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Kentucky Board of Tax Appeals Concludes Common Administrative Services Insufficient to Establish Unity Among Media Giant's Subsidiaries And Unitary Returns Would Be Distortive

Kelvin F. Sellers
Dallas
(214) 969-3691

On July 16, 2008, the Kentucky Board of Tax Appeals issued a final order in *Gannett Satellite Information Network, Inc.*¹ upholding the Kentucky Revenue Cabinet's final ruling that the filing of a unitary return by Gannett was impermissible because the members of the putative unitary group lacked functional integration, unity of operations, or unity of use requisite for the filing of a unitary return.²

Factual Background

Gannett Co., Inc. ("Gannett Co."), a Delaware corporation, is a leading international news and information company. Gannett Co. is the parent corporation to as many as 100 separate media corporations. Appellants are approximately 65 separate corporations (collectively, the "Gannett Group"), all of which are direct or indirect wholly owned subsidiaries of Gannett Co. Gannett Co., through its own operations and the operations of its affiliates, engages in business internationally, including operations in Kentucky.

Courier Journal and Louisville Times Co. ("Courier Journal Co."), a Kentucky corporation, is wholly owned by Gannett Co. Courier Journal Co. publishes a local newspaper in Kentucky titled the *Courier Journal*. Courier Journal Co. wholly owns four corporations that were also appellants in this action (the "Courier Subsidiaries"). The Courier Subsidiaries were not engaged in the newspaper business. Rather, the Courier

¹ *Gannett Satellite Info. Network v. Revenue Dep't Finance and Admin. Cabinet, Ky.*, File No. K04-R-03, Order No. K-20076 (Ky. B.T.A. Jul. 16, 2008).

² Other assertions were maintained by the Appellants in this proceeding but were summarily and unfavorably dismissed, including: (i) Appellants claimed entitlement to a license tax refund computed on a unitary basis; (ii) the proposition that Appellants had requested a refund of 1988 income taxes before the expiration of the statute of limitations; (iii) Appellants' claim that the NOL carryover deduction from 1988 was allowable; (iv) Appellants' claim that the 1993 income tax refund claim was not precluded by the doctrine of sovereign immunity; (v) Appellants' claim that another Kentucky statute authorized its unitary filing; and (vii) Appellants' claim that certain tax overpayments were made to the Revenue Department.

Subsidiaries' operations consist of computer retail, computer access advertising, and passive investments in non-newspaper related businesses.

Gannett Satellite Information Network, Inc. ("Gannett Satellite"), a Delaware corporation, is wholly owned by Gannett Co. Gannett Satellite publishes *USA Today* and about 40 other local newspapers published outside of Kentucky. Gannett Satellite engages in some activity in Kentucky. The only other subsidiaries that reported any Kentucky sales, property, or payroll during the relevant time period were: Gannett River States Publishing Corp. ("Gannett River States"), a company that published at least one local newspaper outside of Kentucky; and Gannett Direct Marketing Services, Inc. ("GDMS"), a company that was engaged in direct mail marketing.

Courier Journal Co., the four Courier Subsidiaries, Gannett Satellite, Gannett River States, and GDMS, each filed a separate Kentucky corporate income and license tax return for the years 1988 through 1993. Neither Gannett Co. nor its other affiliates filed a Kentucky tax return before the due date for any of the relevant years.

Several years after filing its separate tax returns, the Gannett Group determined that they would be entitled to a tax refund by filing unitary returns. On the last day before the statute of limitations expired for tax year 1988, Appellants filed unitary tax returns for taxable years 1988 and 1989; on December 30, 1993 Appellants filed unitary tax returns for taxable years 1990 through 1992; and on November 3, 1995 Appellants filed unitary tax returns for taxable year 1993. Each of the unitary returns was filed under the name of Gannett Satellite. The unitary returns filed by the Gannett Group were composed of the above-mentioned subsidiaries and approximately 57 other Gannett affiliates, some of which were involved in the newspaper business and many of which were not. Prior to 1988, none of the Gannett affiliates had filed a unitary return in Kentucky.

GTE Establishes That Unitary Filings Are Permissible In Kentucky

Although not the crux of the holding, the matter in controversy in *Gannett Satellite* was precipitated by a prior opinion issued by the Kentucky Supreme Court in 1994: *GTE v. Revenue Cabinet, Kentucky*.³ In *GTE*, the court tussled with the question of whether a taxpayer and its subsidiaries had the right to file a combined Kentucky income tax return.

At the circuit court proceeding in *GTE*, the judge concluded that there was "sufficient satisfaction of the 'three unities' test addressing unity of not only ownership but also of use and operations"⁴ Accordingly, the circuit court held that the facts were similar to those in *Armco, Inc. v. Revenue Cabinet, Kentucky*,⁵ which ruled that the

³ *GTE v. Revenue Cabinet, Kentucky*, 899 S.W.2d 788 (Ky. 1994).

⁴ *Id.*

⁵ *Armco, Inc. v. Revenue Cabinet, Kentucky*, 748 S.W.2d 372 (Ky. 1988).

net income of the taxpayer and its affiliate should be combined because of their unitary nature.

The Kentucky Court of Appeals distinguished *GTE* from *Armco*, announcing that the post-*Armco* interpretation of KRS 141.120 in Revenue Policy 41P225⁶ applied despite contrary reading of the same state for the previous 16 years.

The Kentucky Supreme Court in *GTE* held that the Court of Appeals erred in finding that the statute did not authorize a unitary multistate corporate organization to file a Kentucky income tax return using the unitary method of reporting. The court reasoned that the adoption by the Revenue Cabinet of Policy 41P225 was improper because it improperly abandoned a long-standing policy of permitting the combining of income of unitary groups. Thus, the Kentucky Supreme Court struck down the policy and held that unitary filings were permissible.

Unitary Filings Are Permissible In Kentucky, But Not if You Are Not Unitary

While the Revenue Department continued to contend that *GTE* was wrongly decided, the Court in *Gannett Satellite* appropriately adhered to the canons of stare decisis and gave deference to the decision in *GTE*. The *Gannett Satellite* court acknowledged that there is no constitutional right to file unitary returns, but that a taxpayer is permitted under certain circumstances to file a unitary return in Kentucky.

To determine the propriety of the Gannett Group's unitary filings, the Court focused its inquiry on the corporate operations of the Gannett Group. In its analysis, the court noted that: (1) virtually all of the income of the Foreign Newspaper Subsidiaries was derived from business activity that could not be fairly attributed to Kentucky (only one Foreign Newspaper Subsidiary conducted any business in Kentucky);⁷ (2) Gannett Satellite reported approximately 2% of its sales as Kentucky sales and less than 1% of its property and payroll was reported as derived from Kentucky; (3) Gannett Co. conducted no business activity in Kentucky; (4) there was no unity of operations, unity of use, functional integration, or economies of scale between Courier Journal Co. and any of the Courier Subsidiaries or the Non-Newspaper Subsidiaries; and (5) the gross income earned by Courier Journal Co. from its revenues was directly attributable to advertising and circulation of the *Courier Journal*, which was circulated almost exclusively in Kentucky.

One of the more salient facts that the Court noticed was that with the exception of newsprint purchasing, none of the basic business operations of the Courier Journal Co.'s newspaper business – its news, production, mailroom, circulation, advertising, accounting, promotion, building, and administration departments – was functionally

⁶ Revenue Policy 41P224 was released in 1988. It abandoned the long-standing policy of permitting the combining of income for unitary groups.

⁷ "Foreign Newspaper Subsidiaries" represent those newspaper subsidiaries wholly owned by Gannett Co. who publish one or more local newspapers outside of Kentucky. Gannett River States is the only Foreign Newspaper Subsidiary with factors in Kentucky.

integrated with the basic business operations of any other newspaper. The personnel and facilities of each Courier Journal Co. department were not integrated, combined, or unified with the similar departments of any other newspaper. The personnel and facilities of each operations department were utilized only for the *Courier Journal*. Likewise, none of the personnel and facilities of the operations department of other newspaper subsidiaries was utilized in publishing the *Courier Journal*. There were also no material common customers between the *Courier Journal* and the other newspapers.

Furthermore, the Court held that any connection between the subsidiaries as a result of Gannett Co.'s provision of services was tenuous at best. The only link between Gannett Co. and its subsidiaries aside from ownership was its administrative services, stewardship functions, and minor operational involvement. Gannett Co.'s intercompany activities were insufficient to establish the material economic relationships between subsidiaries that are prerequisite to a finding that the subsidiaries conduct a unitary business with each other. Rather, the Court recognized that Gannett Co.'s administrative services are common stewardship activities of virtually any publicly held company and would have been performed regardless of the existence of different lines of business. Moreover, the administrative services provided by Gannett Co. did not impact the day-to-day operations of any of the Gannett Co. subsidiaries.

Notably, a number of other states had determined that the correct unitary group was Gannett Co. and all of its subsidiaries. The Multistate Tax Commission, having audited Gannett Co. and its affiliates, arrived at a similar determination. The Court, supported by overwhelming evidence, alternatively ruled that the refund claims were based on the wrong unitary group. Since the statute of limitations has expired, Gannett Co. is precluded from filing an alternative refund claim including all Gannett affiliates.

Ultimately, the Court ruled that the unitary returns filed by the Gannett Group distort the business activity conducted in Kentucky and improperly reduce the taxable income reported by Courier Journal Co., Gannett River States, and Gannett Satellite. The Court reasoned that Gannett Group's unitary return filings are inconsistent with KRS 141.120(9) which provides that the Revenue Department may require the use of an apportionment formula which will "fairly represent the extent of the corporation's business activity in this state." Because the Court concluded that Gannett's unitary filings do not fairly represent the extent of the corporation's business activity in Kentucky, the filing of unitary returns was disallowed. Accordingly, no refund may be granted to Gannett or its affiliates.



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