IN THE SUPREME COURT OF TENNESSEE
MIDDLE SECTION, AT NASHVILLE

BLUE BELL CREAMERIES, LP,	)	
	)	
Plaintiff-Appellee,	)	
	)	
v.	)	**No. M2009-00255-SC-R11-CV**
	)	
REAGAN FARR, COMMISSIONER	)	
DEPARTMENT OF REVENUE,	)	
STATE OF TENNESSEE	)	
	)	
Defendant-Appellant.	)	

On Application for Permission to Appeal from the Judgment of the Court of Appeals

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BRIEF OF *AMICUS CURIAE* MULTISTATE TAX COMMISSION IN SUPPORT OF APPLICATION OF COMMISSIONER OF REVENUE FOR PERMISSION TO APPEAL

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TABLE OF CONTENTS Page

TABLE OF AUTHORITIES……………………………………………………………..ii

I. INTERESTS OF THE *AMICUS CURIAE*…………………………………………….1

II. ARGUMENT...4

I. A STATE CAN TAX INCOME GENERATED WITHIN ITS BORDERS, WHETHER RECOGNIZED AS CURRENT EARNINGS OR CAPITAL GAINS..4

A. The State Has a Sufficient Nexus to Tax Income Generated Within its Borders Regardless of the Form in Which the Income is Realized..5

B. The “Taxable Activity” the Court of Appeals Should Have Considered Was Not the Reorganization, But the Operation of a Unitary Business Within the State………………7

C. The State Has a Sufficient Nexus Over Gains Resulting from Appreciation in the Value of Intangible Property Attributable to In-State Business Activities…………………………………………11

II. BLUE BELL AND BBC USA ARE PART OF THE SAME UNITARY BUSINESS WHERE BBC USA’S VALUE WAS ENTIRELY DEPENDENT UPON BLUE BELL LP’S OPERATIONS……………………………………………………………………14

A. The Court of Appeals Erred in its Application of the *Mobil Oil* Test to a Holding Company Which Owns Only the Assets of a Unitary Business…………………………………………...17

B. The Taxpayer Failed to Meet its Burden of Demonstrating That the Capital Gain Arose From Non-Unitary Sources……………………………………………………19

C. An Unduly Constricted View of Enterprise Unity Could Have Far-Reaching Consequences in other Contexts.......................21

III. CONCLUSION…………………………………………………………...22

TABLE OF AUTHORITIES

Federal Cases: page

Adams Express Co. v. *Ohio*, 165 U.S. 194 (1897)……………………………………..….11

Allied-Signal, Inc. v. *Director, Division of Taxation,*
504 U.S. 768 (1992)…………………………………………………………5, 10, 12

ASARCO, Inc. v. *Idaho State Tax Commission,*
458 U.S. 307 (1982)………………………………………………………...8, 20

Butler Brothers v. *McColgan,* 315 U.S. 501 (1942)…………………………………..…5

Complete Auto Transit, Inc. v. *Brady*, 430 U.S. 274 (1974)………………………...5, 13

Container Corporation of America, Inc. v. *Franchise Tax Board,*
463 U.S. 159 (1983)………………………………………………………17, 20

Curry v. *McCanless*, 307 U.S. 357 (1939)…………………………………………..…11

Exxon Corporation v. *Wisconsin Department of Revenue*,
447 U.S. 209 (1980)……………………………………………………....5, 10, 11

International Harvester Co. v. *Wisconsin Department of Revenue,*
322 U.S. 435 (1944)……………………………………………………...11, 12

Mobil Oil Corporation v. *Commissioner of Taxation (Vermont),*
445 U.S. 425 (1980)……………………………………………………….*passim*

Shaffer v. *Carter*, 252 U.S. 37 (1920)…………………………………………………11

United States Steel Corp. v. *Multistate Tax Commission*,
434 U.S. 452 (1978)……………………………………………………………...2

Wheeling Steel Corporation v. *Fox,* 298 U.S. 193 (1936)…………………………..…11

Whitney v. *Graves,* 299 U.S. 366 (1937)…………………………………………...10

Tennessee Cases:

Blue Bell Creameries, L.P. v. *Chumley*,
No. M2009-00255-COA-R3-CV (Tenn. Ct. App., 9/29/09)………………….…*passim*

Louis Dreyfus Corporation v. *Huddleston,*
933 S.W.2d 460 (Tenn. Ct. App. 1996)…………………..……………..…5, 14, 15, 20

Cases From Other States:

A.B. Dick Co. v. *McGraw,*
678 N.E.2d. 1100, 1108 (Ill. App. 4th Dist. 1997)……..…………………………………..17

Appeal of Gad Rad West, Inc.,
94A-SBE-0240, 1996 WL 767612 (1996)…………………..……………………………..18

Hugo Neu-Proler Int'l Sales Corp. v. *California Franchise Tax Bd.*,
195 Cal. App. 3d 326, 240 Cal. Rptr. 635 (Cal. App. 2nd dist. 1987)…………..……….…18

PBS Bldg. Sys., Inc. and PKH Bldg. Sys., Inc.,
1994 Cal. Tax LEXIS 434, 94-SBE-008 (11/17/94)……………………………….17, 18

Federal Constitution, Statutes and Reports:

U.S. Const., Art. I, § 8 (Commerce Clause)………………………………...……*passim*

U.S. Const., Amend. XIV (Due Process Clause)…………………………………...*passim*

26 U.S.C.A. § 1361 (Internal Revenue Code)……………………………….………...6

H.R. Rep. No. 89-952 (1965)……………………………………………….……....3

State Statutes:

Tenn. Code Ann. § 67-4-2006(a)(4)………………………………………….….…8

Tenn. Code Ann. § 67-4-2007(d)…………………………………………….….…8

Other Authorities:

California Franchise Tax Board, Rev. Ruling No. 95-8,
1995 WL 831603……………………………………………………………………...18

W. Hellerstein, *State Taxation*
(3rd ed., Warren, Gorham & Lamont 2009)………………………………...11, 12, 18, 19

McIntyre, Mines & Pomp, *Designing a Combined Reporting Regime for a State Corporate Income Tax: A Case Study of Louisiana,* 61 La. L. Rev. 699 (2001)………………………….….21

Multistate Tax Compact, *reprinted in*,
RIA, *All States Tax Guide* (2005)…………………………………………...............2

Swain, *State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective,* 45 William & Mary L. Rev. 319 (2003)……………………….…..11

I. INTERESTS OF *AMICUS CURIAE*

Amicus curiae Multistate Tax Commission ("the Commission") submits this brief in support of the "Application of Commissioner of Revenue for Permission to Appeal" filed by Defendant/Appellant Reagan Farr, Commissioner of Revenue for the State of Tennessee ("Tennessee" or "the state"). The Commission joins the state in urging this Court to hear an appeal of the final decision of the Tennessee Court of Appeals at Nashville rendered on September 29, 2009. *Blue Bell Creameries, L.P.* v. *Chumley*, No. M2009-00255-COA-R3-CV ("*Slip Op*.").

In this matter, the Court of Appeals upheld a Chancery Court decision setting aside an assessment of excise taxes against Blue Bell Creameries, L.P. ("the taxpayer" or "Blue Bell"), which produced and sold ice-cream in several states, including Tennessee. The Court of Appeals held that Tennessee was precluded by the Due Process Clause and the Commerce Clause of the United States Constitution from imposing an excise tax on a fairly apportioned percentage of a capital gain recognized by the taxpayer in early 2001. That gain was triggered by the redemption of stock in a holding company, Blue Bell Creameries U.S.A., Inc. (hereafter "BBC USA"), undertaken as part of a complicated restructuring of the taxpayer's business designed to eliminate entity-level federal taxation of the taxpayer's earnings. T.R., Vol. II at 238-239. The Court of Appeals concluded that the capital gain could not be taxed in Tennessee because BBC USA and the taxpayer were not engaged in the same "unitary business," even though BBC USA's only function was to hold the assets making up the Blue Bell ice cream business, including the intermediary corporations that served as Blue Bell's partners. *Slip. Op*. at 14. The Commission respectfully submits that in reaching this conclusion, the Court of Appeals

misapplied the "unitary business principle"--the constitutional underpinning for formulary apportionment which is the basis for state income and excise taxes of multistate businesses--by failing to recognize the nature and source of the income in question. The Commission has a significant interest in supporting the state's petition, because the Court of Appeals' decision, if allowed to stand, would create uncertainty and confusion in the administration of state excise and corporate income taxes which could resonate beyond the state's borders.

The Commission is the administrative agency for the Multistate Tax Compact ("Compact"), which became effective in 1967. *See* RIA *All States Tax Guide*, ¶ 701 *et seq*., (2005).[1] Today, forty-seven states and the District of Columbia are members of the Commission. Twenty states have legislatively established full membership. Six additional states are sovereignty members and twenty-two are associate members.[2]

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

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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, not on behalf of any particular member state. Compact Members are: Alabama, Alaska, Arkansas, California, Colorado, District of Columbia, Hawaii, Idaho, Kansas, Michigan, Minnesota, Missouri, Montana, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah and Washington. Sovereignty Members: Georgia, Kentucky, Louisiana, Maryland, New Jersey, West Virginia and Wyoming. Associate Members: Arizona, Connecticut, Florida, Illinois, Iowa, Indiana, Maine, Massachusetts, Mississippi, Nebraska, New Hampshire, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont and Wisconsin.

The Compact arose as a result of threatened federal legislation that would have imposed significant limitations on state taxation of interstate commerce. *See, e.g.,* H.R. Rep. No. 89-952, Pt. VI, at 1143 (1965). The promise of increased uniformity established by the states' adoption of the Compact was critical to preserving the recognized sovereignty the states continue to enjoy with respect to taxation of interstate commerce. Preserving state tax sovereignty under our vibrant federalism was the primary purpose of the Compact and continues to be the key goal for the Commission.

The Commission's purpose in filing this brief arises from its twin goals of facilitating the proper determination of state tax liability and promoting uniformity and consistency in the administration of formulary-based taxation of multistate businesses.

The Court of Appeals' decision characterized the source of the income as a "one-time transaction" that triggered the recognition of a capital gain, *Slip Op*. at 11, failing to recognize that the gain represented the appreciation in value of Taxpayer's unitary business being conducted in the state.

The court's determination that Blue Bell was not unitary with BBC USA, an entity which existed solely to hold Blue Bell's assets, is contrary to long-standing understandings of the unitary business principle and established precedent. Allowed to stand, the lower court's decision would lead to a lack of uniformity and confusion in both statutory and constitutional aspects of state taxation.

The Court of Appeals' erroneous application of the unitary business principle would enable taxpayers to escape appropriate state taxation by isolating the legal ownership of their intangible assets in "pure" holding companies (that is, entities like BBC USA with no operations or employees) in states which do not imposes taxes on

income. Under the Court of Appeals' application of the unitary business principle, it would be difficult for a state to demonstrate "operational unity" with a holding company which has no operations anywhere. In each of these respects, the decision is contrary to established precedent in other states and in the U.S. Supreme Court.

The Commission urges this Court to accept review of this decision so that uniformity of interpretation of state laws and proper application of federal constitutional strictures on state taxation of multistate taxpayers will be preserved.

II. ARGUMENT

I. A STATE CAN TAX INCOME GENERATED WITHIN ITS BORDERS, WHETHER RECOGNIZED AS CURRENT EARNINGS OR CAPITAL GAINS.

The question presented by the state's application for permission to appeal is whether Tennessee has the ability to impose a fairly-apportioned excise tax on a taxpayer's capital gain income which reflected the increase in the value of its own business conducted partially within the state.[3] The Court of Appeals held this imposition offended both the Due Process Clause (Amend. XIV) or the Commerce Clause (Art. I, § 8) of the U.S. Constitution.

In *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1974), the Supreme Court established its familiar four-part framework for determining whether a tax which affects interstate commerce is constitutional. A tax must be: (1) non-discriminatory toward interstate commerce; (2) applied to one of more activities with a substantial nexus to the taxing state; (3) fairly apportioned; and (4) fairly related to the services provided by the state. 430 U.S. at 279-80.

[3] Approximately 1.8955% of the taxpayer's business was conducted in Tennessee in 2001. T.R., Vol. I at 65 (Excise Tax Return, line 20).

In its pleadings, the taxpayer does not suggest that the tax is discriminatory, unfairly apportioned or unrelated to services provided by the state. The taxpayer has argued, however, and the Court of Appeals agreed, that the "activity" sought to be taxed--the realization of a capital gain attributable to its own business--lacks a sufficient nexus with Tennessee. T.R., Vol. II at 229 (Plaintiff's Motion for Summary Judgment); *Slip Op*. at 13-15.

A. The State Has a Sufficient Nexus to Tax Income Generated Within its Borders Regardless of the Form in Which the Income is Realized.

A fairly apportioned state tax on income runs afoul of the Due Process and Commerce Clauses only if it reaches income which clearly has its source beyond the state's borders. *Allied-Signal, Inc.* v. *Director, Division of Taxation,* 504 U.S. 768, 778 (1992). In the Supreme Court's previous decisions outlining the contours of state tax jurisdiction, this requirement has been variously described as necessitating "a minimal connection, or nexus between the [taxpayer's] interstate activities and the taxing state", *Exxon Corporation* v. *Wisconsin Department of Revenue*, 447 U.S. 209, 219-220 (1980), and "a rational relationship between the income attributable to the taxing state and the intrastate values of the enterprise." *Mobil Oil Corporation* v. *Commissioner of Taxation (Vermont),* 445 U.S. 425, 436-7 (1980). The taxpayer asserting the invalidity of a tax "has the distinct burden of showing, by 'clear and cogent evidence' that [the state tax] results in extra-territorial values being taxed… ." *Butler Brothers* v. *McColgan,* 315 U.S. 501, 507 (1942); *Accord, Louis Dreyfus Corporation* v. *Huddleston,* 933 S.W.2d 460, 467 (Tenn. App. 1996). The taxpayer in this case offered no "clear and convincing evidence" that extra-territorial values were being subjected to tax because it never

identified any possible source of the income other than the appreciation in value of Blue Bell's ice-cream business operated partially within Tennessee.

The facts in this appeal are complex, but are not in dispute. In late 2000 and early 2001, the taxpayer's predecessor and its related affiliates underwent a complex multi-step legal restructuring intended to allow the tax benefits of pass-though tax treatment for its shareholders at the federal level while continuing to avoid the imposition of Texas franchise tax on the earnings of the taxpayer and its related entities. *See* Deposition of William J. Rankin ("Rankin Depo."), at 17, 21.

The taxpayer and its related affiliates existed for a single business purpose both prior to and after the reorganization: the manufacture and sale of ice-cream products. Rankin Depo., Exhibit 5 (Plan of Reorganization), paragraph 1(a).[4] No other business was conducted by the taxpayer or its affiliates, and thus, there could be no other source of income for either BBC USA or Blue Bell. Rankin Depo., at 55.

In order for BBC USA to elect to be treated as a federally non-taxed S-corporation, it was necessary to "buy out" approximately 250 of the shareholders in BBC USA's predecessor corporation, allowing them to convert their ownership interest from shares in a corporation into limited partnership interests in Blue Bell. Rankin Depo., at 22. BBC USA then had 75 shareholders remaining, the maximum permitted for S-corporation status under Internal Revenue Code ("IRC") § 1361. In furtherance of the plan of reorganization, BBC USA's predecessor donated $142,506,000 million in shares to Blue Bell, and those shares were then resold to BBC USA for total consideration of $14,250,600 in cash and a promissory note from BBC USA for 128,255,400. T.R., Vol.

[4] As William Rankin described in his deposition, "Before we were in the ice-cream business—afterwards we were in the ice cream business. But when we got through with it, we were taxed at the partner level and not the entity level." Rankin Depo., at 21.

I, at 99, ¶ 6. Rankin Dep., Ex. 5, at ¶ 1(a). Blue Bell reported a capital gain of $119,909,317 on the redemption (Rankin Depo., Ex. 2, at 2), because the value of the shares it sold had increased significantly in the years Blue Bell had been in operation. Rankin Depo., at 33-34. Blue Bell then distributed $94,106,645 to its partners. T.R., Vol. I, at 99, ¶ 7. The redemption of the stock triggered recognition by Blue Bell of a capital gain for purposes of Tennessee's excise tax, which is based on federal income amounts. *See* Tenn. Code Ann. §§ 67-4-2006 to -2007.

Tennessee argued in the courts below that the gain which was recognized by Blue Bell could only have its source in the unitary business conducted partially within Tennessee, because of the clear evidence of "enterprise unity" between Blue Bell and BBC USA, and that fact that BBC USA had no other business, and thus, could have had no other source of income. *Slip. Op*. at 8-9. It was incumbent upon the taxpayer to demonstrate that the income in question had its source outside Tennessee, and there is nothing in the record to suggest any source for the income other than the operations of Blue Bell which occurred partially in the state.

D. The "Taxable Activity" the Court of Appeals Should Have Considered Was Not the Reorganization, But the Operation of a Unitary Business Within the State.

The Court of Appeals' focus on the capital nature of the transaction, *Slip Op*. at 11-15, misapprehends the U.S. Supreme Court's precedents with respect to the restrictions on state taxation of multi-jurisdictional income in the Commerce Clause and Due Process Clause. The court appears to have determined that the recognition of income resulting from the appreciation in value of the taxpayer's business was a "taxable event" which was confined to the states where the legal ownership of the business was

held. The court held that the taxpayer's partners were "*entitled to* the earnings since they were in possession of BBC USA stock at the time it appreciated." *Slip Op.* at 15 (emphasis supplied). The Court of Appeals also cited the fact that the benefits of the capital gain were passed on to the shareholders, who were required to recognize gain on the appreciated assets for federal purposes. *Slip. Op.* at 11-12. The court concluded that the gains were accordingly not used by Blue Bell in its unitary business, and could not be taxed by Tennessee. *Slip Op*. at 15.

Tennessee imposes its excise tax on all entities doing business in the state, including partnerships like Blue Bell that are generally not subject to federal tax at the entity level. Tenn. Code Ann. §§ 67-4-2006(a)(4); 67-4-2007(d). Under the Court of Appeals' reasoning, it would be difficult for Tennessee to impose its excise tax on partnerships like Blue Bell to the extent that income is later distributed to its owners, since the distributions would not be used as "operational funds." *Slip Op*. at 15. Whether to impose a fairly apportioned tax on an entity or its shareholders, or neither, are policy determinations which should not have been confused with constitutional restrictions on the states' ability to tax multi-jurisdictional business earnings.

The Court of Appeals' holding follows only if it assumed that a capital gain has some separate constitutional status from other forms of earnings, but there is no basis in law for such a distinction. The U.S. Supreme Court made clear a quarter-century ago that there is no distinction as a constitutional matter between a non-domiciliary state's ability to include in the apportioned tax base current income (in the form of dividends) from unitary sources and accumulated earnings (in the form of capital gains) from unitary sources. *ASARCO, Inc.* v. *Idaho State Tax Commission,* 458 U.S. 307 (1982). The

income in question in *ASARCO* included both dividends and capital gains received as a consequence of investments in five foreign subsidiaries that conducted no direct business in Idaho. The Court wrote in that case:

> 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. [footnote omitted] Brief for Appellant 27; Brief for Appellee 21. *Cf.* 99 Idaho at 937, 592 P.2d at 52 ("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." *Mobil,* 445 U.S. at 445 U.S. 440. Changing the form of the income "works no change in the underlying economic realities of [whether] a unitary business [exists], and accordingly it ought not to affect the apportionability of income the parent receives." *Id.* at 445 U.S. 441.
>
> 458 U.S. at 330.

In *Mobil Oil Corp.* v. *Commissioner of Taxes (Vermont),* 445 U.S. 425 (1980), the Court also held that the form in which income was received had no bearing on whether a non-domiciliary state could impose a tax on that income:

> At the outset, we reject the suggestion that anything is to be gained from characterizing the receipt of dividends as a separate taxable event. In *Wisconsin* v. *J.C. Penny Co., supra*, the Court observed that ‘tags’ of this kind ‘are not instruments of adjudication but statements of result,’ and they add little to analysis. 311 U.S., at 444. Mobil’s business entails numerous ‘taxable events’ that occur outside Vermont. That fact alone does not prevent the State from including income earned from those events in the pre-apportionment tax base.
>
> Nor do we find particularly persuasive Mobil’s attempt to identify a separate business in its holding company functions….One must look principally at the underlying activity, not the form of investment, to determine the propriety of apportionability.
>
> 445 U.S. at 440.

Instead of focusing exclusively on how the reorganization itself did or did not benefit Blue Bell's business in Tennessee, the court should have inquired as to the source of the income. Nothing in the record before the court suggests that the appreciation in value represented by the redeemed shares could have any geographic source other than in the states in which Blue Bell operated, regardless of the form in which the business was held. The record is clear that BBC USA and its predecessors held only the assets of the Blue Bell ice cream business, including Blue Bell itself and related affiliates engaged in the same business. The holding company had no other function or purpose except to hold those interests. Rankin Depo., Ex. 5, p. 2. Any appreciation in the value of BBC USA Inc.'s stock is *ipso facto* a consequence of the appreciation in the value of its only asset, the ice cream business operating in Tennessee and elsewhere. As William Rankin testified in his deposition:

> I think the operational assets of the business always existed before the [re]organization always existed. I don't think there's ever been a change in the operational assets….*It's not like this was an influx of capital from someplace else.* As I told you, there were assets that went up and came back down, and it was just, you know, paper transactions.

Rankin Depo., at 43 (emphasis supplied).

Mr. Rankin's deposition testimony confirms what is apparent from the record: the gain did not result from an infusion of cash from "non-unitary" investment activities by BBC USA, but rather, the gain was the recognition of the appreciation in value of operating assets located partially within Tennessee, triggered when the assets' ownership was transferred to achieve tax savings.

It is beyond dispute that Tennessee has a right to impose its excise tax based on income which has an in-state source. *Allied-Signal*, 504 U.S. at 778; *Exxon Corporation*

v. *Wisconsin*, 447 U.S. at 229; *International Harvester Company* v. *Wisconsin Department of Revenue,* 322 U.S. 435 (1944); *Whitney* v. *Graves,* 299 U.S. 366 (1937); *Shaffer* v. *Carter*, 252 U.S. 37, 52 (1920); See also, Swain, *State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective,* 45 William & Mary L. Rev. 319, 363 (2003)("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."); W. Hellerstein, *State Taxation*, ¶ 6.04, at 6-13 (3rd ed., Warren, Gorham & Lamont 2009).

E. The State Has Sufficient Nexus Over Gains Resulting from Appreciation in the Value of Intangible Property Attributable to In-State Business Activities.

In determining that the appreciation in Blue Bell's value was unrelated to activities conducted within the state, the Court of Appeals may have assumed that the value of intangible property should be confined to the commercial domicile or residencies of property owners. The court's assumption runs counter to decades of jurisprudence with respect to the location of intangible property values in an on-going business.

In the seminal case of *Adams Express Co.* v. *Ohio*, 165 U.S. 194, 223-224 (1897) the Supreme Court stated that for purposes of taxation, intangible property value is not confined to business headquarters or the state of incorporation, but rather it is "distributed wherever its tangible property is located and its work is done[.]" *Accord, Whitney* v. *Graves*, 299 U.S. 366, 372 (1937)(upholding New York's imposition of tax on capital gain received by out-of-state resident from the sale of a membership on the New York stock exchange); *Wheeling Steel Corporation* v. *Fox,* 298 U.S. 193 (1936)(intangible property acquires a taxable business *situs* where employed); *Curry* v. *McCanless*, 307 U.S. 357, 367 (1939)(same). The "intangible" property interest which generated the gain

recognized by the taxpayer in this case was the appreciation in the value of Blue Bell's on-going business, conducted in multiple states including Tennessee; that value was not localized in BBC USA's state of incorporation. Had Blue Bell simply sold some of the physical assets it used in its unitary business resulting in a capital gain, there is no question that Tennessee would have had the constitutional authority to impose a fairly apportioned tax on that income under the principle of source taxation discussed above.

One reason there is no jurisprudential basis for a constitutional distinction between a state's jurisdiction to tax capital gains and ordinary income is that capital gains can represent an appreciation in the value of a business that could have been paid out as ordinary income. This point was made clear by the authors of *State Taxation*:

> It would be incongruous (and, from the state's standpoint, inequitable) for a taxpayer to be able to reduce in-state apportionable income through depreciation or other deductions while the asset was being used in the trade or business and then, when the asset is sold, to avoid "recapture" of that income in the state by treating the income from the sale as non-business income allocable to another state.
>
> W. Hellerstein, *State Taxation*, ¶9.05[2][c], at 9-44 – 9-45.

Absent evidence to the contrary, it is reasonable to consider that the total amount of net income recognized by Blue Bell in any prior year was partially a function of management's decisions to incur expenses, such as purchasing new equipment, advertising the Blue Bell brand, or conducting research and development.[5] Those expenditures reduced the amount of income available for immediate distribution to Blue Bell's partners (and reduced the amount of income subject to Tennessee's excise tax in

[5] The burden of proof was on the taxpayer, of course, to demonstrate that the appreciation in Blue Bell's value represented some source other than its ordinary business operations conducted partially within Tennessee, and the taxpayer provides no such evidence. *Compare, Allied-Signal, Inc.* v. *Director*, 504 U.S. 768 (1992)(gain resulted from appreciation in value of passive stock holding in unrelated business).

those years) but increased the value of the enterprise, a value which was recognized upon the ultimate redemption of Blue Bell USA's stock.

In this case, the appropriate inquiry under the Due Process and Commerce Clause is whether the state provided "protections and benefits" to the underlying business which was the source of the income subject to taxation. *Complete Auto,* 430 U.S. at 279-80. The Commission submits that the Court of Appeals erred in determining that the capital gain in question, fairly apportioned among the states in which Blue Bell operated, bore "no rational relationship to values generated within the state." *Mobil Oil,* 445 U.S. at 436-7. To the contrary, the gain can only be attributed to the on-going operations of Blue Bell in Tennessee and elsewhere.

II. BLUE BELL AND BBC USA ARE PART OF THE SAME UNITARY BUSINESS WHERE BBC USA'S VALUE WAS ENTIRELY DEPENDENT UPON BLUE BELL LP'S OPERATIONS

The Court of Appeals concluded that a capital gain realized by a taxpayer was not unitary income where that gain could be sourced back to the redemption of shares of stock in a holding company, even though that holding company existed solely to own the Blue Bell ice cream business. The Commission respectfully submits that under such circumstances, a "unitary" or "functional" relationship between the taxpayer and what is essentially the value of its own assets should be clear by any appropriate articulation of the unitary test. The Court of Appeals' decision in this case would require a unitary analysis that does not properly take into account the unique aspects of a holding company relationship and that would generally result in finding a "shell" which holds the intangible interests in an on-going business bears no economic relationship to the business itself.

A. The Court of Appeals Erred in its Application of the *Mobil Oil* Test to a Holding Company Which Owns Only the Assets of a Unitary Business.

In *Louis Dreyfus*, 933 S.W.2d at 469, the Court of Appeals described the various tests that courts have employed in determining whether businesses are unitary, holding that "no single factor is controlling," adding that all of the factors should be "examined in combination." *Id.* The court wrote:

> The courts have devised several tests for determining whether a business is unitary. The earliest of these, the so-called "three unities" test required the courts to examine the unity of ownership, the unity of operation as evidenced by central purchasing, advertising, accounting, and management, and the unity of a centralized executive force and general system of operation. *Butler Bros.* v. *McColgan,* 315 U.S. 501, 508, 62 S.Ct. 701, 704-05, 86 L.Ed. 991 (1942); *Peterson Mfg. Co.* v. *State,* 779 S.W.2d at 786; *W.S. Dickey Clay Mfg. Co.* v. *Dickinson,* 200 Tenn. at 34-35, 289 S.W.2d at 537. The second test employed by the United States Supreme Court requires the courts to examine the record for evidence of functional integration, centralization of management, and economies of scale. *F.W. Woolworth Co.* v. *Taxation and Revenue Dep't,* 458 U.S. at 364, 102 S.Ct. at 3135; *Mobil Oil Corp.* v. *Commissioner of Taxes,* 445 U.S. at 438, 100 S.Ct. at 1232. Other courts have used the "dependency and contribution" test to determine whether the business components under consideration contribute to each other and the operation of the business as a whole. *A.M. Castle & Co.* v. *Franchise Tax Bd.,* 36 Cal.App.4th 1794, 43 Cal.Rptr.2d 340, 346 (1995); *Ramsay, Scarlett & Co.* v. *Comptroller,* 302 Md. 825, 490 A.2d 1296, 1302 (1985); *Silent Hoist & Crane Co.* v. *Director, Div. of Taxation,* 100 N.J. 1, 494 A.2d 775, 784 (1985). These tests are not mutually exclusive but rather are alternative ways to determine whether the components of the business operate under "an umbrella of central management and controlled interaction," *Exxon Corp.* v. *Wisconsin Dep't of Revenue,* 447 U.S. at 224, 100 S.Ct. at 2120.
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> *Id.*

Although in this case the Court of Appeals acknowledged the existence of many different articulations of the unitary test, *Slip Op.* at 6, it analyzed the relationship between Blue Bell and BBC USA only by applying the three factors identified in *Mobil Oil* v. *Vermont*, 445 U.S. 425 (1980) to the shell corporation, BBC USA, and did not

consider the underlying business which the shell owned and controlled. This approach was rejected in the *Mobil Oil* decision itself, in which the Court held that the unitary relationship between the operating company which generated dividends and the taxpayer's oil business could not be severed by paying the dividends in question to a holding company. 445 U.S. at 440. The underlying business of BBC USA is the ownership of Blue Bell and other operating subsidiaries, all engaged in the ice cream business.

A holding company relationship, such as that between Blue Bell and BBC USA, is more appropriately evaluated under the "contributions and dependency" test recognized by the Court of Appeals in *Louis Dreyfus*:

> A business is unitary when the operation of one of its components depends upon and contributes to the operation of its other components. *Barclays Bank PLC.* v. *Franchise Tax Bd.,* 512 U.S. at ---- n. 1, 114 S.Ct. at 2272 n. 1; *Tenneco West, Inc.* v. *Franchise Tax Bd.,* 234 Cal.App.3d 1510, 286 Cal.Rptr. 354, 361 (1991); *Champion Int'l Corp.* v. *Bureau of Revenue,* 88 N.M. 411, 540 P.2d 1300, 1302 (Ct.App.1975).
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> 933 S.W.2d at 466.

In the present case, the contributions and dependencies between BBC USA and Blue Bell arise from the nature of the relationship between the two entities. BBC USA served as the investment vehicle for hundreds of shareholders, allowing them to freely exchange shares of stock rather than partnership interests, while retaining limited liability and other advantages of corporate form. Rankin Depo., at 37. The capital structure of BBC USA facilitated investment in Blue Bell's ice-cream business and the income derived from that business flowed through to BBC USA, allowing it to pay dividends to shareholders. Without Blue Bell's operations, BBC USA would have had no income. The in-state business, Blue Bell, both contributed to and benefitted from BBC USA.

In applying the *Mobil Oil* test--which considers common management, functional integration and economies of scale—the unitary relationship between Blue Bell and BBC USA is clear. BBC USA had the right to control Blue Bell and had at least some common management. The record reflects that William Rankin was the chief financial officer for both Blue Bell's general partner and BBC USA. Rankin Depo., at 5; T.R., Vol. II, at 214-5. Paul Kruse was vice-president for both Blue Bell's general partner and BBC USA. Rankin Depo., Ex. 5 (Redemption Agreement), p. 6. Both officers signed critical documents simultaneously on behalf of both entities. *Id.*; T.R., Vol. II, at 214-5. These are the only officers of either entity identified in the record.

The record indicates that BBC USA exercised actual control over Blue Bell when it ordered Blue Bell and other subsidiaries to transfer their assets pursuant to the Second Amended and Restated Plan of Reorganization, T.R., Vol. II, at 202, ¶ 3(b); ordered Blue Bell to assume an $8 million debt of the parent corporation to the Broken Arrow Revenue Bond Authority, T.R., Vol. II, at 174, 191 (Resolution of [BBC USA] Board of Directors); ordered Blue Bell to change its name, T.R. Vol. II, at 202; and ordered Blue Bell to sell its 1,131 shares of BBC USA stock back to BBC USA in exchange for $14,250,600 and a promissory note from BBC USA in the amount of $128,255,400. T.R., Vol. II, at 202-203, ¶ 3(c) & 3(e). Soon thereafter, Blue Bell agreed to assume BBC USA's obligations for a $20 million facilities loan from Chase Manhattan Bank, with William Rankin signing the document once as CFO of BBC USA and a second time as CFO of Blue Bell's managing partner. T.R., Vol. II, at 214-5.

With respect to functional integration, BBC USA was an integral part of a multi-tiered corporate structure that eliminated Texas franchise tax on Blue Bell's earning by

paying dividends through a Delaware limited partner, Blue Bell Creameries USA, Inc. Rankin Depo., at 18. The holding company also served as a means by which investors could more freely exchange their ownership interests. Rankin Depo., at 37. The reorganization itself resulted in the elimination of all entity-level federal taxation of Blue Bell's profits. Rankin Depo., at 21.

Intercompany guarantees and shared tax attributes are both signs of functional integration, as the Court of Appeals acknowledged. *Slip Op.* at 12-13, *citing, In re: PBS Bldg. Sys., Inc. and PKH Bldg. Sys., Inc*., 1994 Cal. Tax LEXIS 434, 94-SBE-008. Where two entities are in the same line of business and the right to control exists, a presumption arises that the entities are in a unitary relationship. *Container Corp of America, Inc.* v. *Franchise Tax Board,* 463 U.S. 159, 178 (1983); *A.B. Dick Co.* v. *McGraw,* 678 N.E.2d. 1100, 1108 (Ill. App. 4th Dist. 1997). There is significant evidence in this case of a unitary relationship between Blue Bell and BBC USA.

Blue Bell is not the first litigant to realize that an overly regimented application of the *Mobil Oil* factors might yield incongruous results when the entity to be combined owns unitary assets while lacking any operational attributes. In *Appeal of PBS Building Systems, Inc., and PHK Building Systems, Inc.,* 1994 Cal. Tax LEXIS 434, 94-SBE-008 (11/17/94), the State Board of Equalization (SBE) held that an operating company should be deemed unitary with the holding company which held its stock because of significant flows of value and contributions and dependencies in the form of shared tax advantages and loan guarantees, both of which are evident in this case. The SBE noted that the Franchise Tax Board had abandoned its earlier position that a pure holding company could not be unitary with an operating company under the *Mobil Oil* test because it

lacked operational characteristics. The SBE noted that the Franchise Tax Board recognized the inappropriateness of the "functional integration" standard for determining unity with a holding company. The FTB and the SBE have continued with that position. *Appeal of Gad Rad West, Inc.*, 94A-SBE-0240, 1996 WL 767612 (1996); Franchise Tax Board Rev. Ruling 95-8, 1995 WL 831603; *See also*, *Hugo Neu-Proler Int'l Sales Corp.* v. *California Franchise Tax Bd.*, 195 Cal. App. 3d 326, 240 Cal. Rptr. 635 (Cal. App. 2nd. Dis. 1987)(finding unitary relationship with holding company despite lack of direct majority ownership, where holding company provided tax benefits to operating company and was by necessity in same line of business since it had no other operational characteristics).

In *State Taxation*, the authors note that with respect to the unitary relationship between holding companies and their affiliates:

> Th[e] exclusion from the unitary business of a parent company whose ownership of the stock of subsidiaries gives it control over their operations (one which in practice is virtually universally exercised, at least with respect to budgets, large expenditures, major policies, and the general mode of operations) is inconsistent with the basic concept of a unitary business. It is fundamental to the unitary doctrine that common control (as well as ownership) be present and be exercised within the enterprise, not by a corporation outside the enterprise. To exclude the owning, controlling, integrating parent company that binds the affiliated group into a unity is to play Hamlet without the Prince.
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> Accordingly, we believe that a holding company, which holds a majority or more of the shares of stock of one or more subsidiaries of an unitary business and which controls such subsidiaries, should be recognized without more as a member of the unitary business.

State Taxation ¶ 8.11[6] [e], at pp. 447-448.

Under the facts of this case, where BBC USA existed entirely to hold the partnership interests in Blue Bell and the entities contributed to and depended on each other, enterprise unity exists as a matter of law.

D. The Taxpayer Failed to Meet its Burden of Demonstrating That the Capital Gain Arose From Non-Unitary Sources.

The Commission is equally concerned that the Court of Appeals inappropriately placed the burden of proof on the state to demonstrate unity between Blue Bell and BBC USA. The burden should have been on the taxpayer to demonstrate that the income arose from sources entirely independent of Blue Bell's operations within the state. For instance, while the Court of Appeals acknowledged the "evidence of overlap in management of the entities," *Slip Op*. at 10, it concluded that the record contained insufficient evidence of actual control. *Id*. The burden of proof should have been on the taxpayer to affirmatively demonstrate the lack of control. The only evidence in the record which addressed the issue was the affidavit of William Rankin, an affidavit comprised almost entirely of legal conclusions, not factual statements. T.R., Vol. III, at 263-4.[6]

All the "unitary" cases addressed in the Court of Appeals' decision concern the apportionment of income which arguably had a source in a separate business operating outside of the taxing jurisdiction, such as dividends from a corporation exporting oil from

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[6] For instance, the only evidence in the record supporting the lack of centralized management or functional integration appears to be the following passage from Mr. Rankin's affidavit:

> 4. BBC and BBC USA are two unrelated business enterprises whose discreet [sic] business activities are unrelated to one another.
> 5. As discreet [sic], unrelated business enterprises, BBC and BBC USA share no functional integration, centralized management, or economies of scale.

Id.

Saudi Arabia, *Mobil Oil,* 445 U.S. at 428, capital gains from a business in Peru, *ASARCO,* 458 U.S. at 321, or income from bond trading in Connecticut, *Louis Dreyfus,* 933 S.W.2d. at 462. The question presented in those decisions was whether a portion of the income received from outer-jurisdictional activities could be attributed in part to an integrated business conducted in the taxing state. In this case, the taxpayer never even identified what the holding company's discrete business might be or where the value arising from that business was generated.

It is possible that the Court of Appeals applied such high standard of proof to the state because of some confusion on the court's part about the purpose of the unitary business principle. Early on in its decision, the Court of Appeals described the unitary business principle as a means by which the state could "tax a portion of Taxpayer's income earned outside the state." *Slip Op.* at 4-5. Contrary to what the Court of Appeals wrote, the unitary business principle does not allow Tennessee to impose its excise tax on "out-of-state income." *Id.* The unitary business principle recognizes that when a multi-jurisdictional business is conducted in an integrated manner, it is impossible to accurately determine the source of any portion of that income in isolation. *Container Corporation,* 463 U.S. at 165-166. Hence, it is appropriate to impose an apportioned tax on the income of the entire unitary enterprise in order to reasonably approximate the amount of income generated within the taxing jurisdiction. The unitary business principle is not a method by which out-of-state earnings can be taxed, but rather, it is the foundation for measuring the in-state income of an integrated business operating in multiple states. *Id*. at 183.

The Commission respectfully suggests that the taxpayer did not meet its burden of showing that BBC USA operated a discrete business from Blue Bell or that extra-

territorial values were improperly subjected to Tennessee's apportioned excise tax in these circumstances.

E. An Unduly Constricted View of Enterprise Unity Could Have Far-Reaching Consequences in other Contexts.

The Commission has described the evidence supporting a finding of the unitary relationship in some detail because of its concern that if this case is not reviewed, other courts may follow in the steps of the court below and apply the *Mobil Oil* factors in a similarly rote manner to reach results which also appear to defy common sense. In particular, should the Court of Appeals' analysis take hold, taxpayers would be encouraged to shield income from taxation simply by transferring the legal ownership of intangible assets to a "pure" holding company with no employees or operations. That type of income-shifting is the very practice that formulary apportionment was intended to prevent. *See, e.g.,* McIntyre, Mines & Pomp, *Designing a Combined Reporting Regime for a State Corporate Income Tax: A Case Study of Louisiana,* 61 La. L. Rev. 699, 706-709 (2001)(describing accounting methods by which income can be shifted to subsidiaries for tax purposes).

The Court of Appeals' decision thus presents the potential to complicate application of the unitary business principle in situations where assets are transferred to an intangible holding company with the intent to circumvent state taxation by shifting profits to a low-tax jurisdiction.

III. CONCLUSION

For the reasons set forth above, *amicus curiae* Multistate Tax Commission prays that the Tennessee Supreme Court will enter an order accepting review of the decision of the Court of Appeals in this matter.

Respectfully submitted,

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Certificate of Service

I hereby certify that a true and correct copy of this *Brief of Amicus Curiae Multistate Tax Commission in Support of Application of Commissioner of Revenue for Permission to Appeal* was served on the following counsel of record this 1st. day of December, 2009 by depositing a copy of the same in the U.S. mails to the addresses listed below, and via electronic transmission via Microsoft Outlook:

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