

IT 02-9

Tax Type: Income Tax

Issue: Unitary – Inclusion of Company(ies) In A Unitary Group

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

“ABERNATHY SPECIALTIES, INC.”; “JAMES” & “JOAN BRUBAKER”, Taxpayers	}	No. 99-IT-0000
v.		FEIN 13-0000000 (“Abernathy”) SSN 000-00-0000 (“Brubaker”) Tax Year 12/31/94
THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	}	John E. White, Administrative Law Judge

**RECOMMENDED ORDER REGARDING
THE PARTIES’ CROSS-MOTIONS FOR SUMMARY JUDGMENT**

Appearances: Fred Czerwionka, appeared for “Abernathy Specialties, Inc.” and “James” and “Joan Brubaker”; Ralph Bassett, Jr., Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis: This matter involves the Illinois Department of Revenue’s (“Department”) denial of amended returns filed by “James and Joan Brubaker” (“the Brubakers”), and by “Abernathy Specialties, Inc.” (“Abernathy”), to claim a refund of Illinois income and replacement taxes previously paid regarding tax year ending December 31, 1994. The “Brubakers” were 50% shareholders in “Abernathy”. Since they are nonresidents, their Illinois income tax liability was attributable to “Abernathy’s” business activities.

The parties agreed to proceed by filing cross-motions for summary judgment regarding a single issue, whether each of “Abernathy’s” three divisions conducted a separate business, or whether, together, they conducted a single business. As part of their cross-motions, the parties relied on a comprehensive stipulation of facts. “Abernathy” and the “Brubakers” also submitted the sworn affidavits of “Dan Devine”, “Abernathy’s”

treasurer and assistant secretary, and of “James Brubaker”. Following briefing of their cross-motions, the parties also made oral arguments at hearing. After considering the parties’ cross-motions, I am including in this recommendation a statement of material facts not in dispute, and conclusions of law. I recommend that the issue be resolved in favor of “Abernathy” and the “Brubakers”.

Statement of Material Facts Not in Dispute:

Procedural Facts Regarding Taxpayers’ Returns

1. “Abernathy” filed an Illinois income and replacement tax return for 1994 (Form IL-1120-ST). Stipulation of the Parties (“Stip.”) ¶ 1; Stip. Ex. 1 (copy of “Abernathy’s” 1994 IL-1120-ST).¹ “Abernathy” also filed a federal Form 1120S for 1994. Stip. ¶ 1; Stip. Ex. 2 (a copy of “Abernathy’s” 1994 federal 1120S).
2. The “Brubakers” filed a joint individual Illinois income tax return for 1994 (Form IL-1040). Stip. ¶ 2; Stip. Ex. 3 (copy of the “Brubaker’s” 1994 IL-1040).
3. On or about October 14, 1998, “Abernathy” filed a claim for refund, Form IL-843, for 1994, seeking a refund of \$93,814. Stip. ¶ 3; Stip. Ex. 4 (copy of “Abernathy’s” 10/14/98 IL-843).
4. On or about June 3, 1999, “Abernathy” filed an amended Illinois refund claim for 1994, in the amount of \$117,530. Stip. ¶ 4; Stip. Ex. 5 (copy of “Abernathy’s” 6/3/99 IL-843).
5. On October 10, 1998, the Brubakers filed an amended individual income tax return, Form IL-1040-X for 1994, requesting a refund of \$93,180. Stip. ¶ 5; Stip. Ex. 6 (copy of the “Brubaker’s” 1994 IL-1040X).
6. On March 12, 1999, the Department’s revenue auditor issued a report recommending, *inter alia*, that “Abernathy’s” and the “Brubakers” amended

¹ The parties labeled their stipulated exhibits using letters of the alphabet. To conform such exhibits to Department’s applicable hearing regulation, I am substituting the numbers 1-37 for the parties’ stipulated exhibits A-KK. 86 Ill. Admin. Code § 200.155(c).

returns / claims for refund be denied in their entirety. Stip. ¶ 6; Stip. Ex. 7 (copy of audit report), p. 5.

7. In his report, the auditor also removed the receipts related to the gain from “Abernathy’s” sale of one of its operating divisions from the denominator of the sales factor, even though there was no dispute that the gain was reported as being, and in fact was, business income. Stip. Ex. 7, pp. 4, 8. That change had the effect of increasing the amount of tax due regarding “Abernathy’s” & the “Brubaker’s” original returns. *See id.* The “Brubakers” paid that additional tax due, and included that issue as part of “Abernathy’s” 6/3/99 amended claim for refund. Stip. Ex. 5.
8. On August 11, 1999, the Department issued a Notice of Denial (“Denial”) to “Abernathy” denying its original and amended claims for refund in the amount of \$117,530. Stip. ¶ 7; Stip. Ex. 8 (copy of “Abernathy’s” Denial).
9. On September 27, 1999, the Department issued a Denial to the “Brubakers”, denying their \$93,180 claim for 1994. Stip. ¶ 8; Stip. Ex. 9 (copy of the “Brubaker’s” Denial).
10. “Abernathy” and the “Brubakers” timely protested the respective Denials, and asked for a hearing. Stip. ¶¶ 9-10; Stip. Exs. 10-11 (respectively, a copy of “Abernathy’s” and the “Brubaker’s” protests).

Facts Regarding “Abernathy’s” Structure, Ownership and Management Operations

11. “Abernathy”, a Subchapter S corporation, was incorporated under the laws of the State of Delaware. Stip. ¶ 11.
12. “Edgar Bergen” (“Bergen”) owned 50% of the issued and outstanding shares of “Abernathy”. Stip. ¶ 16. “Bergen” resided in New York City and maintained offices in New York. *Id.*
13. Together, the “Brubakers” owned the other 50% of “Abernathy’s” issued and outstanding stock. Stip. ¶ 16; Taxpayer’s Motion for Summary Judgment

(“TMSJ”), Attachment 1 (affidavit of “James Brubaker”, ¶ 3 (hereinafter, “TMSJ, “Brubaker” Aff. ¶ []”)) (“James” owned 44.68% and “Joan” owned 5.32% of “Abernathy”). The “Brubakers” resided in Virginia. Stip. ¶ 16.

14. “Bergen” and “James Brubaker” were “Abernathy’s” directors. Stip. ¶ 17.

15. “Abernathy’s” officers were:

- President: “Edgar Bergen”
- Vice-President: “James Brubaker”
- Secretary: “Thomas Mulligan” (“Mulligan”), a New York attorney
- Treasurer & Assistant Secretary: “Dan Devine” (“Devine”)

Stip. ¶ 18.

16. “Abernathy” had three divisions: “AV” division; “TE” division; and “DH” division. Stip. ¶ 12.

17. “AV” manufactured automotive accessory products such as bug deflectors, window shades, light covers and step shields Stip. ¶ 12a; Stip. Ex. 12 (copy of promotional material for “AV’s” products). Its offices, manufacturing facilities and warehouse were located in Georgia. Stip. ¶ 12a. “AV” had no property, payroll or sales in Illinois. Stip. ¶ 15.

18. “TE” manufactured locomotive components, such as air compressors, water and oil pumps and other railroad-related components Stip. ¶ 12b; Stip. Ex. 13 (copies of promotional material for “TE’s” products). Its offices, manufacturing facility and warehouse were located in Illinois. Stip. ¶ 12b.

19. “DH” manufactured hinges, fasteners and related hardware Stip. ¶ 12c; Stip. Ex. 14 (copy of “DH’s” memo stationary showing examples of “DH’s” products). Its offices, manufacturing facility and warehouse were located in Michigan. Stip. ¶ 12c. “DH” did not have any payroll, property or sales in Illinois. Stip. ¶ 15.

20. “AV”, “TE” and “DH” each were separate corporations prior to their acquisition by “Bergen” and the “Brubakers”, through “Abernathy”. TMSJ, “Brubaker” Aff. ¶¶ 1-

2. In 1988, the corporations were merged into and became divisions of “Abernathy”. *Id.*, Stip. ¶ 13.
21. The formerly separate corporations were merged into divisions of “Abernathy” to facilitate “Bergen’s” and the “Brubaker’s” election to structure “Abernathy” as a subchapter S corporation. Stip. ¶ 13; TMSJ, “Brubaker” Aff. ¶¶ 1-2.
22. Once acquired by “Abernathy”, the complete management team of each former corporation was left intact. TMSJ, “Brubaker” Aff. ¶ 2.
23. “Bergen” and “James Brubaker” were venture capitalists by profession. TMSJ, “Brubaker” Aff. ¶ 3. While officers and directors of “Abernathy”, they did not perform any operational duties for any of the divisions. *Id.*; Stip. ¶ 56.
24. Each of the divisions was managed by an individual holding the title of president. “Ally McBeal” (“McBeal”) was “AV’s” president, “Randy Royce” (“Royce”) was “DH’s” president, and “Bruce DuMont” was “TE’s” president. Stip. ¶ 19.
25. “Bergen” and “James Brubaker” approved the salaries and bonus paid to “McBeal”, “Royce” and “DuMont”. Stip. ¶ 19.
26. “Abernathy” did not have any corporate offices or headquarters. Stip. ¶ 48. It used “Bergen’s” office address on its letterhead, and “TE’s” Illinois address on its tax return filings. *Id.*

Facts Regarding “Abernathy’s” Officers’ Responsibilities

27. “Bergen’s” responsibility for “Abernathy” was to keep in touch with “TE” personnel to monitor “Abernathy’s” investment in that division. Stip. ¶ 52. He had no day-to-day duties or management responsibilities in any of the respective division’s trade or business activities. Stip. ¶ 56.
28. While he was not an employee of “Abernathy” or any of its divisions, “Bergen” executed various documents for “Abernathy”. Specifically, “Bergen” signed:
- the Loan and Credit Agreement, by and between “Abernathy” and NBD Bank

- the First Amendment to Loan and Credit Agreement, by and between “Abernathy” and NBD Bank
- the Revolving Credit Note, by and between “Abernathy” and NBD Bank
- a 12/20/94 letter from NBD Bank regarding “Abernathy’s” loan agreement

Stip. ¶ 52; Stip. Exs. 30-33 (respectively, copies of the documents listed above).

29. “James Brubaker’s” responsibilities for “Abernathy” were to keep in touch with “AV” personnel and with “DH” personnel to monitor “Abernathy’s” investment in those divisions. Stip. ¶ 53. He had no day-to-day duties or management responsibilities in any of the respective divisions’ trade or business activities. Stip. ¶ 56.

30. “James Brubaker” signed:

- the Agreement For Purchase and Sale of Assets, by and among “Abernathy”, the “Brubakers”, “Bergen”, and “AV”
- the Noncompetition Agreement entered into by and among “AV” and “Abernathy”, the “Brubakers” and “Bergen”.

Stip. ¶ 53; Stip. Exs. 34-35 (respectively, copies of the documents listed above).

31. “Mulligan” had no corporate responsibilities other than to sign legal documents. Stip. ¶ 54. “Mulligan” represented the shareholders and “Abernathy”, as an attorney, in ownership matters. Stip. ¶ 31.

32. “Devine” signed legal documents and tax returns for “Abernathy”, put together quarterly consolidated financial statements for the shareholders, monitored “Abernathy’s” cash sweep account and make disbursements from that account, including payment of certain insurance premiums for each division’s property, liability, worker’s compensation and automobile insurance. Stip. ¶ 55.

33. There was no formal approval process for each division’s annual budget. Stip. ¶ 57. Each division created a budget which was then sent to “Devine”, who consolidated them and passed them on to “James Brubaker” and “Bergen”. *Id.*

Facts Regarding “Abernathy’s” Cash Sweep Account

34. “Abernathy” and each of its divisions maintained separate bank accounts at NBD/Bank of Michigan. Stip. ¶ 23.
35. “Abernathy Specialties” account no. 00000-00 was used as a cash sweep account into which excess funds from the divisions’ accounts were transferred on a daily basis. Stip. ¶ 23.
36. “Devine” was a signatory on “Abernathy’s” account no. 00000-00. Stip. ¶ 23. Neither “Bergen” nor either of the “Brubakers” signed checks drawn on this account. *Id.*
37. “Abernathy’s” cash sweep account no. 00000-00 was used primarily to make distributions to shareholders. Stip. ¶ 26. Those shareholder distributions of profits were made quarterly from “Abernathy’s” account, along with distributions sufficient to pay the shareholders’ individual income taxes on those profits. Stip. ¶ 26.
38. “Abernathy’s” excess cash was used to pay down a line of credit. Stip. ¶ 26.
39. NBD Bank charged “Abernathy” a fee of approximately \$500 per month in exchange for designing and implementing “Abernathy’s” line of credit and cash sweep account to work, automatically, in the following way:
 - Each division would deposit all of its cash receipts into its individual NBD Bank account. On a daily basis, these receipts would be netted against the checks that cleared. If there were a surplus remaining in a division account, it would automatically be swept into “Abernathy’s” account. If there were a shortage in a division account, it would automatically be funded by the “Abernathy” account.
 - Any surplus in the “Abernathy” account would be used to pay down the line of credit and any shortage in the “Abernathy” account would be cause for

additional borrowing. If any of the divisions and “Abernathy” incurred shortages on the same day, “Abernathy” would borrow from the line of credit and distribute funds to the division reporting the shortage.

- No division had any direct access to “Abernathy’s” line of credit.

Stip. ¶ 29.

40. “Abernathy’s” line of credit was not used to fund the divisions’ operations. Stip. ¶ 27.
41. But for distributions to shareholders, each division would have had sufficient cash deposits to fund its operations without any transfer from “Abernathy’s” cash sweep account. Stip. ¶ 29.
42. Except for “Devine”, the employees at the divisions had no knowledge of any activity with regard to the line of credit. Stip. ¶ 29.
43. Since “AV”, “TE” and “DH” were divisions of “Abernathy”, their assets would have been available as collateral to secure the line of credit for “Abernathy”. Stip. ¶ 27.

Facts Regarding the Division’s Operations

44. There are no financing arrangements negotiated by “Abernathy” on behalf of “AV”, “TE” or “DH”. Stip. ¶ 28.
45. The president of each division and local division personnel had signatory authority over each division’s separate bank account. Stip. ¶ 24. Each division also maintained bank accounts at local banks near its headquarters on which the division’s president and authorized personnel had signatory authority. *Id.* In addition to its account at NBD Bank, “AV” maintained the following bank accounts:

- Wachovia Bank, Acct. no. 00000000, was used for deposits from lock box and for federal tax deposits;
- Nations Bank, Acct. no. 00000000, was used for payroll/payroll checks; and
- Nations Bank, Acct. no. 00000000, was used for freight charges.

Stip. ¶ 24.

46. “McBeal” and “Mark Farkel”, an “AV” employee, were the only persons authorized to sign checks drawn on “AV”s’ accounts. Stip. ¶ 24.
47. “Farkel” supervised and monitored “AV”s’ bank accounts; an employee named “LaWanda” managed “DH”s’ bank account; “Devine” and “Louis Lamour”, “TE” employees, managed, supervised and monitored that division’s bank accounts. Stip. ¶ 25.
48. Each division handled its own leasing and financing of equipment and systems (e.g. copiers, telephones, etc.). Stip. ¶ 28.
49. Each division had its own accounting department, staffed by its own employees. Stip. ¶ 30. “Devine”, however, put together quarterly consolidations for “Abernathy’s” shareholders, “rolling up” the financial data received from each division. *Id.*
50. Each division engaged its own local counsel to represent it in matters affecting the division (i.e. contracts, leases, union contracts, etc.). Stip. ¶ 31.
51. BDO “Franks” prepared “Abernathy’s” federal and state income tax returns. Stip. ¶ 32.
52. Each division prepared its own payroll tax return information. Stip. ¶ 32. “Devine” filed “Abernathy’s” consolidated federal payroll tax returns, based upon the information and data provided by each division. Stip. ¶ 45
53. Each division performed its own marketing and sales function. Stip. ¶ 33.
54. Each division performed its own research and development. Stip. ¶ 34.
55. Each division performed its own purchasing function. Stip. ¶ 35. But for certain insurance coverage, there were no common purchases of services. *Id.*

56. Each division purchased its own raw materials, to wit:
- “AV” purchased plastic, PVC, cardboard, acrylic, MBS, polyethylene and packaging materials. “AV’s” largest suppliers were Plaskolite, Target Container, 3M, Spartech Plastics and Coschoton Steel.
 - “TE” purchased pistons, piston rings, various casting and hose fittings, and gaskets and bearings. “TE’s” largest suppliers of raw materials were Berry Bearing (pistons), AE Goetze (pistons), Hoerbiger (machined valve parts), General Manufacturing Co. (machine castings) and Dana Corp. (piston rings); and
 - “DH” purchased steel bar, rolled steel and aluminum.

Stip. ¶ 35.

57. Each division purchased its own equipment and machinery. Stip. ¶ 36.

58. There was no major supplier that sold to all of the divisions. Stip. ¶ 36.

59. Each division had different competitors.

- “AV’s” major competitors were GT Stylinks, EGR and Kenco;
- “TE’s” major competitors were Gardner Denver, Westington House Air Break and Power Parts Company; and
- “DH’s” major competitors were Sands Hinge, Bassick Company and an Australian “door handle” company.

Stip. ¶ 37.

60. There were no joint or common sales to customers. Stip. ¶ 38. There was no common sales force or strategy. *Id.*

61. While each of the three divisions was engaged in manufacturing, the divisions did not manufacture, fabricate, sell or distribute the same or common products. Stip. ¶ 38. Each division manufactured and sold different products, to different types of customers, in different types of markets:

- “AV’s” major customers were Walmart, Keystone Automotive Warehouse, AutoZone, and Pep Boys;
- “TE’s” major customers were Southern Pacific/DRGW, Union Pacific and Morrison Knudsen; and
- “DH’s” major customer was Grumman Olsen and Utilimaster.

- Stip. ¶ 38.
62. There was no common advertising. Stip. ¶ 39.
 63. Each division performed its own human resources/personnel administration function. Stip. ¶ 40.
 64. Each division handled and administered its own payroll. Stip. ¶ 45.
 65. “Abernathy” obtained insurance covering property, general liability, worker’s compensation and automobiles of each division through a single broker, Johnson & Higgins. Stip. ¶ 41. Insurance premiums for general liability, workers compensation and automobile insurance were paid out of “Abernathy’s” cash sweep account at NBD Bank. *Id.*
 66. In June 1993, “Devine” sought “Bergen’s” input regarding a recommendation by Johnson & Higgins that “Abernathy” increase its umbrella insurance coverage from \$5 million to \$10 million, which required a \$20,000 additional annual premium. Stip. ¶ 41; Stip. Ex. 16 (copy of 6/9/93 letter from “Devine” to “Bergen”). That increase was accepted, and each division paid its proportionate share of the premiums. *See* Stip. ¶ 41; Stip. Exs. 15-16.
 67. Each division obtained other insurance coverage separately. Stip. ¶ 41.
 68. Each division handled its own employee benefit administration. Stip. ¶ 42.
 69. Each division did its own capital expenditure planning. Stip. ¶ 43.
 70. Each division used its own manufacturing technology; there was no common manufacturing technology shared by the divisions. Stip. ¶ 44.
 71. But for “Devine”, there were no employees who had responsibilities for more than one division. Stip. ¶ 46. Most of “Devine’s” time (over 96.35%) was devoted to his duties as controller of “TE”. *Id.*
 72. “Devine” spent approximately 2 to 4 hours per calendar quarter consolidating federal payroll tax returns. Stip. ¶ 46. He spent approximately 1 to 3 hours each calendar quarter rolling up the general ledger. *Id.* He spent 10 to 20 hours per year

doing the annual forecast and about 1 to 2 hours per month on miscellaneous items such as banking and insurance. *Id.* At most, “Devine” spent 76 hours per year, or approximately 3.65% of the “Devine’s” working hours, on matters involving divisions other than “TE”. *Id.*

73. None of the employees of any of the divisions were members of the same bargaining unit nor covered by the same union contract. Stip. ¶ 47. There was no common union contract that covered the employees of more than one division. *Id.*; Stip. Exs. 27-29 (copies of, respectively, labor agreements between each division and the bargaining representative of each division’s covered employees).
74. The divisions did not share computer equipment or services, including processing, storage, software or hardware. Each division had separate computer systems and their own hardware and software. Stip. ¶ 48.
75. The decision to sell “AV” was based upon the advice of “McBeal”, its president. Stip. ¶ 58. “McBeal” suggested to “James Brubaker” and “Bergen” that it was “time to sell,” and he handled all the preliminary sales matters. Stip. ¶ 58. “WB & Company” was hired to help negotiate the final agreement. *Id.* The transaction was closed while “James Brubaker” was on vacation in Europe, but he did have a number of telephone conversations with “WB” regarding the negotiations. *Id.* “AV” was sold for approximately \$27 million. *Id.* “McBeal” was paid approximately \$3 million of that price for his efforts. *Id.*; *see also* Stip. Ex. 36. “McBeal” had been the president of “AV” before it was acquired by “Abernathy”. Stip. ¶ 58; Stip. Ex. 37 (copy of documents entitled Acquisition of “AV” Co. by “Vermong Holdings, Inc.” November 21, 1994, which include the sales contract, exhibits and closing documents).
76. “TE” and “DH” continued their respective business activities after the sale of “AV”. Stip. ¶ 59.

Effect of Determination That “Abernathy’s” Divisions Do Not Conduct a Unitary Business

77. Neither “AV” nor “DH” had any Illinois property, payroll or sales. Stip. ¶ 15. Thus, if the business activities of those divisions were conducted separately from “TE’s” business activities, as described in Illinois Income Tax Regulation (“ITR”) § 100.3010(b), no portion of the income or loss attributable to those divisions would be attributable to Illinois. *Id.*; 86 Ill. Admin. Code § 100.3010(b).

78. If “AV”, “TE” and “DH” operated as separate and distinct trades or businesses, “Abernathy’s” Illinois apportionable business income would be computed, pursuant to ITR § 100.3010(b)(1), as follows:

	“AV”	“DH”	“TE”
Federal Taxable Income	20,369,252	259,648	1,275,395
Additions	0	0	131,633
Subtractions	0	0	0
Illinois Base Income	20,369,252	259,648	1,407,028
Business Income	20,369,252	259,648	1,407,028
Illinois Apportionment Percentage	0 %	0 %	100 %
Business Income Apportionable to Illinois	0	0	1,407,028

Stip. ¶ 60a.

79. If “AV”, “TE” and “DH” operated as separate and distinct trades or businesses, “Abernathy’s” Illinois replacement tax for 1994 would be computed as follows:

Business Income Apportionable to Illinois	\$ 1,407,028
Nonbusiness income	0
Total	1,407,028
Less Standard Exemption	314
Net Illinois taxable income	1,406,714
Replacement Tax	\$ 21,101

Stip. ¶ 60b.

80. If “AV”, “TE” and “DH” operated as separate and distinct trades or businesses, the “Brubakers” individual Illinois income tax liability for 1994 would be \$21,101.

81. If “AV”, “TE” and “DH” operated as separate and distinct trades or businesses, then “Abernathy” and the “Brubakers” are entitled to refunds for 1994, plus statutory interest thereon.

Conclusions of Law:

Procedurally, this matter involves the parties’ cross-motions for summary judgment. Taxpayer’s Motion for Summary Judgment (“TMSJ”), p. 1; Department’s Cross-Motion for Summary Judgment and Response to Taxpayer’s Motion for Summary Judgment, (“DMSJ”), p. 1. The parties take opposite stands on whether, under the undisputed facts regarding “Abernathy’s” business operations, and a matter of law, “Abernathy’s” three divisions constitute three separate businesses, or whether they constitute a single business. The Department claims that “Abernathy’s” three divisions constitute a single business; taxpayers’ assert that they constitute three separate businesses. Department’s Memorandum in Support of Its Cross-Motion for Summary Judgment and Response to Taxpayer’s Motion for Summary Judgment (“Department’s Response”), pp. 7-8; Taxpayers’ Memorandum in Support of Taxpayer’s Motion for Summary Judgment (“Taxpayers’ Brief”), *passim*.

A motion for summary judgment is appropriate where the pleadings, affidavits, and other documents on file show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. 735 ILCS 5/2-1005; People ex rel Department of Revenue v. National Liquors Empire, Inc., 157 Ill. App. 3d 434, 510

N.E.2d 495 (4th Dist. 1987). Here, the parties have presented a comprehensive stipulation of facts regarding “Abernathy’s” structure, ownership and filing history, and regarding the operations of the three divisions. Stip. ¶¶ 1-60. The parties’ stipulation of facts includes facts relevant to each of these essential elements of the issue in dispute. Stip., *passim.*; 86 Ill. Admin. Code § 100.3010(b)(3)(A)-(C). Finally, they both agree that there is no dispute regarding the facts material to the issue presented. Taxpayers’ Motion for Summary Judgment (“TMSJ”), p. 1; DMSJ ¶ 14. “When parties file cross-motions for summary judgment, they agree that (1) no material issue of fact exists; and (2) only a question of law is involved.” Subway Restaurants of Bloomington-Normal, Inc. v. Topinka, 322 Ill. App. 3d 376, 381, 751 N.E.2d 203, 208 (4th Dist. 1997).

Taxpayers’ Motion

Taxpayers’ motion is premised solely on IITR § 100.3010. Taxpayers’ Brief, pp. 7-8. Taxpayers assert that the undisputed facts show that the activities of each of “Abernathy’s” divisions were not integrated, interdependent or inter-contributory. Because the operations of each division were not integrated, were not dependent upon one another, and did not contribute anything to the operations of the other divisions, those operations did not constitute a single trade or business under IITR § 100.3010(b)(3). In its response to the Department’s cross motion, taxpayers additionally contest the Department’s assertion that the activities of “Abernathy’s” three divisions constitute a unitary business.

The Department’s Motion

The Department asserts that “Abernathy’s” three divisions constitute a single trade or business under IITR § 100.3010(b) because their activities are all in the same general

line. Department's Response, pp. 7-8. It further argues that "Abernathy's" three divisions constitute a unitary business because the divisions were commonly owned, were engaged in the same general line of business, and were functionally integrated through the exercise of strong centralized management. *Id.*, pp. 1, 8-16.

Analysis

I. The Issue Is Not Whether "Abernathy" And Its Three Divisions Conduct A Single Unitary Business, But Whether "Abernathy" Conducts A Single Business Or Separate Businesses

Whether two or more persons conduct a single unitary business enterprise is, in some important ways, similar to the question whether a single person, such as "Abernathy", conducts a single trade or business, or separate businesses. They are similar because both use some similar criteria, i.e., both require an investigation as to whether the potential group members or operating divisions are in the same type of business, whether they constitute steps in a vertical process, and whether they operate under strong centralized management. *Compare* 86 Ill. Admin. Code § 100.3010(b)(3) *with* 86 Ill. Admin. Code § 100.3010(c) *and* 86 Ill. Admin. Code § 100.9700(g)-(h). The inquiries also share similar goals in that they either require a group or allow a person to use a method of apportionment that elevates economic substance over corporate form. 35 **ILCS** 304/(a), (e); A.B. Dick Co. v McGaw, 287 Ill. App. 3d 230, 237, 678 N.E.2d 1100, 1105 (4th Dist. 1997); 86 Ill. Admin. Code § 100.3010(b)-(c). Where two or more distinct persons conduct a single unitary business, they must use combined apportionment when determining and reporting their Illinois income tax liabilities. 35 **ILCS** 304/(e); A.B. Dick Co., 287 Ill. App. 3d at 237-38, 678 N.E.2d at 1105. The separate business concept described in IITR § 100.3010(b) does the same thing for the opposite situation, i.e., it

allows separate apportionment where a single corporation conducts substantially separate and distinct businesses. 86 Ill. Admin. Code § 100.3010(b)(1).

The inquiries are also different, however. For example, the unitary inquiry has additional elements that include: (1) common ownership among persons; (2) similarity of apportionment methods; and (3) whether each person's business activities are primarily conducted within the water's edge of the United States. 35 ILCS 5/1501(a)(27); 86 Ill. Admin. Code §§ 100.3010(c), 100.9700(f)-(g). The critical distinction between the two inquiries, however, is that a unitary business group requires the existence of at least two separate and distinct persons. 35 ILCS 5/1501(a)(27); *see also* 35 ILCS 5/1501(18) (definition of "person").

Here, there is no dispute that "Abernathy" is one person, a subchapter S corporation. Stip. ¶¶ 1-3-4, 11; Stip. Ex. 7. Throughout the greater part of its memorandum, however, the Department argues that "Abernathy's" three divisions were engaged in a unitary business. Department's Response, pp. 1 ("Abernathy" ... and its three divisions were engaged in a unitary business enterprise."), 6 (Statement of Issues), 8-16 (argument under the heading, "Abernathy" And Its Three Divisions Were Engaged in a Unitary Business Enterprise."). The Department's preference for a unitary approach to this case is somewhat understandable, since most Illinois apportionment cases dealing with the elements ITR § 100.3010(b) share in common with ITR § 100.3010(c) and ITR § 100.9700 (i.e., same general line of business, steps in a vertical process, strong centralized management) arise from unitary business fact patterns, and not cases in which a single person conducts more than one separate trade or business. *E.g.*, Citizens Utilities Co. of Illinois v. Department of Revenue, 111 Ill. 2d at 39-40, 488 N.E.2d at 987; A.B. Dick Co.,

287 Ill. App. 3d at 239, 678 N.E.2d at 1106. But as a matter of substantive Illinois law, the different segments of a single person can never constitute a unitary business group. 35 ILCS 5/1501(a)(27) (“The term ‘unitary business group’ means *a group of persons* related through common ownership whose business activities are integrated with, dependent upon and contribute to each other. ***”) (emphasis added). Therefore, the Department’s Motion’s claim that it is entitled to judgment as a matter of law because the evidence establishes that “Abernathy” and its divisions are engaged in a unitary business enterprise, must be denied. If the Department is entitled to judgment as a matter of law, it is because “Abernathy” conducts a single business, under IITR § 100.3010(b), and not because it conducts a unitary business, as defined in IITA § 1501(a)(27).

Whether a person conducts separate trades or businesses or a single business is a question of fact. 86 Ill. Admin. Code § 100.3010(b)(3). Since the parties have stipulated to the facts material to each essential element, however, the question becomes whether, as a matter of law, the activities of the three divisions fit the definition of a single trade or business. Subway Restaurants, 322 Ill. App. 3d at 381, 751 N.E.2d at 208. “In general, the activities of the person will be considered a single business if there is evidence to indicate that the segments under consideration are integrated with, dependent upon, or contribute to each other and the operations of the person as a whole.” 86 Ill. Admin. Code § 100.3010(b)(3).

II. Same General Line of Business

As to the first element, the parties’ stipulation is clear that each division manufactured tangible personal property for sale to others. Stip. ¶ 12. The stipulation is also clear that the divisions manufactured different types of products, which were made

from different types of materials purchased from different vendors, and which were sold to different types of purchasers. Stip. ¶¶ 12, 35, 38. The parties dispute the effect of the fact that all of “Abernathy’s” divisions were engaged in manufacturing. The Department asserts that since they were all engaged in the same general line of business, “... there is a strong presumption that those entities are engaged in a single trade or business.” DMSJ, p. 8 (citing 86 Ill. Admin. Code § 100.3010(b)(3)). Taxpayers assert that, since “... the three divisions did not manufacture, fabricate, sell or distribute the same or common products”, they “... were not engaged in the same type of business.” Taxpayers’ Brief, p. 9.

The applicable regulation provides that, “...the presence of any one of these factors creates a strong indication that the activities of the person constitute a single trade or business” (86 Ill. Admin. Code 100.3010(b)(3)), and I must heed the regulation’s plain language. Heavner v. Illinois Racing Bd., 103 Ill. App. 3d 1020, 432 N.E.2d 290 (2d Dist. 1982). Since the three divisions were all engaged in manufacturing, there is a strong indication that they were engaged in a single business. That de facto presumption² of singularity, however, does not render irrelevant the other stipulated facts regarding the operations of “Abernathy’s” divisions, nor does it negate the overriding regulatory directive that a single person such as “Abernathy” “... will be considered a single business if ... the segments under consideration are integrated with, dependent upon, or contribute

² There is no need to quibble about whether ITR § 100.3010’s “strong indication” of singularity amounts to the “strong presumption” of singularity that the Department advocates. That is because the legislature has made the Department’s determinations following its review of a taxpayer’s original or amended returns prima facie correct (35 ILCS 5/904(a)), after which the burden rests with the taxpayer to present documentary evidence closely identified with its books and records to show that the Department’s determination is incorrect. PPG Industries, Inc. v. Department of Revenue, _ Ill. App. 3d _, 765 N.E.2d 34, 38, 2002 WL 113011, *13 (1st Dist. 2002); *see also*, Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296, 421 N.E.2d 236, 238 (1st Dist. 1981).

to each other and the operations of the person as a whole.” 86 Ill. Admin. Code § 100.3010(b)(3). In short, the presumption of singularity based on the fact that “Abernathy’s” divisions are all in the same general line of business is not conclusive of the ultimate issue, nor does it truncate the fact finding process. 86 Ill. Admin. Code § 100.3010(b)(3).

III. Steps in a Vertical Process

IITR § 3010(b)(B) gives the following example of a trade or business whose divisions or segments are engaged in a vertically structured enterprise:

... a person which explores for and mines copper ores; concentrates, smelts and refines the copper ores; and fabricates the refined copper into consumer products is engaged in a single trade or business, regardless of the fact that the various steps in the process are operated substantially independently of each other with only general supervision from the person’s executive offices.

86 Ill. Admin. Code § 100.3010(b)(3)(B).

The stipulated facts show that one division’s products or services were not sold, used, refined or processed by either of the other divisions’ operations. “TE”, “DH” and “AV” all manufactured different kinds of products and sold them to different types of customers, in different types of markets. Stip. ¶ 38. “AV” manufactured auto accessories like bug deflectors, window shades, light covers and step shields and sold them to retailers like Walmart, Keystone Automotive Warehouse, AutoZone, and Pep Boys. Stip. ¶¶ 12a, 38; Stip. Ex. 12. “TE” manufactured locomotive components such as air compressors, water and oil pumps and other railroad-related components and sold them to railroad companies and suppliers like Southern Pacific/DRGW, Union Pacific and Morrison Knudsen. Stip. ¶¶ 12b, 38; Stip. Ex. 13. “DH” manufactured hinges, fasteners and related

hardware and sold them to manufacturers like Grumman Olsen and Utilimaster. Stip. ¶¶ 12c, 38; Stip. Ex. 14. Each division purchased its own materials, machinery and equipment from different suppliers. Stip. ¶ 36. No divisions made any joint or common sales to customers (Stip. ¶ 38), and each had different competitors. Stip. ¶ 37. They neither had nor used a common sales force or strategy (Stip. ¶ 38), and used no common advertising. Stip. ¶ 39.

Finally, the Department's Motion does not assert that the divisions are steps in a vertical process. Thus, the divisions were not steps in a vertical process.

IV. Strong Centralized Management

The applicable income tax regulation provides:

C) Strong centralized management. A person which might otherwise be considered as engaged in more than one trade or business is properly considered as engaged in one trade or business when there is a strong central management, coupled with the existence of centralized departments for such functions as financing, advertising, research, or purchasing. Thus, some corporations may properly be considered as engaged in only one trade or business when the central executive officers are normally involved in the operations of the various divisions and there are centralized offices which perform for the divisions the normal matters which a truly independent business would perform for itself, such as accounting, personnel, insurance, legal, purchasing, advertising, or financing. Note in this connection that neither the existence of central management authority, nor the exercise of that authority over any particular function (through centralized departments or offices), is determinative in itself; the entire operations of the person must be examined in order to determine whether or not strong centralized management absent other unitary indicia as described above (i.e., same type of business or steps in a vertical process) justifies a conclusion that the activities of the person constitute a single trade or business. Both elements of strong centralized

management, i.e., strong central management authority and the exercise of that authority through centralized departments or offices, must exist in order to justify a conclusion that the operations of seemingly separate divisions are significantly integrated so as to constitute a single trade or business.

86 Ill. Admin. Code § 100.3010(b)(3)(C).

The Department argues that “Abernathy” and its three divisions were functionally integrated through the exercise of strong centralized management. Department’s Response, p. 10. It asserts that “Abernathy’s” officers, directors and shareholders provided centralized functions that resulted in significant economies of scale and flows of value for the divisions. *Id.*, pp. 10-11. The Department asserts that this conclusion is supported by the following facts: (1) “Abernathy” and its divisions participated in a cash management system; (2) “Bergen” approved loans and lines of credit; (3) “Abernathy” used common insurance services; and (4) “Devine” performed common services for Liberties divisions. *Id.*, pp. 11-15. I address each of these in turn.

A. “Abernathy’s” Cash Sweep Account and “Bergen’s” Approval of Loans and Lines of Credit

The stipulated facts are that “Abernathy” and each of its divisions maintained separate bank accounts at NBD Bank in Detroit, Michigan, and that “Abernathy” also maintained a cash sweep account there. Stip. ¶ 23. NBD Bank designed “Abernathy’s” line of credit and cash sweep account to work in the following way: Each division would deposit all of its cash receipts into its individual NBD Bank account. On a daily basis, these receipts would be netted against the checks that cleared. If there were surplus funds remaining in a division account, it would automatically be swept into “Abernathy’s” account. If there were a shortage in a division account, it would automatically be funded by the “Abernathy” account. Any surplus in the “Abernathy” account would be used to

pay down the line of credit and any shortage in the “Abernathy” account would be cause for additional borrowing. If any of the divisions and “Abernathy” incurred shortages on the same day, “Abernathy” would borrow from the line of credit and distribute funds to the division reporting the shortage. NBD Bank set up the account to work automatically, that is to say, the bank was the entity that did the netting, sweeping and/or transferring funds between the division’s accounts and the “Abernathy” account. No division had any direct access to “Abernathy’s” line of credit. Stip. ¶ 29. “Abernathy’s” line of credit, moreover, was not used to fund the operations of the divisions. Stip. ¶ 27. “Abernathy’s” excess cash was used to pay down its line of credit. Stip. ¶ 26.

The Department argues that “Abernathy’s” cash sweep account was, in reality, a cash management system like the one used by the parent of the unitary taxpayer in Citizens Utilities Co. of Illinois v. Department of Revenue, 111 Ill. 2d 32, 50, 488 N.E.2d 984 (1986). Department’s Response, pp. 11-12. Despite its stipulation to the contrary, the Department contends that the divisions, as opposed to NBD Bank, daily transferred their excess cash into “Abernathy’s” cash sweep account. *Id.* p. 12. The Department then cites Borden, Inc. v. Department of Revenue, 295 Ill. App. 3d 1001, 1008, 692 N.E.2d 1335 (1st Dist 1998) for the proposition that any transfer of funds from “Abernathy’s” sweep account to cover a shortage in a division’s bank account constitutes an interest-free loan from one member of “Abernathy’s” group to another. Department’s Response, p. 12.

“Abernathy” disputes the Department’s claims that it or its divisions had or used a cash management system, and it also disputes that its cash sweep account created any inter-company loans between the divisions. “Abernathy’s” Reply, pp. 14-15. “Abernathy”

bases its rejection of the Department's arguments on the parties' stipulation that the cash sweep account's primary function was to make distributions to shareholders. Stip. ¶ 26. "Abernathy" also argues that any transfers its sweep account may have made to a division would not be a transfer from one division to another, but a retransfer of the division's own funds, previously swept into the cash account by NBD Bank, back to the division that needed it. "Abernathy" bases that argument on the parties' factual stipulation that, but for the cash sweep account's quarterly profit distributions, each division generated sufficient cash to fund its operations without any transfers from the sweep account. Stip. ¶ 29. "Abernathy" finishes by pointing out that, unlike the case in Citizens Utilities, the cash sweep account it used did not serve the operational purpose of funding or controlling the operations of the various divisions, but rather, it served an investment function, since there is no dispute that its primary use was to make quarterly distributions to the shareholders. "Abernathy's" Reply, p. 15.

When asked directly at oral argument what evidence the Department was relying on for its assertion that "Abernathy's" cash sweep account was a cash management system, counsel for the Department responded that the evidence consisted of the parties' stipulation of facts. But the fact the Department asserts in its motion — that "Abernathy" and its divisions received interest free loans from a cash sweep account that was the centerpiece of "Abernathy's" cash management system" (DMSJ, ¶ 6) — is not supported by any fair understanding of the undisputed facts. In fact, some of its arguments are wholly inconsistent with the facts the Department admits are true. For example, it was not the divisions but NBD Bank that daily transferred any cash remaining in the divisions' separate accounts into "Abernathy's" cash sweep account, after it first applied any debits,

i.e., checks drawn on the division's account, against the cash within a division's separate account. Stip. ¶ 29. Further, the Department stipulated that "Abernathy's" line of credit was not used to fund the divisions' operations (Stip. ¶ 27), and that, but for distributions to shareholders, each division would have had sufficient cash deposits to fund its operations without any transfer from "Abernathy's" cash sweep account. Stip. ¶ 29. Finally, the exhibits admitted by stipulation clearly show that "Abernathy" paid interest at prime or a negotiated rate for whatever loan and/or extensions of credit NBD Bank advanced to it (Stip. Ex. 30, ¶¶ 2.6-2.7; Stip. Ex. 31, ¶ 5; Stip. Ex. 32, p. 1), and there is no distinction in form between "Abernathy" and its divisions. Stip. ¶¶ 11-12. Given all of those stipulations, the Department simply cannot assert that "Abernathy's" cash sweep account made interest free loans to the operating divisions. Dayan v. McDonald's Corp., 125 Ill. App. 3 972, 984, 466 N.E.2d 958, 967 (1st Dist. 1984) (a party's judicial admission conclusively precludes its assertion of a contrary position). As "Abernathy" argued, the better understanding of the undisputed facts is that "Abernathy's" cash sweep account allowed each division to use the cash previously swept from its own account, if such a need arose. Thus, the Department's motion offers no credible reason why "Abernathy's" cash sweep account should be treated as though it were, in fact, a cash management system, or why that account should be seen as having given "Abernathy's" three divisions interest-free loans.

Moreover, the Citizens Utilities court described in depth the type of cash management system that existed in that case:

The record shows the taxpayer and all other subsidiaries in the group to be wholly owned subsidiaries of the parent, and — with few exceptions — the parent and all its subsidiaries share the same officers as well as interlocking

boards of directors. Although day-to-day management of the operating subsidiaries is controlled by local managers, the parent's headquarters in Connecticut (hereafter, headquarters) must specifically approve disbursements made by local managers over certain amounts. In the taxpayer's case, specific approval is required for all purchases exceeding \$500. Headquarters also reviews major engineering projects and provides legal assistance in interpretation of State and Federal laws. Complex accounting functions, including preparation of the taxpayer's income tax returns, are also provided by the headquarters. All of these services are performed for the taxpayer, and the other subsidiaries, at cost: the parent charges only to recover labor and overhead costs associated with those services provided.

Revenues received by the taxpayer are deposited in a local bank and can be withdrawn by the parent at any time. When revenues are withdrawn by the parent, a debit is entered on the taxpayer's inter-company account. That account, carried as a liability by all the subsidiaries with a corresponding account on the parent's books, is the means by which the parent skims earnings from one subsidiary for investment in another. Such investments are made as interest-free loans routed through the inter-company account.

Citizens Utilities Co. of Illinois v. Department of Revenue, 111 Ill. 2d 32, 48, 488 N.E.2d 984, 990-91 (1986).

The cash management system used in Citizens Utilities was primarily used as one of the means by which a corporate parent's managers exercised control over a single unitary business. That integrated system included the parent's management of the group's cash, as well as the parent's creation and maintenance of a system of debits and/or credits regarding a subsidiary's use of the parent's centralized accounting, legal, engineering and other specialized spheres of operational expertise. In contrast, "Abernathy's" use of those banking tools were not parts of an integrated system by which "Bergen", the "Brubakers", and/or others exercised management control over the operations of the divisions. For example, "Abernathy" exercised no formal approval over each division's budgets or capital

expense forecasts. Stip. ¶ 57; TMSJ, “Devine” Aff., ¶ 7. Nor, from the stipulated facts, is there any indication that “Abernathy’s” shareholders or its officers had or exercised any specialized knowledge or expertise to coordinate the operational activities of the divisions. See TMSJ, “Brubaker” Aff., ¶¶ 3-4. As “Abernathy” cogently points out, the stipulated facts show that the cash sweep account served an investment function for “Abernathy’s” owners, and not an operational function to fund, control or otherwise manage the divisions. “Abernathy’s” Reply, p. 15. What “Bergen” and the “Brubakers” controlled by having NBD Bank create and maintain the cash sweep account was the timing of the return on their investment, and not the day-to-day or long-term operations of the separately run divisions. Stip. ¶¶ 26-29, 56.

Thus, the fundamental difference between the cash management system used by Citizens Utilities and the cash sweep account “Abernathy” used is the difference between the purposes for which the two tools were used. When writing tax law, legislators often trigger the taxability of particular commercial or corporate transactions on the purposes underlying the transactions. In sales and use tax cases, for example, taxability frequently depends on how one, in fact, uses a particular item of tangible personal property, i.e., sales or purchases for exempt purposes are exempt from tax. *E.g.*, 35 ILCS 105/2 (definition of use), 3-5 (uses exempt from tax); 35 ILCS 120/1 (definition of sale at retail), 2-5 (exemptions based on purchaser’s primary use of tangible personal property sold at retail). Additionally, in income tax cases, the function a particular transaction or asset serves may determine a state’s ability to apportion the income derived from that transaction or asset. Allied-Signal, Inc. v. Director, Div. of Taxation, 504 U.S. 768, 784, 112 S.Ct. 2251, 2262, 119 L.Ed.2d 533 (1992) (the relevant inquiry is “... whether in pursuing maximum profits

[a taxpayer] treated particular intangible assets as serving, on the one hand, an investment function, or, on the other, an operational function.”); Home Interiors and Gifts, Inc. v. Department of Revenue, 318 Ill. App. 3d 205, 211-12, 741 N.E.2d 998, 1004 (1st Dist. 2000) (discussing Allied Signal’s “operational function” test). Here, the undisputed facts show that “Abernathy’s” cash sweep account did not provide a centralized method for funding, managing, coordinating or integrating the activities of “Abernathy’s” operating divisions.

The Department also argues that “Abernathy’s” use of the divisions’ assets as collateral to secure repayment of “Abernathy’s” line of credit creates a flow of value between among the divisions. Department’s Response, p. 12. As part of the process of obtaining the line of credit, “Abernathy”, the borrower, either pledged to NBD Bank, or agreed to pledge to it the corporation’s assets. Stip. ¶ 27; Stip. Ex. 30, pp. 1 (definition of “Acceptable Accounts Receivable” and “Acceptable Inventory”), 4 (Affirmative Covenants).³ Those assets included tangible and intangible assets attributable to the operations of each of “Abernathy’s” divisions. Stip. ¶ 27; Stip. Ex. 30, p. 1. The act of allowing one person’s assets to be used to secure the repayment of a loan taken by a distinct person would be significant were this a unitary case. Such evidence would, in fact, tend to show that one person was functionally integrated with another person.

The Department’s contention that “Abernathy’s” use of its “divisions” assets show that “flows of value” existed between “Abernathy” and its divisions, however, does not

³ Since pages 5-8 are missing from the Loan and Credit Agreement within Exhibit no. 30, it is unclear whether “Abernathy” pledged its accounts receivable or inventory to secure the repayment of loans or credit extensions, or whether it agreed that it would pledge those assets should NBD Bank’s review of “Abernathy’s” financial reports lead it to believe that “Abernathy’s” creditworthiness had materially decreased. *See* Stip. Ex. 30, pp. 1, 4.

support the proposition it wants to prove. “Flows of value” and “economies of scale” are phrases ordinarily discussed in unitary cases to describe how two or more different persons are, in fact, functionally integrated, or, to put it another way, how they work together under common management for a common purpose. *E.g.*, Allied-Signal, Inc. v. Director, Div. of Taxation, 504 U.S. 768, 783, 112 S.Ct. 2251, 2260-61, 119 L.Ed.2d 533 (1992).⁴ So where the board members or officers of one corporation consist of the same board members and/or officers of a second corporation, that fact tends to make it more probable that both persons benefit from the integrated managerial decisions made on the corporations’ mutual behalf — the significant factor being the mutuality of the separate persons’ business goals and/or operations. *Accord* A.B. Dick Co., 287 Ill. App. 3d at 233 678 N.E.2d at 1102 (“It seems logical that whenever there is functional integration of operations there is also strong centralized management and vice versa.”). Similarly, where two or more persons are both engaged in the same general line of business, they may very well purchase raw materials from common vendors to obtain better prices using economies of scale, or from a related corporation having a reliable supply of such materials. The facts of the common vendors or common purchases, as well as other facts like centralized

⁴ The Supreme Court said in its Allied Signal decision:

In the course of our decision in Container Corp., we reaffirmed that the constitutional test focuses on functional integration, centralization of management, and economies of scale. [citations omitted] We also reiterated that a unitary business may exist without a flow of goods between the parent and subsidiary, if instead there is a flow of value between the entities. The principal virtue of the unitary business principle of taxation is that it does a better job of accounting for “the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise” than, for example, geographical or transactional accounting.

Allied-Signal, 504 U.S. at 783, 112 S.Ct. at 2260-61.

accounting functions, purchasing, financing, etc., tend to make it more probable than not that the separate corporations are either functionally integrated or that they are operating under strong centralized management. *Id.*

Here, however, “Abernathy” and its divisions are *not* separate persons, and the parties’ stipulation suggesting that certain assets belonged to the divisions only helps to confuse the undisputed facts. *Compare* Stip. ¶ 27 (“Since “AV”, “TE” Engineered Products and “DH” were divisions of “Abernathy Specialties, Inc.”, their assets would have been available as collateral to secure the line of credit for “Abernathy”) *with* Stip. Ex. 30. The assets that could have been used as collateral by “Abernathy” were not the divisions’ assets — they were “Abernathy’s” assets. Again, “Abernathy” is a single person. Stip. ¶¶ 11-12. Therefore, “Abernathy’s” use of, or its ability to use, the accounts receivable and the inventory nominally attributable to each of its divisions does not so much tend to show that “Abernathy” had or used “... strong central management [over the divisions], coupled with the existence of centralized departments for such functions as financing, advertising, research, or purchasing” (86 Ill. Admin. Code § 100.3010(b)(3)(C)) as much as it shows only that those assets were, in fact, “*Abernathy’s*” property.

What the Department attempts to do in its motion is to use the fact that “Abernathy” owned the divisions as evidence to establish that “Abernathy” exercised strong centralized management over them, or as evidence to show that those divisions were functionally integrated. *See e.g.*, Department’s Response, p. 10. But common ownership

of assets is one of the defining attributes of a single person. That is why common ownership, standing alone, is not sufficient to establish functional integration or strong centralized management. *See* 86 Ill Admin. Code § 100.3010(b)(3)(C).

B. “Bergen’s” Approval of Loans and Lines of Credit

The Department asserts that since “Bergen” signed various loan agreements with NBD Bank, “... the funds the divisions used to cover cash shortages were obtained from “Abernathy” through services performed by ... “Bergen”, one of “Abernathy’s” officers, directors and shareholders.” Department’s Response, p. 13. But again, it was NBD Bank that was lending money to “Abernathy” if, because of the profit transfers to “Bergen” and the “Brubakers”, sufficient funds were not available in “Abernathy’s” cash sweep account to cover an operating division’s needs. Stip. ¶ 29; *see also* Stip. Ex. 30. And were it not for the shareholders’ desire to create a method of paying themselves on a schedule that did not account for the possibility of a temporary cash shortfall, the Department concedes that each division would have had sufficient cash to fund its operations. Stip. ¶ 29. Therefore, “Bergen’s” signature on “Abernathy’s” bank loan agreements does not tend to show that the divisions were “... integrated, dependent upon, or contribute[d] to each other and the operations of the person as a whole” (*see* 86 Ill. Admin. Code § 100.3010(b)(3)) because the undisputed facts show that the divisions were managed separately and independently. Stip. ¶¶ 19, 24-25, 28, 30-31, 33-47, 49-51, 56-57; TMSJ, “Brubaker” Aff. ¶¶ 1-2. Nor does the Department attempt to explain how “Bergen’s” acting on “Abernathy’s” behalf overcomes its concession to facts which show that each division was run by separate managers, and that each performed its traditional management activities separately and independently. *See A.B. Dick Co.*, 287 Ill. App. 3d at 239, 678 N.E.2d at 1106 (contrasting

the facts in the F.W. Woolworth case, where, “Woolworth’s operations were not functionally integrated with that of its subsidiaries, and there was no centralization of management or achievement of other economies of scale. Each subsidiary operated as a distinct business enterprise at the level of full-time management”).

“Brubaker’s” affidavit, moreover, puts defining texture on the parties’ bone-bare stipulation that each division was run by a separate manager. *Compare* Stip. ¶ 56 with TMSJ, “Brubaker” Aff. ¶¶ 1-2. His affidavit establishes that each division was a separate corporation before “Bergen” and the “Brubakers” acquired it. TMSJ, “Brubaker” Aff. ¶ 1; Stip. ¶ 13. Once each division was acquired, the former corporation’s entire management team was kept in place to run the division. TMSJ, “Brubaker” Aff. ¶ 1. More specifically, each separate division’s management, marketing, accounting, product lines, sales, advertising research and development and purchasing functions and departments were kept in place. TMSJ, “Brubaker” Aff. ¶ 2. The undisputed facts show that the divisions were fully functioning and separate businesses from the day “Abernathy’s” shareholders acquired them. *Id.*, ¶¶ 1-2.

One of the things that makes “Abernathy’s” shareholders different than other small business owners is that “Bergen” and the “Brubakers” did not create a corporation intending to carry out the business in which each primary owner was engaged. TMSJ, “Brubaker” Aff. ¶¶ 1-2. That is to say, they did not create and then manage and operate a venture capital business. Instead, they incorporated “Abernathy” as the vehicle through which they held title to their mutual purchase of all of the stock (and/or all of the assets, the record does not reveal which) of three separate and distinct manufacturing companies. TMSJ, “Brubaker” Aff. ¶¶ 1-2. After that acquisition, the former companies, now

divisions, continued to function under the same management each had previously used. *Id.* In other words, the undisputed facts indicate that “Abernathy’s” shareholders purchased companies not so much to control or to manage their day-to-day or long term operations as to enjoy the profits produced by the formerly separate corporations. *See id.* ¶¶ 1-3; Stip. ¶ 26 (cash sweep account primarily used to make quarterly profit distributions to shareholders).

To be sure, treating one’s, or a group of individuals, acquisition of three whole corporations as a mere passive investment goes against intuition, but that, in itself, is consistent with the comparative rarity of a single corporation that, in fact, conducts separate trades or businesses. But here, the parties’ stipulations confirm that each division’s management team, in fact, performed most of the traditional management functions for the divisions, and that no centralized departments existed to provide common services to each of the divisions. Specifically, the president of each division and other named division personnel had control over respective division’s bank accounts. Stip. ¶¶ 24-25. Each division handled its own equipment and systems leasing and financing. Stip. ¶ 28. Each division had its own accounting department and personnel. Stip. ¶ 30. Each division planned its own capital expenditures, and created its own annual budget. Stip. ¶¶ 43, 57. There was no formal approval process for the divisions’ annual budgets. Stip. ¶ 57. Each division engaged its own local counsel. Stip. ¶ 31. Each division performed, respectively, its own sales and marketing, research and development, and purchasing. Stip. ¶¶ 33-35. Each division performed its own human resources, personnel administration functions. Stip. ¶ 40. Other than the general liability, workers compensation and auto insurance “Abernathy” obtained through Johnson & Higgins, each division purchased all

of its other insurance separately. Stip. ¶ 41. Each division handled its own employee benefit administration. Stip. ¶ 42. Each used its own manufacturing technology. Stip. ¶ 44. Each division handled its own payroll administration. Stip. ¶ 45. Other than the work “Devine” performed as “Abernathy’s” treasurer and assistant secretary, no division employees performed duties for other divisions. *See* Stip. ¶ 46; *see also infra*, pp. 36-38 (discussing “Devine’s” activities). Each division’s unionized employees were represented by different bargaining units. Stip. ¶ 47. The divisions had no common retirement, pension or profit sharing plans. Stip. ¶ 49. They had no common offices, warehouses or manufacturing facilities, and no common computer equipment or systems. Stip. ¶¶ 50-51. Finally, neither “Bergen” nor Grant “Brubaker” had any duties or management responsibilities in any of the respective division’s trade or business activities. Stip. ¶ 56.

C. “Abernathy’s” Purchase of Insurance for the Divisions

In contrast to the numerous stipulated facts tending to show that the divisions operated separately and independently, the only common purchase “Abernathy” made for the three divisions was for certain insurance coverage. Stip. ¶ 41. “Abernathy” used a single broker, Johnson & Higgins, to obtain property, general liability, and worker’s compensation insurance for all three of its divisions. *Id.* Each division, however, obtained its other insurance, e.g., employee health and dental insurance, separately. *Id.*

The Department cites to that stipulated fact and argues that “Abernathy’s” common purchase “generated significant savings that inured to all of the divisions.” Department’s Response, p. 13. It also argues that “Although each division paid its proportionate share of the insurance premiums, the cost per division was less than it would have been if each division had purchased such coverage separately. Thus, each division enjoyed the benefits

of economies of scale[,] one of the hall marks of a unitary business enterprise.” *Id.*, p. 14. Those arguments, however, presume facts that are not set forth within the four corners of the Department’s motion. The only way to know whether the Department’s argument is true is to know what each division would have paid for comparable insurance coverage separately, and no such evidence is included in this record. Nothing within the stipulation of facts or the stipulated exhibits, therefore, supports the Department’s factual arguments regarding the asserted savings caused by “Abernathy’s” common insurance purchase. *See* Stip. ¶ 41; Stip. Ex. 15.

Further, even if I were to accept, with no evidence, the Department’s mere argument that “Abernathy” enjoyed a savings by purchasing common insurance for its divisions operations, the applicable income tax regulation provides that,

...the exercise of ... [central management] authority over any particular function (through centralized departments or offices), is [not] determinative in itself; the entire operations of the person must be examined in order to determine whether or not ... the activities of the person constitute a single trade or business. Both elements of strong centralized management, i.e., strong central management authority and the exercise of that authority through centralized departments or offices, must exist in order to justify a conclusion that the operations of seemingly separate divisions are significantly integrated so as to constitute a single trade or business. ***

86 Ill. Admin. Code 100.3010(b)(3)(C). Note, in the second sentence quoted above, the use of the plural “departments” or “offices.” *Id.* This record unequivocally shows that there was not one central office or department through which “Abernathy” or any one else performed any of the traditional management activities or functions, e.g., accounting, purchasing, finance, legal, etc., for all of the divisions. Stip. *passim*; *see also* A.B. Dick Co., 287 Ill. App. 3d at 234-35, 678 N.E.2d at 1103-04 (summarizing the different

activities showing functional integration through strong centralized management); 86 Ill. Admin. Code § 100.3010(b)(3)(C) (“A person ... is properly considered as engaged in one trade or business when there is a strong central management, coupled with the existence of centralized departments for such functions as financing, advertising, research, or purchasing.”). Here, the parties agree that each division supplied those services for itself, separately.

Finally, even if “Abernathy’s” purchase of common insurance were attributable to “Bergen’s” exercise of actual control over one aspect of the divisions’ operations, that single common purchase does not meet the applicable regulation’s requirement that “... the entire operations of the person ... be examined ...” to see whether the “... seemingly separate divisions are significantly integrated so as to constitute a single trade or business.” Compare 86 Ill. Admin. Code § 100.3010(b)(3)(C) with Department’s Response, p. 14 (calling “Bergen’s” approval of an increase in “Abernathy’s” umbrella insurance coverage “... an example of the exercise of strong centralized management ”). The regulation clearly requires more than just one example of strong centralized management. 86 Ill. Admin. Code § 100.3010(b)(3)(C).

D. “Devine’s” Activities as “Abernathy’s” Secretary

The parties made the following stipulations regarding “Devine’s” activities: “Devine” was employed as “TE’s” controller, and was “Abernathy’s” treasurer and assistant secretary. Stip. ¶ 18. The accounting department of each division regularly gave “Devine” the financial data from their respective division, after which “Devine” would use such data to compile quarterly financial reports to give to “Bergen” and the “Brubakers”. Stip. ¶ 30. He did the same with the annual budgets prepared by each division. Stip. ¶ 57.

“Devine” prepared consolidated federal payroll tax returns using the information provided by the division’s separate accounting and or personnel departments. Stip. ¶¶ 40, 45. He paid “Abernathy’s” common insurance premiums using checks drawn on “Abernathy’s” cash sweep account. Stip. ¶¶ 41, 55. He asked “Bergen” what to do when “Abernathy’s” insurance broker recommended increasing “Abernathy’s” liability limits, which required a \$20,000 premium increase. Stip. ¶ 41; Stip. Ex. 16. He monitored “Abernathy’s” cash sweep account, and signed “Abernathy’s” tax returns and undescribed “legal documents.” Stip. ¶ 55. Finally, the parties agreed that if all of the time “Devine” spent as “TE’s” controller and as “Abernathy’s” treasurer and/or assistant secretary were added together, “Devine” would have spent less than 4% of his time performing the duties just described, as a “Abernathy” officer. *See* Stip. ¶ 46.

Based on those facts, the Department argues that “Devine” “... performed valuable accounting, tax finance and administrative services for both “Abernathy” and its divisions. *See* Department’s Response, p. 14. First, I cannot agree that “Abernathy” performed any of the undisputed activities listed above for *the divisions*. He certainly acted on “TE’s” behalf when, as its controller, he either prepared or supervised the preparation of “TE’s” financial reports before he consolidated that data with the data from the other divisions. *See* Stip. ¶¶ 18, 30, 46, 55, 57. But when he rolled up, consolidated and otherwise acted on such data, he was acting on “Abernathy’s” behalf, as its treasurer and assistant secretary. *Id.*

Further, I do not view “Devine’s” activities on “Abernathy’s” behalf as tending to show that its divisions were functionally integrated through the actual exercise of strong centralized management, so much as they show that the divisions were, in fact, all parts of

one corporation. For financial and tax reporting purposes, the activities of the divisions — whether they constituted a single business or separate businesses — would still have to be reported as “Abernathy’s” activities. *See, e.g.*, Stip. Exs. 1-2, 4-5 (federal and Illinois tax returns for “Abernathy”). That it was “Devine” who compiled the financial reports describing those activities, and filed its federal consolidated payroll tax returns, however, does not show, for example, how “AV’s” plastic bug shield manufacturing operations worked together with or contributed to “TE’s” locomotive parts manufacturing operations, when the parties have stipulated that those divisions each conducted all of their major management activities separately.

Moreover, when using the three divisions’ financial information as a “Abernathy” officer, “Devine” was merely consolidating the data that each division’s own accounting, budget and/or finance departments and personnel had already compiled regarding its activities and passed onto him. Stip. ¶¶ 30, 46, 55, 57. In other words, there is no evidence which indicates that “AV’s” and/or “DH’s” accounting departments and/or personnel compiled the financial and tax information regarding their respective division solely because of a management edict issued by “Devine”, “Bergen” and/or the “Brubakers”. The assumption should rather be that, since the divisions had all previously been engaged in separate businesses within the United States, they had each produced similar financial reports in the regular course of their distinct businesses. *See* TMSJ, “Brubaker” Ex. ¶ 1-2. Once the divisions were acquired by “Abernathy”, the fact that their accounting or finance personnel passed such financial information along to “Devine” did nothing to integrate or coordinate each division’s separate business activities or operations; the only thing integrated was the data contained in the separate reports of those distinct business

operations. In sum, while the parties agree that “Devine” performed certain financial reporting activities for “Abernathy”, and that these activities involved his use of data or other information obtained from the three operating divisions, all of the other stipulations show that “Abernathy’s” operating divisions were managed and operated separately and independently.

Conclusion

After examining all of the undisputed facts regarding “Abernathy’s” entire operations, as well as the stipulated documents and affidavits of record, I conclude that the operations of “Abernathy’s” separate divisions are not significantly integrated so as to constitute a single trade or business. *See* 86 Ill. Admin. Code § 100.3010(b).

WHEREFORE, IT IS HEREBY RECOMMENDED THAT:

- Taxpayer’s Motion for Summary Judgment be granted.
- The Department’s Motion for Summary Judgment be denied.
- The Director reconsider and cancel the Department’s prior denials of “Abernathy” and the “Brubakers” amended returns/claims for refund, and that he grant those refund requests in full, with interest pursuant to statute.

4/29/02
Date

Administrative Law Judge