



1 Appellant filed amended returns for 1994 and 1995 claiming refunds for these tax years. The  
2 amended returns reflected a change in filing method from separate company (PNI only) to full  
3 combination (PNI, Central, Central Newsprint, Bradley, Topics Newspapers, Inc.; Indianapolis  
4 Newspapers, Inc.; and Muncie Newspaper, Inc.) The Arizona Department of Revenue (the "Department")  
5 denied the refund claims. Appellant timely protested the denial and amended the refund claims to reflect  
6 a select combination filing which included only PNI, Central Newsprint and Bradley (Phoenix Newspaper,  
7 Inc. and Affiliates) (collectively, "Appellant"). This amendment resulted in an increase of the refunds  
8 claimed.

9 A Hearing Officer denied Appellant's protest. Appellant then timely protested the Hearing  
10 Officer's decision to the Director of the Department, who upheld the decision. Appellant now timely  
11 appeals to this Board.

12 DISCUSSION

13 The issue before the Board is whether the Department properly denied Appellant's refund claims.

14 A.R.S. § 43-492 provides the following:

15 A. In any case of two or more corporations owned or controlled directly or indirectly by  
16 the same interest, the department may distribute, apportion or allocate gross income,  
17 deductions, credits or allowances between or among such taxpayers, if it determines that  
such distribution, apportionment or allocation is necessary in order to prevent evasion of  
taxes or clearly to reflect the income of any such taxpayer.

18 B. For the purpose of enforcing this section, the department may require the filing of a  
19 combined report . . . .

20 The Department generally requires corporations to file combined returns if they operate as a unitary  
21 business.

22 Members of a unitary business may be horizontally integrated, as are segments of a railroad  
23 operated in several states. *State v. Talley*, 182 Ariz. 17, 25, 893 P.2d 17, 25 (App. 1994). Or they may  
24 be vertically integrated, as are companies that manufacture, produce, and sell at retail, doing business in  
25 several states. *Id.* It is difficult to determine the correct tax liability for a member of a unitary business  
because of the existence of substantial transactions, interrelations, or interdependence of basic

1 operations among the various income earning entities. *Id.* The entities in a unitary business derive  
2 income from their own business efforts plus the efforts of other members of the unitary business  
3 operation. *Caterpillar Tractor Co. v. Lenckos*, 417 N.E.2d 1343, 1347 (Ill. 1981). Thus, the unitary  
4 business doctrine was created because states were unable to establish a fair arm's length price for goods  
5 transferred, or basic services rendered, between controlled branches of an enterprise. *Talley*, 182 Ariz.  
6 at 25, 893 P.2d at 25.

7 Under Arizona law, in order to form a unitary group companies must show that they share 1)  
8 common ownership, 2) common management, and 3) reconciled accounting. A.A.C R15-2D-401(D). The  
9 regulations further indicate that the presence of these three characteristics alone is not sufficient to  
10 establish a unitary group "without evidence of substantial operational integration" among the members.  
11 R15-2D-401(E). Presumptive evidence of operational integration exists where there is an inter-company  
12 "transfer of over twenty percent (20%) of the total goods annually manufactured, produced or purchased  
13 as inventory for processing and/or sale by the transferor, or over twenty percent (20%) of the total goods  
14 annually acquired for processing and/or sale by the transferee. A.A.C R15-2D-401(G).

15 Appellant argues that PNI, Central Newsprint and Bradley may file combined income tax returns  
16 as a unitary group for 1993 and 1994 because they share common ownership, common management,  
17 and a reconciled accounting system. Appellant further contends that it satisfies the threshold requirement  
18 demonstrating operational integration because PNI purchased over 20% of its newsprint (whether  
19 measured by weight or cost) from Ponderay.

20 Appellant acknowledges that Ponderay is not a member of the unitary group but argues that its  
21 sales should be attributed to Central Newsprint and Bradley because these companies were established  
22 for the sole purpose of holding partnership interests in Ponderay and are precluded by a partnership  
23 agreement from conducting any other business or activity. However, the administrative rule makes it  
24 clear that PNI must purchase its materials from an entity that is a part of the unitary group. See A.A.C.  
25 R15-2D-401(G). There are no cases in which a court has held that vertical integration exists based on

1 sales from an uncontrolled entity outside of the unitary group. Therefore, Ponderay's sales to PNI are  
2 irrelevant, and Appellant has failed to demonstrate the operational integration necessary to establish a  
3 unitary group.

4 In any event, PNI has not demonstrated the necessity of filing a combined return to accurately  
5 reflect its Arizona income or to prevent the evasion of its Arizona tax liability. There is no evidence that  
6 PNI's Arizona income is attributable to anything other than its own efforts. There is no difficulty  
7 establishing a fair arm's length price for the purchase of paper from Ponderay; the purchase agreement  
8 confirms that PNI pays market price for the paper. Given these facts, the Board concludes that the  
9 Department did not abuse its discretion in disallowing the combined return. Accordingly, the Department  
10 properly denied Appellant's refund claims.

11 CONCLUSIONS OF LAW

12 The Department properly denied Appellant's refund claims. A.R.S. § 43-492; A.A.C R15-2D-401.

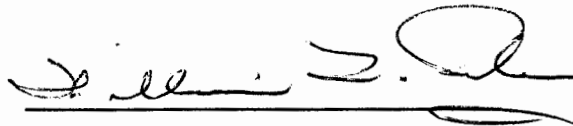
13 ORDER

14 THEREFORE, IT IS HEREBY ORDERED that the appeal is denied, and the final order of the  
15 Department is affirmed.

16 This decision becomes final upon the expiration of thirty (30) days from receipt by the taxpayer,  
17 unless either the State or taxpayer brings an action in superior court as provided in A.R.S. § 42-1254.

18 DATED this 15th day of July, 2003.

19 STATE BOARD OF TAX APPEALS

20  
21 

22 William L. Raby, Chairperson

23  
24 WLR:ALW

1 **CERTIFIED**

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