



ERNIE FLETCHER
GOVERNOR

OFFICE OF THE SECRETARY
FINANCE AND ADMINISTRATION CABINET
383 CAPITOL ANNEX
FRANKFORT, KENTUCKY 40601
(502) 564-4240
(502) 564-6785 FAX

ROBBIE RUDOLPH
SECRETARY

In the matter of:

[REDACTED] COMPANY & SUBSIDIARIES

Contact: [REDACTED]
Assistant Treasurer

[REDACTED] Co. and Subsidiaries

FINAL RULING NO. 2006-18
March 24, 2006

[REDACTED] Company
[EIN [REDACTED]]
Corporation Income Tax and License Tax (1988—1993)

FINAL RULING

The Kentucky Department of Revenue has reviewed the “unitary” corporation income and license tax returns filed by a group of separate corporations under the name “[REDACTED] Company and Subsidiaries” (the “[REDACTED] Corporations”) for the taxable years 1988 through 1993.

These “unitary” returns constitute refund claims for an aggregate alleged overpayment of corporation income tax of \$[REDACTED], exclusive of statutory interest, as follows.

Taxable Year	Refund Claim Filed	Alleged Tax Overpayment
1988	~ 04.21.92 ~	+\$ [REDACTED]
1989	~ 04.21.92 ~	+\$ [REDACTED]
1990	~ 04.21.92 ~	+\$ [REDACTED]
1991 ¹	~ 09.02.92 ~	+\$ [REDACTED]
1992 ²	~ 09.01.93 ~	+\$ [REDACTED]
1993	~ 09.06.94 ~	+\$ [REDACTED]
Total		+\$ [REDACTED]

¹ Although the 1991 return is dated 09.02.92, it appears to have been mailed to the Revenue Cabinet in an envelope postmarked September 3, 1993.

² As of March 18, 2005, the return for 1992 did not appear to have been filed. The Department of Revenue requested [REDACTED] to provide a copy of the 1992 return. On [REDACTED], 2005, [REDACTED] submitted a copy of its 1992 return, which is dated September 1, 1993.

Also in issue are refund claims for alleged overpayments of corporation license tax of \$██████████ for 1988; \$██████████ for 1991; \$██████████ for 1992; and \$██████████ for 1993.

These income and license tax refund claims have been made in the context of protests of the Department of Revenue's assessment of additional income taxes for the taxable years 1987 through 1989, totaling \$██████████. Assessments of additional tax and notices of tax due for the years 1987 through 1989 were mailed to ██████████ Company on ██████████, 1992 and remain outstanding.

The claimed tax payments made by ██████████ for the years in question have not been verified. The alleged tax overpayments set forth above appear, in at least several of the years, to include alleged overpayment credit carryforwards from prior years. For example, the alleged overpayment of \$██████████ made for 1993, includes the \$██████████ alleged overpayment made for 1992.

Original Returns and "Unitary" Returns

1988. The original return of ██████████ Company ("██████████") for 1988, postmarked 09.08.89, states that the return is a "separate company" return. However, the original 1988 return appears to have been a consolidated return including the income and loss not only of ██████████ but several other separate corporations.

A first amended return for 1988, postmarked 12.05.90, states that it is filed on a separate company basis, and claims that ██████████ made a \$██████████ overpayment of corporation income taxes for 1988, based on alleged remittances of \$██████████ against a tax liability per the amended return of \$██████████. The \$██████████ in claimed remittances is listed on the original 1988 return as having been paid as license tax. The original 1988 return does not indicate that any income tax payments were ever made to Kentucky for 1988.

The original 1988 return (which reported negative taxable income), also sought a license tax refund of \$██████████. This license tax refund claim was not changed by the first amended 1988 return filed 12.05.90. License tax liability appears to have been determined on a separate company basis, computed at \$██████████, versus alleged remittances of \$██████████ (consisting of \$██████████ paid and an alleged overpayment carryover of \$██████████ from 1987).

Thus aggregate alleged income (\$██████████) and license (\$██████████) overpayments for 1988 reflected on the original 1988 return and the first amended 1988 return, exceed the aggregate alleged remittances for the year (\$██████████).

A second amended return for 1988, filed on or about April 21, 1992, states that it has been prepared on a "unitary" basis, i.e., that ██████████ and the other separate corporations included in the combined return conduct a unitary business. The second amended

The original 1991 return states that it has been prepared on a “consolidated” rather than “unitary” basis. The original 1991 return reports remittances of \$██████████ for income tax (versus reported income tax liability of zero) and \$██████████ for license tax (versus reported license tax liability of \$██████████).

1992. The original return of ██████████ Company for 1992 is dated 09.01.93.

The original 1992 return states that it has been prepared on a “consolidated” rather than “unitary” basis. The original 1992 return reports remittances of \$██████████ for income tax (versus reported income tax liability of zero) and \$██████████ for license tax (versus reported license tax liability of \$██████████).

The original 1992 return requests that an alleged license tax overpayment of \$██████████ be credited to 1993 tax liability. The original 1992 return requests that the alleged income tax overpayment of \$██████████ be credited against 1992 license tax liability.

1993. The original return of ██████████ Company for 1993, filed on or about 09.06.04, claims income tax remittances of \$██████████ for 1993 and a prior year (1992) overpayment credit carryover of \$██████████, or a total of \$██████████. The alleged 1993 remittance and any overpayment credit carryover from 1992 do not appear to have been verified. The original 1993 return reports an income tax liability of zero, and an alleged income tax overpayment of \$██████████. The original 1993 return reports a license tax liability of \$██████████, and claimed license tax remittances of \$██████████, resulting in an alleged license tax overpayment of \$██████████.

“Unitary Business”

Under a well established line of Kentucky cases, the taxpayer has the burden of providing sufficient information to the Department of Revenue to support a refund claim. Eagle Mach. Co., Inc. v. Com. by Gillis, 698 S.W.2d 528, 529 (Ky. App. 1985); Scotty’s Const. Co., Inc. v. Revenue Cabinet, 779 S.W.2d 234, 235 (Ky. App. 1989).

Following various correspondence from ██████████ addressing some of the outstanding issues involved in (i) ██████████’s protest of the \$██████████ assessment of additional income tax for the years 1987 through 1990, and (ii) ██████████’s refund claims for 1988 through 1991 and 1993, a conference was held at the Department of Revenue on ██████████, 2004. ██████████ was invited to submit any additional information in support of its position within 45 days.

No additional information was submitted by ██████████.

On ██████████, 2005, the Department of Revenue issued a Notice of Disallowance of ██████████'s refund claims for the years 1988 through 1991 and for the year 1993.

On ██████████, 2005, ██████████ protested the Notice of Disallowance.

Based on the information supplied by ██████████, there is no substantial reason to think that the separate company returns of the ██████████ Corporations, do not appropriately reflect each separate corporation's "income derived from business activity fairly attributable to the taxing state" of Kentucky. GTE v. Revenue Cabinet, 889 S.W.2d, 788, 791 (Ky. 1994). A combined or unitary return does not appear to be necessary to fairly measure the income of each of the ██████████ Corporations that is properly taxable by Kentucky.

According to the information supplied by ██████████, "██████████ and its affiliates are functionally integrated through the exercise of centralized management in the areas of intercompany financing, cash management, tax compliance, employee benefits, insurance, legal, internal audit, accounting, purchasing, and capital investment." It appears that these alleged administrative services are provided to the ██████████ Corporations by their common parent, ██████████ Company ("██████████") (EIN ██████████). No information has been supplied as to the scope or economic impact of these administrative services.

The fact that various administrative services are provided to the ██████████ Corporations by their common parent is generally irrelevant to the question of whether the various operating companies conduct a unitary business. Such administrative services do not make the discrete businesses conducted by the separate corporations unitary. Unless there is substantial interdependence of basic operations between different corporations, the corporations do not conduct a unitary business.

The information supplied by ██████████ in no way demonstrates any substantial interdependence of basic business operations between the two principal operating subsidiaries (██████████ and ██████████), or for that matter between any of the operating subsidiaries.

Stated another way, several separate corporations should be treated as a unitary business only if their basic operations are substantially interdependent. Otherwise, there is no reason to think that separate returns filed by separate corporations under the normal apportionment formula do not appropriately reflect the "income from business activity fairly attributable to the taxing state" of each corporation. GTE v. Revenue Cabinet, 889 S.W.2d 788, 791 (Ky. 1994).

Nor has there been any sufficient showing by the ██████████ Corporations of any flow of value between the separate corporations that is not adequately measured by the separate company returns of the separate corporations. The mere existence of intercompany financing

and administrative services, demonstrates neither a substantial flow of value, nor substantial functional integration, nor substantial interdependence of basic operations.

The unitary method refund claims made by the ██████████ Corporations for the taxable years 1988 — 1993 are disallowed in their entirety, on the ground that the ██████████ Corporations have not established that the ██████████ Corporations conduct a “unitary business” which would require the separate corporations to be treated as a single “unitary” corporate taxpayer.

Net Operating Loss Carryovers

The unitary method refund claims made by the ██████████ Corporations for the taxable years 1988 — 1993 are also disallowed, on the ground that the ██████████ Corporations have not established the correct taxable income of the alleged unitary group for the years in question.

Each of the unitary or consolidated returns for the years in question calculates taxable income by taking into account a net operating loss carryover from taxable years ending on or before December 30, 1986.

According to the information supplied by the ██████████ Corporations, these net operating losses were not incurred by any of the corporations that are included within the alleged unitary group consisting of the ██████████ Corporations. Rather, these NOLs were incurred by a completely different group of corporations, all of which were subsidiaries of ██████████ Corporation (the “██████████ Subsidiaries”) during the years the losses were incurred.

According to the information supplied by the ██████████ Corporations, on December 30, 1986, the corporation named ██████████ Company and two sister corporations (*i.e.*, other subsidiaries of the ultimate parent), acquired all of the stock of a corporation named “██████████ Company” (EIN ██████████), which was itself a subsidiary of ██████████ Corporation (the “██████████ Sub”).

The ██████████ Sub was named “██████████ Company,” which is the same corporate name as the parent corporation of ██████████. But the ██████████ Sub named “██████████ Company” and ██████████’s parent corporation named “██████████ Company,” are two completely different corporations.

Following the acquisition of the stock of the ██████████ Sub by ██████████ and its two sister corporations on ██████████, 1986, the ██████████ Sub was liquidated. That is, its assets were distributed to its shareholders. Those shareholders were ██████████ and its two sister subsidiaries. The liquidation of the ██████████ Sub and the

distribution of its assets occurred on ██████████, 1986, the day after ██████████ and the two other corporations purchased the stock of the ██████████ Sub.

██████████ contends that the net operating losses incurred by the ██████████ Sub during the years it was a subsidiary of ██████████ Corporation and prior to its acquisition by ██████████ and its two sister subsidiaries (the "██████████ Period NOLs"), carried over to ██████████ and the two other corporations.

The key premise of this contention is the argument that the liquidation of the ██████████ Sub, and the distribution of its assets to three corporate shareholders, qualified as a parent-subsidiary liquidation described by Section 332 of the Internal Revenue Code.

IRC § 332 applies only if "the corporation" to which the assets are distributed, owns at least 80% of the liquidating corporation's stock. IRC § 332(b)(1). The stock of the ██████████ Sub was owned, according to ██████████, by three separate corporations, none of which owned at least 80% of the stock of the ██████████ Sub.

The ██████████ Period NOLs therefore did not carry over under Section 332 from the ██████████ Sub to ██████████ or to either of the other two corporate shareholders of the ██████████ when the ██████████ Sub was liquidated on ██████████, 1986, because none of the three corporations owned at least 80% of the liquidating corporation's stock.

It is irrelevant, for Kentucky corporate income tax purposes, that the federal consolidated return regulations aggregate the stock ownership of consolidated group members for purposes of § 332. See Treas. Reg. § 1.1502-34. The Kentucky corporate income tax law did not permit corporations to file consolidated Kentucky income tax returns for the years in question. ██████████ and its two sister corporations were no more allowed in 1986 to use the federal consolidated return regulations to determine tax attribute carryovers, than they were to use the federal consolidated return regulations to combine their separate items of income and expense. The federal consolidated return regulations are not applicable unless a consolidated return is permitted under state law.

Because the returns in question incorrectly include net operating loss carryovers incurred by other corporations during the ██████████ Period Returns, the ██████████ Corporations have not established the correct taxable income of the alleged unitary group for the years in question, and therefore have not established that any "overpayment" of tax has been made.

Alleged License Tax Overpayments

Based on the information supplied by ██████████, the Department of Revenue has been unable to verify the claimed tax payments made to Kentucky for the years in question, or the computation of the alleged corporate license tax liability for the years in question.

Under Kentucky law, the corporate license tax is determined on a separate company basis, not on a unitary basis. The returns submitted by the ██████████ Corporations appear to compute the applicable corporate license tax liability on a consolidated basis.

The ██████████ Corporations have therefore failed to establish any "overpayment" of corporate license tax for the years in question.

FINAL RULING

Based on the foregoing, the refund claims made by the separate corporations under the name ██████████ Company and Subsidiaries for the taxable years 1988 through 1993 are disallowed in their entirety.

Based on the foregoing, the tax returns and supporting information filed with the protest of the Notice of Disallowance by ██████████ and all related information submitted by the ██████████ Corporations, the Department of Revenue has determined that the ██████████ Corporations (i) have not established that the separate company returns of the ██████████ Corporations do not appropriately reflect each separate corporation's "income derived from business activity fairly attributable to the taxing state" of Kentucky, as required by GTE v. Revenue Cabinet, 889 S.W.2d, 788, 791 (Ky. 1994), (ii) have not established that the ██████████ Corporations conduct a "unitary business" which would require the separate corporations to be treated as a single "unitary" corporate taxpayer under applicable law, and (iii) have not established the correct taxable income of the alleged unitary group for the years in question, and therefore have not established that any "overpayment" of corporate income tax has been made.

The claims for refund of alleged corporate license tax overpayments are disallowed because the ██████████ Corporations have failed to substantiate the alleged tax remittances for the years in question and to correctly compute the corporate income tax liability for the years in question on a separate company basis, and therefore have not established that any "overpayment" of license tax has been made.

This letter is the final ruling of the Kentucky Department of Revenue.

APPEAL

You may appeal this ruling to the Kentucky Board of Tax Appeals pursuant to the provisions of KRS 131.110, KRS 131.340-131.365, 103 KAR 1:010 and 802 KAR 1:010. If you decide to appeal this ruling, you must file your complaint or petition of appeal with the Clerk, Kentucky Board of Tax Appeals, 128 Brighton Park Boulevard, Frankfort, Kentucky 40601, within 30 days from the date of this letter. The rules of the Kentucky Board of Tax Appeals, which are set forth in 802 KAR 1:010, require that the complaint or petition of appeal must:

1. Be filed in quintuplicate;
2. Contain a brief statement of the law and facts in issue;
3. State the petitioner's position regarding the law, facts or both; and
4. Include a copy of this final ruling letter with each copy of the complaint or petition.

The petition of appeal must be in writing and signed by the petitioner or appellant. Filings by facsimile or other electronic means will not be accepted.

Proceedings before the Kentucky Board of Tax Appeals are conducted in accordance with 103 KAR 1:010, 802 KAR 1:010 and KRS 131.340-131.365 and KRS Chapter 13B. Formal hearings are held by the Board concerning the tax appeals before it, with all testimony and proceedings officially reported. Legal representation of parties to appeals before the Board is governed by the following rules set forth in Section 2 (3) of 802 KAR 1:010:

1. An individual may represent himself in hearings before the Board;
2. An individual who is not an attorney may not represent any other individual, corporation, trust, estate, or partnership before the Board;
3. An attorney who is not licensed to practice in Kentucky may practice before the Board if he complies with Rule 3.030(2) of the Rules of the Kentucky Supreme Court.

You will be notified by the Clerk of the Board of the date and time set for any hearing.

Sincerely,
DEPARTMENT OF REVENUE
FINANCE AND ADMINISTRATION CABINET



THOMAS H. BROWN
Director
Division of Protest Resolution

CERTIFIED MAIL
RETURN RECEIPT REQUESTED



