COMMONWEALTH OF MASSACHUSETTS

SUPREME JUDICIAL COURT

No. SJC-13139

VAS HOLDINGS & INVESTMENTS LLC,

Plaintiff-Appellant,

v.

COMMISSIONER OF REVENUE,

Defendant-Appellee.

Brief of *Amicus Curiae* Multistate Tax Commission in Support of Defendant-Appellee Commissioner of Revenue, Urging Affirmance of the Decision of the Appellate Tax Board

---

December 14, 2021

Bruce Fort, Senior Counsel
New Mexico Bar No. 960, appearing *pro hac vice*
Counsel of Record
Multistate Tax Commission
444 North Capitol Street, N.W., Suite 425
Washington, D.C. 20001
(202) 580-9779
bfort@mtc.gov

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Constitutional Provisions

Statutes

Regulations

Treatises

Other Authorities

INTEREST OF THE AMICUS

The Multistate Tax Commission ("MTC") is an intergovernmental agency formed in 1967 through the Multistate Tax Compact. The MTC comprises the tax agency heads of the sixteen states that have adopted the Multistate Tax Compact by statute; all other states, except Nevada, participate as members on some level.[1]

The stated goals of the Compact are: (1) to facilitate the proper determination of state and local tax liabilities of multistate taxpayers; (2) to promote uniform and consistent tax policy and administration among the states; (3) to assist taxpayers in achieving compliance with existing tax laws; and (4) to avoid duplicative taxation.

Preservation of the states' authority as sovereigns to pursue their own tax policies as permitted under the U.S. Constitution remains a key objective for the MTC. We focus on issues relating to income, franchise, sales, and use taxes.

For more than 50 years, the MTC has worked with the states and taxpayers to improve the uniformity and administration of multistate business taxation by drafting model tax laws and regulations through a public process that involves taxpayers and tax agency representatives, by providing training and legal advice to state tax agencies, and by conducting joint state audits of multistate businesses. We

[1] Information about the MTC, its member states, and its activities is available at www.mtc.gov.

regularly file amicus briefs in support of state tax agencies to help state and federal courts understand the greater context for their decisions and the potential effects on state tax jurisprudence across the country. No counsel for any party is ever permitted to author an MTC brief in whole or in part. Only the MTC and its member states, through the payment of their membership fees, make any monetary contribution to the preparation or submission of its briefs. The MTC has never represented either party to this appeal, nor has it been involved in the proceeding or legal transaction that is at issue.

The MTC has a significant interest in this appeal because it involves a challenge to one of the most basic tenets of state sovereignty—the right to impose taxes on persons deriving income from property or business activities occurring within a state's borders. There is no doubt that states may tax income or gains from tangible property or intangible property that has acquired a taxable situs in the state. There is also no doubt that states may tax an out-of-state partner on operating income passed to the partner from a partnership or other type of pass-through entity ("PTE") doing business within the taxing state.

The MTC has recently initiated a project to study state tax issues arising from the increased use of PTEs to conduct business activity within the states, including taxation of non-resident owners of such entities. The goals of the project include improving state guidance available to taxpayers and promoting uniformity in procedures and practices.[2]

The MTC joins with the Appellee-Defendant, the Commissioner of Revenue of Massachusetts, in urging affirmance of the decision of the Appellate Tax Board below because the application of law to the facts of this case by the Appellate Tax Board is constitutionally sound.

We write separately to explain the proper relationship of the unitary business principle to state taxing jurisdiction and to show that the principle has no application to the facts of this case. We also write to explain how Massachusetts' imposition of tax on the capital gain at issue in this case is consistent with how many other states currently tax non-resident PTE owners on their gains and with federal tax treatment of such gains in the international context.

SUMMARY OF THE ARGUMENT

This appeal concerns Massachusetts' right to impose income tax on the capital gain income realized by an out-of-state S corporation, Plaintiff-Appellant VAS Holdings and Investments, LLC ("VASHI"), on the sale of its 50% ownership interest in a limited liability company, Cloud5, LLC ("Cloud5") that was actively

---

[2] For more information see https://www.mtc.gov/Uniformity/Project-Teams/Partnership-Tax.

engaged in business in the Commonwealth in the years immediately preceding the sale.

The Appellate Tax Board correctly held that Cloud5's operations within the Commonwealth provided Massachusetts with a sufficient connection under the Constitution[3] to impose tax on VASHI's capital gain income from the sale of its ownership interest in Cloud5. The Board correctly rejected VASHI's claim that the gain could only be subject to tax if VASHI's owners were engaged in a unitary business with Cloud5 conducted in the state. The Board recognized that the proper role of the unitary business principle is to ensure that the apportioned tax base of a multi-jurisdictional taxpayer only includes income that is fairly connected to activity that takes place in the taxing state. The principle has no application in the context of this case, where the Commonwealth bases its taxing power on the undisputed in-state activity of Cloud5, not VASHI.

The assessment of tax at issue in this appeal is entirely in accord with recognized constitutional principles governing state taxing authority, principles that undergird our federal system of government. States' authority to impose income

[3] VASHI contends the assessment against it violates both the Due Process Clause, U.S. Const. amend. XIV, and the (dormant) Commerce Clause, Art. I, Section 8, cl.3, but does not describe how the latter clause is implicated. Our brief accordingly focuses on the states' jurisdiction to tax under the Due Process Clause.

taxes on non-domiciled persons deriving income from activity or property within the taxing state is unquestioned.

Because the capital gain income Massachusetts seeks to tax was derived from sources within the state, there is no need to apply the unitary business principle as a jurisdictional basis to support taxation of an apportioned share of multistate business activities with no other connection to the taxing state. Nor is there any constitutional basis for recognizing some new limitation on the states' taxing authority for capital gains arising from the sale of business operations located within the taxing state; the Supreme Court has repeatedly held that it is the source of income, not its form, that determines the states' taxing authority.

Massachusetts is not an outlier among states, nor does it depart from the federal government, in how it sources the gain from the sale of an interest in a PTE. Massachusetts' system for apportioning an owner's capital gain income arising from the sale of PTE interests, based on the relative percentages of the PTE's property and payroll in the state, is consistent with how other states and the federal government tax such income.

ARGUMENT

I. Massachusetts has constitutional authority to tax non-domiciliary owners of businesses operating within the state because it provides those owners with benefits and protections.

It is beyond question that states provide benefits to those conducting business activities within their borders. It should also be beyond dispute that states have a right to impose their taxes on the owners of those businesses based upon the income derived from within the state. This principle of source-based taxation is expressed in *Shaffer v. Carter*, 252 U.S. 37, 52 (1920). It is also the foundational principle of *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435 (1940), where the Court upheld the state's power to tax dividends distributed by a corporation operating within the state.

The Court in *J.C. Penney* explained that a withholding tax on the distribution of dividends to the corporation's shareholders was not an unconstitutional "taking" of the shareholder's property without due process of law because the shareholders benefitted from what the state had provided to the business itself:

> A state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society.
>
> . . .
>
> That test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by

> the state. The simple but controlling question is whether the state has given anything for which it can ask return.

311 U.S. at 444.

Four years after *J.C. Penney*, in *Int'l Harvester Co. v. Wis. Dep't of Revenue*, 322 U.S. 435 (1944), the Supreme Court re-affirmed the constitutionality of Wisconsin's tax even after that state's highest court clarified that the burden of that tax was imposed on the out-of-state *shareholders'* dividend income, not just on the corporations themselves. The Court has likewise upheld taxation of a non-resident trust's income derived from the sale of intangible property interests, based on the protections and benefits afforded to those property interests by the state. *See Curry v. McCanless*, 307 U.S. 357 (1939).

The jurisdictional principle established in these cases remains intact today: A state's taxing power arises from the protection, benefits, and opportunities afforded by the state to the owners of property, including intangible property, who derive income from that property. No decision of the Supreme Court since *J.C. Penney* has questioned that the presence of a "fiscal relation" between benefits and burdens continues to be the touchstone for tax jurisdiction analysis.[4]

---

[4] *J.C. Penney*, 311 U.S. at 444. *J.C. Penney's* "benefits and protections" test was cited with approval by the Court in its most recent case to consider state taxing jurisdiction, *N.C. Dep't of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust*, 139 S.Ct. 2213, 2219 (2019).

The Appellate Tax Board was justified in relying on the jurisdictional standards announced in *Int'l Harvester* and *J.C. Penney* as the seminal cases establishing a state's right to tax non-residents on income derived from their ownership interests in businesses operating within the state.

Nevertheless, VASHI tries to distinguish the principle established in these cases on the grounds that taxation of income recognized in the form of a capital gain from the sale of the business should be subject to different rules than taxation of dividends or operational income of the business. This argument runs afoul not only of the reasoning of *J.C. Penney* and *Int'l Harvester*, but of a prior decision of the Court directly applicable to capital gains taxation: *New York ex rel. Whitney v. Graves*, 299 U.S. 366 (1937).

In *Whitney*, the U.S. Supreme Court upheld New York's imposition of income tax on Massachusetts resident C. Handasyde Whitney, a partner in a Boston stock trading company who obtained a one quarter interest in a "seat" (the right to conduct trading activities) on the New York Stock Exchange. Mr. Whitney sold that intangible property right, recognizing a capital gain of over $100,000. New York asserted the right to tax Whitney on the gain although neither he nor his partnership maintained a place of business in New York.

In finding that New York had sufficient taxing jurisdiction, or "nexus," over the income to sustain the tax in the face of a challenge under the Due Process Clause, the Court reiterated the principle, established the year before in *Wheeling Steel Corp. v. Fox*, 298 U.S. 193 (1936), that intangible property can be considered to have a taxable "business situs" within a state where the intangible property is employed in the creation of income.[5] That business situs justified the state's imposition of tax on the capital gain derived from the sale of the intangible property.

The Court in *Whitney* gave no indication that a state's authority to tax the capital gain income was subject to a different constitutional standard than would have applied to income derived from the taxpayer's trading activity. The Court held that Mr. Whitney's failure to exercise his intangible property rights before sale (*e.g.*, through active management or integration into his business) had no bearing on New York's ability to tax the gain. 299 U.S. at 373. The relevant inquiry was whether the property rights were sufficiently localized as to provide a basis for the state's protections.

[5] "When we speak of a 'business situs' of intangible property in a taxing State we are indulging in a metaphor," the Court in *Whitney* explained. "We express the idea of localization by virtue of the attributes of the intangible property in relation to the conduct of affairs at a particular place." 299 U.S. at 372.

Experts in state tax jurisprudence agree with this analysis—that the location of the property, not the location of the income recipient, determines the states' taxing authority. In *State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective*, 45 Wm. & Mary L. Rev. 319, 363 (2003), longtime state and local tax Professor John Swain sums up the Court's early jurisprudence concerning taxation of non-resident business owners as follows:

> . . . the Court in *International Harvester* and *Whitney* strongly adhered to the principle of source taxation, and, more generally, to acknowledging the primacy of economic substance in income tax matters.

The authors of the leading state tax treatise likewise point to the continuing relevance of the *J.C. Penney* and *Int'l Harvester* decisions in affirming the constitutional basis for a state's ability to tax income based upon its source within the taxing state. *See* Hellerstein, Hellerstein & Appleby, *State Taxation,* (Thomson Reuters/Tax & Accounting, 3rd ed. 2001, with updates through Aug. 2021 (online version accessed on Checkpoint (www.checkpoint.riag.com) 12/8/2021), ¶ 6.04.

II. The unitary business principle applies when determining the extent to which a state has nexus over income from *extra-territorial* sources.

In order to understand the proper relationship of the unitary business principle to taxing jurisdiction, it may be helpful to briefly recount how states tax the income of multistate businesses.

States have long used a system called formulary apportionment to determine how much of a multistate businesses' profits can be attributed to and taxed by a state.[6] Rather than using geographic sourcing rules to determine the location of each item of income or expense, formulary apportionment uses certain "factors" (generally property, payroll, or sales, or some combination), representing the operations of the business, to divide the income among multiple states.

First, the income base is established, usually starting with a business's federal taxable income. Next, the income base is apportioned by each state using a ratio of the business's factors in that state compared to the totals in all states. Formulary apportionment is grounded in the principle that when the factors in the apportionment formula and the income in the tax base are closely related to a single undivided business conducted across state lines, the resulting division of income will fairly reflect how much income was generated in the state. *See Mobil Oil Corp. v. Comm'r of Taxes of Vt.*, 445 U.S. 425, 436-442 (1980)(upholding the use of formulary apportionment).

The role of the unitary business principle in formulary apportionment is twofold: it provides the foundation for states to include income that arises in multiple jurisdictions in the tax base to be apportioned and it ensures that the tax base does

[6] *See, e.g., Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920).

not include income from activities that are unrelated to the business conducted in the taxing state.[7]

The unitary business principle has found its most frequent application in state tax jurisprudence when determining whether discrete income recognition events or flows of income from *extra-territorial sources* are sufficiently connected to the taxpayer's unitary business as to provide the state with a nexus over that income that would otherwise be lacking. In *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 308-9 (1982) the Court framed the nexus question as follows:

> [W]hether the state of Idaho constitutionally may include within the taxable income of a nondomiciliary parent corporation doing some business in [the state] a portion of intangible income—such as dividends and interest payments, as well as capital gains from the sale of stock—that the parent corporation receives from subsidiary corporations *having no other connection with the taxing state.*[emphasis added]

III. The unitary business principle has no application when the income to be taxed has a clear connection to the taxing state and to the apportionment formula.

VASHI concedes that Massachusetts has sufficient authority under the U.S. Constitution to subject it to tax on the operational income passed through from

---

[7] The Supreme Court has accordingly described the unitary business principle in *Mobil* as the "linchpin of apportionment," likening its role to a linchpin ensuring that a wheel does not slip from its axle. 445 U.S. at 439.

Cloud5.[8] It concedes that the "protection, opportunities and benefits" Due Process standard in *J.C. Penney Co.* provides the relevant test for whether a state can tax a non-resident on operational income derived from a PTE doing business within a state.[9]

Nevertheless, VASHI asserts that the state's taxing jurisdiction over the capital gain arising from the sale of a business operating within the taxing state is conditioned upon a finding that the capital gain arose from the taxpayer's "unitary business" conducted in part in the taxing state. VASHI incorrectly argues that the unitary business principle "quite clearly subsumes the 'protection, opportunities and benefits' principle stated in *J.C. Penney*."[10]

VASHI bases its argument on a passage in *MeadWestvaco Corp. v. Ill. Dep't of Revenue*, 553 U.S. 16, 24-25 (2008), which discusses the relationship between state taxing limitations under the Commerce Clause and the Due Process Clause. Its reading of this case, however, is flawed. The Court first explained the "nexus" inquiry under the Due Process Clause as whether there is "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax," as well as a rational relationship between the tax and the "values connected

[8] Brief for Appellant at 50-51.
[9] *Id.* at 31.
[10] *Id. at* 33.

with the taxing State." 553 U.S. at 24, *quoting Quill Corp. v. North Dakota,* 504 U.S. 298, 306 (1992).

The Court continued:

> The Commerce Clause forbids the States to levy taxes that discriminate against interstate commerce or that burden it by subjecting activities to multiple or unfairly apportioned taxation. [Citations omitted] The "broad inquiry" subsumed in both constitutional requirements is "'whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state'" — that is, "'whether the state has given anything for which it can ask return.'"(citing *ASACRO,* 458 U.S. at 315 and *J.C. Penney*, 311 U.S. at 444)
>
> 553 U.S. at 24-25.

We read the Court's statement as announcing that, although the Due Process and Commerce Clause serve different purposes, the principles of source-based taxation identified in *J.C. Penney* are the foundation for state taxing authority under both clauses. We cannot see that the unitary business principle is even implicated in this passage. Nor can we understand how an inference could be made that the Court intended to substitute application of the unitary business principle for the tax jurisdictional standards set out in *J.C. Penney, International Harvester, Whitney*, and other precedent.[11]

[11] In addition, the argument proves too much. If the *J.C. Penney* "protection and benefits" test had been "subsumed" into the unitary business principle for purposes of taxing capital gain income, it should be equally subsumed for purposes of taxing operational income. VASHI does not address or even try to explain this dichotomy.

VASHI relies heavily on *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768 (1992), but VASHI misreads *Allied-Signal* to create a rule that either "operational unity" or "asset unity" is a prerequisite for a state to tax the non-domiciliary owner of a business operating *within the state* on the owner's capital gain income.[12] The case offers no support for that proposition because the issue of whether a state could assert taxing jurisdiction over a capital gain arising from the sale of a business based on that business' presence in the taxing state was not before the Court.

In fact, all of the Supreme Court's cases discussing application of the unitary business principle cited in the taxpayer's brief in chief applied that principle in determining whether capital gains or other types of income generated from businesses operating *outside* of the taxing jurisdiction were sufficiently related to in-state activity as to permit inclusion in the taxpayer's apportioned tax base.[13] In each

---

[12] Brief for Appellant, pp. 35-37.

[13] *Mobil Oil* concerned inclusion of dividends and capital gains from operations of a subsidiary in Saudi Arabia in Mobil Oil's apportioned tax base in Vermont, where the taxpayer's activities in that state were limited to retail sales of petroleum products. 445 U.S. 425. *F.W. Woolworth Co. v. New Mexico*, 458 U.S. 354 (1982), concerned inclusion of dividends and capital gains from operations of subsidiaries in England, Brazil, and Germany in the taxpayer's apportioned tax base in New Mexico. The Court framed the question to be decided as whether New Mexico could include dividends in the apportioned tax base received from subsidiaries "*that do no business in New Mexico.*" 458 U.S. at 356 (emphasis added). *Container*

of these cases, the reference to the unitary business principle was occasioned precisely because *there was no other connection* between the source of the income and taxing state.

In stark contrast to the question presented in these cases, the capital gain in question here did not arise from a dividend or capital gain received from a subsidiary operating *outside* the taxing jurisdiction. Rather, the gain was derived from the sale of a PTE operating *in Massachusetts.* Massachusetts sourced the gain based upon the PTE's apportionment percentages (property and payroll) located in the state during the year of the sale. *See* 830 CMR § 63.38.1 (2013). That is, Massachusetts has asserted its authority to tax such gains on the basis of their in-state source. It is what the Appellate Tax Board and the parties refer to as "investee apportionment," which in this case means taxing an apportioned share of the gain based on Cloud5's business presence in the state.[14]

Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983), concerned dividend income arising from operations in Brazil and Japan in the apportioned tax base in California.

[14] *See VAS Holdings & Investments LLC v. Comm'r of Revenue*, Mass. App. Tax Bd. Docket Nos. C332269 & C332270 at ATB-2020-521 & 522 (Oct. 23, 2020).

Because the Commonwealth is taxing an apportioned share of the capital gain income based upon its source, its nexus with the gain is not dependent upon a connection with VASHI's own operations in the state.

The same capital gain at issue in the Supreme Court's *Allied-Signal* decision was the subject of consideration by the New York Court of Appeals and the Appellate Division of the Supreme Court of New York. The New York Court of Appeals upheld New York City's assessment against Allied-Signal's based on the City's investee apportionment rules. *Allied-Signal, Inc. v. Comm'r of Fin.*, 580 N.Y.S. 2d 696 (1991). Five years later, the Supreme Court Third Appellate Division upheld New York State's assessment based upon the State's investee apportionment statute. The courts in both cases cited *International Harvester* and *J.C. Penney* in upholding the taxing jurisdiction's authority to tax a portion of the gain realized from the disposition of the ASARCO stock, based upon the percentage of the ASARCO's business conducted in those jurisdictions.

Other states also have "investee apportionment" rules in place for capital gains arising from the sale of PTEs operating within their borders.[15] No state conditions taxation of such gains on the existence of a unitary business relationship between the owner of such businesses and the business activities of the PTEs themselves.

[15] *See infra* Section VI.

VASHI's ownership and exploitation of its intangible property in the Commonwealth satisfies the Due Process Clause requirement that there be "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *See, e.g., Miller Bros. Co.* v. *Maryland*, 347 U.S. 340, 344-45 (1954). The presence of Cloud5 in the state is the basis for the state's taxing authority. Invoking the unitary business principle to establish a second basis for upholding the state's taxing power has no support in Supreme Court jurisprudence.

IV. Massachusetts' constitutional authority to tax income based upon its source is unaffected by distinctions between operational income and capital gains income.

The overwhelming weight of authority supports Massachusetts' constitutional authority to impose income taxes on a non-resident partner or shareholder deriving income from a PTE operating within the state. *See, e.g., Issacson v. Iowa State Tax Comm'n*, 183 N.W.2d 693 (Iowa 1971); *Kulick v. Dep't of Revenue*, 624 P.2d 93, 99 (Or. 1981); *Borden Chem. and Plastics v. Zehnder*, 726 N.E.2d 73 (Ill. App. Ct. 2000); *Prince v. State Dep't of Revenue,* 55 So.3d 273 (Ala. Civ. App. 2010) (overruling *Lanzi v. Ala. Dep't of Revenue*, 968 So.2d 18 (Ala. Civ. App. 2007)); *Valentino v. Franchise Tax Board*, 87 Cal. App. 4th 1284, 1293 (Cal. Ct. App. 2001); *General Accessory Mfg. Co. v. Okla. Tax Comm*'n, 122 P.3d 476, 480 (Okla. Civ.

App. 2005); *Mandell v. Auditing Div*. of the Utah State Tax Comm'n, 186 P.3d 335 (Utah 2008).[16]

VASHI concedes that Massachusetts has the authority to tax it on the operational income derived from Cloud5 but argues that there are meaningful differences between the gain from a sale of a business versus the income derived from the operation of a business, citing differences, for instance, in how capital gains are treated for federal tax purposes.[17] These differences say nothing about the source of income generation from activity taking place within the Commonwealth.

Importantly, the Appellate Tax Board made extensive findings that the gains in question were attributable to improvements in business practices taking place largely within the state,[18] leading to increased earnings. VASHI has not challenged those findings. The burden of showing that a statute or regulation operates in an

---

[16] Many of these cases were decided against a background of uncertainty as to whether the Supreme Court's "physical presence" nexus requirement for imposing sales and use tax collection obligations on remote sellers would extend to income tax impositions as well. *See, generally, Capital One Bank v. Comm'r of Revenue,* 453 Mass. 1 (2009). The Court's decision in *South Dakota v. Wayfair, Inc.*, 585 U.S. ___, 138 S.Ct. 2080 (2018) has abrogated those concerns by eliminating the Commerce Clause physical presence nexus requirement, recognizing that the nexus requirements for both the Due Process Clause and the Commerce Clause standards have "significant parallels."

[17] Appellant's Brief, pp. 46-48

[18] *See VAS Holdings & Investments LLC v. Comm'r of Revenue,* Mass. App. Tax Bd. Docket Nos. C332269 & C332270 at ATB-2020-514 (Oct. 23, 2020).

unconstitutional fashion is a high one. *See, e.g., Moorman Mfg. Co. v. Bair,* 437 U.S. 298 (1978); *Container*, 463 U.S. at 170.

VASHI's argument also runs contrary to Supreme Court precedent. In *ASARCO*, the Court considered whether taxation of capital gain income should be treated differently from dividends (which VASHI characterizes as flowing from operational income) for Due Process Clause purposes. The Court answered that question in the negative, referencing its previous holding in *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425 (1980):

> Idaho and ASARCO agree that interest and capital gains income derived from these companies should be treated in the same manner as the dividend income. ("In our view, the same standard applies to the question whether gains from the sale of stock are business income as applies to the question whether dividends from the stock are business income"). *We also agree*. "One must look principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability." [quoting *Mobil Oil*].

458 U.S. at 330.

In short, the same constitutional principles that support the use of a business's factors to apportion that business's operating income also serve to support the use of those factors to apportion any gain (or loss) from the sale of that business. Even if the capital gain were entirely attributable to goodwill of the business, rather than to appreciation in the value of particular assets, it cannot be separated from Cloud5's operations. *See Adams Express Co. v. Ohio*, 165 U.S. 194 (1897)(attributing goodwill values for property tax purposes to the locations where the business conducts its operations). *See also Visa U.S.A., Inc. v. Birmingham Trust Nat'l Bank*, 696 F.2d 1371, 1375 (Fed. Cir. 1982) and *Home Depot USA, Inc. v. Ariz. Dep't of Revenue*, 287 P.3d 97 (Ariz. Ct. App. 2012)(trademark income associated with location of business activity).

V. The analysis in *Corrigan v. Testa* has been disfavored and ignored.

Many of the arguments raised by VASHI in this appeal echo the analysis of the Ohio Supreme Court in *Corrigan v. Testa*, 73 N.E.3d 381 (Ohio 2016). *Corrigan* is the single appellate-level state tax case to suggest a distinction should exist between the constitutional standards for taxing a non-resident on operational income from an in-state LLC and taxing a non-resident on the capital gains arising from the sale of that LLC. The court held that under the Due Process Clause, Ohio was precluded from taxing a non-resident owner of an Ohio-based LLC on his gains from the sale of the business. To the court, it was "self-evident" that the dividend income at issue in *J.C. Penney* and *International Harvester* "has a more direct relationship to corporate earnings … than does the capital gain from the sale of corporate ownership." 73 N.E.3d at 392.

The fundamental flaws in the *Corrigan* court's reasoning were laid bare just weeks later by another appeal pending at the time *Corrigan* was decided, *T. Ryan Legg Irrevocable Trust v. Testa*, 75 N.E.3d 184 (Ohio 2016).

In *T. Ryan Legg*, an Ohio resident (the grantor) had set up a non-resident trust to hold and then liquidate the grantor's interest in a business operated in Ohio. The trust was assessed income tax on the subsequent gain. Relying on *Corrigan's* reasoning, the trust argued that as a mere 35% owner of the underlying business, the trust could not be "unitary" with it the underlying business as a matter of law, and thus could not be taxed on the amount of the gain apportioned to Ohio. The Ohio Supreme Court, laboring to distinguish its previous holding in *Corrigan,* upheld the tax on the trust's gain, citing differences in how trusts were taxed under Ohio law. Justice Lanzinger, writing a special concurrence, was dissatisfied with the court's efforts to distinguish *Corrigan* and urged the court to repudiate the analysis it had utilized in that decision:

> *Corrigan* was wrongly decided because we erroneously focused on whether *Corrigan* was engaged in the business that the pass-through entity had conducted in Ohio. Instead, we should have focused, as we do here, on the fact that gain from selling an investment in in-state assets and activities can usually be taxed in proper proportion—whether or not the person realizing the gain is a resident or engages in the business. No one would dispute, for example, that a nonresident owing an asset located in Ohio—say, real estate in Cleveland—can be taxed on the gain derived from selling that asset.

75 N.E.3d at 200-201.

Justice Lanzinger was further concerned that the court in *Corrigan* had ignored the presumption of constitutionality attaching to all legislative enactments, implicitly shifting the burden of proof to the state to demonstrate the statute's constitutionality.

A leading scholar of state tax jurisprudence agrees *Corrigan* was wrongly decided. In *Substance and Form in Jurisdictional Analysis: Corrigan v. Testa*, 80 State Tax Notes 849 (June 13, 2016),[19] Professor Hellerstein outlined how the *Corrigan* court had misapprehended the function of the unitary business principle while misconstruing decades of Supreme Court decisions beginning with *International Harvester*.

Professor Hellerstein focused on the Ohio court's confusion between nexus over the property (*in rem* jurisdiction) and nexus over the taxpayer (*in personam* jurisdiction). The Ohio court understood that the state had *in personam* jurisdiction over the taxpayer by virtue of his ownership interest in the Ohio PTE and *in rem* jurisdiction over the taxpayer's operating income under its previous holding in *Agley v. Tracy*, 719 N.E.2d 951 (Ohio 1999). Strangely, the Ohio court failed to appreciate the implications of finding nexus over both the source of the income and the income recipient.

---

[19] Available at https://www.mtc.gov/MTC/media/Partnership/Hellerstein-(June-13,-2016).pdf

The *Corrigan* court also engaged in some protracted speculation as to the implications of the Supreme Court's decision not to address the constitutionality of an alternative argument raised for the first time on appeal in *MeadWestvaco Corp. v. Illinois Dept. of Revenue,* 553 U.S. 16 (2008). Mead Corporation had operated two distinct businesses, paper and software, as separate divisions of a single corporate entity, later selling the software division's operations for a substantial capital gain. The Court found that because the two divisions were not unitary, the gain could not be included in the apportioned tax base for the paper division in Illinois.

Amici in the *MeadWestvaco* case, including the MTC,[20] urged the Court to consider using the Illinois factors of the software business alone to apportion a percentage of the gain to the state, rather than including the gain in the taxpayer's overall apportioned tax base. The Court declined the invitation to rule on this alternative argument because it had not been raised in the courts below or addressed in the state's *certiorari* petition. 553 U.S. at 31-32.

If the Court had thought that this alternative argument was constitutionally flawed, it seems unlikely that it would have gone to great pains to distinguish the argument and explain its reasons for not addressing it. *Id*. at 32 n. 4.

[20] Available at https://www.mtc.gov/Resources/Amicus-Briefs.

It seems equally unlikely that the Court's explanation for why it could not consider the alternative argument signaled its intent to overrule *Whitney v. Graves* and *Curry v. McCanless*, cases where a capital asset located in the state *was* deemed sufficient to support the state's taxation of the asset's owner. There was no hint in any of the Court's discussion that it considered these cases to be obsolete. *Id*.

Notably, the analysis in *Corrigan v. Testa* has not been followed by any other state courts, nor do we expect it to be. The New York investee apportionment cases discussed in Section III, above, have never been challenged. And recently, the New York City Tax Appeals Tribunal rejected a similar argument that the City lacked authority under the Due Process Clause to tax a PTE owner on its gains from the sale of its PTE interest. *In the Matter of Goldman Sachs Petershill Fund Offshore Holdings (Delaware) Corp.* New York City Tax Appeal Tribunal Decision No. TAT(E) 16-9(GC) (March 21, 2021). [21] As in this appeal, the taxpayer contended that the City's nexus over the capital gain income hinged on a requirement that the taxpayer and its PTE be engaged in a unitary business in the state. The Tribunal wrote:

> We have not found any controlling precedent on the unitary business issue in which the income from an investment, generally dividends, is treated as unitary and apportionable, but not the gain on the sale of that

[21] That case is now on appeal to the New York Supreme Court, Appellate Division.

investment. The United States Supreme Court in *Allied Signal v. Director Div. Taxation*, 504 U.S. 768, 780 (1992) stated the contrary.

VI. Massachusetts' rules for sourcing capital gain income arising from the disposition of pass-through entity ("PTE") interests is consistent with federal tax treatment of non-resident owners of PTEs operating in the United States and how other states source such income.

In the past 25 years we have witnessed a sea change in the range of permissible legal structures for businesses. A 1996 change in federal tax policy gave unincorporated businesses broad authority to elect to be taxed as Subchapter C corporations, Subchapter S corporations, or partnerships under Subchapter K of the Internal Revenue Code.[22] States quickly changed their own laws regarding permissible business organizational structures to conform with the new federal tax policy.

These and other changes in federal tax allowed more businesses to choose to be taxed as PTEs. Between 1980 and 2015, the number of federal Subchapter C Corporation returns decreased, from around 2.1 million to 1.6 million, while the number of federal partnership returns increased, from around 2.7 million to 3.7 million. Likewise, net income reported on C corporation returns went from $288 billion to $1.5 trillion, whereas net income reported on partnership returns went from

[22] 26 C.F.R. § 301.7701-1 through 301.7701-3, informally known as the "check the box" regulations.

$45 billion to $1.1 trillion. More income is now reported on S corporation and partnership returns than on C corporation returns.[23]

Owners are generally unconstrained when choosing the form of entity in which to do business. Often that choice is driven by both state and federal tax consequences. VASHI chose to conduct the business operations of Cloud5 in Massachusetts using an LLC. Had VASHI chosen to do business as a corporation and to be taxed as one, this would have altered the tax treatment of both the operating income of Cloud5 and VASHI's sale of its ownership interest under Massachusetts law.[24] As Professor Hellerstein noted in his critique of the *Corrigan* decision, a legislature may choose to consider a partnership as an entity for some purposes and choose the aggregation approach for other purposes.[25] There is no due process right

---

[23] See Internal Revenue Service Selected Financial Data on Businesses, Tax Years 1980-2015, available at https://www.irs.gov/statistics/soi-tax-stats-integrated-business-data.

[24] VASHI's objection to the Commonwealth's exclusion of apportionment factors of a separate C corporation, VAS, USA, in Cloud5's apportionment calculation fails for this reason. While states commonly "flow up" apportionment factors and income of partnerships into the calculation of the corporate base income and the apportionment formula by which that income is divided, the reverse is not true. We are aware of no state that includes the apportionment factors of a C corporation in the calculation of a partnership's apportionment percentages, because the C corporation is a separate taxable entity with its own tax liability calculated based upon its own apportionment percentages. Nor does any state currently permit taxpayers to file a combined return including C corporations and PTEs on the same report.

[25] *Substance and Form in Jurisdictional Analysis: Corrigan v. Testa*, 80 State Tax Notes at 850-851 (June 13, 2016).

for any business organization to be afforded status as an entity instead of an aggregation of interests, since the right to limited liability, including corporate form, is a legislative-granted privilege.

In 1991, the IRS published Revenue Ruling 91-32, 1991-1 C.B. 107, which provided that a foreign partner's gain on the sale of a U.S. partnership would be determined in the same manner as if the partnership itself had disposed of the underlying assets in the partnership. In *Grecian Magnesite Mining, Indus. & Shipping Co. v. Commissioner*, 149 T.C. 63, 149 T.C. No. 3 (2017), the Tax Court refused to defer to Rev. Rul. 91-32. The court held that because Congress had not addressed the issue by statute, the general rules providing for taxation based on the owner's domicile should apply.

In response to *Grecian Magnesite*, Congress amended IRC § 864(c) in the 2017 Tax Cuts and Jobs Act to effectively codify the source-based taxation principles in former Rev. Rul. 91-32. Under this approach, foreign partners are required to source gains from the sale of domestic businesses that operate and are taxed as partnerships to the U.S. in the same ratio as the U.S. assets.

States have made a similar shift on sourcing income from sales of PTE interests, as seen in the example of *Appeal of Holiday Inns Inc.*, 86-SBE-074 (Cal. State Bd. Equal. April 9, 1986). The taxpayer in that case sold an interest in a partnership that had significant real estate holdings in California. The California

Franchise Tax Board assessed the taxpayer additional franchise tax on the theory that the gain should be allocated to California because it represented an interest in real property in the state. The California Board of Equalization disagreed because California law did not clearly support this result and mandated sourcing to the taxpayer's commercial domicile. In response, Cal. Rev. & Tax Code § 25125(d) was passed two years later, providing that gains and losses arising from the disposition of a partnership interest are sourced to California based on the ratio of the original cost of partnership tangible property in the state to the original cost of partnership tangible property everywhere.

Since *Holiday Inns,* many states have recognized that more specific rules were necessary to ensure income from capital transactions was consistently taxed at its source.[26] Hawaii, Maine, Minnesota, Montana, North Dakota, and Oregon have joined California in sourcing receipts to the state based on the ratio of the original

---

[26] In *Noell Industries, Inc. v. Idaho State Tax Comm'n*, 470 P.3d 1176 (2020), *cert. denied*, 209 L. Ed. 2d 130 (2021), the Idaho Supreme Court held that the lack of a unitary relationship between Blackhawk Industries, an LLC with a substantial presence in Idaho, and Noell Industries, a Virginia-domiciled holding company, meant that Idaho could not include the capital gain income arising from the sale of Blackhawk in Noell's apportioned tax base. The case is cited by VASHI (Appellant's Brief at 21), but it offers no support for its Due Process Clause arguments. Because Idaho did not have an investee apportionment rule in place during the tax year in question, the court never considered whether Idaho could have taxed a portion of the gain using Blackhawk's own apportionment factors. The case does highlight the difficulty in applying unitary business concepts to the relationship between an operating company and its owner, in this case a holding company with no other activity except its ownership of an LLC.

cost of partnership tangible property in the state to the original cost of partnership tangible property everywhere.[27] Idaho, New Jersey, North Carolina, New York, Ohio, and Massachusetts source receipts based upon the percentages of one or more of the PTE's apportionment factors in the taxing state in the year of the sale, or in the immediately preceding year.[28] In sum, every state that has adopted specific sourcing rules for capital gains arising from the sale of PTEs operating within the states has generally followed the Massachusetts approach of assigning gains to the location of the PTE's operations, measured by property, payroll, or sales.

[27] California: Cal. Rev. & Tax. Code § 25125(d)
Hawaii: Haw. Rev. Stat. § 235-26(d)
Maine: Me. Rev. Stat. Ann. tit. 36, § 5211(16-A)(F)
Minnesota: Minn. Stat. § 290.17(Subd. 2)(c)
Montana: Mont. Admin. R. 42.26.229(2)
New York: New York TSB-M-18(1)I
North Dakota: N.D. Cent. Code § 57-38.1-17.1
Oregon: Or. Admin. R. 150-316-0171(2)(C)-(G)

[28] Idaho: Idaho Admin. Code r. 35.01.01.266.01(d)
Massachusetts: 830 MASS. CODE REGS. § 63.38.1 (2013)
New Jersey: N.J. Admin. Code tit. 18, § 35-1.3(d)(5)
New York: New York TSB-M-18(1)I
North Carolina: N.C. Admin. Code tit. 17, r. 06B.3527
Ohio: Ohio Rev. Code Ann. § 5742.212

CONCLUSION

The constitutional principles that support taxing VASHI on pass-through earnings derived from Cloud5's operations in Massachusetts apply equally to the taxation of capital gains arising from the sale of VASHI's interest in Cloud5. In both instances, Massachusetts provided benefits and protections to VASHI for which it can constitutionally ask for something in return.

Respectfully submitted,

/s/Bruce Fort

Bruce Fort, Senior Counsel
Multistate Tax Commission
New Mexico Bar No. 960, appearing *pro hac vice*
Counsel of Record
444 North Capitol Street, NW, Suite 425
Washington, D.C. 20001
(202) 580-9779
bfort@mtc.gov

Date: December 14, 2021

CERTIFICATE OF COMPLIANCE

Pursuant to Rule 16(k) of the
Massachusetts Rules of Appellate Procedure

I, Bruce Fort, hereby certify that the foregoing brief complies with the rules of court that pertain to the filing of briefs, including, but not limited to:

Mass. R. A. P. 16 (a)(13) (addendum);
Mass. R. A. P. 16 (e) (references to the record);
Mass. R. A. P. 18 (appendix to the briefs);
Mass. R. A. P. 20 (form and length of briefs, appendices, and other documents); and
Mass. R. A. P. 21 (redaction).

I further certify that the foregoing brief complies with the applicable length limitation in Mass. R. A. P. 20 because it is produced in the proportional font Times New Roman at size 14, and contains 7,210 total non-excluded words as counted using the word count feature of Microsoft Office Professional Plus 2016.

/s/Bruce Fort
Bruce Fort, Senior Counsel
Multistate Tax Commission
New Mexico Bar No. 960, appearing *pro hac vice*
Counsel of Record
444 North Capitol Street, NW, Suite 425
Washington, D.C. 20001
(202) 580-9779
bfort@mtc.gov

December 14, 2021

CERTIFICATE OF SERVICE

Pursuant to Mass. R. A. P. 13(d), I hereby certify, under the penalties of perjury, that on December 14, 2021, I have made service of this Brief and Addendum, by the Electronic Filing System, upon the attorney of record for each party:

Michael J. Bowen
Akerman LLP
50 North Laura Street, Suite 3100
Jacksonville, Florida 32202
(904) 798-3700
michael.bowen@akerman.com

Maura Healey
Michael T. Fatale
Brett M. Goldberg
Andrew P. O'Meara
Massachusetts Department of Revenue
Litigation Bureau, P.O. Box 9565,
100 Cambridge Street
Boston, Massachusetts 02114-9565
617-501-1062
goldbergb@dor.state.ma.us

/s/Bruce Fort
Bruce Fort, Senior Counsel
Multistate Tax Commission
New Mexico Bar No. 960, appearing *pro hac vice*
Counsel of Record
444 North Capitol Street, NW, Suite 425
Washington, D.C. 20001
(202) 580-9779
bfort@mtc.gov

ADDENDUM TABLE OF CONTENTS

ADDENDUM

California: Cal. Rev. & Tax. Code § 25125(d)

Gain or loss on the sale of a partnership interest is allocable to this state in the ratio of the original cost of partnership tangible property in the state to the original cost of partnership tangible property everywhere, determined at the time of the sale. In the event that more than 50 percent of the value of partnership's assets consist of intangibles, gain or loss from the sale of the partnership interest is allocated to this state in accordance with the sales factor of the partnership for its first full tax period immediately preceding the tax period of the partnership during which the partnership interest was sold.

Hawaii: Haw. Rev. Stat. § 235-26(d)

Gain or loss from the sale of a partnership interest is allocable to this State in the ratio of the original cost of partnership tangible property in the State to the original cost of partnership tangible property everywhere, determined at the time of the sale. If more than fifty per cent of the value of a partnership's assets consists of intangibles, gain or loss from the sale of the partnership interest shall be allocated to this State in accordance with the sales factor of the partnership for its first full tax period immediately preceding its tax period during which the partnership interest was sold.

Idaho: Idaho Admin. Code r. 35.01.01.266.01(d)

Gains or losses from the sale or other disposition of a partnership interest or stock in an S corporation are sourced to Idaho by using the Idaho apportionment factor for the entity for the taxable year immediately preceding the year of the sale of the interest or stock. However, a gain or loss from the sale of an interest in a publicly traded partnership transacting business in Idaho is Idaho source income to the extent of the gain or loss determined under Section 751, Internal Revenue Code, multiplied by the Idaho apportionment factor of the partnership for the year in which the sale occurred. (7-1-21)T.

Maine: Me. Rev. Stat. Ann. tit. 36, § 5211(16-A)(F)

Gross receipts on the sale of a partnership interest must be sourced to this State in an amount equal to the gross receipts multiplied by the ratio obtained by dividing the original cost of partnership tangible property located in Maine by the original cost of partnership tangible property everywhere, determined at the time of the sale. Tangible property includes property owned or rented and is valued in accordance with subsection 10. If more than 50% of the value of the partnership's assets consists of intangible property, gross receipts from the sale of the partnership interest must be sourced to this State in accordance with the sales factor of the partnership for its first full tax period immediately preceding the tax period of the partnership during which the partnership interest was sold. For purposes of this paragraph, the sales factor of a partnership is determined in accordance with subsection 14, subsection 15 and subsection 16-A, paragraphs A to E. This paragraph does not apply to the sale of a limited partner's interest in an investment partnership when more than 80% of the value of the partnership's total assets consists of intangible personal property held for investment, except that such property cannot include an interest in a partnership unless that partnership is itself an investment partnership.

Massachusetts: 830 Mass. Code Regs. § 63.38.1(9)(d)(3)(e)

Income-producing activity includes the sale of a partnership interest other than a partnership interest treated as a security under 830 CMR 63.38.1. Gross receipts from the sale of a partnership interest are attributable to Massachusetts if the sum of the partnership's Massachusetts property and payroll factors for the taxable year in which the sale occurred exceeds the sum of its property and payroll factors for any other one state. (However, in determining the partnership's apportionment percentage for purposes of 830 CMR 63.38.1(9)(e)3.e., the Commissioner may disregard partnership transactions after the taxpayer's disposition of its partnership interest whenever necessary to reflect accurately the partnership's activity at the time of the disposition.)

Minnesota: Minn. Stat. § 290.17(Subd. 2)(c)

Income or gains from intangible personal property not employed in the business of the recipient of the income or gains must be assigned to this state if the recipient of the income or gains is a resident of this state or is a resident trust or estate.

Gain on the sale of a partnership interest is allocable to this state in the ratio of the original cost of partnership tangible property in this state to the original cost of partnership tangible property everywhere, determined at the time of the sale. If more than 50 percent of the value of the partnership's assets consists of intangibles, gain or loss from the sale of the partnership interest is allocated to this state in accordance with the sales factor of the partnership for its first full tax period immediately preceding the tax period of the partnership during which the partnership interest was sold.

Gain on the sale of an interest in a single member limited liability company that is disregarded for federal income tax purposes is allocable to this state as if the single member limited liability company did not exist and the assets of the limited liability company are personally owned by the sole member.

Gain on the sale of goodwill or income from a covenant not to compete that is connected with a business operating all or partially in Minnesota is allocated to this state to the extent that the income from the business in the year preceding the year of sale was allocable to Minnesota under subdivision 3.

When an employer pays an employee for a covenant not to compete, the income allocated to this state is in the ratio of the employee's service in Minnesota in the calendar year preceding leaving the employment of the employer over the total services performed by the employee for the employer in that year.

Montana: Mont. Admin. R. 42.26.229(2)

Gain or loss from the sale of a non-unitary partnership or disregarded entity owner interest is allocable to this state in the ratio of the original cost of partnership or disregarded entity tangible property in this state to the original cost of partnership or disregarded entity tangible property everywhere, determined at the time of sale. In the event that more than 50 percent of the value of the assets of a partnership or disregarded entity consists of intangibles, gain, or loss from the sale of the partnership or disregarded entity owner interest shall be allocated to this state in accordance with the receipts factor of the partnership or disregarded entity for its first full tax period immediately preceding its tax period during which the partnership or disregarded entity interest was sold. If a disregarded entity does not have a tax period, the allocation will be made in accordance with the receipts factor of the partnership or disregarded entity for the 12 full calendar months preceding the month the interest was sold.

New Jersey: N.J. Admin. Code tit. 18, § 35-1.3(d)(5)

The allocation of gain or loss from a complete liquidation is determined as follows:

i. The gain or loss from the sale of real and tangible assets located in New Jersey is sourced to New Jersey.

ii. The gain or loss from the sale of motor vehicle equipment is sourced to the state where the vehicle is registered, unless the vehicle was used predominantly in another state.

iii. The gain or loss from the sale of intangibles is allocated using the average of the business allocation used for the last three years, as defined in (d)4 above.

New York: New York TSB-M-18(1)I
New York State Department of Taxation and Finance
Technical Memorandum
TSB-M-18(1)I
Income Tax
April 6, 2018

Definition of New York Source Income of a Nonresident Individual Expanded

The definition of New York source income of a nonresident individual in Tax Law § 631(b)(1)(A)(1) was expanded to include the gain or loss from the sale of ownership interests in certain entities that own shares in cooperative housing corporations located in New York (*New York co-op*).

The entities covered by this are:

- partnerships,
- limited liability companies (LLCs),
- S corporations, and
- non-publicly traded C corporations with 100 or fewer shareholders.

This change applies to a sale or exchange of an interest that occurs on or after January 1, 2017. For a sale or exchange of an interest in an entity that occurred before January 1, 2017, but on or after May 7, 2009, see TSB-M-09(5)I. *Amendment to the Definition of New York Source Income of a Nonresident Individual.*

Determining New York source income

As a nonresident you include all or part of the gain or loss from the sale or exchange of an interest in any of the above entities in your New York source income if the entity owns:

- real property located in New York, and/or
- shares of stock in a New York co-op,

and the fair market value (FMV) of all the real property in New York and shares of stock in New York co-ops equals or exceeds 50% of the FMV of the assets the entity has owned for at least two years on the date of the sale or exchange. If all the entity's assets have been owned for less than two years, then the 50% condition is met.

The portion of the gain or loss you include in New York source income is the total gain or loss reported on your federal return from that sale or exchange multiplied by the following fraction as of the date of the sale or exchange:

(FMV of the entity's real property in New York and the shares of stock in New York co-ops/FMV of all the assets that the entity owns)

Example: *On August 1, 2017, John, a nonresident individual of New York State, sold his entire interest in Partnership ABC. John reported a gain of $40,000 from the sale on his federal return.*

Partnership ABC owns shares of stock in a New York co-op. On August 1, 2017, the FMVs are:

- *shares of stock in the New York co-op - $850,000*
- *total assets - $1,450,000*
- *total assets (including any real property and shares of stock in New York co-ops) owned for at least two years - $1,100,000*

On August 1, 2017, the FMV of Partnership ABC's real property in New York and shares of stock in a New York co-op exceeds 50% of the FMV of all the assets that Partnership ABC owned for at least two years ($850,000/$1,100,000 = .77 or 77%). Therefore, all or part of John's gain from the sale of his partnership interest is considered derived from New York sources.

To determine the amount of the gain that must be included in New York source income, John divides the FMV of Partnership ABCs shares of stock in New York co-ops by the FMV of all the assets owned on the date of sale ($850,000/$1,450,000) and multiples the result by his federal gain reported on the sale of his partnership interest ($40,000). He determines that $23,600 is the amount of the gain from his sale of his partnership interest that must be included in New York source income as shown below:

• *$40,000 ($850,000/$1,450,000) = $23,600*

Part-year residents

This change also applies if you are a part-year resident individual that has a sale or exchange of an interest in an entity and the gain or loss on the sale or exchange occurs in the nonresident portion of the tax year.

Tiered entities

If you sell or exchange an interest in an entity that is part of a tiered structure of entities, the change applies to the sale or exchange if any entity in the tiered structure owns real property in New York or shares of stock in New York co-ops.

If a partnership in a tiered structure of entities sells or exchanges its interest in an entity in the tiered structure, the partnership must determine whether it has any New York source income relating to the sale or exchange for personal income tax as if it were a nonresident individual.[1]

Trusts

If you are a nonresident or part-year resident trust use the rules above for individuals. If you were a resident trust who was previously not subject to New York State income tax because you meet the conditions to not be subject to tax,[2] and you sold or exchanged your interest in a covered entity that owns real property in New York or shares of stock in New York co-ops, you will no longer meet the conditions and will be required to file.

References:

Tax Law §§ 605(b)(3)(D) and 631(b)(1)(A)(i)

Part Z of Chapter 59 of the Laws of 2017

TSB-M-09(5)I. *Amendment to the Definition of New York Source Income of a Nonresident Individual*

Note: A TSB-M is an informational statement of existing department policies or of changes to the law, regulations, or department policies. It is accurate on the date issued. Subsequent changes in the law or regulations, judicial decisions, Tax

---

[1] Tax Law § 631(b)(1)(A)(1)
[2] Tax Law § 605(b)(3)(D)

Appeals Tribunal decisions, or changes in department policies could affect the validity of the information presented in a TSB-M.

North Carolina: N.C. Admin. Code tit. 17, r. 06B.3527

(a) An interest in a partnership is intangible personal property. Gain from the sale of a nonresident partner's interest in a partnership is not included in the numerator of the fraction the nonresident uses to determine the amount of income subject to tax in North Carolina unless the sale of the partnership interest conveys title to tangible partnership property. If a partnership owning an interest in another partnership sells its interest in that partnership, the nonresident partners of the partnership selling its interest do not include their distributive shares of the gain realized by the partnership from the sale of its partnership interest in the numerator unless the partnership selling its interest is carrying on a trade or business in this State.

(b) Nonresident partners must include their distributive share of the gains or losses from the sale or other disposition of the partnership's assets in the numerator of the fraction in determining North Carolina taxable income. If the sale of partnership interests conveys title to tangible partnership property instead of to limited interests in the partnership, the transaction is considered a sale of partnership assets for purposes of determining North Carolina taxable income.

North Dakota: N.D. Cent. Code § 57-38.1-17.1

Gain or loss on the sale of a partnership interest is allocable to this state in the ratio of the original cost of partnership tangible property in the state to the original cost of partnership tangible property everywhere, determined at the time of the sale. In the event that more than fifty percent of the value of the assets of the partnership consist of intangibles, gain or loss from the sale of the partnership interest is allocated to this state in accordance with the ratio of total North Dakota income to total income of the partnership for its first full tax period immediately preceding the tax period of the partnership during which the partnership interest was sold. This section applies to the extent, that prior to the sale of the partnership interest, the partnership's income or loss constituted nonbusiness income.

Ohio: Ohio Rev. Code Ann. § 5742.212

(A) This section applies solely for the purpose of computing the credit allowed under division (A) of section 5747.05 of the Revised Code and computing income taxable in this state under division (D) of section 5747.08 of the Revised Code.

(B) A taxpayer, directly or indirectly, owning at any time during the three-year period ending on the last day of the taxpayer's taxable year at least twenty per cent of the equity voting rights of a section 5747.212 entity shall apportion any income, including gain or loss, realized from each sale, exchange, or other disposition of a debt or equity interest in that entity as prescribed in this section. For such purposes, in lieu of using the method prescribed by sections 5747.20 and 5747.21 of the Revised Code, the investor shall apportion the income using the average of the section 5747.212 entity's apportionment fractions otherwise applicable under section 5733.05, 5733.056, or 5747.21 of the Revised Code for the current and two preceding taxable years. If the section 5747.212 entity was not in business for one or more of those years, each year that the entity was not in business shall be excluded in determining the average.

(C) For the purposes of this section:

(1) A "section 5747.212 entity" is any qualifying person if, on at least one day of the three-year period ending on the last day of the taxpayer's taxable year, any of the following apply:

(a) The qualifying person is a pass-through entity;

(b) Five or fewer persons directly or indirectly own all the equity interests, with voting rights, of the qualifying person;

(c) One person directly or indirectly owns at least fifty per cent of the qualifying person's equity interests with voting rights.

(2) A "qualifying person" is any person other than an individual, estate, or trust.

(3) "Estate" and "trust" do not include any person classified for federal income tax purposes as an association taxable as a corporation.

Oregon: Or. Admin. R. 150-316-0171(2)

(c) S corporation stock. In general, a nonresident's gain or loss from the sale, exchange, or disposition of S corporation stock is not attributable to a business carried on in this state and is not Oregon source income. The gain or loss from the S corporation stock may not be used in the determination of Oregon taxable income unless the stock has acquired a business situs in this state. See section (1) of this rule.

(d) General Partnership Interests. A nonresident's gain or loss from the sale, exchange, or disposition of a general partnership interest in an Oregon partnership is attributable to a business carried on in Oregon and is Oregon source income. The gain or loss is allocated as provided in ORS 314.635.

(e) Limited Partnership Interests. In general, a nonresident's gain or loss from the sale, exchange, or disposition of a limited partnership interest is not attributable to a business carried on in Oregon and is not Oregon source income. The gain or loss from the sale of the interest will not be used in the determination of Oregon taxable income unless the limited partnership interest has acquired a business situs in this state (see section (1) of this rule.).

(f) Limited Liability Company Interests. The taxation of a nonresident's gain or loss from the sale, exchange, or disposition of an interest in a limited liability company (LLC) operating in Oregon is Oregon source income and is taxed in the same manner as:

> (A) The sale of a general partnership interest under subsection (2)(d) of this rule if the selling member is a member-manager of the LLC; or
>
> (B) The sale of a limited partnership interest under subsection (2)(e) of this rule if the selling member is not a member-manager of the LLC.
>
> (C) For purposes of this rule, a person is a "member-manager" of an LLC if that member has the right to participate in the management and conduct of the LLC's business. For an LLC that is designated as a member-managed LLC in its articles of organization, all members of the LLC will be member-managers. For an LLC that is designated as a manager-managed LLC in its articles of organization, only those persons who are both members of the LLC and are designated as a manager in the LLC's operating agreement (or elected as managers by the LLC members pursuant to the operating agreement) will be member-managers.

(g) Limited Liability Partnership Interests. A nonresident’s gain or loss from the sale, exchange, or disposition of an interest in a limited liability partnership is taxed in the same manner as if it were a general partnership interest under subsection (2)(d) of this rule.