Virginia is Prohibited from Attributing Non-Unitary Partnership’s Factors to a Minority Partner

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In *Department of Taxation v. FJ Management, Inc.*, the Virginia Court of Appeals recently concluded that the apportionment factors of a partnership in which a taxpayer held a minority interest could not flow up to the partner because there was no unitary relationship between the partner and the partnership. As state scrutiny over apportionment of corporate partners increases, this is an important case in understanding the guardrails the US Constitution requires.

FJ Management, Inc. is a corporation with its principal place of business in Utah and was qualified to do business in Virginia. Prior to 2008, the company operated approximately 220 interstate travel centers in the US and Canada. It also had subsidiaries that operated oil refineries in Utah and California, oil pipelines in Texas, and a bank that provided banking services to truckers. In 2008, as part of a bankruptcy process, FJM sold the travel centers to a third party in exchange for cash and a minority ownership interest in the third party purchaser. The agreement between the two parties also resulted in FJM’s refineries supplying the travel centers a fuel supply for a period of 20 years.

On its Virginia amended returns for the 2013-2015 tax years, FJM reported the distributions from its minority partnership interest as allocable non-unitary business income and excluded the partnership’s receipts, property, and payroll entirely from its Virginia apportionment factor. These amendments would have reduced FJM’s Virginia tax due in 2013 and 2014, but increased taxes due for 2015. The Department denied the amended returns, concluding that FJM’s ownership minority ownership interest was insufficient to render the income non-unitary and the apportionment factors of the partnership should flow up to FJM.

In a bread-and-butter analysis of the unitary business principal that all SALT professionals should read as a refresh on unitary case law, the Virginia Court of Appeals held that there was no functional integration between FJM and the partnership, no centralized management, and that the parties did not derive any economies of scale through their relationship with one another. The court also addressed whether despite the lack of a unitary relationship, FJM’s minority interest served an operational purpose under *Allied-Signal*, 504 U.S. 768 (1992) but concluded that “there is no evidence in the record before this Court on appeal suggesting that FJM used the income it earned… as part of FJM’s own working capital or for any other operation purpose related to FJM’s independent business activities.”

As we see states look to incorporate income and tax attributes of partnerships to their corporate partners, taxpayers would do well to familiarize themselves with a case like *Department of Taxation v. FJ Management, Inc.* There remain limits to what states can do.

> Under the unitary-business principle, the Department would be constitutionally permitted to apply PTC's apportionment factors to FJM's out-of-state business activity only if FJM and PTC formed a unitary business. We hold that the trial court correctly found that FJM and PTC did not form a unitary business, as the evidence sufficiently established that the three unitary-business factors of functional integration, centralized management, and economies of scale did not exist between FJM and PTC.

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