IN THE SUPREME COURT OF
THE STATE OF LOUSIANA

No. 2013-C-1855

ROBERT L. THOMAS,
Plaintiff-Appellant,

v.

CYNTHIA BRIDGES, DIRECTOR OF THE
DEPARTMENT OF REVENUE, STATE OF LOUISIANA,
Defendant-Applicant.

BRIEF OF MULTISTATE TAX COMMISSION AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANT-APPLICANT'S APPLICATION FOR WRITS OF CERTIORARI

TO REVIEW THE JUDGMENT OF THE
LOUISIANA FIRST CIRCUIT COURT OF APPEAL, DOCKET NO. 2012 CA 1439

APPEALED FROM THE TWENTY-FIRST JUDICIAL DISTRICT COURT, PARISH OF LIVINGSTON, DOCKET NO. 130592, HONORABLE ELIZABETH P. WOLFE, PRESIDING

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The Multistate Tax Commission ("the Commission") urges this Court to grant the Petition filed by Defendant-Petitioner, Cynthia Bridges, Director of the Department of Revenue, State of Louisiana ("the Department") and issue a Supervisory Writ of Certiorari to the Louisiana First Circuit Court of Appeal in Docket No. 2012 CA 1439. The Commission believes that the First Circuit Court of Appeal misinterpreted the state's tax laws in holding that legal effect must be given to the purported registration in Montana of a motor home by a "shell" limited liability company established for the exclusive purpose of avoiding Louisiana's sales tax on motor vehicles purchased in the state. The limited liability company in question, Angels Rocks, LLC, had, by the admission of its sole owner, no intended business function, no business purpose, no employees or activities, no assets beyond a cash infusion equal to the $351,800 purchase price of the motor home, and no planned business activities or functions other than holding title to motor home to avoid sales tax obligations in the owner's state of residence.[1] Were the decision of the First Circuit Court of Appeal allowed to stand, taxpayers throughout the country would be encouraged to use artifice to shirk their responsibilities in "paying for civilized society." *Compania General de Tabacos v. Collector of Internal Revenue*, 275 U.S. 87, 100 (1927)(Holmes, J., *dissenting*).

I. INTEREST OF THE *AMICUS*

The Commission is the administrative agency for the Multistate Tax Compact ("Compact"), which became effective in 1967. (See RIA *State & Local Taxes: All States Tax Guide* ¶ 701 *et seq*.

[1] *Application for Writ of Superintending Control*, pp. 12; 14-17, *citing to*: Transcript of August 2010 Hearing before Board of Tax Appeals, p. 19, lines 22-25; p. 21, lines 11-13; p. 23, lines 14-15; p. 24, lines 1-2; 6-24.

(2005).) Sixteen states and the District of Columbia are signatories to the Compact, and another 31 states, including Louisiana, are associate or sovereignty members of the Commission.[2] See http://www.mtc.gov/AboutStateMap.aspx.

The Commission is charged with "facilit[ating the] proper determination of state and local tax liability for multistate taxpayers" and with "promoting uniformity or compatibility with significant components of tax systems," as well as "facilitating taxpayer convenience and compliance" in tax administration. Compact, Article I, Sec. 1-3. The Commission submits this brief as *amicus curiae* because of its concern that the lower court's erroneous interpretation of the law could have a detrimental effect on tax administration throughout the country by encouraging tax avoidance – and tax evasion – contrary to the intent of the legislatures of Louisiana and every other state that imposes sales or similar taxes on the purchase and registration of motor vehicles. A precedent that rewards taxpayers for abusing state laws meant to encourage legitimate economic development – by giving legal effect to the creation of fictitious business entities to avoid taxation – impacts the Commission's member states in carrying out the purposes of the Multistate Tax Compact.

Currently, in the field of motor vehicle taxation, the states employ many different taxing mechanisms, procedures, and rates but have broadly compatible policies. Those policies call for the primary imposition of a sales or similar excise tax in the state where a vehicle is sold to a customer for his use and initially registered, with compensating tax due in states to which the vehicle is subsequently moved, with a credit allowed by that state for sales/excise tax previously paid. *See generally*, Florida Department of Revenue Tax Information Publication H12A01-01, *Motor Vehicle*

[2] The Commission submits this brief on its own behalf, and not on behalf of any member state except Louisiana.

Sales Tax Rate by State and Tax Credit Application (1/19/12), available at: http://dor.myflorida.com/dor/tips/tip12a01-01.html.

The sales and use tax system for motor vehicles effectuated by the states over a period of many decades would be harmed if in-state purchasers could artificially change their reported residence and state of registration for the purposes of avoiding sales and similar excise taxes. The Commission believes that the decision of the Louisiana First Circuit Court of Appeal encouraging those efforts should be reviewed by this Court because, if the decision were allowed to stand, it would hamper the states' efforts to ensure taxpayer compliance and convenience, and could ultimately lead to less compatibility among state taxing systems and less fairness to taxpayers legitimately changing their states of residence.

II. ARGUMENT

THE QUESTION OF WHETHER AN ENTITY LACKING SUBSTANCE AND BUSINESS PURPOSE SHOULD BE ALLOWED TO DEFEAT STATE TAX LAWS MERITS REVIEW BY THIS COURT

The Louisiana First Circuit Court of Appeal concluded that the taxpayer, Robert Lane Thomas, did not commit "fraud" under La. R. S. 12:1320(D) in the creation of a Montana LLC for the sole and express purpose of avoiding Louisiana's sales and use taxes. *Decision*, p. 6. Yet, the evidence below demonstrated that the creation of Angels Rocks LLC was intended solely to shield the true purchaser of the motor home from payment of his legal debts. See *Application for Writ of Superintending Control by Department of Revenue*, pp. 14-18, comparing facts of the case to factors identified in *Riggins v. Dixie Shoring, Inc.*, 967 So.2d 1164 (La. 1991). The evidence below also indicated that Angels Rocks, LLC was at all times the alter-ego of Robert Lane Thomas, since Thomas controlled the LLC and the LLC had no independent business purpose other than the

purchase of a motor home for the personal benefit of the LLC's owner, Robert Lane Thomas. In finding that the evidence was insufficient to pierce the corporate veil, *id*., the Court of Appeal cited nothing in the record from which an inference could be drawn that the LLC operated independently of Thomas' desire to own and operate a motor home for his personal pursuits.

But quite apart from the lower court's application of Louisiana law regarding the "fraudulent" use of an LLC and the *alter-ego* doctrine applicable to closely-held corporations, the Commission files this brief to urge review of the lower court's understanding of the role of the economic substance doctrine in tax matters. The failure to acknowledge the role of the "sham" or "economic substance" doctrine in this case is inconsistent with how those doctrines have been interpreted and applied in other states and in similar circumstances, and encourages taxpayer non-compliance with legislative intent.

The seminal case of *Gregory v. Helvering*, 293 U.S. 465 (1935), established that in the field of taxation, the law must be applied in a manner which furthers the goals of the legislative bodies that enact those laws. That is to say, that the substance of a transaction takes precedence over its form in interpreting and applying tax laws. In *Gregory*, the Supreme Court declined to give effect to non-recognition rules on corporate reorganizations where the taxpayer had created "an elaborate and devious form of conveyance" intended to disguise the true object to paying a taxable dividend to its shareholder. Like the transaction in this case, the transactions in *Gregory* met the letter of the Internal Revenue Code but nonetheless were disallowed because those transaction were intended to defeat the legislative *purpose* behind the Code. *Gregory*, 293 U.S. at 469-70. The Supreme Court stated that while taxpayers have a legal right to act in a way that will decrease their tax burden, they may not do so by creating an entity with no other business or corporate purpose, but whose "sole

object and accomplishment [is] the consummation of a preconceived plan" to avoid taxation. *Id.* at 69. The Supreme Court expanded on the idea in *Moline Properties, Inc. v. Comm'r,* 319 U.S. 436 (1943), where the Court set forth a basic test for determining whether an entity should be disregarded for tax purposes. First, a court should determine whether the transaction creating the entity had a business purpose other than tax avoidance, and second, whether the transactions had objective economic substance beyond the creation of tax benefits, that is, whether the transactions reasonably were expected to change the economic position of the taxpayer.

More recently, the Fifth Circuit Court of Appeals in *Nevada Partners Fund L.L.C. ex rel. Sapphire II, Inc. v. U.S. ex rel. I.R.S.,* 720 F.3d 594 (5th Cir. 2013) refused to give tax recognition to a series of transactions establishing tiered partnerships in Nevada for the sole purpose of creating artificial capital losses to offset the taxpayer's capital gains. The court held that it was the taxpayer's burden to demonstrate that the transaction "exhibit[s] objective economic reality, a subjectively genuine business purpose, and some motivation other than tax avoidance", 720 F.3d at 609, *citing Southgate Master Fund, LLC* ex rel. *Montgomery Capital Advisors, LLC v. United States,* 659 F.3d 466, 480 (5th Cir.2011).

The Fifth Circuit noted that the conjunctive nature of the test was the majority rule in the federal courts – if any of the three factors was missing, the transaction should not be given tax recognition. *Id.* The federal economic substance doctrine has now been codified in that form, with the burden of proof on the taxpayer to prove non-tax business purpose and objective profit-making intent, in 26 U.S.C. Sec. 7701(O). In the present case, it is undisputed that the creation of Angels Rocks, LLC, and the transfer of funds to it to complete the purchase of the motor home had no

objective economic reality, had no business purpose since Angels Rocks did not intend to use the motor home for profit making activities, and was motivated entirely by tax avoidance purposes.

The economic substance doctrine is not limited to federal cases; indeed, state courts are equally concerned with "elaborate and devious forms of conveyance" designed to defeat legislative intent. For instance, in *T.D. Banknorth v. Department of Taxes*, 967 A.2d 1148 (Vt. 2008), the Vermont Supreme Court upheld tax and penalty assessments against three banks that established holding companies to hold their intangible assets so that the banks could reflect lower incomes, where the holding companies had no employees or operations and were "shell corporations" with no function other than to allow the banks to reflect lower profits on their books. The court wrote:

> We affirm the Commissioner's determination that the holding companies had no nontax business purpose and lacked economic substance, and that the holding companies therefore do not qualify as independent entities for tax purposes.
>
> As for taxpayer's motivation to create the holding companies, the Commissioner concluded that the plan originated exclusively as a vehicle to reduce taxes. The genesis of the idea was a suggestion by taxpayer's accountant that establishing the holding companies would be a "slam dunk strategy" for achieving substantial bank franchise tax savings. Taxpayer acknowledged the same at oral argument.
>
> Even if we disregard taxpayer's intent and focus solely on the economic activity of the holding companies, it is clear that the entities conducted insufficient independent business to qualify as taxable entities separate from taxpayer under this doctrine. Taxpayer operated the entities out of its back office, without any independent property, tangible assets, or staff.

967 A.2d at 1155-56.

Similarly, in *Syms Corp. v. Commissioner of Revenue*, 765 N.E.2d 758, 764 (Ma. 2002), the Massachusetts Supreme Court used the economic substance doctrine in upholding the denial of claimed deductions for dividends paid to a shell corporation established solely for tax purposes, where the corporation establishing the shell remained in control of the intangible assets transferred to

it, there were no third party transactions, and the income flowed in a circular manner between parent and subsidiary. 765 N.E.2d at 764.

And in *Pacificare Health Systems, Inc. v. Dep't. of Rev.*, 2008 WL 2596371 (Or. Tax Regular Div. 2008), http://www.publications.ojd.state.or.us/docs/TC4762.htm, the Oregon Tax Court declined to give effect to a similar transfer of intellectual property to a shell corporation in order to create an artificial deduction based on the re-licensing of that property to the transferor, citing the lack of economic substance for the transaction. The tax court approached the matter by looking at the "tax ownership" of the property. Under the "tax ownership" doctrine, the party who controls property and receives the benefit, rather than the party who nominally holds it, is responsible for the tax consequences of that ownership. *See, e.g., National Lead Company v. Comm'r*, 336 F.2d 134 (2d Cir. 1964), *cert. den.*, 380 U.S. 908 (1965). Tax ownership analysis does not call into question the status of the newly formed entity as *bona fide* for tax purposes. Instead, the key questions are control and economic benefit. *Grifiths v. Helvering*, 308 U.S. 355 (1939); *Higgins v. Smith*, 308 U.S. 473, 475 (1940).

In the instant case, Mr. Thomas, not Angels Rocks, LLC, has enjoyed both full control of the motor home and its benefits,. Under the tax ownership doctrine, Mr. Thomas should also be held responsible for the taxes arising from that purchase and ownership.

This Court should review the First Circuit Court of Appeal's conclusion that because the Louisiana legislature has recognized the separate legal status of domestic and foreign LLC's, it must have intended that such entities could be used as a mechanism for allowing taxpayers to avoid their obligations under the law. This holding, if allowed to stand, would create a dangerous precedent that would only encourage other taxpayers to engage in "elaborate and devious forms of conveyance" in

order to avoid their tax obligations. In the realm of taxation of motor vehicle purchases or similar mobile property dependent upon registration systems for tax administration, including airplanes, construction equipment and boats, such a precedent would have serious consequences felt well beyond Louisiana's borders. The precedent would also run contrary to almost a century of law establishing that in implementing legislative intent in tax matters, the substance of a transaction takes precedence over its form.

III. CONCLUSION

The Taxpayer, Richard Lane Thomas, does not dispute that he formed a Montana LLC for the sole purpose of defeating Louisiana's sales tax laws,[3] and he may similarly have failed to comply with the tax laws in a bordering state where the motor home is allegedly garaged.[4] When it comes to property which is designed to be moved across state borders, every state depends on its sister states to fairly and equitably administer their tax laws in order to avoid the necessity of intrusive use tax compliance measures. The Louisiana First District Court of Appeal erred when it concluded that the Louisiana legislature intended that limited liability companies could be used to defeat fair and equitable taxation measures.

WHEREFORE, the Multistate Tax Commission respectfully asks this Court to issue a Writ of Certiorari to the First Circuit Court of Appeal of Louisiana, and having taken the matter under advisement, prays that the Court will issue a mandate to uphold the decision of the Louisiana Board of Tax Appeals for the reasons just stated, and for such other and further relief as the Court deems just.

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[3] *Application for Writ of Superintending Control by Department of Revenue,* p. 12, quoting counsel for Mr. Thomas at July 10, 2010 Board of Tax Appeals Hearing.

[4] *Application for Writ of Superintending Control by Department of Revenue,* p. 21, citing Transcript to August 10, 2010 Hearing before Board of Tax Appeals, p.30, lines 1-2.

Respectfully submitted,

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VERIFICATION

BEFORE ME, the undersigned Notary, personally came and appeared LILA DISQUE, Esq., who, after being duly sworn, did depose that:

She is counsel for the Multistate Tax Commission; she reviewed the forgoing Original Brief of Multistate Tax Commission as *Amicus Curiae* in Support of Defendant-Applicant's Application for Writs of Certiorari; the allegations contained therein are true and correct to the best of her knowledge, information and belief; and Patricia H. Wilton delivered via U.S. Mail or electronic mail a copy of said Brief to the following, __ day of September, 2013:

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