COMMONWEALTH OF MASSACHUSETTS

Supreme Judicial Court

SUFFOLK, ss. No. SJC-11609

THE FIRST MARBLEHEAD CORPORATION AND GATE HOLDINGS, INC.,
Plaintiffs-Appellants,

v.

COMMISSIONER OF REVENUE,
Defendant-Appellee.

ON APPEAL FROM A DECISION OF THE APPELLATE TAX BOARD

BRIEF OF AMICUS CURIAE MULTISTATE TAX COMMISSION IN SUPPORT OF DEFENDANT-APPELLEE THE COMMISSIONER OF REVENUE

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INTEREST OF THE AMICUS CURIAE

Amicus curiae Multistate Tax Commission ("the Commission") submits this brief in response to a request for amicus briefs issued by this Court on January 16, 2014.

This Court's request sought comment on two questions arising from the April 17, 2013 decision of the Appellate Tax Board construing Massachusetts' Financial Institutions Excise Tax, G.L. c. 63, §§ 1-2A: (1) whether the Appellate Tax Board erred in applying a statutory presumption to conclude that the preponderance of the substantive contacts with the taxpayer's loan property occurred in Massachusetts, where the taxpayer has no "regular place of business" but has its commercial domicile in Massachusetts, and (2) whether an agency relationship should be considered as a predicate for attributing the out-of-state activities of independent "loan servicing" companies to the taxpayer for purposes of establishing where the preponderance of substantive activities took place.

The Commission believes the Massachusetts Appellate Tax Board ("the Board") reached the right result in this case in concluding that the taxpayer's loan

property was properly assigned to the state for purposes of determining the percentage of the taxpayer's income subject to tax on an apportioned basis. The Commission does not believe, however, that the Board used the correct analysis in applying G.L. c. 63, §§ 1-2A to the very complicated facts of this case.

The two questions posed by the court cannot be cogently answered without first explaining how the statutes should apply to a "financial institution" receiving income as compensation for facilitating the issuance of loan-backed securities. The purpose of the statutes is to apportion income based on a taxpayer's business activity carried on in the state, and the statutes afford flexibility in their application to ensure that result. G.L. c. 63, § 2A(g). The two questions presented by this Court pertain to the apportionment of income of a taxpayer engaged in lending activities. Although the taxpayer in this case does receive income in the form of interest payments, lending is not the "business activity" engaged in by this taxpayer.

The Commission was established by the Multistate Tax Compact ("Compact"), which became effective in

1967. See RIA All States Tax Guide, ¶ 701 et seq. (RIA 2005).[1] The Compact was the states' answer to the need for improved state taxation of interstate commerce. See, e.g., H.R. Rep. No. 952, 89th Cong., 1st. Sess., Pt.VI (1965). Article IV of the Compact incorporates the Uniform Division of Income for Tax Purposes Act ("UDITPA"), promulgated in 1957 by the National Conference of Commissioners on Uniform State Laws, predecessor to the Uniform Laws Commission. See 7A Uniform Laws Annotated 141-193 (West 2002). Article VII of the Compact charges the Commission with interpretation of UDITPA through promulgation of model regulations. (Compact, Art.VII.1.) Today, forty-seven states and the District of Columbia participate in the Commission or its multistate programs. Sixteen of those jurisdictions have adopted the Compact by statutory enactment. Seven jurisdictions are sovereignty members. Another twenty-five states, including Massachusetts, are associate members.[2]

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[1] The validity of the Compact was upheld in United States Steel Corp. v. Multistate Tax Commission, 434 U.S. 452 (1978).

[2] This brief is filed by the Commission, and is not filed in support of any particular member state except Massachusetts. Compact Members: Alabama, Alaska, Arkansas, Colorado, District of Columbia, Hawaii, Idaho,

The purposes of the Compact are: (1) to facilitate proper determination of state and local tax liabilities of multistate taxpayers, including equitable apportionment of tax bases and settlement of apportionment disputes; (2) to promote uniformity or compatibility in significant components of tax systems; (3) to facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration; and (4) to avoid duplicative taxation. See Multistate Tax Compact, Art. I.

The Commission has a significant interest in this case because G.L. c. 63, §§ 1-2A incorporate one of the Commission's most important uniformity efforts, the Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions, adopted by the Commission on November 17, 1994 (the

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Kansas, Missouri, Montana, New Mexico, North Dakota, Oregon, Texas, Utah and Washington. Sovereignty Members: Georgia, Kentucky, Louisiana, Michigan, Minnesota, New Jersey, and West Virginia. Associate Members: Arizona, California, Connecticut, Florida, Illinois, Iowa, Indiana, Maine, Maryland, Massachusetts, Mississippi, Nebraska, New Hampshire, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Vermont, Wisconsin, and Wyoming.

"Recommended Formula").[3] The Recommended Formula has subsequently been incorporated into the laws of many states as either a stand-alone statute or as a regulation.[4] This case is important to the Commission because, despite its widespread adoption by the states, the Recommended Formula has not been the subject of any reported appellate court decision. Correct application of G.L. c. 63, §§ 1-2A in this case of first impression will provide a solid foundation for future court decisions.[5]

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[3] Available at http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/FormulaforApportionmentofNetIncomeFinInst.pdf.

[4] See, e.g., Arkansas: ARK. CODE ANN. § 26-51-1404; Kansas: KAN. STAT. ANN. § 79-1131; Kentucky: KY. REV. STAT. ANN. § 136.535; Maine: ME. REV. STAT. ANN. tit. 36 § 5206-E; Mississippi: MISS. CODE ANN. § 27-7-24.5; Ohio: OHIO REV. CODE ANN. § 5733.056; Rhode Island: R.I. GEN. LAWS 1956, § 44-14-14.4; Alabama: ALA. ADMIN. CODE r. 810-9-1-.05; California: CAL. CODE REGS. tit. 18, § 25137-4.2; Colorado: 1 COLO. CODE REGS. 201-3: INCOME TAX; Hawaii: HAW. CODE R. § 18-241-4-04; Idaho: IDAHO ADMIN. CODE r. 35.01.01.582; Maryland: MD. CODE REGS. 03.04.08.05; New Hampshire: N.H. CODE ADMIN. R. ANN. Rev. 304.10; New Mexico: N.M. CODE R. 3.5.19; Oregon: OR. ADMIN. R. 150-314.280-(N); Utah: UTAH ADMIN. CODE R. 865-6F-32.

[5] The Commission's Uniformity Committee recently endorsed several proposed changes to the Recommended Formula, including elimination of loans from the property factor, a central issue in this appeal. However, the current model will likely continue to play an im-

The original UDITPA omitted financial institutions from its scope, see UDITPA § 2, but a number of adopting states amended that section to include such institutions. See 7A Uniform Laws Annotated, pp. 155-157.[6] The Recommended Formula arose out of the common desire of state tax administrators and industry representatives to increase uniformity in state taxation of financial institutions while also balancing the interests of so-called money center states and market states in creating income. See Final Report of the Hearing Officer Regarding Proposed Multistate Tax Commission Formula for the Uniform Apportionment of Net Income from Financial Institutions, at pp. 3-4, 6, 14.[7]

The Recommended Formula was primarily intended for traditional financial institutions engaged in retail lending activities. Id. at 14-15. For financial

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portant role in apportioning financial institution income.

[6] The movement to taxation of financial institutions based on UDITPA principles increased in the wake of the U.S. Supreme Court's decision striking down capital stock taxes on the value of U.S. Obligations held by banks. See Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983).

[7] Available at http://www.mtc.gov/uploadedFiles/ Multistate_Tax_Commission/Uniformity Uniformity_Projects/ A_-_Z/Final%20HO%20Rpt%20FinInst.pdf (last visited July 22, 2014).

institutions that perform other types of income-generating activities, a flexible approach may be required in order to reflect where and how income is generated. Id. at 18-22. That flexibility is incorporated in G.L. c. 63, § 2A(g).

Accurately apportioning the income of financial institutions is a challenge, because loan portfolios and other intangible property can be easily transferred among related entities and the assets are sometimes held in non-operating legal entities, as is the situation in this appeal.[8]

ARGUMENT

I. THE APPELLATE TAX BOARD CORRECTLY CONCLUDED THAT GATE'S LOAN PROPERTY SHOULD BE SOURCED TO MASSACHUSETTS, WHERE ALL OF FIRST MARBLEHEAD'S ECONOMIC ACTIVITY OCCURRED.

A. Although Gate May Have Been Properly Classified as a Financial Institution, Gate's Income Should Not Have Been Apportioned as if it were a Loan Originator.

This appeal concerns the application of a broadly-written model apportionment formula to a special-

[8] See, e.g., In re InterAudi Bank F/K/A Bank Audi (USA), State of New York Tax Appeals Tribunal Decision DTA No. 821659 (4/14/11)(operating bank's transfer of assets but not related expenses to investment subsidiary resulted in distortion of reported earnings).

ized segment of the financial industry that is engaged in complex, multi-party, multi-step transactions leading to the creation and marketing of securitized loan instruments. The parties involved include student loan customers, originating banks, colleges, guarantors, underwriters, investors, intermediaries, trusts, independent trustees, and quasi-governmental loan administrators.[9] The Appellate Tax Board ("the Board") required 13 pages in its decision just to summarize the parties and transactions involved in this case. First Marblehead Corp. and Gate Holdings, Inc. v. Commissioner of Revenue, Mass. ATB Findings of Fact and Reports 2013-241, 246-259 (Apr. 17, 2013). Perhaps not surprisingly, the Board was not in complete agreement with either party about the application of the statutes to every aspect of this intricate financial world, and in particular the nature of Gate Holdings LLC ("Gate" or "the taxpayer"), and the tax consequences which flowed from its determinations.

[9] Most of the loan servicing activities were carried out by the Pennsylvania Higher Education Assistance Agency ("PHEAA"), a governmental agency with its principal office in Harrisburg, Pennsylvania. First Marblehead Corp. and Gate Holdings, Inc. v. Commissioner of Revenue, Mass. ATB Findings of Fact and Reports at 2013-241, 259 (Apr. 17, 2013).

Gate is a wholly-owned subsidiary of First Marblehead Corporation ("First Marblehead" or "FMC"). Id. at 243. First Marblehead is a Massachusetts-based corporation involved in many aspects of the private student loan business, including assisting lending institutions (loan originators) in issuing student loans that would be eligible for guarantees and securitization as Student Loan Asset-Backed Securities ("SLABS"). Id. at 250-51. First Marblehead was also closely involved in many aspects of marketing these derivative investments to investors. Id.

Gate is a holding company holding a residual interest in some 16 trusts established by First Marblehead. Id. at 256-57. Gate has no employees and no operations. Id. at 262. SLABS issued by the trusts were sold to independent underwriters who in turn sold those interests to investors. Id. at 246-47. Gate also owned National Collegiate Funding LLC, which received bond proceeds from investors and was the legal entity used to purchase the student loans from originating banks; the student loans served as security for repayment of the bonds. Id. at 247, 254. Like Gate, National Collegiate Funding was a paper entity in that it had no employees or operations of its own, id. at

247, so that any business functions attributed to either entity for legal or contractual purposes were by necessity carried out by First Marblehead employees in Massachusetts. Therefore, any and all transactions, legal rights and obligations of either entity were by necessity a consequence of the business decisions of their direct and indirect 100% owner, First Marblehead. Among other duties, First Marblehead entered into agreements with the originating banks that committed First Marblehead to use "best efforts" to purchase loans made by the banks in accordance with First Marblehead's criteria, committed the banks to sell those loans to First Marblehead, and ensured the loans would be eligible to be guaranteed by The Educational Resources Institute ("TERI") and securitized. Id. at 252-53. First Marblehead then prepared "cash flow models [that] were presented for evaluation to underwriters and rating agencies," structured the securitization offering, and coordinated the activities of attorneys, trustees, loan servicers and other transaction participants. Id. at 254-55; The First Marblehead Corporation, Annual Report (Form 10-K), at 10 (Sept. 15, 2004) (the "FMC 2004 10-K").

Although Gate held residual beneficial ownership interests in the securitization trusts, those interests were subordinated to those of the SLABS' interest holders, and accordingly Gate never received any distribution arising from its residual interest in the trusts during the years in question. Id. at 257. Gate's taxable income was exclusively interest payments on the student loans held by the trusts, but neither Gate nor First Marblehead issued any loans themselves. First Marblehead at 262. The record is clear that Gate did not receive residual interests in the trusts as compensation for acting as a lender, but rather as compensation for First Marblehead's securitization services. See, e.g., FMC 2004 Form 10-K at 10 ("Our residual interest is derived almost exclusively from the services we have performed in connection with each securitization"). Gate should accordingly be seen for what it was: not an operational entity, but rather a legal mechanism by which First Marblehead received compensation for the financial services involved in bringing together borrowers, originating banks, securities investors, underwriters, trustees, rating agencies, loan servicers, and the guarantor TERI.[10]

[10] The FMC 2004 10-K at 10 explains that First Marble-

In the proceedings below, the Commissioner argued that Gate did not meet the definition of a "financial institution" under G.L. c. 63, § 1. The Board disagreed. Equating Gate's activities with those of the trusts in which it held a residual interest, the Board concluded that because Gate derived its income from "lending-related activities" it was properly subject to tax as a financial institution. First Marblehead at 273.

While one could dispute Gate's classification as a financial institution, the Commission does not believe it is necessary to revisit that aspect of the Board's determination in order to ensure that Gate's income is fairly apportioned. Instead, the Commission believes that the Recommended Formula can be used to fairly apportion Gate's income if that income is properly characterized as arising from First Marblehead's activity of facilitating securitization transactions, rather than as income from lending activity conducted by Gate. Gate itself engaged in no activity and received no compensation for any activity of its

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head received "several types of fees in connection with our securitization services," including "up front" structural advisory fees, "additional" structural advisory fees, "administrative fees" from the trusts, and "residuals" held by Gate.

own. The fact that the form of the compensation paid to Gate for First Marblehead's economic activity was a residual interest in the securitization trusts should not drive application of the Recommended Formula, because it is intended to apportion income based on the location of the underlying economic activity. G.L. c. 63, § 2A(g). Cf. Mobil Oil v. Commissioner, 445 U.S. 425, 440 (1980)("One must look principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability."). First Marblehead's activity, as described in great detail in the Board's decision, occurred entirely in Massachusetts.

The Board's application of the apportionment rules of G.L. c. 63, § 2A to what it deemed to be Gate's loan property did not adequately take into account Gate's role in the securitization process. The statute should be construed to effectuate the legislature's larger purpose of measuring the taxpayer's business presence, and thus earnings, originating within the state.

B. The Commission's Recommended Formula for Financial Institutions was intended to Reflect UDITPA's Underlying Equitable Theory.

a. UDITPA's Standard Apportionment Formula was based on the Idea that Income Results from Activity in "Market" States and "Production" States.

The Recommended Formula for Financial Institutions is one of eight "special industry" model regulations developed by the Commission pursuant to the "equitable apportionment" provisions of Compact Article IV, Section 18.[11]

The Recommended Formula was intended to adapt UDITPA's standard apportionment system to the unique attributes of the financial industry. It retains the same basic structure and is built on the same basic principles as UDITPA's standard formula, including the use of the average in-state percentages of three factors to approximate in-state earnings: property, payroll and sales.

The principal goal of any apportionment formula is to reflect the extent of a multistate taxpayer's business activities carried out in each state in order to determine where taxpayers have earned their income. Container Corp. of America v. Franchise Tax Bd., 463

[11] The other special industry regulations apply to airlines, railroads, construction contractors, telecommunications providers, interstate truckers, broadcasters, and publishers. See http://www.mtc.gov/Uniformity/Adopted-Uniformity-Recommendations.

U.S. 159, 170 (1983); Boston Prof'l Hockey Ass'n v. Comm'r of Revenue, 443 Mass. 276, 280 n.7 (2005); E.I. Du Pont de Nemours & Co. v. State Tax Assessor, 675 A.2d 82, 91 (Me. 1996). Under the standard UDITPA formula applicable to most industries, receipts from sales are sourced to the "destination", reflecting the contributions of the market states to income generation. UDITPA §§ 16, 17. JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION, note 23, ¶ 8.06 (Warren, Gorham & Lamont 3d. rev. ed. 2003). The payroll factor (UDITPA § 14) and property factor (UDITPA §15) represent contributions of production states to income generation. Id. at 13. Intangible property, however, is excluded from the measure of in-state property under UDITPA's standard formula. See UDITPA §§ 14 (payroll) and 15 (property).

b. The Financial Institutions Recommended Formula Adapted UDITPA to Take into Account "Market" States and "Production" States in the Context of Banking Activities.

The development of the Commission's financial institutions Recommended Formula was a collective multi-year effort involving state tax administrators, tax practitioners, and financial institutions. As the Hearing Officer's report makes clear, the participants

sought a formula that would reflect the contributions of the so-called "money-center" (production) states and the contributions of the so-called market states. Final Report of Hearing Officer at 5-9. They chose to have the sales factor in the Recommended Formula follow rules based on market sourcing for interest and other income from loans: "The proposed formula recognizes to a reasonable degree the in-state marketing activities that are conducted, as well as contributions to income that are made by the residents and government infrastructure within the market state." Id. at 19.[12]

On the other hand, the drafters intended the property factor to reflect the contribution of the production states. Id. at 17-20. However, loans under the Recommended Formula constitute "property" — which is not the case under the standard UDITPA property factor[13] — and that presented a challenge. In general,

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[12] As the Hearing Officer notes at page 46 of his report: "For the reasons set forth in Section III.B.2. of this Final Report, the sourcing of the receipts factor that is recommended here has a distinct market-state flavor."

[13] Both UDITPA and G.L. c. 63, § 38(d), exclude all intangible property from the property factor of regular (non-financial) corporations. For financial institutions, the Recommended Formula and G.L. c. 63,

loans (and other intangible property) have no physical "location," so assigning a location for tax purposes necessarily involves use of a "convenient fiction." Curry v. McCanless, 307 U.S. 357, 367 (1939)(upholding state's ability to tax intangible property based on (a) situs of owner; (b) situs of the holder; or (3) business situs).

In the Recommended Formula, the drafters' production state approach is evidenced by the general rule that assigns loans to the physical location of the taxpayer's "regular place of business" where the loans are recorded "in the regular course of business consistent with federal or state regulatory requirements." G.L. c. 63, § 2A(e)(vi)(A)(2).[14] The statute

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§ 2A(e), include loans and credit card receivables, but exclude all other intangibles.

[14] "(2) A loan is properly assigned to the regular place of business with which it has a preponderance of substantive contacts. A loan assigned by the taxpayer to a regular place of business without the commonwealth shall be presumed to have been properly assigned if:
(a) the taxpayer has assigned, in the regular course of its business, such loan on its records to a regular place of business consistent with federal or state regulatory requirements;
(b) such assignment on its records is based upon substantive contacts of the loan to such regular place of business; and
(c) the taxpayer uses said records reflecting assignment of loans for the filing of all state and local

further provides that a "regular place of business" is "an office at which the taxpayer carries on its business in a regular and systematic manner and which is consistently maintained, occupied and used by employees of the taxpayer." G.L. c. 63, § 1. In situations where a taxpayer has multiple regular places of business, the loan is sourced to the location where the preponderance of substantive contacts with that loan occurred.[15] And if a loan is assigned outside the state — that is, carried on the taxpayer's non-tax books and records kept in the ordinary course — to a location that is not a regular place of business, then a presumption arises that the location with the most sub-

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tax returns for which an assignment of loans to a regular place of business is required."

[15] The Hearing Officer's Report notes (at 52): "On such occasions [a conflict between states on assignment of loan property], the initial point of deference should be given to assigning such asset to a state in which there is a regular place of business of the taxpayer, wherever such place may be, and not on the basis of location of the borrowers or credit card holders. This is in keeping with the sense of the proposal that assignment of intangible assets should remain as is under the current practice—to the state in which the taxpayer maintains a regular place of business and to which the asset has a preponderance of substantive contact, whether at the home office, at a particular branch or subsidiary of the institution, or a loan production office."

stantive contacts to the loan is the taxpayer's commercial domicile. G.L c. 63, § 2A(e)(vi)(B).

These provisions, taken together, carry into execution the intent of the drafters of the Recommended Formula to source loan property to the production state, i.e., the state where the taxpayer's income-producing activity with respect to that loan occurred.

C. None of the Recommended Formula's Criteria for Assigning a Loan to the Location of the "Preponderance of Substantive Contacts" Apply to Gate.

The Commission's Recommended Formula was written broadly enough to apply to many types of financial institutions, but it was primarily intended to apply to traditional banking institutions. The hearing officer noted that the "principle focus" of the Recommended Formula, "has been on the institutions that have traditionally been lenders of money and moneyed capital and it was drafted with these institutions in mind."[16]

This point is made again elsewhere in the Report, where a distinction is drawn between loans and other types of intangible property:

[16] Final Report of Hearing Officer at 14.

> Since the term "loan" includes most leases (see Section 2(j))[17], this provision adequately deals with the more traditional financial institutions, such as commercial banks, savings and loans, finance companies, leasing companies and the like that engage in retail lending transactions as a [sic] regular course. All other types of intangibles, such as securities of all kinds, futures or forward contracts, options, notional principal contracts, assets held in a trading account and the like are to be excluded from the proposed formula's property factor.

Final Report of Hearing Officer at 20. (Emphasis supplied.)

Implicit in the Recommended Formula's structure is the assumption that the institution to which the "loan" provisions are applied will have certain operational chacteristics, including employees, one or more physical locations at which business is regularly conducted, and some identifiable income-producing economic activity. Gate was the legal repository for certain rights and obligations created by First Marblehead and a mechanism by which First Marblehead received compensation for its own financial services. But because Gate was not an operational entity, the Recommended Formula's loan sourcing criteria designed for "traditional retail institutions," Id. at 20, are

[17] The term "loans" includes leases treated as loans for federal income tax purposes. G.L. c. 63, § 1.

an uneasy fit at best. First, the record does not reflect that Gate reported these loans at any place on its books and records, or that the "assignment" would have been consistent with regulatory requirements, or even that Gate was subject to regulation. The Board apparently assumed that "assignment" referred to how the taxpayer reported its income on its tax returns. First Marblehead at 288; G.L. c. 63, § 2A(e)(vi)(A)(2)(a). That assumption conflicts with the statute's separate requirement that "the taxpayer uses said records reflecting assignment of loans for the filing of all state and local tax returns for which an assignment of loans to a regular place of business is required." G.L. c. 63, § 2A(e)(vi)(A)(2)(c). Second, and more fundamentally, Gate is a holding company with no retail loan activities, no regular place of business anywhere, no activities of its own, and no customers to which it provides services.

The "preponderance of substantive contacts" rule arose in response to industry concern that states might take different approaches to determining where an operating company's substantive contacts with a loan occurred. The hearing officer responded to those

concerns by recommending New York's method of "analyzing the facts of a given loan transaction and determining where the loan was solicited, investigated, negotiated, approved, and administered" (commonly referred to as "SINAA" elements)(emphasis in original). Final Report of Hearing Officer at 47-48. He stated, "The ultimate issue the SINAA elements are used for is to determine if the state to which the loan (or credit card receivable) has been assigned [in the taxpayer's non-tax business records] is the state with the 'preponderance of substantive contacts.'" Id. These five elements were subsequently incorporated into the Commission's Recommended Formula and G.L. c. 63, § 2A(e)(vi)(C).

The Board appeared to agree with Gate that four of the five SINAA factors were not "relevant" to the analysis, perhaps because the loans had been sold by the originating banks and repackaged, and looked to the only remaining factor, administration. First Marblehead at 288-89. The Board then properly rejected the taxpayer's argument that "administration" should include the activities of third-party loan administrators. It is true that the Recommended Formula contemplates that a loan assigned to one location using

SINAA factors could be re-assigned to "another state if said loan has a preponderance of substantive contact to a regular place of business there." G.L. c. 63, § 2A(e)(viii). But Gate did not have a regular place of business in any state. The Board correctly declined to impute the business location of independent loan servicers to Gate where the statute so clearly defines a "regular place of business" to be where the taxpayer's employees are engaged in business.[18] G.L. c. 63, § 1.

Assigning the loans to the taxpayer's commercial domicile was consistent with the statutes' purpose in avoiding "nowhere" assignment which could give multistate taxpayers a tax advantage over solely in-state taxpayers.[19] Assigning the loan property to Gate's commercial domicile is also consistent with the statutes' intent that loans should be assigned to the taxpayer's

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[18] It would also be incongruous to attribute a third party administrator's "substantive contacts" with the underlying loans to Gate, where Gate does not have involvement in loan administration, while simultaneously ignoring the involvement of First Marblehead in assisting the originating banks in making the loans and in securitizing those loans.

[19] See, e.g., G.L. c. 63, § 2A(d)(xiii)("All receipts which would be assigned under this section to a state in which the taxpayer is not taxable shall be included in the numerator of the receipts factor, if the taxpayer's commercial domicile is in the commonwealth.")

regular place of business, or to its commercial domicile.

D. Alternatively, the Court May Affirm the Board Under Either the Equitable Apportionment Provisions of the Recommended Formula, or By Treating Gate's Receipts as Income for Services.

While the Board's analysis was consistent with the statutory intent in assigning loan property to the taxpayer's commercial domicile, the Commission believes that the inapplicability of any of the SINAA factors to Gate's loans, together with Gate's lack of any "regular place of business," strongly suggests that this taxpayer's income is better suited to treatment under G.L. c. 63, § 2A(g), the "equitable apportionment" provisions of the Recommended Formula.

G.L. c. 63, § 2A(g) provides that:

> If the provisions of subsections (a) to (f), inclusive, are not reasonably adapted to approximate the net income derived from business carried on within the commonwealth, a financial institution may apply to the commissioner, or the commissioner may require the financial institution, to have its income derived from business carried on within this commonwealth determined by a method other than that set forth in subsections (a) to (f),inclusive.
>
> If . . . the commissioner determines that the provisions of subsections (a) to (f), inclusive, are not reasonably adapted to approximate the financial institution's net income derived from business carried on within the commonwealth, the commissioner shall by reasonable methods determine the amount of net

> income derived from business activity carried on within the commonwealth. The amount thus determined shall be the net income taxable under section two and the foregoing determination shall be in lieu of the determination required by subsections (a) to (f), inclusive.

In the proceedings below neither the Commissioner nor the Board explicitly invoked these provisions. Nevertheless, the Board's apportionment of Gate's income may fairly be construed as applying an alternate method of apportionment under G.L. c. 63, § 2A(g) in fact. In an unpublished 2005 opinion, the California Court of Appeals noted that the Franchise Tax Board ("FTB") had not explicitly invoked alternative apportionment. But the court went on to hold that the FTB's interpretation of the regular apportionment rule (an interpretation which the court rejected) had the same effect:

> Nor can we agree with the trial court's ruling that the FTB failed to advance an alternate method of apportionment under section 25137. The FTB proposed simply omitting the returned principal part of Microsoft's securities dispositions from the gross receipts element of the sales factor. Such a solution is both reasonable and well within the authorization provided in section 25137, subdivision (d): "The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income."

Microsoft Corp. v. Franchise Tax Bd., Docket No. A105312, 2005 WL 459697, at *2, 2005 Cal. App. Unpub. LEXIS 1684 (Cal. Ct. App. Feb. 28, 2005) (unpublished, not citeable in California per Rules of Court 8.1115 (formerly 977)), as modified on denial of reh'g (Mar. 23, 2005).

In this case, the apportionment method applied by the Board to Gate resulted in 51% of Gate's income being apportioned to to Massachusetts. Brief of Appellee at 18. Even if the court concludes that the Board's interpretation of G.L. c. 63, § 2A(a)-(f) is incorrect, the Commission believes that it nevertheless should affirm the Board's apportionment method as "reasonably adapted to approximate the net income derived from business carried on within the commonwealth" under G.L. c. 63, § 2A(g), given the undisputed fact that Gate's income derived entirely from First Marblehead's business activities in Massachusettts. See 19-205 MOORE'S FEDERAL PRACTICE - CIVIL § 205.05 ("A prevailing party may support its judgment on any ground that is found in the record, even if that ground was not the basis of the decision below"); Cf. Comptroller of Treasury v. Gore Enter. Holdings, Inc., 60 A.3d 107 (Md. 2013)(appropriate to impute op-

erating company factors to holding company for apportionment purposes); Media General Inc. v. South Carolina, 694 S.E.2d 525 (S.C. 2010)(combined reporting is available as a remedy under equitable apportionment provisions); In re InterAudi Bank F/K/A Bank Audi (USA), supra; cf., Blue Bell Creameries, LLP v. Roberts, 333 S.W.3d 59 (Tenn. 2011)(apportionment of holding company income).

Alternatively, regardless of how the Gate's interests in the trusts are treated for property factor purposes, the Board's judgment could be affirmed on the grounds that Gate's receipts are not interest from loans, but rather income from services, namely, the securitization-related services provided by First Marblehead to its client banks seeking to monetize their student loan portfolios, as discussed in Part I(A) above. Under that approach, all of Gates receipts would be sourced to the Commonwealth as the state in which the services were performed. G.L. c. 63, § 2A(d)(xi).[20]

[20] For the years in question, G.L. c. 63, § 2A(d)(xi) provided: "The numerator of the receipts factor includes receipts from services not otherwise apportioned under this section if the service is performed in the commonwealth. If the service is performed both within and without the commonwealth, the numerator of

II. ANY AGENCY RELATIONSHIP BETWEEN GATE AND INDEPDENDENT LOAN SERVICERS WOULD HAVE LIMITED RELEVANCE TO ENSURING FAIR APPORTIONMENT GIVEN THE FACTS AND CIRCUMSTANCES OF THIS CASE.

Both questions posed by this Court concern where the "preponderance of substantive contacts" with student loans held by Gate occurred for purposes of sourcing the taxpayer's property factor. The Commission believes that, if the loan property sourcing rules are applied to Gate as if it were a lending institution, the Board's use of the "default" provision to source the property to Gate's commercial domicile is a reasonable application of the statutes. The Commission also suggests that use of the equitable apportionment authority in G.L. c. 63, § 2A(g) is an alternative path to fairly apportioning the taxpayer's income, given the taxpayer's non-operational nature and the nature of the underlying income producing activity

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the receipts factor includes receipts from services not otherwise apportioned under this section, if a greater proportion of the income-producing activity is performed in the commonwealth, than in any other state, based on costs of performance." The Commission notes, however, that the Massachusetts legislature recently changed the generally-applicable sourcing rule for income for services from a "cost of performance" to a "market" approach. See G.L. c. 63, §§ 2A(d)(xi), 38(f), as amended by An Act Relative to Transportation Finance, H 3535, St. 2013, c. 46 (2013). Under draft regulations, income from professional services is sourced to the location of the service recipient where the service contract is principally managed.

carried on by its parent corporation, First Marblehead.

The second question posed by this Court is whether the existence of an "agency" relationship is an appropriate factor in determining whether third-party service providers can create a "preponderance" of substantive contacts with a loan. The question arose because the Board in the case below cited the lack of any evidence of an agency relationship between Gate and the service providers as one reason for declining to consider those activities as the predominate substantive contacts. First Marblehead at 284.

As set forth in Part I(B)-(C) above, the Commission believes that the Recommended Formula and G.L. c. 63, §§ 1-2A are designed to ensure that loans are sourced to a regular place of business, which is in turn explicitly defined as the location where the taxpayer's employees conduct operations.[21] This definition of a regular place of business, as well as the repeated reference to the taxpayer's activities in G.L. c. 63, § 2A(e)(vi)(C), suggests that the activi-

[21] "'Regular place of business,' an office at which the taxpayer carries on its business in a regular and systematic manner and which is consistently maintained, occupied and used by employees of the taxpayer." G.L. c. 63, § 1.

ties of third parties should not be considered in determining where substantive contacts with a loan occur. Additionally, the legislature established a default rule (corporate domicile) to resolve ambiguous situations in a manner that ensures full apportionment. Second, if the activities of independent parties were to be considered in determining where the preponderance of substantive contacts occur, it is something one would have expected the legislature to have provided guidance for in this detailed description of the substantive contacts rule. See Comm'r of Corr. v. Superior Court Dep't of the Trial Court, 446 Mass. 123, 126 (2006)("We do not read into the statute a provision which the Legislature did not see fit to put there, nor add words that the Legislature had an option to, but chose not to include.").

To the extent the statute could be read as contemplating some recognition of the activities of unaffiliated parties, the existence of a formal agency relationship among the parties would be one fact to consider. But the statute requires the court to consider the totality of facts and relationships on a case-by-case basis, G.L. c. 63, § 2A(e)(vi)(C), and should be construed to effectuate a fair apportionment based up-

on the *taxpayer's* income producing activity. G.L. c. 63, § 2A(h). There are no grounds in the statute for attributing the activities of unaffiliated independent contractors to the taxpayers for purposes of G.L. c. 63, § 2A(e)(vi)(C).

In this case, the record shows that Gate exercised no actual control over the activities of the loan servicers in order to maximize its profits. Most loans were serviced by the Pennsylvania Higher Education Assistance Agency ("PHEAA"), an unrelated party. First Marblehead at 259. By the terms of the loan servicing agreement with PHEAA, the servicer was granted "flexibility over the methods and techniques of Servicing." Ex. XII: 6222. The agreement further specified that PHEAA was an independent contractor, and could not be considered an agent of the trust. Ex. XII: 6228. PHEAA's activities were governed by terms over which the trusts had no control, and the trusts could not instruct, direct, or otherwise control PHEAA. Brief of Appellee at 32-33. Since Gate could not control the activities of the loan servicers through the trusts or otherwise, it is axiomatic that the servicers were not Gate's agents. Restatement (Second) of Agency §§ 159-161A (1958). Gate was in fact a passive

investor in the trusts. Therefore, even if there were a statutory basis for attributing activities of an independent contractor to a taxpayer, this would not be an appropriate case for such attribution to apply.

CONCLUSION

For the reasons set forth above, the Commission believes that the decision of the Massachusetts Appellate Tax Board should be upheld.

Respectfully submitted,

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Dated: September 17, 2014

CERTIFICATION UNDER MASS. R. APP. P. 17

I, Lila Disque, hereby certify that the foregoing brief complies with all of the rules of court that pertain to the filing of briefs, including, but not limited to, Mass. R.A.P. 17 (brief of an Amicus Curiae) and Mass. R.A.P. 20 (form of briefs, appendices and other papers).

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COMMONWEALTH OF MASSACHUSETTS
SUPREME JUDICIAL COURT

SUFFOLK, ss. NO. SJC-11609

THE FIRST MARBLEHEAD CORPORATION AND GATE HOLDINGS, INC.,

Plaintiffs-Appellants,

v.

COMMISSIONER OF REVENUE,

Defendant-Appellee.

CERTIFICATE OF SERVICE

I, Lila Disque, hereby certify that I have on this day caused the accompanying Brief of Amicus Curiae Multistate Tax Commission In Support of Defendant-Appellee The Commissioner of Revenue to be served upon all parties by causing two copies thereof to be mailed first class, postage prepaid, to:

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