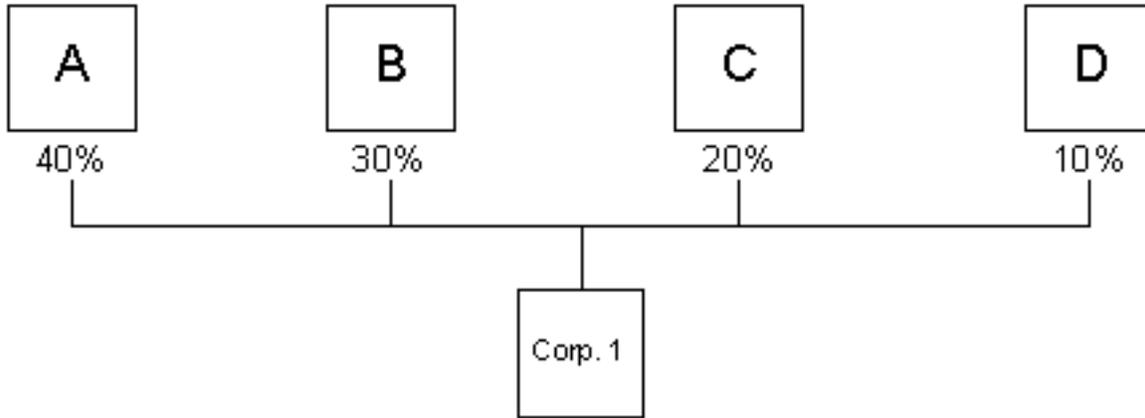


Example 3: Brother-sister groups

Corporation A owns 50 percent of the voting stock of Corporations C and D; Corporation B owns 50 percent of the voting stock of Corporations C and D. If Corporations C and D are unitary, they can be combined if Corporations A and B together are acting in concert to control the voting stock of C and D.



Example 4: Indirect ownership



Individuals A, B, C, and D are related family members and own identical interests in two corporations.

Corporation 1 and Corporation 2 can be combined providing they have the necessary unitary characteristics and family members A, B, C, and D are acting in concert. Family members would be limited to parents, brothers, sisters, grandparents, children, and grandchildren, and their respective spouses.

RULING:

A. If one individual or entity has direct ownership or control of more than 50 percent of the voting stock of two or more corporations, unity of ownership exists among the corporations under A.R.S. § 43-942(A) and A.A.C. R15-2-1131 (E).

B. If indirect ownership exists, such as when a parent corporation owns a chain of corporations, the fact that an intervening corporation in that chain is not a member of a unitary group, for reasons other than unity of ownership, will not prevent the unitary combination of lower tier members with other corporations higher in the chain.

C. Stock is owned when title to the stock is directly held. In addition, stock is considered indirectly owned when title to the stock is constructively owned.

(1) An individual will generally be considered to constructively own stock that is owned by any of the following:

(a) his or her spouse, children, including adopted children, who have not attained the age of 21 years,

(b) An estate or trust, of which the individual is an executor, trustee, or grantor, to the extent that the estate or trust is for the benefit of that individual's spouse or children.

(2) Stock owned by a corporation is constructively owned by any shareholder owning stock that represents more than 50 percent of the voting stock of the corporation.

(3) Stock owned by a partnership is constructively owned by any partner, other than a limited partner, in proportion to the partner's capital interest in the partnership.

(a) For this purpose, a partnership is treated as owning proportionately the stock owned by any other

partnership in which it has a tiered interest, other than as a limited partner.

(b) In any case where a member of a commonly controlled group, or shareholders, officers, directors, or employees of a member of a commonly controlled group, is a general controlling partner in a limited partnership, stock held by the limited partnership is owned by a limited partner to the extent of its capital interest in the limited partnership.

D. When minority shareholders cumulatively own or control more than 50 percent of the voting stock of two or more corporations and have common voting patterns, substantially equal ownership percentages, and the corporations share substantial contribution or dependency, there is an inference that the shareholders are a concerted group and as such shall be required to file a combined return if all unitary requirements are met.

(1) If two or more shareholders, cumulatively owning or controlling in excess of 50 percent of the voting stock of two corporations, are members of the same family, there is an inference that the family members constitute a concerted group and meet the ownership requirements in A.R.S. §§ 43-941 and 43-942. (See Example #4 above.)

E. Evidence of combined ownership or control of voting stock by a group of shareholders will require examination of all of the facts and circumstances, including the business relationship of the corporations sought to be combined, shareholder relationships, the degree of common ownership, and the relative percentage of ownership or control by each shareholder.

Mark W. Killian, Director
Signed: August 21, 2000

Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law that are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement that provides interpretation, detail, or supplementary information concerning application of the law. Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling. See GTP 96-1 for more detailed information regarding documents issued by the Department of

Revenue.