No. _______

In the
Supreme Court of the United States

VERMONT NATIONAL TELEPHONE COMPANY,
Petitioner,

v.

VERMONT DEPARTMENT OF TAXES,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF VERMONT

PETITION FOR A WRIT OF CERTIORARI

ROMAN MARTINEZ
Counsel of Record
ERIC J. KONOPKA
CHRISTINE C. SMITH
LATHAM & WATKINS LLP
555 Eleventh Street, NW
Suite 1000
Washington, DC 20004
(202) 637-3377
roman.martinez@lw.com

HENRY P. BUBEL
TIFFANY N. TAM
PATTERSON BELKNAP WEBB & TYLER LLP
1133 Avenue of the Americas
New York, NY 10036

WM. ROGER PRESCOTT
TIMOTHY C. DOHERTY, JR.
DOWNS RACHLIN MARTIN PLLC
199 Main Street
Burlington, VT 05401

Counsel for Petitioner

QUESTION PRESENTED

The Due Process Clause permits states to tax nonresidents on income from the sale of an intangible asset if that asset has a "situs," or is "localized," in the state. This Court has held that an intangible asset has a "situs" if it grants a right that is "identified with a particular place because the exercise of the right is fixed exclusively or dominantly at that place." *People of the State of New York ex rel. Whitney v. Graves*, 299 U.S. 366, 372 (1937). Vermont's corporate taxation scheme incorporates this federal constitutional situs principle. Under that scheme, if an intangible asset has a situs in another state, Vermont may not tax nonbusiness income earned from that asset. *See* Vt. Tax Reg. § 1.5833-1(e).

This case concerns a nonbusiness gain earned on the sale of two licenses issued by the Federal Communications Commission (FCC). Even though the licenses granted rights to broadcast exclusively in New York, the Vermont Supreme Court held that they were not "localized" in New York and thus had no "situs." It did so by adopting a novel rule that *Whitney*'s situs test is satisfied only if the intangible asset at issue was "created or protected" by the law of the state of the proposed situs. Solely because the FCC licenses were created by federal law—not state law—and the FCC governed their use and sale, the Vermont Supreme Court held that Vermont could properly tax the gain. The question presented is:

Whether the Vermont Supreme Court erred in holding that a federal license, that can be used only in one state, lacks a situs in that state under *Whitney*'s interpretation of the federal due process principles governing state taxation.

RULE 29.6 STATEMENT

Pursuant to this Court's Rule 29.6, Vermont National Telephone Company states that it has no parent corporation and that no publicly held company owns 10% or more of its stock.

RELATED PROCEEDINGS

Vermont National Telephone Company v. Department of Taxes, No. 2019-280, Supreme Court of Vermont, judgment entered October 9, 2020 (2020 VT 83, __ A.3d __), motion for reargument denied November 2, 2020.

Vermont National Telephone Company v. State of Vermont Department of Taxes, No. 528-9-18 Wncv, Superior Court of Vermont, Washington Unit, judgment entered July 31, 2019.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Vermont National Telephone Company (Vermont National or Petitioner) respectfully petitions this Court for a writ of certiorari to review the judgment of the Vermont Supreme Court in this case.

OPINIONS AND ORDERS BELOW

The opinion of the Vermont Supreme Court (App. 1a-39a) is reported at 2020 VT 83, __ A.3d __ (2020). The decision of the Vermont Superior Court (App. 109a-23a) and the determination of the Vermont Commissioner of Taxes (App. 40a-108a) are unreported.

JURISDICTION

The Vermont Supreme Court entered its opinion and judgment on October 9, 2020. App. 1a-39a. On November 2, 2020, the Vermont Supreme Court denied Petitioner's timely motion for reargument, Vermont's equivalent to a petition for rehearing. *Id.* at 124a-25a; *see* Vt. R. App. P. 40. This petition is timely because it is filed within 150 days of the denial of reargument, as authorized by 28 U.S.C. § 2101(c) and this Court's order of March 19, 2020. This Court has jurisdiction under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND REGULATORY PROVISIONS INVOLVED

Section 1 of the Fourteenth Amendment to the United States Constitution provides:

> No State shall . . . deprive any person of life, liberty, or property, without due process of law . . . .

Vermont Tax Regulations Section 1.5833-1(e) provides:

> Nonbusiness income will be allocated to the state in which the income producing assets are located. If the income producing asset has no situs, the income will be allocated to the state of commercial domicile, the principle [*sic*] place from which the business is directed or managed.

INTRODUCTION

The Vermont Supreme Court blatantly misconstrued this Court's controlling precedent—and the limits of due process—in an effort to allow Vermont to tax income that should have been taxable only in New York. The resulting decision conflicts with this Court's precedent, is at odds with the laws of at least 11 other states, and transgresses basic principles that promote fairness in taxation. Whether by summary reversal or plenary review, the Court should overturn this erroneous decision.

In this case, the State of Vermont asserted the right to tax a gain on the sale of two FCC licenses that allowed the holder to broadcast exclusively in New York. Under Vermont law, whether the State had that right turns on whether the licenses had a "situs" in New York for federal due process purposes: If those licenses had a situs in New York, then New York could tax the gain and Vermont could not; but if they did not have a situs in New York, then Vermont was free to tax the gain.

The situs principle recognizes that, for due process purposes, a state may tax income from an asset that is sufficiently linked to the state, regardless of

whether the owner has a connection to the state. And this Court has long held that intangible assets like the government licenses at issue here are so linked to a state if they grant a right whose "exercise . . . is fixed exclusively or dominantly" in that state. *People of the State of New York ex rel. Whitney v. Graves*, 299 U.S. 366, 372 (1937). This case should have been decided based on a straightforward application of *Whitney*. The FCC licenses at issue explicitly granted rights whose exercise was "fixed exclusively" in New York. Those licenses therefore had a situs in New York. Hence, Vermont could not tax the gain earned from selling them.

Rather than follow that syllogism to its logical conclusion, the Vermont Supreme Court took a different path. According to that court, an intangible asset can be "fixed exclusively or dominantly," *id.*, in a state only if it was "*created or protected by [that] state's laws*," App. 19a (¶ 39) (emphasis added). But that requirement is nowhere to be found in *Whitney*—or in any of this Court's other due process case law. Indeed, the exception to the situs rule the Vermont Supreme Court invented would have produced the opposite result in *Whitney* itself.

The magnitude of the Vermont Supreme Court's error is reason enough to grant review. But the likely effects of the decision amplify the need for this Court's attention. The Vermont Supreme Court took an unduly narrow view of situs, constraining states' normally broad powers of taxation to enlarge its own—at least for this particular case. That court's decision is at odds with a model law and the laws of at least 11 states that follow it; unjustifiably treats intangible assets differently depending on whether they are created by state or federal law; and creates a

significant risk of double taxation on the sale of FCC licenses, as well as countless other federally and privately conferred rights to conduct activity exclusively within defined out-of-state geographic locations. The court's decision also leads to an unfair result in this case: The decision exacerbated Vermont's unjustified money-grab by approving a draconian strict-liability penalty of nearly 25%, even though Petitioner acted in good faith and obtained accurate tax advice that—because the gains were taxable in New York—they were not taxable in Vermont.

The Vermont Supreme Court's radical revision of this Court's precedent is plain, unmistakable, and important. This Court's intervention is warranted.

STATEMENT OF THE CASE

A. Legal Background

1. This case turns on a basic principle of federal constitutional due process known as the "situs" principle. Although states have "broad powers to impose and collect taxes," the Due Process Clause imposes some limits on those powers. *Allegheny Pittsburgh Coal Co. v. County Comm'n of Webster Cnty.*, 488 U.S. 336, 344 (1989). Among other things, "there must be 'some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.'" *North Carolina Dep't of Revenue v. Kimberley Rice Kaestner 1992 Family Tr.*, 139 S. Ct. 2213, 2219-20 (2019) (citation omitted). That link often comes from the taxpayer's residence or domicile in a state. *See, e.g.*, *People of the State of New York ex rel. Cohn v. Graves*, 300 U.S. 308, 314-15 (1937) (New York could tax rents a resident earned on out-of-state property); *Graves v. Schmidlapp*, 315

U.S. 657, 660-61 (1942) (domicile generally provides a sufficient constitutional basis to tax income from property). With respect to nonresidents and nondomiciliaries, however, that link must be established another way. That is where situs comes into play.

The situs concept recognizes that a piece of property may be so connected to a state that the state can tax it, even if the state could not otherwise tax the property's owner. In the case of, say, real property, this is easy to understand. Rights in land "are to be regarded in many respects as localized at the place where [the land] is located," such that the "government within whose territorial limits" the land is situated may tax it. *Curry v. McCanless*, 307 U.S. 357, 363-64 (1939).

The same basic rule applies to intangible property, including the government licenses at issue in this case. As this Court held in *Whitney*, if an intangible asset is "localized" to a particular state, that asset acquires a situs in—and may be taxed by—that state. 299 U.S. at 372; *see id.* at 372-74 (holding that fractional membership in the New York Stock Exchange had a situs in New York). In *Whitney*, the Court set out the basic constitutional test for determining the situs of an intangible asset: An intangible asset has a situs if it (1) "grow[s] out of the actual transactions of a localized business" or (2) provides a right that is "identified with a particular place because the exercise of the right is fixed exclusively or dominantly at that place." *Id.* at 372. This case concerns *Whitney*'s second prong.

2. As the Vermont Supreme Court recognized below, Vermont's corporate tax system incorporates *Whitney*'s constitutional situs principle into the tax

treatment of intangible assets. *See* App. 16a (¶¶ 33-34). The Vermont regulation at issue here provides: "Nonbusiness income will be allocated to the state in which the income producing assets are located. If the income producing asset has no situs, the income will be allocated to the state of commercial domicile, the princip[al] place from which the business is directed or managed." Vt. Tax Reg. § 1.5833-1(e).

In other words, if an intangible asset has a situs, Vermont will allocate all nonbusiness income earned from it to the situs state. But if the asset lacks a situs, Vermont will allocate all nonbusiness income earned from it to the state of the taxpayer's commercial domicile. *See* App. 16a (¶ 34). This allocation matters because a corporation owes Vermont taxes only on nonbusiness income allocated to Vermont. This rule thus prevents double taxation where an intangible asset has a situs outside of Vermont because—pursuant to Vermont's own regulations—Vermont may not tax nonbusiness income earned from that asset.

To see how this works, consider a corporation domiciled in Vermont that owns two intangible assets: (1) air rights over a tract of land in New York, and (2) film rights in a popular novel. The air rights have a situs in New York because their exercise is "fixed exclusively or dominantly" in New York. *Whitney*, 299 U.S. at 372. If the corporation sold those rights, Vermont would allocate any gain from the sale to New York and would not tax the gain itself. In this way, Vermont's regulatory scheme avoids the potential for double taxation by not taxing income that New York can constitutionally tax. In contrast, the film rights have no situs. Those rights can be used anywhere in the United States; their exercise is not

tied to any particular state. Therefore, if the corporation sold those rights, Vermont would allocate any gain from the sale to the state of commercial domicile, *i.e.*, Vermont.

B. Factual Background

Vermont National is a small, family-owned corporation that provides internet and telephone service to predominantly rural areas of Vermont. In 2003, it acquired two licenses from the FCC for the lower 700 megahertz portion of the electromagnetic spectrum in upstate New York. App. 44a (¶ 14). The "Albany license" covered Albany, Troy, Schenectady, Amsterdam, and Saratoga Springs. *Id.* at 3a (¶ 4). The "Glens Falls license" covered Glens Falls, Whitehall, and Fort Ann. *Id.* At that time, the 700 megahertz band was being used by television broadcasters, but the FCC had plans to transition television to a different frequency, which would free up the band for mobile telecommunications use. P.C. 193-94;[1] *see* App. 3a (¶ 3).

Vermont National purchased the New York-based FCC licenses as an investment, believing it could acquire at a reasonable price the right to broadcast a specific radio frequency over Albany/Schenectady, New York, which at the time was one of America's 50 largest metropolitan areas. It chose these particular licenses because "Albany is a fairly large metropolitan area that has both a significant static population and a significant commuter population," meaning there are "many potential . . . customers." P.C. 193. At the

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[1] "P.C." references are to the Appellant's Printed Case (appendix) filed in *Vermont National Telephone Co. v. Department of Taxes*, 2020 VT 83 (2020) (No. 2019-280).

same time, Albany was not such a large market that the cost of the licenses was prohibitive. *Id.* Vermont National's intuition about the value of the licenses proved correct. In 2013, it sold the licenses, excluding a small area covering Hebron, New York, to AT&T Mobility Spectrum, LLC (AT&T), realizing a gain of approximately $24 million. App. 3a (¶ 5).

Before reporting this income to the state taxing authorities, Vermont National diligently consulted its accountant about the tax consequences of the sale. *See* P.C. 94-96. Based on its accountant's advice, Vermont National concluded that the gain on the sale of the New York-based FCC licenses constituted nonbusiness income that should be allocated to New York. It reasoned that the licenses granted rights that were "fixed exclusively or dominantly" in New York and thus had a New York situs. *Whitney*, 299 U.S. at 372. Consistent with the Vermont regulation described above, Vermont National reported the capital gain on its Vermont tax return as nonbusiness income allocated to a non-Vermont source. App. 3a-4a (¶¶ 5-6); *see* Vt. Tax Reg. § 1.5833-1(e) (nonbusiness income from an asset is allocated to the situs state if there is one). As a result, Vermont National did not pay Vermont corporate tax on that gain.

In 2015, the Vermont Department of Taxes (Department) audited Vermont National. The Department determined that the gain on the sale of the New York-based licenses should have been allocated to Vermont and assessed state corporate taxes of $1,947,437, plus $334,899 in interest. App.

4a-5a (¶ 6 & n.2).[2] Moreover, despite finding Vermont National "[a]bsolutely" cooperative during the audit, the Department also imposed an automatic underpayment penalty of $445,223. P.C. 214; *see* App. 5a (¶ 6); *see also* Vt. Stat. Ann. tit. 32, § 3202(b)(3) (authorizing penalty of up to 25% of an underpayment). As a Department employee later explained, that automatic penalty simply "comes out of our system"—Department employees have no discretion over the penalty and do not assess a taxpayer's culpability or good-faith efforts to comply with the tax laws. P.C. 218. On the contrary, "every single time, there's a penalty assessed." *Id.*

C. Procedural History

1. Vermont National appealed the tax assessment and penalty to the Commissioner of the Department. App. 5a (¶ 7). Before the Commissioner, Vermont National argued that the New York-based licenses had a situs in New York under a straightforward application of *Whitney*, because they conveyed rights that could be used *only* in New York. *Id.* As Vermont National explained, the licenses covered New York regions exclusively, and their value was inextricably tied to New York's population levels, geography, state and local regulations, and the like. *Id.*; *see also* P.C. 241-57 (testimony regarding the licenses). Vermont National also argued that the automatic underpayment penalty was inappropriate, especially in light of the company's good-faith consultation with its accountant, its transparent reporting of its income,

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[2] The asserted tax liability also included a small unrelated tax adjustment that is not at issue here. *See* App. 4a (¶ 6 & n.2).

and its admittedly "[a]bsolute[]" cooperation during the audit. P.C. 214.

The Commissioner affirmed the assessment of the tax and penalty. App. 5a-6a (¶ 8). The Commissioner determined that "situs" as used in the relevant regulation is a "term of art referring to whether an asset is constitutionally subject to taxation in a state." *Id.* at 6a (¶ 9). Thus, the Commissioner recognized, the key question was whether the New York-based FCC licenses had a situs in—and were potentially taxable by—New York under the Due Process Clause. *Id.*

The Commissioner found, however, that the New York-based licenses were not constitutionally eligible for taxation in New York. The Commissioner determined that the licenses were not "localized" in New York, and therefore did not have a situs in New York. *Id.* at 75a (citation omitted). Instead of focusing on whether the licenses granted a right that was "fixed exclusively or dominantly" in New York as *Whitney* requires, 299 U.S. at 372, the Commissioner focused on whether the licenses granted a right "to use an extant building," App. 70a. Because the licenses were not connected to existing cell towers and "had nothing to do with New York State real property," the Commissioner concluded that they lacked a situs. *Id.* at 65a. Although the Commissioner acknowledged that the licenses granted broadcasting rights exclusively in New York, he dismissed those broadcasting locations as "simply market areas drawn on the map." *Id.*

The Commissioner also upheld the automatic underpayment penalty. *Id.* at 104a-07a. The Commissioner refused to consider Vermont National's good-faith efforts to comply with the tax laws, going

out of his way to emphasize that Vermont's "no-fault penalty does not require a showing of negligence, fraud, or any other state of mind; it is a strict-liability provision, meaning it is triggered by mere nonpayment." *Id.* at 106a. Accordingly, the Commissioner continued, the Department was within its rights to apply a penalty of up to 25%—on top of a punitive, above-market interest rate—to any taxpayer "who simply failed to pay a tax when due, for whatever reason." *Id.*; *see* Vt. Stat. Ann. tit. 32, § 3202(b)(3); *id.* § 3108(a) (2019) (mandating that interest rate on underpayments exceed standard interest rate by 2%).

2. Vermont National appealed to the Vermont Superior Court. On appeal, the Department defended the Commissioner's approach to *Whitney*, arguing that an intangible asset had to be tied to real property in New York to have a situs there, and that "[a]n FCC License does not grant rights in any physically situated New York organization." Dep't Super. Ct. Br. 14 (Jan. 18, 2019). But the court took a different tack. It declined to apply *Whitney* altogether because, it said, "situs" as used in the regulation was not a term of art referring to constitutional situs but rather merely a synonym for physical location. App. 114a-16a. Since intangible assets, by definition, have no physical location, the court held that the regulation allocated income from the FCC licenses to Vermont National's commercial domicile, Vermont. *Id.* at 116a-21a. The court also affirmed the automatic penalty, finding that it did not violate the Excessive Fines Clause without even addressing Vermont National's lack of culpability. *Id.* at 122a-23a.

3. Vermont National appealed to the Vermont Supreme Court. That court agreed with the

Commissioner that "situs" as used in the relevant regulation "is a term of art referring to where an intangible asset is constitutionally subject to taxation." *Id.* at 13a (¶ 27). But it rejected the Commissioner's view that intangible assets must be tethered to an "extant building" to have a situs. *See id.* at 15a-17a (¶¶ 32-34). Yet the Court still concluded that the fact that the licenses "granted rights to broadcast in New York was . . . not sufficient to establish a situs" in New York. *Id.* at 17a (¶ 35).

To reach that conclusion, the Vermont Supreme Court created a novel exception to *Whitney*. The court acknowledged that the "Supreme Court [has] held that an intangible asset may have a situs, regardless of any business use, if the intangible grants a right that 'is fixed exclusively or dominantly' at a particular place." *Id.* at 17a-18a (¶ 37) (quoting *Whitney*, 299 U.S. at 372). But instead of applying *Whitney*'s test as written, the court invented a brand-new exception. Purporting to ascertain *Whitney*'s hidden meaning, the Vermont Supreme Court determined that *Whitney*'s test applied only to assets "*created or protected by a state's laws*." *Id.* at 18a-19a (¶¶ 38-39) (emphasis added). Solely because the New York-based licenses "were created by the FCC," and the FCC governed their use and sale, the court concluded that the licenses lacked a situs in New York, and it therefore affirmed the tax assessment. *Id.* at 20a-26a (¶¶ 40-50).

The court also sustained the automatic underpayment penalty against Vermont National's Excessive Fines Clause challenge. The court concluded that the penalty was not constitutionally excessive because it was "proportionate" to Vermont National's supposed offense—even though the

penalty applied "regardless of the taxpayer's fault or good faith" and even though Vermont National had made a good-faith effort to comply with Vermont's tax laws and regulations. *Id.* at 31a-39a (¶¶ 61-76).

4. Vermont National filed a motion for reargument. It contended that the Vermont Supreme Court's novel "created or protected by state law" rule was flatly inconsistent with *Whitney*. Mot. for Reargument 4 (Oct. 23, 2020). Moreover, Vermont National explained, that rule was in tension with the laws and regulations of at least 11 other states, as well as with the Uniform Division of Income for Tax Purposes Act (UDITPA), which permit the taxation of business income from licenses that merely *authorize* business activity in the state. *Id.* at 5-6. The Vermont Supreme Court denied that motion without opinion. *See* App. 124a-25a.

REASONS FOR GRANTING THE WRIT

This Court should overturn the Vermont Supreme Court's radical departure from binding precedent of this Court. Under *People of the State of New York ex rel. Whitney v. Graves*, FCC licenses to broadcast *only* in New York plainly grant rights that are "fixed exclusively or dominantly" in New York. 299 U.S. 366, 372 (1937). Here, the New York-based licenses were constitutionally subject to taxation in New York—and therefore were *not* taxable in Vermont. Certiorari is warranted because the Vermont Supreme Court's decision "has decided an important federal question in a way that conflicts with relevant decisions of this Court." Sup. Ct. R. 10(c).

The decision below is not only clearly wrong under *Whitney*—it is also in serious tension with UDITPA and the laws of at least 11 states that have adopted

it. Moreover, it undermines states' broad powers of taxation, arbitrarily treats similar intangible assets differently, and, if allowed to proliferate, will create a significant risk of double taxation of multistate corporations. Because of the clarity and importance of this error, summary reversal is appropriate. But either way, this Court's intervention is necessary.

A. The Vermont Supreme Court Blatantly Departed From *Whitney*

According to the Vermont Supreme Court, Vermont National's gain on the sale of the New York-based FCC licenses was taxable by Vermont because those licenses had no situs, in New York or anywhere else. The corollary to that holding is that New York could not have taxed that gain without violating the federal Due Process Clause. That holding rested entirely on the state court's novel and incorrect interpretation of *Whitney*. The Vermont Supreme Court's blatant departure from this Court's precedent requires the Court's immediate attention.

1. *Whitney* is one of many cases recognizing that the Due Process Clause requires "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *North Carolina Dep't of Revenue v. Kimberley Rice Kaestner 1992 Family Tr.*, 139 S. Ct. 2213, 2219-20 (2019) (citation omitted). For due process purposes, the "simple but controlling question is whether the state has given anything for which it can ask return." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940); *see also, e.g.*, *Curry v. McCanless*, 307 U.S. 357, 367 (1939) (a state may tax intangible assets "when the taxpayer extends his activities with respect

to his intangibles, so as to avail himself of the protection and benefit of the laws of [that] state").

Whitney addressed the tax treatment of income from the sale of a partial, one-quarter membership (or "seat") in the New York Stock Exchange (NYSE or Exchange). *Whitney*, 299 U.S. at 369. The taxpayer, Whitney, was a partner in a Boston-based brokerage firm that owned a full membership in the NYSE. *Id.* "[B]y virtue of an increase in the number of members of the Exchange, each member became entitled to a 'right' to one-fourth of a new membership," which Whitney and his partners sold for a substantial gain. *Id.* The State of New York sought to tax that gain. Whitney claimed that the State lacked authority to do so under the Constitution.

Drawing on prior precedents of this Court, Whitney asserted that a membership in the Exchange is "intangible personal property" that "is taxable only at the domicile of the owner" unless it "has a 'business situs'" elsewhere. *Id.* at 371-72; *see Citizens' Nat'l Bank of Cincinnati v. Durr*, 257 U.S. 99, 109 (1921) (holding that Ohio, the state of domicile, could tax stockbroker's NYSE seat). He argued that "the membership cannot be said to have a business situs in New York because he and his copartners reside[d] and transact[ed] all their business in Massachusetts." *Whitney*, 299 U.S. at 372. Therefore, Whitney said, the gain was taxable only by the state of commercial domicile, *i.e.*, Massachusetts. *See id.*

This Court disagreed, believing that Whitney's "argument fail[ed] to give adequate consideration to the nature and incidents of the [NYSE] membership." *Id.* The Court explained that an intangible asset like an NYSE membership has a situs if it is "localiz[ed] by virtue of [its] attributes . . . in relation to the

conduct of affairs at a particular place." *Id.* While situs may be—and often is—established through "the actual transactions of a localized business," the Court stressed that the asset need not actually be used in business to have a situs. *Id.* Rather, an intangible asset can also have a situs if it grants a right that is "identified with a particular place because the exercise of the right is fixed exclusively or dominantly at that place." *Id.*

Because "the dominant feature" of an Exchange seat is the "privilege of conducting the business of the buying and selling of securities on the floor of the Exchange," the Court held that the asset had a situs in New York. *Id.* at 373. That was true even though Whitney and his partners (1) did not conduct any business in New York, (2) did not actually use their NYSE membership to directly buy or sell securities on the floor of the Exchange, and (3) could not use the fractional membership they sold to transact any business whatsoever. Thus, the Court held, New York could tax the gain. *See id.* at 374.

2. Under a straightforward application of *Whitney*, the New York-based FCC licenses at issue here have a situs in New York. Like the NYSE membership in *Whitney*, "the privilege which inheres" in the licenses is localized in New York and "can be exercised nowhere else." *Id.* at 372-73.

Most importantly, the licenses authorized the holder to broadcast *exclusively* within specified geographic regions of New York. It is hard to imagine a more clear-cut example of an intangible right "localized"—or "fixed exclusively or dominantly"—in New York. *Id.* at 372. Indeed, the holder of an FCC license may be penalized for broadcasting *outside* its licensed geographic area. *See* 47 U.S.C. § 301; *United*

States v. Hodson Broad., 666 F. App'x 624, 627 (9th Cir. 2016).

Additionally, it is undisputed that the value of the licenses was "very specific to [its New York] location." P.C. 257. As uncontested expert testimony in the record shows, the price that a buyer pays for an FCC license depends heavily on local factors such as:

- Resident population, *id.* at 241-42;
- Commuter population, *id.* at 242-43;
- Average income level, *id.* at 243-44;
- Demographic trends, *id.* at 245;
- Infrastructure development, *id.* at 248-49;
- Physical terrain, *id.* at 250-52;
- State and local regulations governing construction, labor, commercial activities, and the like, *id.* at 255-56;
- The presence of any "exclusion zones," such as military bases, that would diminish the customer base, *id.* at 252-54; and
- The geographic reach of competing telecommunications companies, *id.* at 247.

All of these characteristics reinforce the inherently local, New York-based character of the licenses at issue here. Indeed, it is presumably because AT&T wanted to exploit these valuable local characteristics that it agreed to pay Vermont National a substantial sum for the licenses.

That Vermont National did not itself use the licenses to broadcast in New York is irrelevant. After all, Whitney and his partners did not conduct any business in New York or use their NYSE membership to directly trade securities on the floor of the Exchange. *See Whitney*, 299 U.S. at 372. The Court

nonetheless found that Whitney's one-quarter NYSE membership had a situs in New York because the "nature and incidents" of the rights it conveyed "so link[ed]" it to New York that it came "within the taxing power of New York"—regardless of whether those rights had ever been exercised. *Id.* at 372, 374. As the Court explained, "[t]he nature of that right is not altered by the failure to exercise it." *Id.* at 373.[3]

Indeed, the facts in this case weigh even more strongly in favor of finding a New York situs. Not only did Whitney and his partners not do business in New York, but the intangible asset that gave rise to income—the fractional NYSE membership—could not be used for anything on its own. By contrast, the FCC licenses at issue here conferred real, valuable rights to broadcast in New York. Because the licenses were "so link[ed]" to New York as to have a situs there, *id.* at 374, under Vermont's regulation, the gain on the sale of those licenses should have been allocated to New York, not Vermont. Accordingly, Vermont could not tax the gain.

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[3] Even though *Whitney* found the "failure to exercise" a right irrelevant to the situs analysis, much of the questioning at oral argument before the Vermont Supreme Court focused on the fact that Vermont National had not used the FCC licenses to broadcast in New York. *See, e.g.*, Oral Argument at 1:25-4:40, 8:35-9:47, 27:40-28:42, *Vermont Nat'l Tel. Co. v. Department of Taxes*, 2020 VT 83 (2020) (No. 2019-280), https://soundcloud.com /user-970290540/2019-280a. Tellingly, counsel for the Department was unable to square his argument with *Whitney*'s express holding that an intangible asset need *not* be used in a state to have a situs there, telling the court "I don't know what to make of that" holding and insisting that such use was required. *Id.* at 25:43-26:30.

3. Instead of simply applying *Whitney*'s long-settled rule, the Vermont Supreme Court devised a brand-new—and entirely unjustified—exception to that rule. To have a situs in a state, the Vermont Supreme Court said, an asset not yet used in business must have been "created or protected *by [that] state's laws*." App. 19a (¶ 39) (emphasis added). That the asset grants rights that are "fixed exclusively or dominantly" in a state is, according to that court, not enough. *Id.* at 18a-19a (¶¶ 38-39). Because the FCC licenses were created by federal law—and because federal law governed their use and sale—the Vermont Supreme Court held that they did not have a situs, in New York or anywhere else. *Id.* at 20a (¶ 40).

This novel restriction has no basis in *Whitney* or any other precedent. *Whitney* recognized that a sufficient due process link is established between an intangible asset and a state when the rights conveyed by that asset are "localized" in the state. *Whitney*'s focus was on the location of the business activity that the intangible asset authorized. *Whitney* imposed no requirement that state law create or protect the asset.

In fact, the intangible asset sold in *Whitney* would have flunked the Vermont Supreme Court's test, for the rights and privileges on which the *Whitney* Court focused were neither created nor protected by New York state law. New York law did not create the membership rights in *Whitney*; those rights were created by the NYSE, an unincorporated association. *See* 299 U.S. at 370. New York law did not directly protect those rights either; "the constitution, by-laws and rules of the Exchange" governed the purchase, sale, transfer, and use of memberships. *Id.* at 372.

To be sure, New York state law *indirectly* benefited NYSE memberships. New York laws

governed the physical site of the NYSE and perhaps facilitated the trading activities that took place there that made the memberships so valuable. But the Vermont Supreme Court discounted the same sorts of indirect benefits in the case of FCC licenses. It gave no weight whatsoever to the fact that New York's laws made the state a good place to live, work, and do business—the very reasons why the right to broadcast over New York's airwaves was so valuable. *See supra* at 17 (describing testimony regarding the value of FCC licenses). Those are the New York features that "localized" the FCC licenses in New York, and those are the New York features that the Vermont Supreme Court erred in ignoring.

In short, the Vermont Supreme Court fundamentally and self-servingly misunderstood the basis of the "definite link" or "minimum connection" in *Whitney*. The fact that a state does not create, or directly regulate the sale of, an asset does not mean the taxpayer has received no benefits from the state. Although New York did not create or directly regulate Whitney's NYSE seat, the seat's value depended highly on New York features, including local commercial regulations and business conditions. And Whitney's membership right could be used only in New York. That is more than enough to establish situs there and satisfy the Due Process Clause.

4. Other precedents buttress that conclusion. This Court has long recognized that a state need not directly regulate an income-producing asset to tax it. For example, in *International Harvester Co. v. Wisconsin Department of Taxation*, the Court concluded that Wisconsin could constitutionally tax dividends received by out-of-state residents from an out-of-state corporation, just because those dividends

were supposedly traceable to income previously earned in the state. *See* 322 U.S. 435, 442 (1944). That Wisconsin did not create or regulate the stock, the dividends, or the shareholders to whom the dividends belonged was unimportant. As the Court explained, the fact that Wisconsin could not "prevent the withdrawal of the earnings from the state or the declaration of the dividends" has "no bearing on [Wisconsin's] right to measure, in terms of taxes, both the benefits which it has conferred on the stockholders in their relations with the state, and the activities or transactions which are within the reach of its regulatory power." *Id.* at 443. Along similar lines, this Court allowed a state to tax membership rights in a grain exchange, even though those rights were created and regulated by the local Chamber of Commerce rather than state law. *Rogers v. County of Hennepin*, 240 U.S. 184, 186, 191 (1916).

Other state courts have likewise recognized that the key to *Whitney* was not the direct effect of state law, but the fact that "the chief characteristic of the membership right was so connected to the physical site of the NYSE as to bring ownership, including the sale, of that right within the jurisdiction of New York." *Bridges v. Autozone Props., Inc.*, 900 So. 2d 784, 803 n.8 (La. 2005); *see Stark v. Comptroller of the Treasury*, 554 A.2d 458, 462-64 (Md. Ct. Spec. App. 1989). As one commentator has explained, the "privilege [in *Whitney*] was localized in New York since it could be exercised there, but nowhere else." Michael T. Fatale, Geoffrey *Sidesteps* Quill: *Constitutional Nexus, Intangible Property and the State Taxation of Income*, 23 Hofstra L. Rev. 407, 440 n.201 (1994). The Vermont Supreme Court's decision flies in the face of this longstanding authority.

B. The Decision Below Interferes With State Powers Over Taxation, UDITPA, And The Laws Of At Least 11 States

Not only is the decision below obviously incorrect, it unduly narrows states' broad powers of taxation and is at odds with UDITPA and the laws of at least 11 states that follow it. Moreover, the decision below arbitrarily treats similar intangible assets differently and, if allowed to proliferate, will create a significant risk of unjust double taxation of multistate corporations. This Court should reject the Vermont Supreme Court's misinterpretation of *Whitney* and thereby nip any spillover consequences of that court's decision in the bud.

1. In cases going back to at least *McCulloch v. Maryland*, this Court has recognized the importance and breadth of states' taxing power. 17 U.S. (4 Wheat.) 316, 425 (1819); *see, e.g.*, *Weston v. City Council of Charleston*, 27 U.S. (2 Pet.) 449, 466 (1829) ("The power of taxation is one of the most essential to a state, and one of the most extensive in its operation."); *Allegheny Pittsburgh Coal Co. v. County Comm'n of Webster Cnty.*, 488 U.S. 336, 344 (1989) ("The States, of course, have broad powers to impose and collect taxes."). And while the Due Process Clause of course constrains that power, this Court has been careful to interpret due process pragmatically, so as to allow a state to tax people, activities, and property that are practically connected to it. *Cf., e.g.*, *Mobil Oil Corp. v. Commissioner of Taxes of Vt.*, 445 U.S. 425, 440-42 (1980) (allowing Vermont to tax dividends from a foreign corporation that was part of a unitary business that operated in the state).

Indeed, the situs principle itself is an outgrowth of this Court's pragmatic understanding of the Due Process Clause. It permits a state to tax (among other things) income from intangible assets that are inherently connected to the state—even if the taxpayer and its other activities are located outside the state. *See supra* at 4-5, 14-15.

The Vermont Supreme Court's decision threatens to artificially limit states' ability to tax intangible assets. As explained above, that court found that the FCC licenses at issue here lacked a situs in New York—meaning that New York could not tax them without violating the Due Process Clause—even though those licenses conferred rights that could be exercised solely in New York and were valuable only because characteristics of the state and its people, businesses, and markets made them valuable. *See supra* at 14-21. To say that New York cannot tax those licenses simply because they were created by the FCC, instead of by state law, ignores the fundamental connection they have to New York.

Nor can the Vermont Supreme Court's decision be cabined to FCC licenses. Its holding that an intangible asset is "fixed exclusively or dominantly" in a state under *Whitney*'s situs rule only if it was "created or protected by [that] state's laws," App. 18a-19a (¶¶ 38-39), directly calls into question whether states may tax other geographically confined rights created by the federal government—such as air, timber, and mineral rights over federally controlled land. Presumably those other intangible assets would also lack a situs under the Vermont Supreme Court's rule. What is more, any right created by private parties and not directly regulated by state law could be deemed to lack a situs under that rule too.

The potential reach of the Vermont Supreme Court's misguided interpretation of *Whitney* is substantial. And its result is (unsurprisingly) self-serving: The whole purpose of denying New York and other states the right to tax intangible assets plainly localized in those states is to grant Vermont the ability to impose such taxes.

2. The Vermont court's decision is also in serious tension with UDITPA and the laws of at least 11 other states that follow it. UDITPA is a model law that, among other things, establishes rules for multistate corporations to apportion income among the states where they operate. Most relevant here, UDITPA provides that a state may tax business income from "a contract right, *government license*, or similar intangible property that *authorizes* the holder to conduct a business activity in a specific geographic area" of the state. Multistate Tax Comm'n, Model Multistate Tax Compact with Recommended Amendments to Article IV, art. IV, § 17(a)(4)(ii)(A) (adopted July 2014 and 2015) (emphases added) ("Multistate Tax Compact");[4] *see* Multistate Tax Comm'n, Model General Allocation & Apportionment Regulations § IV.17.(f)(1)(E), Example (ii) (July 25, 2018) (giving as example the sale of an FCC license, the proceeds of which are in a state because "the intangible property sold is a government license that authorizes the holder to conduct business activity" in

[4] Available at https://www.mtc.gov/The-Commission/Multistate-Tax-Compact (last visited Feb. 18, 2021).

that state).[5] At least 11 states have adopted UDITPA's model rule in some form.[6]

Under that rule, it does not matter whether the taxpayer actually uses the government license to conduct business in a state, or whether the source of the license is state or federal law. Rather, the rule covers *any* license that *authorizes* business activity in the state. UDITPA thus recognizes that income generated by any intangible government license to conduct activity within a particular state is intrinsically linked to that state for federal due process purposes—and, thus, that the state is fully entitled to tax that income.

The Vermont Supreme Court's decision directly contradicts this principle. Although the FCC licenses plainly authorized business activity in New York—and *only* New York—the Vermont Supreme Court held that New York could not constitutionally tax Vermont National's gain from the sale of those licenses. This holding calls into question UDITPA's premise that authorization, not use or source, is the touchstone for taxation of income from government licenses. And it likewise undermines UDITPA's view that when a government license authorizes activity

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[5] Available at https://www.mtc.gov/MTC/media/AUR/FINAL-APPROVED-2018-Proposed-Amendments-042020.pdf.

[6] *See* 1 Colo. Code Regs. § 201-2:39-22-303.6-12(1)(a); Ind. Code § 6-3-2-2(f)(3)(E)(i); Ky. Rev. Stat. Ann. § 141.120(11)(a)(4)(b)(i); La. Admin. Code tit. 61, § 1135(L)(3)(a); 830 Mass. Code Reg. § 63.38.1; Mo. Rev. Stat. §§ 143.451, 143.455; Mont. Code Ann. § 15-1-601; Mont. Admin. R. 42.26.250(1)(a); N.C. Gen. Stat. § 105-130.4; 17 N.C. Admin. Code 5G.1201(1); Or. Rev. Stat. § 314.666(3)(a); Or. Admin. R. 150-314-0435(6)(a), 150-317-1040(6)(a); 280-20-25 R.I. Code R. § 9.8(Q)(1)(a); Tenn. Code Ann. §§ 67-4-2012, 67-4-2111.

inside a state, that state necessarily has a sufficient connection to the license to tax income derived from its sale or use.[7]

3. The Vermont Supreme Court's novel interpretation of *Whitney* is also at odds with basic tax principles that promote fairness, including horizontal equity and the avoidance of double taxation.

Horizontal equity is a "universally accepted . . . criteria of a 'good tax'" that "demands that similarly situated individuals face similar tax burdens." David Elkins, *Horizontal Equity as a Principle of Tax Theory*, 24 Yale L. & Pol'y Rev. 43, 43 (2006). Under that principle, all licenses that authorize business activity primarily in a single state should be treated the same. Yet by holding that an intangible asset has a situs in a state only if it was "created or protected by [that] state's laws," App. 19a (¶ 39), the Vermont Supreme Court's decision subjects such licenses to disparate tax rules depending solely on whether they are creatures of state or federal law. Under that approach, for example, a federal license to fish in New York waters would not have a tax situs in New York—but a New York license to fish in those same waters *would* have such situs. That court never justified such differential treatment, which has no basis in logic—a clear violation of horizontal equity principles.

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[7] To be sure, UDITPA applies to *business* income, while the Vermont Supreme Court's decision applies to *nonbusiness* income. *See* App. 2a (¶ 2), 78a; Multistate Tax Compact, art. IV, § 1(a). But regardless of the type of income at issue, both answer the question of whether that income is sufficiently connected to a state to allow the state to tax it. UDITPA's recognition that mere authorization of business activity brings income from an intangible asset within a state's taxing power is at odds with the contrary reasoning of the Vermont Supreme Court.

Moreover, if the Vermont Supreme Court's decision is allowed to proliferate, corporations that operate in more than one state will be subject to a significant risk of double taxation. Regulations like the Vermont one at issue here are designed to avoid such double taxation. Vermont's regulation allocates all nonbusiness income from intangible assets to *either* the state where those assets have a situs *or* the state of the owner's commercial domicile. *See* Vt. Tax Reg. § 1.5833-1(e). This all-or-nothing allocation amplifies the double taxation risk from the Vermont Supreme Court's erroneous interpretation of *Whitney*. If, for example, New York's courts held that the FCC licenses at issue here had a situs in New York—as *Whitney* dictates—then New York could tax the entire gain that Vermont National earned, even though Vermont already did. The Vermont Supreme Court's decision thus uniquely disfavors federal license-holders by subjecting them to double taxation not faced by state license-holders.

This double taxation risk is not small or hypothetical. Recognizing that risk, other states have statutes and regulations that, like Vermont's, attempt to avoid such double taxation.[8] And a number of states do in fact tax nonresidents on

[8] *See, e.g.*, Ky. Rev. Stat. Ann. § 132.190(2) (all intangible personal property of domestic corporations is considered in fixing the value of corporate franchises "unless it has acquired a business situs without this state"); Okla. Stat. Ann. tit. 68, § 2358(b) (income from intangible personal property is allocated to the taxpayer's state of domicile except "where such property has acquired a nonunitary business or commercial situs apart from the domicile of the taxpayer").

income from intangible assets that have an in-state situs.[9]

Notably, Vermont National has itself been subjected to double taxation as a result of Vermont's mistaken rule. In 2018, after the sale of the FCC licenses at issue here, Vermont National sold another license covering broadcasting areas in Michigan. The Michigan Bureau of Taxes determined that it had the power to tax the sale of that Michigan-based license, even though Vermont National "never provided services to customers in Michigan under the license." Mich. Bureau of Tax Pol'y, Letter Ruling 2018-1 (Nov. 21, 2018);[10] *see also, e.g.*, Vermont Nat'l Vt. Sup. Ct. Reply Br. 10 (Dec. 27, 2019) (discussing this letter). "Because the license covered a geographic area entirely within Michigan," the Michigan Bureau of Taxes concluded that the sale of the license to Michigan should be "sourced" to Michigan. Mich. Bureau of Tax Pol'y, Letter Ruling 2018-1. The sale was ultimately subject to tax in *both* Michigan and Vermont.

If the Vermont Supreme Court's decision is left intact, multistate corporations will be subject to double taxation on federal licenses—as well as on a

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[9] *See, e.g.*, Ariz. Rev. Stat. § 43-1092(A) (income from intangible personal property "is not income from sources within this state unless the property has acquired a business situs within this state"); Cal. Rev. & Tax Code § 17952 (same); Ga. Comp. R. & Regs. 560-7-8-.01(1)(b)(5) (gain on sale of intangible personal property "ordinarily is not taxable . . . except to the extent that such intangible personal property has acquired a business situs in this State"); Or. Admin. R. 150-316.0171(2)(b) (same).

[10] Available at https://www.michigan.gov/documents/treasury/Letter_Ruling_2018-1_641184_7.pdf.

broad array of commercial transactions—by Vermont and any other state that adopts Vermont's approach to *Whitney*. That result is plainly unjust, unduly penalizes federal licenses (and license-holders), and could also prevent corporations from making productive—and economically efficient—business deals. This Court should eliminate any uncertainty over the tax consequences of such sales by rejecting the Vermont Supreme Court's flawed rule.

C. The Vermont Supreme Court's Error Allowed Vermont To Penalize Vermont National For Its Good-Faith Tax Compliance

As explained, Vermont's misinterpretation of *Whitney* is custom-tailored to serve the state's own interest in maximizing revenue, at the expense of other states and taxpayers subject to double taxation. Here, though, the State compounded its legal error by going out of its way to impose a nearly 25% penalty on Vermont National's perceived violation of law, to the tune of almost half a million dollars. It did so, moreover, despite Vermont National's undisputed (and amply documented) good-faith effort to comply with its tax obligations. P.C. 94-96, 214; App. 5a (¶ 7), 36a-39a (¶¶ 72-76). The unjustified penalty reinforces the need for this Court's intervention.

Vermont imposed the penalty under a statute that allows the Commissioner to assess a penalty of 1% *per month* for an outstanding income tax liability, up to a maximum of 25%. Vt. Stat. Ann. tit. 32, § 3202(b)(3). That potentially draconian penalty is triggered even when the taxpayer has made a reasonable and sincere good-faith effort to comply with its tax obligations. The Department imposed almost the highest penalty

possible on Vermont National, at 23% of the liability, even though Vermont National reasonably relied on the (accurate) advice of its tax accountant—and even though the Department conceded the company was "[a]bsolutely" cooperative during the audit. P.C. 214; App. 36a-37a (¶ 73).

Vermont's application of that penalty is highly questionable under the Excessive Fines Clause. A government exaction violates the Excessive Fines Clause if it is both "punitive" and "excessive." *United States v. Bajakajian*, 524 U.S. 321, 334 (1998). "The touchstone of the constitutional inquiry under the Excessive Fines Clause is the principle of proportionality: The amount of the [penalty] must bear some relationship to the gravity of the offense that it is designed to punish." *Id.* at 334; *see also Timbs v. Indiana*, 139 S. Ct. 682, 687-88 (2019) ("The Excessive Fines Clause traces its venerable lineage back to at least 1215, when Magna Carta guaranteed that '[a] Free-man shall not be amerced for a small fault, but after the manner of the fault . . . .'" (alteration in original) (citation omitted)).

Here, "the Department's penalty undoubtedly constitutes punishment," App. 35a (¶ 71), and Vermont National bore absolutely no culpability for its supposed "offense." It consulted a professional accountant before filing its taxes, was fully transparent in its accounting, and was "[a]bsolutely" cooperative during the audit. P.C. 214. Moreover, for the reasons explained above, Vermont National's tax position was not merely reasonable, but unquestionably *right*.

Ultimately, Vermont National was subjected to an excessive tax penalty of 23% only because it failed to anticipate the Vermont Supreme Court's drastic—

and unjustified—departure from this Court's settled precedent. The excessive, no-fault penalty provides all the more reason for this Court to reverse the supposed underpayment on which it is based.

D. The Vermont Supreme Court's Error Is Sufficiently Egregious To Warrant Summary Reversal

This is one of the rare cases in which summary reversal is warranted. As explained, the Vermont Supreme Court's decision conflicts with *Whitney*, resulted in nearly $3 million in unjustified liabilities, interferes with state taxation, and violates basic principles of fairness in taxation. In these circumstances, summary reversal is the right course.

Summary reversal is appropriate where a state court decision is "flatly contrary to this Court's controlling precedent" on a principle of federal constitutional law. *Arkansas v. Sullivan*, 532 U.S. 769, 771 (2001) (per curiam). As the leading treatise explains, summary reversal is warranted "[i]f it clearly appears at the certiorari stage that the premise or basis of the state court's ruling respecting state law is a misreading of a federal constitutional proposition." Steven M. Shapiro et al., *Supreme Court Practice* § 3.23 (11th ed. 2019); *see also* Sup. Ct. R. 10(c).

This Court has granted summary reversal in numerous similar cases where the lower court plainly misapplied clear Supreme Court precedent.[11] And

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[11] *See, e.g.*, *Johnson v. City of Shelby*, 574 U.S. 10, 12 (2014) (per curiam) (courts below incorrectly dismissed plaintiffs' suit for failing to expressly invoke 42 U.S.C. § 1983 in the complaint); *KPMG LLP v. Cocchi*, 565 U.S. 18, 19 (2011) (per curiam) (state

the Court has not hesitated to correct such errors in the tax arena.[12] Indeed, history shows that the Court developed its recent practice of granting summary reversal in tax cases. *See* Ernest J. Brown, *The Supreme Court, 1957 Term—Foreword: Process of Law*, 72 Harv. L. Rev. 77, 82-87 (1958) (describing Court's then-emerging trend of summary reversals and noting that many such cases in this trend involved tax liens).

Here, the Vermont Supreme Court upheld Vermont's authority to tax gains from the sale of certain types of intangible property—and declared that New York (and presumably other states) lack such authority—based entirely on its misinterpretation of *Whitney* and the federal constitutional "situs" principle. *See supra* at 14-21.

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court "failed to determine whether" all of the claims were arbitrable under the Federal Arbitration Act); *Ash v. Tyson Foods, Inc.*, 546 U.S. 454, 455, 457 (2006) (per curiam) (court of appeals "erred in articulating the standard" for pretext under 42 U.S.C. § 1981 and Title VII); *Sao Paulo State of the Federative Republic of Brazil v. American Tobacco Co.*, 535 U.S. 229, 232 (2002) (per curiam) (court of appeals applied the wrong standard for judicial disqualification); *Horn v. Banks*, 536 U.S. 266, 271 (2002) (per curiam) (court of appeals "committed a clear error by failing to perform" the required retroactivity analysis); *Ohio v. Reiner*, 532 U.S. 17, 21 (2001) (per curiam) (state court's decision "clearly conflict[ed]" with this Court's Fifth Amendment case law).

[12] *See, e.g.*, *Commissioner v. McCoy*, 484 U.S. 3, 6 (1987) (per curiam) (court of appeals "clearly exceeded its jurisdictional bounds" in forgiving interest and statutorily imposed penalty); *Commissioner v. Asphalt Prods. Co.*, 482 U.S. 117, 120 (1987) (per curiam) (court of appeals disregarded tax penalty statute that "could not [have] be[en] clearer"); *United States v. White Bear Brewing Co.*, 350 U.S. 1010, 1010 (1956) (per curiam) (summarily reversing prioritization decision in a tax lien case).

An error of this magnitude and clarity cannot stand. Indeed, the Vermont Supreme Court's holding is not only directly contrary to *Whitney*, but would have produced the opposite result on *Whitney*'s very facts. This is precisely the sort of case for which the summary reversal mechanism exists.[13]

For all the reasons discussed, the Vermont Supreme Court's decision is wrong and clearly conflicts with *Whitney*. Summary reversal is entirely justified. But if this Court disagrees, it should grant plenary review to clarify *Whitney*'s situs rule and how the Due Process Clause applies to state taxation of intangibles like the FCC licenses at issue here. Either way, this Court should not let the Vermont Supreme Court's erroneous holding stand.

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[13] This is not the first time in recent memory the Vermont Supreme Court has ignored this Court's precedent to rescue state officers. A few months ago, three Justices issued a statement rebuking that court for upholding a search without analyzing controlling Fourth Amendment precedent—which "almost certainly required a different result." *Bovat v. Vermont*, 141 S. Ct. 22, 23 (2020) (Gorsuch, J., joined by Sotomayor & Kagan, JJ., respecting the denial of certiorari). The Vermont Supreme Court's lopsided enforcement of this Court's precedent in an effort to justify unconstitutional actions by state officials warrants the strong medicine of summary reversal.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

HENRY P. BUBEL
TIFFANY N. TAM
PATTERSON BELKNAP WEBB & TYLER LLP
1133 Avenue of the Americas
New York, NY 10036

WM. ROGER PRESCOTT
TIMOTHY C. DOHERTY, JR.
DOWNS RACHLIN MARTIN PLLC
199 Main Street
Burlington, VT 05401

ROMAN MARTINEZ
Counsel of Record
ERIC J. KONOPKA
CHRISTINE C. SMITH
LATHAM & WATKINS LLP
555 Eleventh Street, NW
Suite 1000
Washington, DC 20004
(202) 637-3377
roman.martinez@lw.com

Counsel for Petitioner

February 18, 2021

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No. 2019-280

Vermont National Telephone Company	Supreme Court
	On Appeal from Superior Court, Washington Unit, Civil Division
v.	
Department of Taxes	March Term, 2020

Mary Miles Teachout, J.

William R. Prescott and Timothy C. Doherty, Jr. of Downs Rachlin Martin PLLC, Burlington, and Henry P. Bubel and Tiffany N. Tam of Patterson Belknap Webb & Tyler LLP, New York, New York, for Plaintiff-Appellant.

Thomas J. Donovan, Jr. Attorney General, and Will S. Baker, Assistant Attorney General, Montpelier, for Defendant-Appellee.

PRESENT: Reiber, C.J., Robinson, Eaton, Carroll and Cohen, JJ.

¶ 1. **Carroll, J.** Vermont National Telephone Company (VNT) appeals the Commissioner of Taxes' determination that, pursuant to Department of Taxes Regulation § 1.5833-1, the capital gain VNT earned from the 2013 sale of two Federal Communications Commission (FCC) telecommunications licenses is

subject to Vermont tax.[1] VNT also argues that the penalty the Commissioner assessed for VNT's failure to report the 2013 sale violated 32 V.S.A. § 3202(b)(3) and the Vermont and United States Constitution. We affirm.

¶ 2. Before turning to the facts, we briefly discuss the Department regulation governing this dispute. Regulation § 1.5833-1 governs the taxation of corporate income. It provides that business income shall be "apportioned" to Vermont to the extent the income "is derived from any trade, business or activity conducted" within the state. Allocation and apportionment of "Vermont net income" by corporations § 1.5833-1, Code of Vt. Rules 10 060 002(a)(1) [hereinafter Regulation § 1.5833], http://www.lexisnexis.com/hottopics/codeofvtrules. Nonbusiness income, however, is "allocated" in full to the state where the income-producing assets are "located" or have a "situs." Regulation § 1.5833-1(e). If the assets have neither a location nor a situs, the income is allocated to the state of the business's commercial domicile, which is defined as "the principle place from which the business is directed or managed." With that background, we turn to the facts of this dispute.

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[1] Section 5862(d) of Title 32 provides that "[a] taxable corporation which is part of an affiliated group engaged in a unitary business shall file a group return containing the combined net income of the affiliated group." At all times relevant to this appeal, VNT was part of a unitary group doing business in Vermont and elsewhere that included subsidiaries VTel Wireless, Inc., Four Winds Farm, Inc., and VTel Data Networks, Inc. For purposes of this appeal, there is no need to distinguish between VNT and its subsidiaries, so we refer to them collectively as VNT.

¶ 3. The following is undisputed. In 2003, the FCC auctioned licenses granting the right to broadcast in the 700 MHz frequency of the electromagnetic spectrum in specific geographic areas. The 700 MHz frequency was originally licensed for television broadcast. In the 1980s, however, the FCC decided to move television broadcasting to a lower portion of the spectrum and license the 700 MHz frequency for mobile telecommunications. By 2003, many television channels were still broadcasting at 700 MHz and it was unclear when they would stop operating at that spectrum, which was problematic because television operations at this frequency would interfere with mobile telecommunications.

¶ 4. Considering these uncertainties, VNT purchased two FCC licenses in 2003 for investment purposes. These licenses granted the company the exclusive right to broadcast over parts of upstate New York. License WPZW674, otherwise known as the "Albany license," covered a geographic area that included Albany, Troy, Schenectady, Amsterdam, and Saratoga Springs. License WPZW676, otherwise known as the "Glens Falls license," covered Glens Falls, Whitehall, and Fort Ann. In 2010, the FCC granted VNT authorization to "carve out" a portion of the Glens Falls license to provide telecommunications service to approximately 1700 customers around Hebron, New York.

¶ 5. In 2013, VNT sold the Albany and Glens Falls licenses—excluding the "carve-out" area covering Hebron—to AT&T Mobility Spectrum LLC, resulting in a capital gain of approximately $23,970,730. Following the sale, VNT sought advice from its accounting firm about whether the sale would

be subject to Vermont and/or New York tax. In a memorandum to VNT, the firm concluded that the gain would not be subject to Vermont tax. The firm explained that under Regulation § 1.5833-1, the capital gain would qualify as nonbusiness income. Because the Regulation directs nonbusiness income to be allocated to the state where the income-producing assets are located, the firm reasoned that the capital gain would be allocated to New York under the assumption that the licenses were located there. The memorandum expressly cautioned that:

> Any tax advice contained in this correspondence or attachments is based upon our understanding of relevant facts and the tax law and governmental rulings that were in effect at the time the advice was given. Furthermore, in accordance with [Internal Revenue Service] rules, we hereby advise you that any tax advice contained in this correspondence or attachments is not intended or written to be used, and it cannot be used, by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer by the Internal Revenue Service.

¶ 6. On its 2013 Vermont tax return, VNT—based on the advice of its accounting firm—reported the capital gain from sale of the licenses as nonbusiness income allocated entirely to a non-Vermont source. In 2015, the Department audited VNT and assessed corporate income tax on the capital gain from the sale of the licenses,[2] $334,899 in

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[2] The Commissioner assessed corporate income tax in the amount of $1,947,437, which included unpaid tax on the capital

interest, and an automatic underpayment penalty of $445,222.52. VNT appealed to the Commissioner.[3]

¶ 7. Before the Commissioner, VNT argued that the capital gain from the sale of the licenses was not subject to Vermont tax because the income-producing assets—the FCC licenses—were located in New York as "they convey benefits that can only be exercised in New York . . . and their value is inextricably bound to a host of geographic-specific factors in New York." Assuming, in the alternative, that the licenses had no location, VNT contended that the licenses would still not be subject to Vermont tax because VNT's commercial domicile was in Connecticut, not Vermont. VNT also argued the Department should not have assessed an automatic underpayment penalty because, given the complexity of the legal issues, VNT acted reasonably in allocating the gain from the sale of the licenses to New York.

¶ 8. In a lengthy written decision, the Commissioner affirmed the assessment of corporate income tax and the underpayment penalty. First, the Commissioner concluded that the FCC licenses were neither located nor had a situs in New York. The Commissioner reasoned that the geographic-specific factors VNT cited did not locate the licenses in New York because they were "all factors which may affect the unknown, but potential, future cost of acquiring infrastructure and future income in the event the

gain from the sale of the licenses and unpaid tax on wages earned by VNT's president and CEO.

[3] See 32 V.S.A. § 5883 ("Upon receipt of a notice of deficiency . . . or of assessment of penalty . . . the taxpayer may . . . petition the Commissioner in writing for a determination of that deficiency . . . or assessment.").

licenses are used in New York business." That the licenses granted the right to broadcast in New York did not mean the licenses were located there because the broadcast areas "were simply market areas drawn on the map by the FCC."

¶ 9. In determining that the licenses did not have a situs in New York, the Commissioner concluded that the term "situs" in Regulation § 1.5833-1 was a term of art referring to whether an asset is constitutionally subject to taxation in a state. The Commissioner explained that due process requires some minimum connection between "a state and the person, property or transaction" it seeks to tax. (Quotation omitted.) Consistent with this rule, intangible property is generally subject to tax by the owner's state of domicile because intangible property is a source "of actual or potential wealth" that "cannot be dissociated from" its owner. (Quotations omitted.) Intangible property may, however, be subject to tax in a state other than the owner's domicile "if the owner engages in activities related to the intangible and those activities are subject to the taxing state's governmental protections and benefits." In the latter case, the intangible acquires a "business situs" or "tax situs." Based on these constitutional principles, the Commissioner determined that because VNT never engaged in activities related to the licenses in New York—e.g., did not charge or collect broadcast contract fees—the licenses did not acquire a tax situs there.

¶ 10. Second, the Commissioner concluded that in 2012 and 2013, VNT's commercial domicile was in Vermont. The Commissioner made extensive findings to support this conclusion, which were summarized as follows:

> Vermont was the location of the principal office, the place where high-level policy was implemented, where the conduct of day-to-day business operations occurred, where the greatest number of office staff and business employees worked, and where the business records were kept, and was the state that gave the greatest protection and benefits . . . .

¶ 11. Finally, the Commissioner declined to abate the underpayment penalty because the structure of § 3202(b)(3) indicated that the Legislature "intended to create a penalty for simple failure to pay with no fault." In addition, the Commissioner determined that the penalty was appropriate because one of the purposes of penalties was to encourage taxpayers to seek formal guidance from the Department rather than take questionable tax positions. By failing to seek formal guidance, VNT "assumed the risk" of a penalty. VNT appealed to the trial court.

¶ 12. At the trial court, VNT made three arguments. First, it argued that the licenses were "localized" in New York because it is the only place that granted the right to broadcast. Second, VNT argued that the Commissioner improperly considered "all the facts" in determining VNT's commercial domicile. Finally, VNT argued that the automatic penalty violated § 3202(b)(3)—because that section requires the Commissioner to exercise discretion in determining whether to assess a penalty—and was constitutionally excessive.

¶ 13. Although the trial court affirmed the Commissioner's decision, it disagreed with some of his analysis and conclusions about where the FCC licenses were located. First, the trial court

determined that the term "situs" in the Regulation was not being used as a term of art, such as tax situs or business situs. Instead, according to the trial court, the term simply meant location, which was the "parallel term expressly used in the first sentence" of Regulation § 1.5833-1. Applying this interpretation, the trial court determined that the licenses were not located in New York because the licenses had "no intrinsic location," and it distinguished between the business use of the licenses—which has a discernable location—and the licenses themselves—which do not.

¶ 14. Second, the court concluded that the Commissioner properly weighed the relevant factors to determine that VNT's commercial domicile was in Vermont. Finally, with regard to the penalty, the court, quoting Piche v. Department of Taxes, 152 Vt. 229, 234, 565 A.2d 1283, 1286 (1989), held that the automatic penalty did not violate § 3202(b)(3) because the decision to impose automatic penalties "represents the full extent to which the Commissioner has chosen to exercise his discretionary authority as granted under the statute." The court also concluded that the penalty was not constitutionally excessive because it did not exceed the range of penalties permitted by § 3202(b)(3) and constituted only "a small percentage of the outstanding liability." VNT appealed.

¶ 15. VNT makes similar arguments on appeal. First, VNT argues that the licenses are located in New York because they convey "privileges that can only be exercised in a particular place"—namely, the right to broadcast in a defined geographic area and the corresponding right to deny others the ability to broadcast. Second, assuming the licenses are not located in New York, VNT argues that its commercial

domicile is in Connecticut because that is where the high-level decisions of officers and directors are made. Finally, VNT submits that the Department's automatic penalty violates due process because the relevant statute requires the Department to conduct a "particularized inquiry into the considerations pertinent to a specific defendant." (Quotation omitted.) Alternatively, VNT contends that the penalty violates the Excessive Fines Clauses of the Vermont and United States Constitutions.

I. Standard of Review

¶ 16. Because Vermont does not have an intermediate appellate court, this case presents one of the rare circumstances where a party has the right to two appeals. Section 5885 of Title 32 gives taxpayers the right to appeal the Commissioner's determination "concerning a notice of deficiency, an assessment of penalty or interest, or a claim of refund" to the superior court. 4 V.S.A. § 2, in turn, provides a right to appeal judgments of the superior court to this Court. See State v. Philip Morris USA Inc., 2008 VT 11, ¶ 9, 183 Vt. 176, 945 A.2d 887 ("Ordinarily, this Court is empowered to review, and litigants are entitled to appeal from, any final order of the superior court.").

¶ 17. "Where there is an intermediate level of appeal from an administrative body, we review the case under the same standard as applied in the intermediate appeal." Tarrant v. Dep't of Taxes, 169 Vt. 189, 195, 733 A.2d 733, 738 (1999). Although a trial court normally acts as a factfinder, it functions "solely as an appellate body" when reviewing the decisions of administrative bodies. See In re Town of Sherburne, 154 Vt. 596, 603, 581 A.2d 274, 278 (1990).

Accordingly, we review the Commissioner's decision directly, "independent of the superior court's findings and conclusions." Devers-Scott v. Office of Prof'l Reg., 2007 VT 4, ¶ 4, 181 Vt. 248, 918 A.2d 230.

II. Tax Assessment

¶ 18. The Commissioner held, pursuant to Regulation § 1.5833-1, that the capital gain from the sale of the licenses was subject to Vermont tax because the licenses had neither a location nor a situs, and VNT's commercial domicile was in Vermont. VNT argues that the Commissioner erred in holding that the capital gain was subject to Vermont tax because (1) the licenses are located in New York; and (2) assuming the licenses have no location, VNT's commercial domicile is in Connecticut, not Vermont.

A. Location of FCC Licenses

¶ 19. VNT argues that the licenses are localized in New York because they convey "privileges than can only be exercised in a particular place"—namely, the right to broadcast in a specific geographic area and the corresponding right to deny others the ability to broadcast. Regulation § 1.5833-1(a)(1) provides that business income shall be apportioned to Vermont based on the extent to which the income "is derived from any trade, business, or activity conducted" within the state. Nonbusiness income, however, is allocated in full to the state where the income producing assets are "located" or have a "situs." Regulation § 1.5833-1(e). If the assets have neither a location nor a situs, the income is allocated to the business's commercial domicile. Id.

¶ 20. Here, there is no dispute that the sale of the licenses qualified as nonbusiness income. The issue is whether the Commissioner erred in concluding that

the income-producing assets—i.e., the licenses—were neither located in nor had a situs in New York. The Commissioner concluded that the licenses did not have a location because intangible property, by definition, has no physical location, and the mere fact that the licenses conveyed rights that could be exercised in New York did not mean they were located there. According to the Commissioner, the licenses also did not acquire a New York situs because VNT never engaged in business activities with the licenses there, which means that VNT never availed itself of New York's laws.

¶ 21. VNT argues that in interpreting the Regulation, the Commissioner conflated "situs" with the concept of "nexus." According to VNT, whereas nexus is the "constitutional standard that considers the sufficiency of connections between a taxpayer and the state seeking to impose a tax," the term situs in Regulation § 1.5833-1 "simply asks where an asset is located for purposes of allocating nonbusiness income." Citing New York ex rel. Whitney v. Graves, 299 U.S. 366 (1937), VNT argues the FCC licenses are located in New York because they grant a right that can only be exercised there.

¶ 22. "We approach regulatory construction in the same manner as we do statutory interpretation." In re Williston Inn Grp., 2008 VT 47, ¶ 14, 183 Vt. 621, 949 A.2d 1073 (mem.). "[O]ur overall goal is to discern the intent of the drafters." Conservation Law Found. v. Burke, 162 Vt. 115, 121, 645 A.2d 495, 499 (1993). "[W]e do so by examining the plain meaning of the regulatory language, with other tools of construction should the plain meaning rule prove unavailing." In re Conservation Law Found., 2018 VT

42, ¶ 15, 207 Vt. 309, 188 A.3d 667 (quotation and alteration omitted).

¶ 23. However, because agencies, rather than the Legislature, draft regulations, "[w]e employ a deferential standard of review of an agency's interpretation of its own regulations." State v. Grenier, 2014 VT 121, ¶ 20, 198 Vt. 55, 110 A.3d 291 (quotation omitted). "Our deferential level of review, however, does not equate with mere judicial passivity . . . ." In re Wal-Mart Stores, Inc., 167 Vt. 75, 80, 702 A.2d 397, 400 (1997) (quotation omitted).

> We still conduct an independent review and will overturn an agency's interpretation of its own promulgated regulation that exceeds the authority granted under the state enabling statute, that conflicts with past agency interpretations of the same rule, that results in unjust, unreasonable, or absurd consequences, or that demonstrates compelling indications of error.

In re Conservation Law Found., 2018 VT 42, ¶ 16 (quotation and citations omitted).

¶ 24. Consistent with this deferential standard of review, we conclude that the Commissioner correctly determined that "situs" is a term of art referring to where intangible property is constitutionally subject to taxation. Applying this term of art, the Commissioner did not err in determining the licenses did not have a New York situs.

1. Situs

¶ 25. VNT first argues that the term "situs" in Regulation § 1.5833-1 is synonymous with location. We disagree. The Regulation's plain meaning, the

presumption against superfluous language, and VNT's own argument indicate that situs is a term of art referring to where intangible property is constitutionally subject to taxation.

¶ 26. Beginning with the plain text, the Regulation, phrased slightly differently, directs nonbusiness income to be allocated to the state of a business's commercial domicile provided that the income-producing assets have neither a "location" nor a "situs." Regulation § 1.5833-1(e). It is a basic presumption of statutory interpretation "that language is inserted in a statute advisedly." Trombley v. Bellows Falls Union High Sch. Dist. No. 27, 160 Vt. 101, 104, 624 A.2d 857, 860 (1993). We accordingly "construe statutes to avoid rendering one part mere surplusage." In re Jenness & Berrie, 2008 VT 117, ¶ 24, 185 Vt. 16, 968 A.2d 316.

¶ 27. Applying the presumption in this case, we must presume that the Department intended the words "location" and "situs" in the Regulation to carry different meanings. Otherwise, the parts of the Regulation referencing situs would be "mere surplusage." Id. This presumption is confirmed by the fact that "location" and "situs" have different meanings. Whereas "location" refers to a physical position, see Location, Black's Law Dictionary (11th ed. 2019), "situs" is "[t]he location or position (of something) for legal purposes," Situs, Black's Law Dictionary (11th ed. 2019). For taxation purposes specifically, "situs" is a term of art referring to where an intangible asset is constitutionally subject to taxation. See First Bank Stock Corp. v. Minnesota, 301 U.S. 234, 237-38 (1937); Wheeling Steel Corp. v. Fox, 298 U.S. 193, 209-10 (1936).

¶ 28. "[D]ue process requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." Miller Bros. Co. v. Maryland, 347 U.S. 340, 344-45 (1954). A state's authority to tax is accordingly based on the "protection, opportunities and benefits [it] confers." Allied-Signal, Inc. v. Dir., Div. of Taxation, 504 U.S. 768, 778 (1992) (quotation omitted). "The simple but controlling question is whether the state has given anything for which it can ask return." ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 315 (1982) (quotation omitted).

¶ 29. Based on these constitutional principles, tangible property is exclusively subject to tax "within the territorial jurisdiction of the taxing state," First Bank Stock Corp., 301 U.S. at 240, because the taxing state has provided "the benefit and protection of laws enabling the owner to enjoy the fruits of his ownership," Curry v. McCanless, 307 U.S. 359, 364-65 (1939) ("The power of government and its agencies to possess and to exclude others from possessing tangibles, and thus to exclude them from enjoying rights in tangibles located within its territory, affords adequate basis for an exclusive taxing jurisdiction.").

¶ 30. This rule, however, is "meaningless when applied to intangibles which, since they are without physical characteristics, can have no location in space." First Bank Stock Corp., 301 U.S. at 240; see also McCanless, 307 U.S. at 365 ("Very different considerations, both theoretical and practical, apply to the taxation of intangibles, that is, rights which are not related to physical things."). To determine where intangible property is subject to taxation, we indulge in a "metaphor," Graves, 299 U.S. at 372, and assign such property a fictionalized tax situs for the purpose

of "symbolizing . . . those considerations which are persuasive grounds for deciding that a particular place is appropriate for the imposition of [a] tax." First Bank Stock Corp., 301 U.S. at 240-41; Wheeling Steel Corp., 298 U.S. at 209 ("[B]y reason of the absence of physical characteristics [intangibles] have no situs in the physical sense, but have the situs attributable to them in legal conception.").

¶ 31. Intangibles are generally subject to tax at the owner's domicile. Graves, 299 U.S. at 371-72; see also Wheeling Steel Corp., 298 U.S. at 209 ("[W]e have held that a state may properly apply the rule mobilia sequuntur personam and treat [intangibles] as localized at the owner's domicile for purposes of taxation."). This is so because intangible rights "are but relationships between persons, natural or corporate," and the power of government over them "can be made effective only through control over and protection afforded to those persons whose relationships are the origin of the rights." McCanless, 307 U.S. at 366.

¶ 32. Despite "wide application" of the general principle that intangible property is subject to taxation at the owner's domicile, "an important exception has been recognized." Wheeling Steel Corp., 298 U.S. at 209. Intangibles acquire a business situs—"as distinguished from the legal domicil[e] of their owner," First Bank Stock Corp., 301 U.S. at 238—"when the taxpayer extends his activities with respect to his intangibles, so as to avail himself of the protection and benefit of the laws of another state, in such a way as to bring his person or property within the reach of the tax gatherer there." McCanless, 307 U.S. at 367; Graves, 299 U.S. at 371-72 (recognizing that intangibles are "taxable only at the domicile of

the owner" unless they have acquired a "business situs" elsewhere).

¶ 33. By using the terms "location" and "situs" in Regulation § 1.5833-1, the Department clearly intended to distinguish between tangible and intangible assets and incorporate the above-mentioned constitutional principles to determine where nonbusiness income is subject to taxation. The Regulation directs nonbusiness income derived from tangible assets—i.e., assets with a location—to be allocated to the state where the assets are located because, constitutionally speaking, tangible property is exclusively subject to taxation at its location "within the territorial jurisdiction of the taxing state." First Bank Stock Corp., 301 U.S. at 240. The concept of location is "meaningless," however, when considering where intangible assets are subject to taxation. Id. The Regulation accordingly introduces the concept of "situs" to determine where nonbusiness income derived from intangible assets is subject to taxation and incorporates the constitutional rule that intangibles are "taxable only at the domicile of the owner" unless they have acquired a situs elsewhere. Graves, 299 U.S. at 371-72.

¶ 34. This reading of the Regulation—that "situs" is a term of art referring to where intangible property is constitutionally subject to taxation—is the only way that, under the Regulation, nonbusiness income derived from intangible assets could ever be allocated to a state other than a business's commercial domicile, which is exactly the result that VNT advocates for. VNT argues the FCC licenses are allocated to New York, which is not the state of its commercial domicile. However, if—as VNT argues—the term situs in the Regulation is synonymous with

location, then, under the Regulation, intangible assets would always be allocated to the state of commercial domicile because intangible assets, by definition, do not have a physical location. Wheeling Steel Corp., 298 U.S. at 209. Because the FCC licenses are intangible assets, and therefore have no location, the only way they could be allocated to New York is if they have acquired a situs there. Despite arguing that the word situs in the Regulation is synonymous with location, the result VNT seeks requires that situs be interpreted as a term of art.

2. Application

¶ 35. The remaining question is whether the Commissioner erred in concluding the FCC licenses did not have a situs in New York. The Commissioner reasoned that the licenses did not have a situs in New York because VNT never used the licenses in business activity there. That the licenses granted rights to broadcast in New York was also not sufficient to establish a situs because the broadcast areas "were simply market areas drawn on the map by the FCC."

¶ 36. Citing Graves, VNT argues that an intangible asset has a situs, regardless of any actual business use, if the asset grants a right that can only be exercised in a particular place. Because the FCC licenses grant a right to broadcast in New York, VNT argues that the licenses have a situs there. Applying the deferential standard of review associated with an agency's interpretation of its own regulation, we conclude that VNT has not demonstrated that the Commissioner erred in concluding the FCC licenses did not have a New York situs.

¶ 37. It is certainly true that in Graves, the United States Supreme Court held that an intangible

asset may have a situs, regardless of any business use, if the intangible grants a right that "is fixed exclusively or dominantly" at a particular place. 299 U.S. at 372-73. This statement, however, must be placed in context. To do so, we return to some basic principles about taxation. The concept of situs is a way of "symbolizing . . . those considerations which are persuasive grounds for deciding that a particular place is appropriate for the imposition of [a] tax." First Bank Stock Corp., 301 U.S. at 240-41. A state's ultimate power to tax is based on the "protection, opportunities and benefits [it] confers." Allied-Signal, Inc., 504 U.S. at 778 (quotation omitted). "The simple but controlling question is whether the state has given anything for which it can ask return." Idaho State Tax Comm'n, 458 U.S. at 315 (quotation omitted).

¶ 38. Consistent with these principles, in Graves, the United States Supreme Court recognized that an intangible asset may acquire a situs if either (1) the intangible is used in "the actual transactions of a localized business" or (2) the intangible grants a right that is "fixed exclusively or dominantly" at a particular place. 299 U.S. at 372. In the first instance, an intangible acquires a situs because the taxpayer has "extend[ed] his activities with respect to his intangibles, so as to avail himself of the protection and benefit of the laws of another state, in such a way as to bring his person or property within the reach of the tax gatherer there." McCanless, 307 U.S. at 367.

¶ 39. In the second instance, however, the intangible has a situs regardless of whether the intangible is actually used in business. Graves, 299 U.S. at 373 (explaining that "[t]he nature of th[e intangible] right is not altered by the failure to

exercise it"). What is implied in the Court's analysis in Graves is that the intangible has been created or protected by a state's laws. The intangible at issue in that case was a membership in the New York State Stock Exchange. In determining that the membership had a situs in New York regardless of any actual business use, the Court pointed out the multiple benefits that New York law had provided, explaining that the membership embraced:

> the privilege of a member to transact business on the Exchange as well as a valuable right of property which is the subject of transfer with the approval of the Exchange and may survive resignation, expulsion or death. In both aspects the right is held and can be exercised only in subjection to the constitution, by-laws and rules of the Exchange. The Exchange is a market place. The privilege which inheres in the membership is the right to conduct transactions at that market place. That privilege of conducting the business of the buying and selling of securities on the floor of the Exchange is the dominant feature of the membership or "seat."

Id. at 372-73 (footnote omitted). Graves and basic constitutional principles of taxation indicate that intangible assets can have a situs, regardless of any business use, if the right associated with the intangible is fixed in a particular place and that place's laws have provided protection and benefits. Again, "[t]he simple but controlling question is whether the state has given anything for which it can ask return." Idaho State Tax Comm'n, 458 U.S. at 315.

¶ 40. Considering all of these principles, the Commissioner determined that the FCC licenses did not have a situs in New York by virtue of granting rights to broadcast there. Throughout his decision, the Commissioner explained that the FCC licenses granted rights that were created and protected by the FCC, not New York. Because the rights were created by the FCC, the Commissioner concluded that New York did not protect or benefit VNT's passive investment and, therefore, the licenses did not acquire a situs there. Given the deferential standard of review and the Commissioner's thorough reasoning as to why the FCC licenses did not have a situs in New York, VNT has failed to demonstrate any "compelling indications of error." In re Conservation Law Found., 2018 VT 42, ¶ 16 (quotation omitted).

B. Commercial Domicile

¶ 41. Because the FCC licenses have neither a location nor a situs, the capital gain from the sale of the licenses is allocated to VNT's commercial domicile. Regulation § 1.5833-1(e). The Commissioner concluded that the "true test" for commercial domicile is "to consider all the facts, to determine where the actual conduct of business operations occurs, and which state gives the greatest protection and benefits to the corporation." (Quotations omitted.) Applying this test, the Commissioner concluded, based on extensive factual findings, that VNT's commercial domicile in 2012 and 2013 was in Vermont:

> Vermont was the location of the principal office, the place where high-level policy was implemented, where the conduct of day-to-day operations occurred, where the greatest

> number of office staff and business employees worked, and where the business records were kept, and was the state that gave the greatest protection and benefits . . . .

¶ 42. VNT does not challenge any of the Commissioner's factual findings on appeal. Instead, VNT argues that the Commissioner improperly gave "equal weight" to "nonessential factors" in concluding that its commercial domicile was in Vermont. Citing the United States Supreme Court's decision in Wheeling Steel Corp. v Fox., 298 U.S. 193 (1936), VNT argues that the most important factor is "the center of authority and control." Applying this test, VNT argues its commercial domicile is in Connecticut because that is where its president makes "high-level strategic decisions" and the board of directors meets.

¶ 43. As described above, supra, ¶ 23, "[w]e employ a deferential standard of review of an agency's interpretation of its own regulations." Grenier, 2014 VT 121, ¶ 20. We begin with some basic background principles on the concept of commercial domicile, which arose to address where intangible property owned by corporations should be taxed. Intangible property is generally subject to tax at the owner's domicile. Graves, 299 U.S. at 371-72. Because "a corporation is deemed for most purposes to be domiciled in the state of its incorporation, intangibles are usually taxable in that state." S. Pac. Co. v. McColgan, 156 P.2d 81, 93 (Cal. Dist. Ct. App. 1945). The rationale for this rule is that corporations generally carry on their business "in the state of incorporation and generally [have their] principal place of business there." Id. As such, "the corporation benefit[s] from the functions of government in respect

to its activities generally, and in relation to its intangibles, more in that state than in any other." Id.

¶ 44. This rule, however, is based on a fiction, and in some circumstances, "[l]egal fiction should be made to yield to reality." Cargill, Inc. v. Spaeth, 10 N.W.2d 728, 733 (Minn. 1943). When a corporation "does not operate at its legal domicile," but "maintains in another state its principal business office, from which its management functions," the corporation is said to acquire a commercial domicile. Kevin Assocs., L.L.C. v. Crawford, 2003-0211, p. 9 (La. 1/30/04), 865 So. 2d 34, 40; see also Anniston Sportswear Corp. v. State, 151 So. 2d 778, 782 (Ala. 1963) ("[W]hen [a corporation] does not operate at its legal domicile and maintains in another state its principal business office . . . the latter place is considered as its 'commercial domicile.' "); Cargill, Inc., 10 N.W.2d at 733 ("A corporation may make its actual, as distinguished from its technically legal, home in a state other than that of its incorporation."). A corporation is subject to taxation at its commercial domicile because it is there that it receives the benefits provided by the government and may therefore "be required to pay its fair and just share of the cost of such benefits." Anniston Sportswear Corp., 151 So. 2d at 782.

¶ 45. With these background principles in mind, we turn to the question at issue here. What VNT disputes is the relevant test for determining where a corporation acquires a commercial domicile. It asserts that the dispositive factor is the location of high-level decision making and the Commissioner improperly weighed other less important factors. Under Regulation § 1.5833-1(e), commercial domicile is defined as "the principle [sic] place from which the

business is directed or managed." The term commercial domicile was first defined in Wheeling Steel Corp. v. Fox. See Sinclair Pipe Line Co. v. State Comm'n of Revenue & Taxation, 339 P.2d 341, 344 (Kan. 1959) ("The matter of a commercial domicile of a corporation and the power to tax has been considered by the Supreme Court of the United States in several cases." (citing Wheeling Steel Corp., 298 U.S. 193)); N. Baton Rouge Dev. Co. v. Collector of Revenue, 304 So. 2d 293, 297 (La. 1974) (explaining that commercial domicile "is generally understood as defined in Wheeling Steel Corp. v. Fox"); Assoc'd P'ship I, Inc. v. Huddleston, 889 S.W.2d 190, 198 (Tenn. 1994) ("The term, 'commercial domicile,' originated in the U.S. Supreme Court decision, Wheeling Steel Corp. v. Fox.").

¶ 46. In Wheeling Steel Corp., the United States Supreme Court held that a Delaware corporation had a commercial domicile in West Virginia. 298 U.S. at 211-12. The Court explained that the corporation maintained "its general business offices" in West Virginia, which was where the corporation kept "its books and accounting records," directors held their meetings, and officers conducted "the affairs of the corporation." Id. at 211. The general business office was the corporation's "center of authority" that made it "the actual seat of its corporate government." Id. at 212.

¶ 47. In interpreting Wheeling Steel Corp., courts have emphasized that the principal inquiry for commercial domicile is to consider where the business is managed and directed. Memphis Nat. Gas Co. v. Beeler, 315 U.S. 649, 652 (1942) (holding that corporation had commercial domicile in Tennessee because "[i]t manage[d] its business from its office"

there); S. Nat. Gas Corp. v. Alabama, 301 U.S. 148, 153-54 (1937) (concluding that corporation's commercial domicile was in Alabama because the " 'entire management' was conducted from its principal office at the place"); Anniston Sportswear Corp., 151 So. 2d at 782(explaining that commercial domicile is at company's "principal business office, from which its management functions"); N. Baton Rouge Dev. Co., 304 So. 2d at 297 ("[T]he 'commercial domicile' exists where the principal place of business is located and from which the corporation's activities function and are managed." (quotation omitted)); Assoc'd P'ship I, Inc., 889 S.W.2d at 198 ("[T]he commercial domicile of a corporation is the place from which the business is managed or directed . . . .").

¶ 48. To determine where a business is managed or directed, courts consider a variety of factors, including, but not limited to, where employees and officers work, where orders are received and fulfilled, where the books and bank accounts are located, and, of course, where the board of directors meets. Memphis Nat. Gas Co., 315 U.S. at 652 (explaining that company managed business in Tennessee because that is "where it ke[pt] its accounts, provide[d] for the payroll of employees on its line in Tennessee and other states, and prepare[d] and sen[t] out bills for gas delivered in Tennessee and other states"); S. Nat. Gas Corp., 301 U.S. at 154 (explaining that management was conducted in Alabama because that is where company received and fulfilled orders); Assoc'd P'ship I, Inc., 889 S.W.2d at 198 (considering where officers and employees worked, management meetings were held, books kept, and bank accounts located).

¶ 49. Where the board of directors meets is certainly a relevant factor in considering commercial domicile, but it is neither determinative nor does it carry more weight than any other factor. Crawford, 865 So. 2d at 42 (explaining that location of board meetings "alone is not determinative of commercial domicile"). In fact, the notion that the location of the board of directors meetings is the most important factor runs counter to the basic concept of commercial domicile, which is to look beyond the "fiction" that a corporation is domiciled in its state of incorporation and instead require it "to pay its fair and just share of the costs of . . . benefits" provided in the state where it actually operates. Anniston Sportswear Corp., 151 So. 2d at 782; see also S. Pac. Co., 156 P.2d at 99 ("[T]he contention that, as a matter of law the only state that can possibly be held to be its commercial domicile is that state where its board of directors meets, is as unrealistic, unsound, and artificial as the concept that the corporation for all tax purposes is domiciled in the state of incorporation.").

¶ 50. Considering the definition of commercial domicile, and the various precedents interpreting this term, the Commissioner did not err in concluding that VNT's commercial domicile was in Vermont. Consistent with this precedent, the Commissioner considered numerous factors to determine that VNT's commercial domicile was in Vermont because that is where it conducted business operations and received the most benefits. Specifically, the Commissioner found that VNT's day-to-day business was conducted out of its Springfield, Vermont office because at that office, the Chief Financial Officer, among other things, filed all of VNT's 2012 and 2013 Vermont non-income tax returns, paid sales tax, and paid payroll

withholding tax. Most of the business records for the years 2012, 2013, and 2014—including sales records, financial statements, withholding-tax filings, W-2s and W-3s, and supporting work papers—were kept in the Springfield office. In 2012 and 2013, a majority of VNT's employees, fifty-seven out of fifty-nine, were subject to Vermont withholding tax, which meant that VNT had over fifty "employees in each year who were either resid[ing] in Vermont or working in Vermont." The Commissioner also noted that in its 2013 Connecticut corporate return, VNT affirmatively stated, under the penalty of perjury, that its principal place of business was in Vermont. By contrast, the Commissioner found that during those same years, VNT had no property in Connecticut, had no employees there, and did not store any business records there. Furthermore, the Commissioner found that the record was unclear as to "how many board meetings were held in Connecticut in 2012 and 2013." VNT does not challenge any of these findings.

III. Penalty

¶ 51. The Department assessed an automatic penalty of $445,222 because VNT failed to report the gain from the 2013 sale of the FCC licenses and failed to pay taxes on a portion of its president and CEO's wages. VNT argues the automatic penalty violated due process because 32 V.S.A. § 3202(b) requires the Commissioner to exercise discretion on a case-by-case basis in determining whether to impose a penalty. Alternatively, VNT argues that the penalty is constitutionally excessive.

A. Section 3202(b)

¶ 52. Pursuant to § 3202(b)(3) and Department policy, the Commissioner imposed an automatic penalty of $445,222. The Commissioner declined to abate the penalty, explaining that although use of the word "may" in § 3202(b)(3) gives the Commissioner discretion to withhold the penalty on a case-by-case basis, "there were no circumstances here which warranted withholding the penalty."

¶ 53. On appeal, VNT argues the automatic penalty violated due process because in determining whether to assess a penalty, § 3202(b)(3) requires the Commissioner to exercise discretion on an individualized, case-by-case basis. By automatically imposing a penalty, VNT contends the Commissioner failed to exercise discretion as required by the statute. VNT contends that had the Department conducted an individualized review, the Department would not have penalized VNT because it adopted a reasonable construction of Regulation § 1.5833-1 in good faith based on the advice of accountants.

¶ 54. As a threshold matter, VNT's due-process argument is not preserved because it was not raised before the Commissioner. "We have repeatedly stressed that we will not address arguments not properly preserved for appeal." In re White, 172 Vt. 335, 343, 779 A.2d 1264, 1270 (2001). "[T]o properly preserve an issue, a party must present the issue to the administrative agency with specificity and clarity in a manner which gives the agency a fair opportunity to rule on it." Pratt v. Pallito, 2017 VT 22, ¶ 16, 204 Vt. 313, 167 A.3d 320 (quotation and alteration omitted). VNT argued before the Commissioner that the automatic penalty violated § 3202(b)(3). We

accordingly only address VNT's assertion that the automatic penalty violated § 3202(b)(3) because the Commissioner failed to exercise discretion.

¶ 55. Moving to the merits, § 3202(b)(3) provides that the Commissioner "may" assess a penalty for a taxpayer's failure to pay a tax liability imposed by Title 32. The word "may" provides the Commissioner with discretion as to whether to assess a penalty. See Vt. Agency of Nat. Res. v. Duranleau Constr., Inc., 159 Vt. 233, 238, 617 A.2d 143, 146 (1992) (explaining that word "may" gave agency discretion). Because the decision to assess a penalty is a discretionary one, we review for an abuse of discretion. Hall v. Dep't of Soc. Welfare, 153 Vt. 479, 484, 572 A.2d 1342, 1345 (1990) ("This Court will not interfere with the performance of a discretionary duty in the absence of a showing of an abuse of discretion . . . ."). An agency's failure to exercise discretion is an abuse of discretion. Burbo v. Dep't of Soc. Welfare, 157 Vt. 664, 665, 599 A.2d 1045, 1046 (1991) (mem.) (holding that an agency's "refusal to exercise the discretion that its own regulation allow[ed was] an abuse of discretion").

¶ 56. We decided this exact issue in Piche v. Department of Taxes, 152 Vt. 229, 565 A.2d 1283 (1989). In that case, the Commissioner assessed an automatic penalty for a late tax return based on discretionary authority to assess penalties for late filing. Id. at 233, 565 A.2d at 1286. The trial court ruled that the automatic penalty was invalid because the Commissioner "violated his duty . . . to exercise discretion when imposing penalties for delinquent payment." Id. We reversed, explaining,

> The fact that the penalty was imposed automatically by the Department of Taxes

> when the delinquency was discovered does not negate the exercise of discretion on the part of the Commissioner, particularly when any penalty assessed is subject to individual review upon appeal to the Commissioner. It merely represents the full extent to which the Commissioner has chosen to exercise his discretionary authority as granted under the statute.

Id. at 234, 565 A.2d at 1286 (citation omitted).

¶ 57. Citing several other decisions from this Court, VNT argues that Piche was wrongly decided because, as a categorical rule, the exercise of discretion requires individualized consideration. This argument is incorrect. An agency's discretion is not always limited to individualized consideration. "The enabling legislation of virtually every administrative agency must include a certain degree of discretion given to the administrative agency . . . ." Vincent v. Vt. State Ret. Bd., 148 Vt. 531, 535, 536 A.2d 925, 928 (1987). "To determine the scope of authority vested in an administrative agency by a statutory grant of power, we look to its enabling legislation." In re Mountain Top Inn & Resort, 2020 VT 57, ¶ 37, ___ Vt. ___, ___ A. 3d, ___ (quotation omitted).

¶ 58. The scope of an agency's discretionary authority varies depending on the enabling legislation. For example, the Legislature has given the Natural Resource Board the discretionary authority to promulgate regulations of general applicability. See, e.g., 10 V.S.A. § 6025(b) (providing Natural Resource Board with authority to "adopt substantive rules . . . that interpret and carry out the provisions of [Act 250]"). On the other hand, as VNT

observes, in other situations we have held that agencies could not adopt rules of general applicability because the relevant enabling statute required an agency to exercise discretion on a case-by-case basis. For example, in Martin v. State, Agency of Transportation Department of Motor Vehicles, we held that the Department of Motor Vehicles could not adopt a regulation categorically excluding certain vanity license plates because the governing statute only gave the Department discretion to refuse requests for vanity plates on a case-by-case basis. 2003 VT 14, ¶¶ 2-3, 17-20, 175 Vt. 80, 819 A.2d 742.

¶ 59. Here, unlike the statute in Martin, nothing in § 3202(b)(3) indicates that the Commissioner is required to determine whether to assess a penalty on a case-by-case basis. Section 3202 provides the Commissioner with broad discretionary authority to assess penalties for the failure to pay taxes, the negligent failure to pay taxes, and the fraudulent failure to pay taxes. There is nothing that suggests the Commissioner must take individual circumstances into account beyond those general statutory criteria. As we explained in Piche, automatic penalties "merely represent[] the full extent to which the Commissioner has chosen to exercise his discretionary authority as granted under the statute." 152 Vt. at 234, 565 A.2d at 1286.

¶ 60. Furthermore, to the extent VNT argues that § 3202(b)(3) requires the Commissioner to consider penalties on a case-by-case basis, the appeal to the Commissioner as provided in § 5885 creates such individual review because, as we explained in Piche, "any penalty assessed is subject to individual review upon appeal to the Commissioner." 152 Vt. at 234, 565 A.2d at 1286. The record shows that the

Commissioner specifically considered VNT's arguments and circumstances and did not abuse his discretion in determining that the automatic penalty was appropriate.

¶ 61. Before the Commissioner, VNT argued that given the complexity of the legal issues, it acted reasonably and in good faith by relying on the advice of its accountants and allocating the gain to New York. The Commissioner rejected this argument, reasoning that because § 3202(b) authorizes penalties for failure to pay, the negligent failure to pay, and the fraudulent failure to pay, the Legislature intended to penalize the failure to pay regardless of the taxpayer's fault or good faith. It is true that an abuse of discretion occurs when a decision is based on an incorrect interpretation of the law. Bratton v. Holland, 2018 VT 54, ¶ 17, 207 Vt. 517, 192 A.3d 1257. In this case, however, the Commissioner reasonably interpreted § 3202(b)(3). See Shires Hous., Inc. v. Brown, 2017 VT 60, ¶ 9, 205 Vt. 186, 172 A.3d 1215 ("Absent compelling indications of an error, interpretation of a statute by an administrative body responsible for its execution will be sustained on appeal, unless it is unjust or unreasonable." (quotation omitted)). In addition, the Commissioner determined that the penalty was appropriate because one of the purposes of penalties is to encourage taxpayers to seek formal guidance from the Department rather than take questionable positions.

B. Constitutionally Excessive

¶ 62. The United States Constitution prohibits excessive fines. U.S. Const. amend. VIII. The Vermont Constitution provides that "all fines shall be proportioned to the offenses." Vt. Const. ch. II, § 39.

Citing United States v. Bajakajian, 524 U.S. 321 (1998), VNT argues the $445,222 penalty is an excessive fine. The Department argues, however, that VNT failed to preserve this argument because it did not raise it before the Commissioner. We address VNT's Eighth Amendment claim on the merits even though VNT failed to raise it before the Commissioner. We conclude, however, that the penalty is not excessive.

1. Preservation

¶ 63. The Department argues that VNT failed to preserve its constitutional claim because it did not raise it before the Commissioner. VNT argues in response that the claim is preserved because there is "no daylight" between arguing that the penalty was arbitrary in violation of § 3202(b)(3) and arguing that the penalty is constitutionally excessive. Alternatively, VNT submits its constitutional claim falls within an exception to the preservation rule because the Department did not raise its preservation argument before the trial court, and the trial court addressed the claim on the merits. For the reasons articulated below, we will address VNT's Eighth Amendment claim.

¶ 64. "We have repeatedly stressed that we will not address arguments not properly preserved for appeal." White, 172 Vt. at 343, 779 A.2d at 1270. "[T]o properly preserve an issue, a party must present the issue to the administrative agency with specificity and clarity in a manner which gives the agency a fair opportunity to rule on it." Pratt, 2017 VT 22, ¶ 16 (quotation and alteration omitted); In re Morrisville Hydroelectric Project Water Quality, 2019 VT 84, ¶ 17, ___ Vt. ___, 224 A.3d 473 ("To preserve an

argument for appeal, a party must present an argument with specificity and clarity." (quotation omitted)). Even constitutional claims are subject to the preservation rule. Clark v. Menard, 2018 VT 68, ¶ 6, 208 Vt. 11, 194 A.3d 752 (holding that petitioner failed to preserve constitutional argument because it was not raised with specificity below).

¶ 65. VNT did not preserve its constitutional argument. Contrary to VNT's assertion, there is a significant difference between a statutory claim and a constitutional one. VNT advanced a purely statutory claim below, arguing that the penalty violated § 3202(b)(3). The Commissioner accordingly decided only whether the penalty imposed was consistent with the statute. Whether the penalty is constitutionally excessive is a completely different argument that had to be preserved. See Martin, 2003 VT 14, ¶ 11 (holding that constitutional argument was not preserved because appellant's argument throughout litigation was that regulation violated statute).

¶ 66. Nevertheless, in our discretion, we will address VNT's argument that the penalty violated the Eighth Amendment because the "goals of our preservation rules are satisfied" with respect to that claim. In re LaBerge NOV, 2016 VT 99, ¶ 16, 203 Vt. 98, 152 A.3d 1165; see also State v. Nash, 2019 VT 73, ¶ 15, ___ Vt. ___, 221 A.3d 386 (noting that Court has discretion to consider unpreserved issues). "The purpose of our preservation rule is to ensure that the original forum is given an opportunity to rule on an issue prior to our review." Vt. Built, Inc. v. Krolick, 2008 VT 131, ¶ 10, 185 Vt. 139, 969 A.2d 80 (quotation omitted). Preservation also "facilitates the development of a record for appeal." State v. Wool,

162 Vt. 342, 346, 648 A.2d 655, 658 (1994). Although VNT did not raise its constitutional claim before the Commissioner, it raised it with sufficient clarity to allow the trial court to address it. Both parties have briefed the Eighth Amendment claim on appeal. The goals of our preservation rule have therefore been met with respect to the Eighth Amendment claim, and we will address it.

¶ 67. The same cannot be said with respect to VNT's claim under the Vermont Constitution. On appeal, VNT makes a brief reference to the Vermont Constitution's Excessive Fines Clause. The trial court, however, decided only that the penalty did not violate the Eighth Amendment. Furthermore, "[m]erely citing the Vermont Constitution, without providing any analysis of how the state constitutional provision compares with its federal analog, does not adequately present the issue for our review." State v. Brillon, 2010 VT 25, ¶ 6, 187 Vt. 444, 995 A.2d 557.

2. Merits

¶ 68. The trial court concluded that the penalty did not violate the Eighth Amendment because the penalty was "a small percentage of the outstanding liability." The court also explained that civil tax penalties have repeatedly been held not to violate the Eighth Amendment's Excessive Fines Clause, and VNT cited no case in which a similar penalty was held to be constitutionally excessive. VNT argues the $445,222 penalty is constitutionally excessive because in Bajakajian, 524 U.S. at 337, the United States Supreme Court held that a $357,144 fine was excessive. The Department argues, on the other hand, that the penalty is proportionate to the underpayment, which was substantial.

¶ 69. The Eighth Amendment to the United States Constitution prohibits "excessive fines." U.S. Const. amend. VIII. In Timbs v. Indiana, the United States Supreme Court held that the Eighth Amendment's Excessive Fines Clause was applicable to the states through the Fourteenth Amendment's Due Process Clause. 139 S. Ct. 682, 689 (2019). "The Excessive Fines Clause . . . limits the government's power to extract payments, whether in cash or in kind, as punishment for some offense." Bajakajian, 524 U.S. at 328 (quotation omitted). A fine "violates the Excessive Fines Clause only if it is (1) punitive, and (2) grossly disproportional to the gravity of the defendant's offense." United States v. Jalaram, Inc., 599 F.3d 347, 351 (4th Cir. 2010).

a. Punitive

¶ 70. A fine falls within the coverage of the Eighth Amendment's Excessive Fines Clause if it "constitute[s] punishment." Bajakajian, 524 U.S. at 328. Just because a fine serves both remedial and punitive purposes does not mean it is exempt from the Eighth Amendment's protections. Austin v. United States, 509 U.S. 602, 610 (1993). Rather, the inquiry is whether the fine "can only be explained as serving in part to punish." Id.

¶ 71. In this case, the Department's penalty undoubtedly constitutes punishment. As we explained in TD Banknorth, N.A. v. Department of Taxes, § 3202 enables "the Commissioner to penalize taxpayers when they have not properly discharged their tax burden" by assessing a penalty based on the outstanding tax liability. 2008 VT 120, ¶ 37, 185 Vt. 45, 967 A.2d 1148 (emphasis added). As such, a penalty assessed pursuant to § 3202 "does not serve

the remedial purpose of compensating the Government for a loss." Bajakajian, 524 U.S. at 329. While § 3203 allows the Commissioner to recover any underpaid taxes, § 3202 allows the Commissioner to assess a penalty in addition to the outstanding tax liability. The purpose of § 3202 is to penalize taxpayers and, in doing so, allows the state to recover an amount in excess of the outstanding tax liability.

b. Excessive

¶ 72. "The touchstone of the constitutional inquiry under the Excessive Fines Clause is the principle of proportionality: The amount of the forfeiture must bear some relationship to the gravity of the offense that it is designed to punish." Bajakajian, 524 U.S. at 334. A penalty accordingly violates the Excessive Fines Clause if it is grossly disproportionate. Id. at 336 (adopting the "standard of gross disproportionality articulated in . . . Cruel and Unusual Punishments Clause precedents"). Because "the relevant constitutional line is inherently imprecise," each case requires "an independent examination." Cooper Indus., Inc. v. Leatherman Tool Grp., Inc., 532 U.S. 424, 434-35 (2001). Some of the relevant factors to consider include the degree of culpability, the relationship between the penalty and the harm, and "the sanctions imposed in other cases for comparable misconduct." Id. at 435.

¶ 73. As an initial matter, "judgments about the appropriate punishment . . . belong in the first instance to the legislature." Bajakajian, 524 U.S. at 336. There is accordingly "a strong presumption that the amount of a fine is not unconstitutionally excessive if it lies within the range of fines prescribed by the legislature." Moustakis v. City of Fort

Lauderdale, 338 F. App'x 820, 821 (11th Cir. 2009) (quotation omitted). In this case, the penalty the Commissioner assessed fell within the statutory range prescribed by the Vermont Legislature. Section 3202(b)(3) provides that if a "taxpayer fails to pay a tax liability imposed by . . . [T]itle [32]," the Commissioner may assess a penalty of "five percent[] of the outstanding tax liability for each month, or portion thereof, that the tax liability is not paid in full; provided, however, that in no event shall the amount of any penalty assessed . . . exceed 25 percent of the tax liability unpaid." But see 32 V.S.A. § 3202(b)(3) (providing that for income tax, the Commissioner can only assess penalty equal to one percent of the outstanding tax liability). Pursuant to § 3202(b)(3), the Commissioner assessed a penalty of $445,222.52, which was approximately twenty-three percent of the outstanding tax liability. Because the penalty assessed fell with the statutory range, a strong presumption exists that the penalty is not constitutionally excessive.

¶ 74. The relevant factors outlined in Cooper Industries, Inc., confirm that the penalty imposed here is not unconstitutionally excessive. With regard to culpability, VNT argues its conduct was not culpable because VNT relied on the advice of its accounting firm, and it was never alleged they willfully or negligently underpaid. Although VNT may have relied upon the advice of its accounting firm, the memorandum VNT received from its accounting firm was just that—advice. The memorandum expressly cautioned that "[a]ny tax advice contained in this correspondence or attachments is based on upon our understanding of relevant facts and the tax law and governmental

rulings that were in effect at the time the advice was given" and could not be used "for the purpose of avoiding penalties that may be imposed on the taxpayer by the Internal Revenue Service." Despite receiving this cautionary advice, VNT did not seek a formal ruling from the Department. See Organization and Rules of Procedure Rule 7(b), Code of Vt. Rules 10 060 028, http://www.lexisnexis.com/hottopics/codeofvtrules ("Upon request of a taxpayer, the Department will issue a declaratory ruling to as to the applicability of any statutory provision or of any rule or practice of the Department."). Although VNT may not have willfully or intentionally underpaid, by relying on the advice of its accountants and not seeking a formal ruling, it—as the Commissioner explained—"assumed the risk" of receiving a penalty.

¶ 75. With regard to "the sanctions imposed in other cases for comparable misconduct," Cooper Indus., Inc., 532 U.S. at 435, VNT argues the $445,222 penalty is constitutionally excessive because in Bajakajian, 524 U.S. at 337, the United States Supreme Court held that a $357,144 fine was excessive. In Bajakajian, the defendant was found guilty of failing to report, as required by federal law, that he was transporting $357,144 in cash, and the trial court determined the entire amount was subject to forfeiture. Id. at 324-25. The United States Supreme Court held that the forfeiture was an excessive fine because the crime "was solely a reporting offense," and the forfeiture order was "many orders of magnitude" larger than the maximum $5000 fine for the offense under the sentencing guidelines. Id. at 337-38, 340. The Court also noted that the harm to the government was minimal because "[h]ad his crime gone undetected, the Government would

have been deprived only of the information that $357,144 had left the country." Id. at 339.

¶ 76. Nothing about Bajakajian indicates that the Commissioner's twenty-three percent penalty in this case was excessive. Unlike Bajakajian, the $445,222 penalty the Commissioner assessed was not "many orders of magnitude" larger than the unpaid tax liability. Furthermore, in contrast to Bajakajian, the present case involved significantly more harm to the government because VNT initially failed to pay a tax liability of $1,947,437. Based on the foregoing, we conclude the penalty is not constitutionally excessive.

Affirmed.

FOR THE COURT:

____

Associate Justice

STATE OF VERMONT
COMMISSIONER OF TAXES

IN RE: Vermont National Telephone Company, Inc.
Corporate Income Tax
ATC #16-10

DETERMINATION

Introduction

A hearing was held January 30, 2018, on the appeal of Vermont National Telephone Company, Inc., from the Department's assessment of corporate income tax. Attorneys Roger Prescott and Timothy Doherty represented the taxpayer. Dr. Michel Guite, President and CEO of the taxpayer and its subsidiaries, and Dr. Kostas Liopiros testified as witnesses for the taxpayer. Also attending the hearing were Ms. Frances Stocker, Vice President of Finance, Treasurer and CFO of the taxpayer; Mr. Michel Caouette, CPA for the taxpayer; and Attorney Henry Bubel, an attorney for the taxpayer.

Assistant Attorney General Margaret Burke represented the Department. Department Tax Field Auditor Alicia Carusona testified as a witness for the Department.

The record was completed on March 20, 2018.

Findings of Fact

General

1. The parties agreed to a Stipulation of Facts ("Stip.") and to Exhibits ("Ex.") A through YY, but reserved the right to argue the relevance or materiality of any stipulated fact or document. At the hearing, Vermont National Telephone Company, Inc., offered additional Exhibits ZZ, AAA through MMM,

and PPP. Prior to the hearing, Taxpayer submitted written "Pre-Filed Testimony of Dr. Michel Guite," dated January 16, 2018 ("PF"). Because of a technical problem with the recording equipment near the end of the hearing, the transcript of the hearing ("Tr.") is supplemented with the parties' agreed "Supplemental Written Testimony of Dr. Kostas Liopiros and Dr. Michel Guite," dated February 9, 2018 ("SW").

2. The two issues on appeal are whether a 2013 corporate capital gain on sales of intangible licenses is taxable by Vermont and whether Dr. Guite's 2012 and 2013 compensation for time working in his Connecticut home office are includible in the Vermont payroll factor for purposes of unitary corporate income tax apportionment for the audit years. The assessment for 2012 related only to the compensation issue, and was for base tax of $10,880, plus interest, and penalty of $326.40. Stip. 34, Ex. D. The assessment for 2013 includes both the compensation issue and the capital gain issue and was for base tax of $1,947,437, plus interest, and penalty of $445,222.52. Stip. 44, Ex. MM, NN.

Vermont National Telephone Company Inc., and its subsidiaries

3. Dr. Michel Guite is currently, and was in 2012 and 2013, President and CEO of the taxpayer corporation, Vermont National Telephone Company, Inc. ("VNAT"), and all its subsidiaries. PF pp. 2-3; Stip. 4.

4. In 2012 and 2013, VNAT wholly owned three subsidiaries, Vermont Telephone Company, Inc. ("Vtel"), Vtel Wireless, Inc. ("Wireless"), and Four Winds Farm, Inc. ("FWF"). VNAT, Vtel and Wireless were incorporated in Delaware and FWF was

incorporated in Vermont. All four corporations are headquartered at 354 River Street in Springfield, Vermont. Stip. 2.

5. In 2013, VNAT wholly owned an additional subsidiary, VTel Data Networks, Inc. ("DATA"). DATA is a Delaware corporation, also headquartered at 354 River Street in Springfield, Vermont. Stip. 3.

6. VNAT is a holding company that Dr. Guite envisions as "a vehicle for exploring" investment opportunities, VNAT has investigated several investment opportunities, and did invest in "a start-up in Israel, and in a venture fund based in Westport, Connecticut." PF pp. 6, 7.

7. In 2012 and 2013, Ms. Frances Stocker was Chief Financial Officer, Vice President of Finance, and Treasurer for VNAT and had check signing authority for VNAT, Vtel, Wireless and DATA. Stip. 5, Tr. p. 7. Ms. Stocker works in the office at 354 River Street, Springfield, Vermont. Tr. p. 19.

8 Taxpayer's counsel introduced Vtel and Wireless as 'principally in the business of providing telecommunication services, either cellular services or land-line service to paying customers. Nearly all their customer base, their subscribers, are here in Vermont . . . [with] 50, or so, employees." Tr. p. 10. A company Website states "Wireless . . . is building a network across Vermont" and "Vtel proudly serves 17,000 Vermont homes and businesses, offering landline telephone . . . internet, and . . . television over a recently upgraded optical fiber network" and "We're Vermonters serving Vermonters." Ex. QQ.

9. Dr. Guite testified that Vtel initially purchased 17,500 telephone lines in Southern Vermont in the mid-1990s and currently "remains, a

telecommunications business." PF p. 3. When it purchased those lines from GTE, Vtel also took over the lease for the office at 354 River Street, Springfield, Vermont ("the Springfield office"), and "have used that location since." PF p. 4. Vtel provides telecommunications service to customers in Vermont and a small number of customers in New Hampshire, New York and Canada. Id.

10. Wireless began testing services in 2013 and started billing customers in 2014. PF p. 5. It provides cellular or wireless telecommunications services to customers in Vermont and a small number of customers in New Hampshire and New York. Id. Wireless describes itself as a "Springfield, Vermont-based wireless communications company" serving "rural villages across Vermont." Ex. QQ.

11. VNAT's 2012 and 2013 corporate annual reports, filed with the Vermont Secretary of State in 2013 and 2014, report VNAT's principal office address as the Greenwich, Connecticut, home office of Dr. Guite (*see* Finding of Fact 38, below), and VNAT's mailing address as the Springfield office. Ex. A, A2. The 2012 report shows the Greenwich address for all directors and officers, except shows the Springfield office address for Ms. Stocker; the 2013 report shows the Greenwich address for all, except shows the Springfield office address for Ms. Stocker and Diane and Sophie Guite. Id.

12. Vtel's and Wireless' 2012 and 2013 corporate annual reports, filed with the Vermont Secretary of State in 2013 and 2014, show the principal office and mailing address as the Springfield office, and show the Springfield office address for all directors and officers. Ex. C2, C3, E2, E3.

13. The VNAT and Wireless Vermont corporate annual reports for 2012 and 2013 show Dawn Tucker as the accountant for VNAT and Wireless.

FCC licenses: acquisition and sale

14. In 2003, Vtel purchased, through the Federal Communications Commission ("FCC") Auction 49, two FCC licenses ("the Licenses") for broadcast in the Lower 700 MHz electromagnetic spectrum. License WPZW674 was a license for a geographic area designated by the FCC to include Albany, Troy, Schenectady, Amsterdam and Saratoga Springs in New York, State, purchased for $934,150. License WPZW676 was a license for a geographic area designated by the FCC to include Glens Falls, Whitehall and Fort Ann in New York State, purchased for $55,250. Stip. 24, 26, 27.

15. Dr. Guite testified that the two FCC Licenses were acquired "solely for investment purposes" and were not "in any way essential to the core business activity engaged in by VNAT, Vtel or Wireless in 2003." PF p. 13.

16. In 2010, Vtel transferred the Albany License to VNAT, and in 2011 transferred the Glens Falls License to Wireless "through VNAT." Stip. 28, 29.

17. The business sought and was granted FCC authorization to "carve out" a smaller, separate license from the Glens Falls License, to cover telecommunications service by Wireless to approximately 1700 customers in the Hebron, New York area. SW, p. 4.

18. In 2013, VNAT sold the Albany License for $21,302,341, and Wireless sold the non-Hebron Glens Falls License for $3,047,659, to AT&T Mobility Spectrum LLC ("AT&T"). Stip. 30.

19. All communications to and from the FCC in evidence show the business address for VNAT, Vtel, and Wireless, and the address for Dr. Guite as Chairman and President, as the Springfield office. Ex. UU, VV, WW, YY, PPP.

20. Dr. Guite testified that after the 2013 sales to AT&T, his company operated under the retained Hebron portion of the FCC License to provide services to the Hebron area. When asked if his company has a tower that reaches into Hebron, he responded, "Yes, I am not sure whether . that tower is in New York or Vermont." SW p. 5.

2015 Department audit

21. In 2015, the Department began an audit of VNAT and its subsidiaries for the period January 1, 2012 through December 31, 2014, including corporate income tax for tax years 2012, 2013, and 2014. Stip. 6, Ex. H. The Department letter scheduling the audit date and time was sent to the taxpayer at the Springfield office. Ex. H.

22. The Department's Field Auditor conducted a "full audit," and reviewed sales tax, telephone tax, corporate income tax, and other tax records. Tr. p. 20. She conducted the audit at the Springfield office. Tr. p. 19. There, she performed "on-site review of invoices of purchases of either fixed assets or expenses," as well as sales records, financial statements, withholding tax filings, W2s and W3s, filed tax returns, and supporting work papers. Tr. p. 20, 29. Ms. Stocker, in the Springfield office, was the Auditor's primary contact for the audit. Tr. p. 19. Ms. Stocker was shown as the main contact and as the primary signatory on the returns that the Auditor reviewed. Id. Taxpayer's CPA, Michel Caouette of

Berry Dunn McNeil & Parker, LLC, in Portland, Maine, prepared all of the Federal and state corporate income tax returns for 2012 and 2013, and provided the Auditor with records for "the corporate side of the audit." Tr. p. 19, Stip. 9, Ex. L, 12.

Corporate tax returns filed in 2012 and 2013

23. All of the Federal and state corporate income tax returns in evidence, including for tax years 2012 and 2013, reported all corporations' mailing address as the Springfield office address. Ex. K - Q2.

24. Vermont Corporate Estimated Tax Payment Vouchers for VNAT are included in Exhibit G. Payment for these quarterly Vouchers are paid by 2012 and 2013 checks printed with the account name of "Vermont Telephone Company, Inc.," that is, Vtel. The checks are drawn on the People's United Bank and People's United Bank of Burlington, Vermont, and are signed by Frances Stocker. Ex. G.

25. For tax years 2012 and 2013, VNAT and its subsidiaries filed as a consolidated group for Federal corporate income tax, and as a unitary combined group for Vermont corporate income tax. Stip. 10.

26. The group reported on its 2013 Federal corporate income tax return a capital gain of $20,944,250 from sale of the Albany License and $3,026,480 from the Glens Falls License, a total gain of $23,970,730. Stip. 31.

27. The group reported gain from sale of the Licenses on its 2013 Vermont combined return as $23,751,913 "everywhere" nonbusiness income, allocated entirely to a non-Vermont source. Ex. L2.

28. Although Dr. Guite testified that the Licenses were purchased as an investment and not for business use, he testified that after purchase of the Licenses,

his companies depreciated (amortized) them for Federal tax purposes. SW p. 6. The 2013 Federal and Vermont returns in Exhibits K2 and L2 show the 2013 amortization deduction of $976,033 for the Licenses. Id.

29. For tax years 2012 and 2013, VNAT and all subsidiaries filed a Massachusetts combined corporate income tax return; VNAT and Vtel filed a Michigan unitary combined return; Vtel filed a New Hampshire stand-alone business tax return; and Vtel filed a New York stand-alone corporate franchise tax return, and in 2013 also filed a New York City stand-alone corporate return. Stip. 11-18.

30. On the 2012 and 2013 Massachusetts combined returns, Vtel reports on Schedule F the Springfield office as the "VT Headquarters" which "accepts orders," and the Greenwich office in Connecticut as a "Homeoffice" which does not accept orders. Ex. M2.

31. The 2013 New York corporate return for Vtel reports Dr. Guite as a greater-than-five- percent owner, and reports his address as the Springfield office. Ex. S. 32.

32. For tax year 2012, Vtel filed a Connecticut stand-alone corporate business tax return. Ex. O. For tax year 2013, VNAT and Vtel filed a Connecticut combined corporate business tax return, with VNAT indicating on the return that 2013 was its "initial" Connecticut return. Ex. P.

33. The 2012 Connecticut return shows the corporate mailing address for Vtel as the Springfield office, and the 2013 Connecticut return shows the mailing address for VNAT and Vtel as the Springfield office. Ex. O, P. On both Connecticut returns, to the

question "Is the principal place of business located in CT?" the answer entered is "No," and the "principal place of business" is entered as " Vermont." Id. The 2012 return lists the corporate officers as Michel Guite, Norman Koch, Justin Robinson and Frances Stocker, and for all four, reports the address as "Springfield, VT." Ex. O. There is no list of corporate officers included in the 2013 return pages in evidence. Ex. P.

34. All 2012 and 2013 corporate income tax returns in evidence for Federal tax, and for all states, report the business address as the Springfield office for VNAT, Vtel, Wireless, DATA, and FWF. Ex. G. K, K2, L, L2, M, M2, N, N2, 0, P, Q, Q2, R, R2, S.

2012 and 2013 Vermont tax returns for other than income taxes

35. Exhibit G contains various records and returns for Vermont taxes other than income tax, and shows the following:

- In 2012 and 2013, VNAT filed Vermont sales and use tax returns and payroll withholding tax returns.

- All non-income tax returns in evidence report the business address as the Springfield office.

- Frances Stocker signed the returns and signed the 2012 and 2013 VNAT corporate checks for payment of these taxes. The checks were drawn on the People's United Bank, and the October 24, 2013, check shows the location of People's as Burlington, Vermont.

- On a 2012 Vermont Employer's Reconciliation Return, Vtel reported 57 employees and total wages in the quarter of $614,027.

- On a 2013 Vermont Employer's Reconciliation Return, Vtel reported 59 employees and total wages in the quarter of $754,766.

- Both Employer Reconciliations were signed by Frances Stocker and by Dawn Tucker, "Accountant." The 2013 Reconciliation shows the Springfield office address with "ATTN: D Tucker."

- Wireless filed a 2013 Vermont electronic funds transfer form for sales and use tax, signed by Frances Stocker in June, 2013, and showing the Springfield office address. Ex. G.

Certain wages of Dr. Guite omitted from Vermont wage numerator on unitary returns

36. The Auditor questioned the wage apportionment in the Vermont 2012 and 2013 corporate returns because the returns showed Vermont "sales and property factors were 94 and 87 percent, respectively" and "yet wages were only at 30" percent for Vermont. Tr. p. 23, Stip. 20 - 22.

37. The Auditor questioned the CPA about this Vermont wage apportionment. He responded that Dr. Guite often works from his home office in Connecticut, and that when he works in Connecticut, the business considers his wages Connecticut wages, and when he works in Vermont, considers his wages Vermont wages. Tr. p. 24.

38. Dr. Guite owns a residence at 47 Glenville Road in Greenwich, Connecticut. He has an office in his Glenville Road residence, and that office is owned by Dr. Guite. SW p. 6. "VNAT's records, including its tax returns, are generally stored electronically and therefore accessible from my [Dr. Guite's] computer in [his] Greenwich [home] office." PF pp. 7-8; SWP p. 6. Dr. Guite's home office

> . . . has telephone and internet service, a desk overlooking a garden, is about 60' x 30', in a post and beam format, with a conference section in front of a fireplace. It was designed as a place to think, to review documents, store confidential documents, host business guests in a warm and inviting setting, and to walk around during conference calls.

PF p. 7. Dr. Guite also has a space in the Springfield office, "an open desk, in the business office." PF p. 8.

39. Dr. Guite testified that VNAT board of directors' meetings "are typically held" in his home office on Glenville road, but that "When Walter Hewlett served on the Board of Directors, we would also have Directors' meetings at locations that were convenient for him. With my daughters now on the Board of Directors, we are holding more meetings via telephone." PF p. 7. Walter Hewlett was on the VNAT Board "until approximately 2013." PF p. 6. Dr. Guite's daughters, Diane and Sophie, joined the VNAT Board in 2013. Ex. A, A2.

40. Dr. Guite is "responsible for making the ultimate decisions [for VNAT], although I consult with others, including my daughters, Diane and Sophie Guite," who are "now on the Board of Directors." Id. He typically makes those high-level decisions in Greenwich, Connecticut. Id.

41. Dr. Guite made the decisions on how to bid for the FCC licenses and testified, "As I recall, I made the majority of my bidding decisions from the office in Greenwich." PF p. 13. He then "directed those decisions to an employee in Springfield, Vermont, who actually executed the bids." Id. Dr. Guite "was in

Barcelona, Spain" at the time he made the decision to sell the FCC licenses to AT&T. PF p. 20.

42. After the CPA explained to the Auditor that the business had apportioned some of Dr. Guite's wages to Connecticut, the Auditor responded to the CPA that regardless of how the wages might be treated for Dr. Guite's personal income tax purposes, they were Vermont wages for corporate income tax purposes. Tr. p. 24, Ex. U. The Auditor sought internal guidance from the Department, and was instructed to adjust the apportionment of wages to 100 percent for Vermont. Tr. pp. 24-25. The Auditor notified the CPA of her adjustment. Tr. p. 25, Ex. V. She received no further response from the CPA about the wage issue. Tr. p. 25.

43. In Vtel's 2012 stand-alone Connecticut return, in Statement 7 to Form CT-1120A, Vtel reported Connecticut "compensation of officers" as "0" out of a total of officer compensation "everywhere" of $3,133,642. Vtel also reported on Schedule F no Connecticut deduction taken for payroll. (Though Vtel reported non-officer Connecticut compensation, shown as "cost of operations," of $1,034,709, out of a total "everywhere" other compensation of $2,037,559.) Ex. O. The sum of the Connecticut officer-plus-other compensation is $1,034,709, and this equals 20 percent of its total everywhere compensation reported for 2012.

44. In the 2013 combined VNAT-Vtel Connecticut return, Schedule R for VNAT and Schedule R for Vtel each report nothing allocated to Connecticut for wages and compensation in Column A, and nothing to Connecticut for property or sales gross receipts. Ex. P. On Schedule S, the minimum-tax apportionment, VNAT reports no Connecticut

intangible or tangible property, and Vtel reports $5,747 Connecticut tangible property. Schedule F, Line 1, both corporations report no 2013 Connecticut deduction taken for "Payroll." Id.

45. VNAT reported no Connecticut receipts, wages or property in 2012 or 2013. Wireless did not report to Connecticut in 2012 or 2013.

46. There is no evidence in the record that Dr. Guite worked in any state outside Connecticut and Vermont in 2012 and 2013.

FCC licenses: Dr. Liopiros' testimony

47. Dr. Liopiros testified about the Licenses and about cellular telecommunications in general, Tr. pp. 39 - 172, SW pp. 1-2, a follows in Findings of Fact 48 through 56:

48. The Licenses were for broadcast use of the 700 MHz portion of the radio spectrum for telecommunications operation in the Albany and Glens Falls, New York, areas. These areas are designated by the FCC as "Cellular Market Areas" or CMAs. Tr. p. 93. As shown on the FCC map in Taxpayer's Exhibit CCC, the CMAs are made up of MSAs (Metropolitan Statistical Areas) and RSAs (Rural Service Areas). The two CMAs covered by the Albany and Glens Falls Licenses are denoted on the map as RSAs.

49. The radio spectrum is the communications portion of the larger electromagnetic ("EM") spectrum. Different portions of the EM spectrum propagate different wavelengths, that travel through the atmosphere and through matter differently. The EM spectrum is divided into various areas such as "UV," "X-rays," "gamma rays" and other designations. The "mobile spectrum" is the area of the spectrum

best for mobile communications, meaning transmission by cell phone or from car or plane transmissions, etc. The mobile spectrum is considered a finite resource and is regulated by the FCC.

50. Cell phones work by transmitting EM radiation at a designated frequency to a base station, which is the cell tower and its related equipment and power supply. Cell towers may be connected by telephone lines or fiber optic lines. The communication of a cell phone to a cell tower is wireless. The relay of the signal between cell towers may be through the physical lines ("land lines") when practical, or where land lines are impractical, by microwave relay from the cell tower to a mobile-switching office. Base stations, land lines, fiber optic lines, and equipment for microwave relay and switching are infrastructure required for operation of a cellular communications business.

51. A cellular telecommunication signal may be overwhelmed by other, unwanted, signals, such as radio waves or engine "noise" or cellular signals from another operator, that "interfere" with the cellular telecommunication signal. To avoid interference among operators, the FCC regulates communications by licensing specifically-assigned spectrum use, in a specifically-assigned geographic area, to each FCC license holder. An FCC license limits the holder to use of the specified band width portion of the spectrum, to broadcast in the specific geographic area, for the specified number of years. The FCC determines the geographical areas for licenses.

52. An FCC license holder may enforce its right to interference-free operation, and exclude others

from operating in the holder's licensed geographic or spectrum area, by means of a complaint to the FCC.

53. An FCC license is purchased by bidding in an FCC license auction. A license imposes performance requirements on the holder. Performance requirements may include a "build-out" requirement, under which the license holder must agree to obtain or create the infrastructure necessary to provide some level of service in the licensed area. The two Licenses at issue here required build-out only by the date that the Licenses expired in 2019. Ex. WW. In effect, this meant the Licenses had no build-out requirements.

54. The FCC originally licensed the 700 MHz portion of the spectrum for television broadcast. Then, in the 1980s, the Federal Government decided to move television broadcasting to a lower portion of the spectrum, and to auction the use of the 700MHz portion of the spectrum for mobile telecommunications. At the time of the 2003 FCC Auction 49, many television channels were still using the 700 MHz portion of the spectrum. Television broadcasting at 700 MHz would interfere with mobile telecommunications at 700 MHz. It was at that time unclear when television operators might cease such operation. Due to this uncertainty, there were very few mobile telecommunications providers willing to buy a license for 700 MHz. Due to the few mobile telecommunications licensees, there was little market for the kind of cell phones and operating equipment needed for mobile telecommunications at 700 MHz. Since there was little market, such equipment was not being manufactured widely. The lack of available necessary equipment, and the uncertainty about when television operation at 700 MHz would cease, affected the prices people were willing to pay for the

licenses in Auction 49. Dr. Liopiros opined that these uncertainties were also likely the reason why the FCC had no real build-out requirements for the Licenses Taxpayer purchased in 2003. He also opined that the uncertainties were the reason large companies such as AT&T, Sprint and T-Mobile did not participate in Auction 49.

55. Build-out might be more expensive in some license areas than others, depending on whether the terrain is flat or mountainous, open or dense with buildings, where construction and permitting might be more costly, whether the topography might require more cell towers, etc. The potential market for mobile telecommunications might be more lucrative in a more-populated and more-travelled area or higher-wealth area where the populace would pay more for services, and could be less lucrative in other areas. Dr. Liopiros opined that he would consider all these factors when advising a client on how much to pay for a particular FCC license.

56. Dr. Liopiros testified that at the time of FCC Auction 49 "in 2003 . . . not only was equipment not available [for telecommunication at 700 MHz], but the equipment standards had not been developed at this point either." SW p. 3.

57. An FCC Fact Sheet, https://transition.fcc.gov./eb/factsheet/sec310d.html, summarizing licensee obligations under the Federal Communications Act, is Exhibit XX.

58. Taxpayer states in its memorandum that the FCC's CMAs "do not overlap state lines." TP Memo p. 12. The FCC map in Exhibit CCC is difficult to read, but appears to shows several CMAs that overlap state lines, such as #65 overlapping Nebraska and

Iowa, #85 overlapping Tennessee and Kentucky, #11 overlapping Missouri and Illinois, #6 overlapping New Hampshire and Massachusetts, and #156 overlapping Maine and New Hampshire.

Objections

a. The Department objected on grounds of irrelevance to cross-examination of the Auditor about other audits she had performed. The objection was upheld because other audits are irrelevant to this appeal. In addition, the cross-examination was beyond the bounds of the testimony on direct. Tr. ·p. 29.

b. The Department objected on grounds of irrelevance to Exhibit FFF, a map of FCC license areas other than the area at issue here. The Hearing Officer took the objection under consideration and now admits FFF simply to illustrate that other areas were covered by FCC licenses. Tr. pp. 134-136.

c. The Department objected on grounds of irrelevance to Exhibit HHH, a summary of census data and household population for Maine. The Hearing Officer noted the objection for the record and admitted HHH as showing that this census data for various areas is available. Tr. pp.146-147.

Discussion and Conclusions of Law

I. Allocation of gain from sale of two FCC licenses - General

A. Vermont allocation of nonbusiness income

Vermont's corporate tax law provides that the income of a corporation doing business in multiple states must be allocated and apportioned among the states. 32 V.S.A. § 5833.

VNAT and its wholly-owned subsidiaries are an "affiliated group," which is "a group of two or more corporations in which more than 50 percent of the voting stock of each member corporation is directly or indirectly owned by a common owner or owners." 32 V.S.A.§ 5811(22). The parties do not dispute that VNAT and its subsidiaries are engaged in a "unitary business" in which "there exists a unity of ownership, operaton, and use, or an interdependence in their functions." *See* 32 V.S.A. § 5811(23). The "Vermont net income" of a unitary affiliated group is the "allocable share of the combined net income of the group." 32 V.S.A. § 5811(18)(C). As evidenced by their various state income tax returns for 2012 and 2013, VNAT and its subsidiaries did business both within and outside Vermont, and the income of such a multistate group must be allocated and apportioned under Section 5833.

The Department has formally adopted regulations governing allocation and apportionment of multistate corporate income. These regulations are prima facie evidence of the proper interpretation of Section 5833 and have the force of law. 3 V.S.A. § 845(a).

Under the Department's regulations, "business income" of a multistate corporation is *apportioned* among the states. "Nonbusiness income" is *allocated* to the state where the income-producing asset is located or, if the asset has no situs, to the corporation's state of "commercial domicile":

> Reg. § 1.5833 ALLOCATION AND APPORTIONMENT OF INCOME
>
> * * *
>
> (d) Sales and Receipts Factor
>
> * * *

(5) . . . Business receipts include all income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible or intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. ·

(6) Nonbusiness Receipts Nonbusiness receipts are all receipts other than business receipts resulting from operations unrelated to its regular business operations. Typically nonbusiness receipts are comprised of passive or portfolio income. Income from dividends, interest and capital gains will be considered nonbusiness income unless the acquisition, management, and disposition of the underlying property generating the income constitute an integral part of the taxpayer's regular business operations.

(e) Nonbusiness income will be allocated to the state in which the income producing assets are located. If the income producing asset has no situs, the income will be allocated to the state of commercial domicile, the principle [*sic*] place from which the business is directed or managed.

Vermont Department of Taxes Regulations (Effective for tax years beginning on and after January 1, 1998) ("Reg.") § 1.5833-l(d)(S) and (6), (e).

The capital gain from the 2013, sale of the Licenses was nonbusiness income. First, under Regulation (d)(5), the capital gain was not business income because the sale transaction did not "arise

from transactions and activity in the regular course of the taxpayer's trade or business." Taxpayer's regular trade or business was not the sale of FCC licenses. Second, under that Regulation, the capital gain was not income from intangible property whose "acquisition, management, and disposition" constituted "integral parts of the taxpayer's regular business operations." Taxpayer acquired the Licenses as an investment, at a time when the Licenses could not easily be used for cellular telephone operations; Taxpayer managed the Licenses as a passive investment and not as active broadcasting licenses; and Taxpayer was not in the business of selling ("disposition of") FCC licenses.[1] Next, under Regulation (d)(6), the capital gain was nonbusiness income because the sale was "unrelated to Taxpayer's regular business operations," and the Licenses did not function ("acquisition, management, and disposition") as "an integral part of the taxpayer's regular business

[1] Taxpayer took amortization deductions for the Licenses on its corporate income tax returns over a period of years. Federal tax law, which governs the starting point of a corporation's Vermont net income, 32 V.S.A.§ 5811(18), allows amortization of "any license, permit, or other right granted by a governmental unit or an agency or instrumentality thereof," only if it is "held in connection with the conduct of a trade or business." 26 U.S.C. § 197(a), (c)(l)(B), (d)(l)(D). A holding company which acquires and holds an FCC license but does not use it in an active trade or business is not entitled to amortization deductions for the license under Section 197. Broz v. C.I.R., 137 T.C. 46, 68-69 (2011). VNAT, Wireless and Vtel never used the Licenses in active conduct of trade or business. Therefore, the amortization deductions were taken in error, though there is no assessment for disallowance of these deductions at issue in this appeal. The reduced bases were apparently used to calculate the capital gains assessment.

operations." Since none of the tests for business income are met, the capital gain is nonbusiness income that must be allocated, not apportioned.[2]

B. Statement of the question regarding License capital gain

The question regarding capital gain income from the 2013 sale of the Licenses is whether, under the Regulation, Taxpayer's nonbusiness income will be "allocated to the state in which the income producing

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[2] The original Uniform Division of Income for Tax Purposes Act (UDITPA) contained model language for states' allocation and apportionment statutes and regulations. Its test or tests for business income contained the same phrases "transactions in the regular course of trade or business" and "acquisition, management, and disposition." Some states which adopted UDITPA view the phrases as two separate tests; some view the phrases as a single test; and some have, by legislation or judicial gloss, changed the second phrase to, or interpreted it as, "acquisition, management, *or* disposition. *See generally* Construction and Application of Uniform Division of Income for Tax Purposes Act (UDITPA) - Determination of Business Income, 74 A.L.R.6th 1 (Originally published in 2012).

Vermont has never adopted UDITPA, though some of its language is quite similar. Vermont courts have not ruled on whether "and" in the, Vermont regulation should be read as "or." The plain language of Vermont's regulation uses the word "and," not "or." Based on the plain language, all three actions—acquisition , management *and* disposition of the property—must be integral parts of the taxpayer's business operations in order for the income to be "business income." *Cf.* Appeal of Chief Indus., Inc., 255 Kan. 640, 651, 875 P.2d 278, 286 (1994) (Regarding similar Kansas statute at the time, "The drafters' use of the conjunction 'and' clearly indicates that the disposition, as well as the acquisition and management of property must be an integral part of the taxpayer's regular trade or business operations in order to produce business earnings."). The "and/or" issue is moot here, because in Taxpayer's case, none of the three actions were integral to its business operations.

assets were located" or "the income producing assets had no situs [and] the income will be allocated to the state of commercial domicile."

Taxpayer asserts that the Licenses were "located" in New York and the capital gain should be allocated to New York. The Department asserts that the Licenses "had no situs" and the gain should be allocated to Taxpayer's commercial domicile.

C. Location of an asset; nexus

Situs or location of an asset is significant because it can provide a state with sufficient connection to tax the asset or income from the asset. A state has authority to impose a tax upon persons, property and transactions with which it has some definite link or minimum connection:

> [D]ue process requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.

Miller Bros. Co. v. State of Md., 347 U.S. 340, 344–45 (1954).

A state's authority to tax arises out of the benefits and protections the state provides to the object of taxation. ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 315 (1982) ("The simple but controlling question is whether the state has given anything for which it can ask return.").

States have the power to tax residents on their income from whatever source derived, and the required links are the privileges of residence and enjoyment of the protection of the state's laws:

> That the receipt of income by a resident . . . is a taxable event is universally recognized. Domicil itself affords a basis for such taxation.

> Enjoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws are inseparable from responsibility for sharing the costs of government. 'Taxes are what we pay for civilized society.'

People of State of New York ex rel. Cohn. v. Graves, 300 U.S. 308, 312–13 (1937).

States have the power to tax tangible property located in the state for the same reason - because, in essence, the tangible property "resides" in the state, enjoying the privileges and protections which "afford a basis for taxation."

Intangibles, however, have no physical "location." Because they are "sources of actual or potential wealth" which "cannot be dissociated from their owner," they are generally taxable by the owner's state of domicile:

> The power of government over [intangibles] and the protection which it gives them cannot be exerted through control of a physical thing. They can be made effective only through control over and protection afforded to those persons whose relationships are the origin of the rights.

Curry v. McCanless, 307 U.S. 357,367 (1939).

A state other than the owner's domicile may, however, obtain taxing jurisdiction over an intangible or the income from it if the owner engages in activities related to the intangible and those activities are subject to the taxing state's governmental protections and benefits. In that case, the host state may tax income from the intangible, ·

> . . . when the taxpayer extends his activities with respect to his intangibles, so as to avail

> himself of the protection and benefit of the laws of another state, in such a way as to bring his person or property within the reach of the tax gatherer there . . . [because] taxation is but a means of distributing the cost of government among those who are subject to its control and who enjoy the protection of its laws . . . .

Id. at 367, 370.

When a taxpayer engages, in a nondomiciliary state, in business activities using its intangible property, that host state's link, and authority to tax, derive from the benefits and protections afforded to the business activity, and this link is sometimes referred to as the "business situs" of the intangible. Mobil Oil Corp. v. Comm'r of Taxes of Vermont, 445 U.S. 425,445 (1980).

Taxpayer here never used the Licenses in any business activity. Taxpayer asserts, however, that the Licenses have a New York situs that is unrelated to whether New York provided benefits and protections to the Licenses or their use, and states:

> While the power to tax is often framed as a quid pro quo relationship between the state and the party that the state seeks to tax . . . even if it were true that New York has not "given anything for which it can ask return," that determination does not mean that the New York Licenses lack New York situs. For example, states have no power to tax property owned by the federal government and in many instances lack jurisdiction over the activities that occur on that property, such as a military installation. Obviously, the absence of taxing

> power and jurisdiction does not mean that such property lacks situs.

Taxpayer's Memorandum of February 27, 2018 (TP Memo) p. 27-28. A military installation is, however, likely not located in a state, because it is likely on Federal land or a Federal enclave, so this is not a clear example of something located in a state which the state may not tax. *See, e.g.,* U.S. Const. art. 1, § 8, cl. 17; art. 6, § 2. Taxpayer's example is also of property tax on tangible property, not income tax on gain from sale of an intangible, and the example does not explain how an intangible may acquire situs in a state other than by some connection to the state's benefits and protections.

Taxpayer does offer a number of theories in support of its assertion that the Licenses had a New York location, and these will be considered here:

II. Taxpayer theories of New York situs

A. Geographic, topographic, demographic factors

Taxpayer asserts that the Licenses were located in New York "because they convey benefits that can only be exercised in New York and because their value is inextricably bound to a host of geographic-specific factors in New York." TP Memo p. 15. Taxpayer describes these factors as the number and income-level of residents and commuters in the New York area, which indicates potential License revenue; the existence of roads needed for, and the cost of, building telecommunications infrastructure; the terrain, which can interfere with electromagnetic signals and thus increase the cost of infrastructure; the existence of "exclusion zones" such as military bases, which diminish the number of potential customers and revenue; and state and local regulations which can

affect the cost and difficulty of developing infrastructure. TP Memo pp. 7-8. Based on these factors, Taxpayer's witness testified that the Albany FCC License would be worth more than a license for far northern Maine.

From the testimony of Dr. Liopiros, however, it appeared that the greatest factor in determining the value of the Licenses may have been the unavailability (and later availability) of the 700 MHz portion of the spectrum for mobile phone service, a factor which was under sole control of the FCC, not New York.

In any case, the New York factors which Taxpayer recites are all factors which may affect the unknown, but potential, future cost of acquiring infrastructure and future income in the event the Licenses are used in New York business and, on that basis, may affect the price someone is willing to pay for the license. By themselves, these factors did not locate the Licenses on New York terrain.

The fact that Taxpayer's Licenses were for broadcast within areas of New York State had nothing to do with New York State real property. The Albany and Glens Falls "Cellular Market Areas" and "Rural Service Areas" were simply market areas drawn on the map by the FCC. Folden v. United States, 379 F.3d 1344, 1347 (Fed. Cir. 2004) ("To facilitate the allocation of cellular licenses, the Commission divided the United States into two geographic markets—metropolitan statistical areas (MSAs) and rural service areas (RSAs)."). The FCC-drawn RSAs did not-mean the Licenses themselves were located in New York.

Since Taxpayer never charged or collected broadcast contract fees from New York residents for broadcast services, and never engaged in any "activities with respect to his intangibles so as to avail himself of the protection and benefit of the laws of" in New York, there was also nothing to create a tax situs in that state.

B. *Whitney* case

In support of its assertion of New York situs, Taxpayer cites the case of New York ex rel. Whitney v. Graves, 299 U.S. 366 (1937). *Whitney* is inapposite, however, because, as the Court itself stated, it dealt with business income, not nonbusiness income, and because the intangible involved a right in identified, tangible, New York real estate.

The *Whitney* Court addressed the Constitutionality of a New York income tax on a Massachusetts domiciliary taxpayer. New York taxed his capital gain from the sale of an interest in a membership in the New York Stock Exchange (NYSE). The Court upheld New York's right to tax because the "peculiar nature" of the membership "embraces . . . a valuable right of property." Id. at 372. That right of property peculiar to a NYSE membership was the right of "buying and selling securities on the floor of the Exchange":

> Wherever the owner may reside he must go to the Exchange to exercise his privilege to trade upon its floor. If he prefers to have his customers' orders executed through other members, still they must execute these orders on the Exchange . . . .

Id. at 373.

The Massachusetts resident held a full membership in the NYSE and each full member was granted an additional one-fourth interest in a membership. The taxpayer sold that one-fourth interest. The taxpayer had no office or abode in New York and had never traded on the floor of the NYSE, but accepted orders at his Boston office for execution by other members on the floor of the NYSE. When New York taxed him on the gain from the sale, he appealed, asserting that the NYSE membership was intangible and had no "business situs" in New York, and therefore the gain was taxable only by taxpayer's domicile, Massachusetts.

The Court focused on the fact that the NYSE owned a building in New York City and that members or their representatives had to go to that building, the only place where they could buy or sell stocks:

> [T]he New York Stock Exchange . . . owns the building in which the business of the Exchange is transacted, with the land upon which it stands, situated in the city of New York; . . . a member may personally buy or sell only in the Exchange building;
>
> . . . and [a member's] rights and privileges are valuable and are exercisable only in transactions conducted at the Exchange building in the city of New York.

Id. at 370–71. The Court concluded:

> [T]he dominant attribute of membership in the New York Stock Exchange so links it to the situs of the Exchange as to localize it at that place and bring it within the taxing power of New York."

Id. at 374. In contrast, Taxpayer's Licenses were not linked to any existing building or structure in New York.

The fact that Taxpayer could have obtained New York infrastructure does not mean that the FCC Licenses "embraced . . . a valuable right of property" in a potential future acquisition of real property. Nor can it be said that the Licenses created a right in electromagnetic waves located in New York. Radio Common Carriers of New York, Inc. v. State, 601 N.Y.S.2d 513, 515-516 (N.Y. Supreme Ct. 1993) ("[D]ue to the nature of radio waves, the signals cannot be stopped at state borders . . . The 'substantial nexus' component of the test [for sales tax nexus] will not be satisfied merely because electronic signals pass through a state . . . ."). It is not even clear that a licensee would have to go to an FCC-designated license area to broadcast using a license, because Dr. Guite testified that his business was serving Hebron, New York, telecommunications customers from his company's cell tower, and he was "not sure whether that tower is in New York or Vermont."

The *Whitney* Court cited favorably an earlier case in which the Supreme Court held that a Minnesota county could impose a personal-property tax on a nondomiciliary who owned a membership in the Minneapolis Chamber of Commerce. Rogers v. Hennepin Cty., 240 U.S. 184 (1916). *Rogers* is also inapposite because it, too, concerned business income ("[A]pplying a principle . . . with respect to . . . nonresidents *arising from business* within the state . . . that it was competent for the state to fix the situs of the memberships for the purpose of taxation . . . at the place within the state where the exchange was located."). Id. at 191 (italics added). In *Rogers*, the

Chamber of Commerce owned a grain exchange building where members could execute trades. The Court based its holding on the fact that the Chamber owned the Exchange building and that the membership allowed access to the building to engage in grain trades which could only be transacted in that building:

> [The] Chamber of Commerce . . . furnished buildings and equipment for its members, who, under its rules, transacted business with each other (for themselves and their customers) upon the trading floor which was in fact a grain exchange . . . .

Id. at 185.[3] The Court found the membership was inextricably tied to the real property, the only place

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[3] The *Whitney* Court also cited People ex rel. Lemmon v. Feitner, 60 N.E. 265 (NY 1901), but only cited *Lemmon* for its description of a NYSE membership, because "the state courts have not aided us by a discussion or analysis of the nature of the [NYSE membership] right involved or the grounds for the assertion of the authority to lay the tax." *Whitney* at 370.

Lemmon addressed taxation of a nonresident's business income, though under two state statutes and not on Constitutional grounds. The New York court there held that a nonresident's NYSE membership was not taxable because (l) the New York business income statute only taxed a nonresident on capital invested in a New York "business," and the NYSE was not a "business," but only a *place* for transacting business; and (2) the New York personal -property tax statute only taxed an express list of taxable items (*e.g.*, "chattels, money, things in action, debts due [to or from residents]") which did not include a NYSE membership. *Whitney* at 370.

The *Lemmon* court described the NYSE membership's "main object [being] to afford its members the facility for the transaction of business by providing them with a convenient exchange or salesroom." *Lemmon* at 266.

where the membership could be exercised, and on that basis, distinguished the membership from mere "intangible rights":

> It is urged that the memberships are intangible rights held by the member at his domicil. But [the] memberships represented rights and privileges which were exercised in transactions at the exchange in the city of Minneapolis . . . it was competent for the state to fix the situs of the memberships for the purpose of taxation, whether they were held by residents or nonresidents, at the place within the state where the exchange was located.

Id. at 191.

In both *Whitney* and *Rogers* a key to taxation was the right to use an extant building in the taxing jurisdiction. The memberships were not merely intangible rights, but were of a "peculiar" nature because they embraced rights in a physical building. Use of the building in each case was a "dominant attribute" that fixed the situs of the membership, "localizing it" and "bringing it within the taxing power" of the host states

An FCC license does not have the same "peculiar" feature of the memberships in *Whitney* and *Rogers*. Taxpayer's Licenses did not "embrace rights" in an extant New York building or structure. FCC licenses do not convey a right in a building, or a right to build or obtain future infrastructure. The fact that Taxpayer could potentially have acquired its own infrastructure in New York is not analogous to saying that an FCC license includes a right to use a building owned by the FCC and made available to its licensees.

There was no right in a building or structure in New York that was an "attribute" of the Licenses.

C. Ownership to the exclusion of others

Taxpayer asserts that "Although it did not use the FCC licenses to broadcast signals, the Taxpayer certainly used its rights under the license[s] by excluding potential competitors in the telecommunications industry from using the portion of the electromagnetic spectrum in New York State prescribed in the FCC licenses." Taxpayer's Sur-Reply Memorandum of March 20, 2018 (TP Memo2) p. 10. While this may be true, it does not create any link or nexus with New York, because New York's laws did not protect or benefit Taxpayer's passive investment ownership to the exclusion of others; the FCC and Federal courts have exclusive jurisdiction over licensing issues (*see* discussion below, at Section F). Excluded would-be owners do not create state tax nexus and do not locate the licenses in the would-be owners' state of residence. Moreover, Taxpayer's passive ownership was not only to the exclusion of telecommunications providers located in New York, but also to the exclusion of any other business- or passive investors, anywhere in the world.

Passively owning an FCC license, without more, creates no tax link or nexus to a nondomiciliary state. This was the statement of the Oregon Tax Court in a *dictum*. Crystal Communications, Inc. v. State Dep't of Revenue, State of Oregon, 19 Or. Tax 524 (2008), *as amended* (Mar. 2, 2009); *aff'd* 353 Or. 300 (2013). In *Crystal*, the Oregon court considered whether nonresident shareholders of an S corporation that held an FCC telecommunications license for the Oregon #1 Rural Service Area were taxable in Oregon

on the capital gain from sale of the FCC license. The court found that the business "leased the land for each of [two 'cell sites'] . . . and owned the improvements on the land [that] included the towers, antennae, electronics and other equipment ordinarily used to operate the cellular telephone system" and had its sole employee in Oregon "to oversee the acquisition and operation of Crystal's cellular communication system." The court held that these activities "went far beyond mere holding of an asset," and demonstrated that its FCC license was employed in a business in Oregon, as required by the Oregon statute for taxation of the gain from sale of the license. Id. at 529, 531.

In a *dictum*, the court considered the tax results of nonresidents simply owning the license as a passive investment, and concluded that the common law principle would govern and the intangible license would be located at its owner's situs, even though the license covered an Oregon service area:

> [S]eparately existing intangible property such as a patent, trademark, ownership interest (such as stock), or contract right can be used *in* a trade or business . . . However, in the case of a patent, a license, a share of stock, or a contract right, it is possible for a nonresident individual to simply hold the intangible and not "employ" it in a trade or business or any other activity other than passive ownership. Where employment of such an intangible in this state has not occurred, neither income nor gain in respect of the intangible is sourced to this state. Rather, the principle of *mobilia sequuntur personam* is applied to locate and tax the

> intangible, or income from it, at the situs of its owner.

Id. at 537-538.

VNAT and its subsidiaries did "not employ the FCC licenses in a trade or business or any other activity other than passive ownership." That passive ownership, according to the *Crystal* court, was insufficient to locate the intangible at the situs of the FCC license area.

D. Timber, water, and mineral rights: air rights

Taxpayer asserts that an FCC license for "the use of electromagnetic radiation" is like a license to use "any other natural resource, such as timber, water, and minerals" and concludes that the FCC-prescribed geographic area of the New York RSAs "is where the asset is located." TP Memo p. 24.

Electromagnetic radiation differs from timber, water and minerals because, unlike the last three, radiation is not a "profit à prendre" - not a part of real property which may be removed from the land:

> A profit à prendre involves primarily a power to acquire, by severance or removal from another's land . . . an *integral part* thereof [such as] wood, herbage, or coal or other minerals . . . game on another's land, fish in waters thereon, to take seaweed cast thereon, or soil, sand and gravel [or] ice . . . .

§ 839. Nature and incidents of the right, 3 Tiffany Real Prop. § 839 (3d ed.) (italics added).

Profits à prendre also involve a right to "enter on the land" to take the allotted integral part. Id.

An FCC license is not analogous to timber, water or mineral rights because it is not a right to an

integral part of real property and involves no right to enter on land to remove anything. There is thus no land which might give it a "location." The fact that Taxpayer *could potentially have acquired* telecommunications infrastructure or land in New York - but did not - is not the same as holding a right to enter onto and take an integral part of existing, identified, real property.

Taxpayer also asserts that an FCC license is akin to an air right. An air right is not a right to air, but is a type of development right. Wing Ming Properties (U.S.A.) Ltd. v. Mott Operating, 561 N.Y.S.2d 337,340 (1990), *aff'd*, 568 N.Y.S.2d 605 (1991), *aff'd*, 594 N.E.2d 921 (1992) ("[P]revalent custom and usage of the term 'air rights' clearly manifest the acquisition of air development rights."); Friedberg v. C.I.R., 102 T.C.M. 356, fn. 11 (2011) ('The concept of development rights stems from restrictions on the use of "air rights," the rights to construct a building on top of the owner's land. Air rights are rooted in the bundle of rights associated with land ownership."); Conveyance and Taxation of Air Rights, 64 Colum. L. Rev. 338 (1964) (Air rights "may be defined as the right to occupy the space above a specified plane over, on, or beneath a designated tract of land.").

An FCC license is not analogous to air rights or development rights because it does not grant a right to build on or otherwise burden a designated tract of land, and there is thus no related land which could give it a location or make it subject to a state's benefits and protections.

E. In corporeal hereditaments

Taxpayer asserts that FCC licenses are like the licenses in the case of *Louisville and Jeffersonville*

Ferry Co., in that "a governmental license belongs to a class of estates known as incorporeal hereditaments and like real property must be localized to the geographic area where such right may be exercised." TP Memo p. 22, *citing* Louisville and Jeffersonville Ferry Co., 188 U.S. 385 (1903).

The case is inapposite. The governmental licenses at issue were granted by the Governor and Legislature of Indiana, granting rights to a Kentucky ferry company to dock on Indiana shores of the Ohio River. The Court held that Kentucky could not impose a property tax on the Kentucky ferry boat company's Indiana shore rights, because the rights were a "franchise derived from Indiana" for the Indiana shore, and thus were "not within the jurisdiction of Kentucky" for property taxation.

In Taxpayer's case, its Licenses were granted by the Federal government, not by the Governor or Legislature of New York. They were not an "incorporeal hereditament" because they did not grant any tight of entry upon a shore or other land in New York. Black's Law Dictionary, Eighth Edition, defines "incorporeal hereditament" as "An intangible right in land." It was this incorporeal right in Indiana land - the shore - which connected the right to Indiana, and at the same time demonstrated no taxable connection to Kentucky. The FCC Licenses were not incorporeal rights in New York land.

F. Covenant not to compete

Taxpayer asserts that FCC licenses are akin to a covenant not to compete because both are intangibles that have a location "where activity would have occurred but for the right contained in the covenant." TP Memo2 pp. 14-15. This is inaccurate. A

noncompete agreement is a direct prohibition on one contract party; an FCC license grants one party the right to broadcast, and nonparties are prohibited only in the same way anyone not a party to a contract has no rights under the contract.

A noncompete agreement may be enforced by a state court that has jurisdiction over the agreement or a party. This connection to a state might be described as "locating" the agreement in that state. But if "court jurisdiction" is the meaning of "location," then Taxpayer's Licenses do not have location in New York, because New York courts have no jurisdiction over FCC licensing rights. It anyone attempted to operate under Taxpayer's FCC Licenses in New York, New York courts would have no jurisdiction to police that activity. An action in violation of an FCC license is under the exclusive jurisdiction of the Federal Communications Commission and Federal courts. 47 U.S.C. § 301 ("No person shall use or operate any apparatus for the transmission of energy or communications or signals by radio . . . except under and in accordance with this chapter and with a license . . . granted under the provisions of this chapter."); McIntire v. Wm. Penn Broad. Co. of Philadelphia, 151 F.2d 597, 600 (3d Cir. 1945) ("[E]nforcement of the [Federal Communications] Act rests in the FCC."); 47 U.S.C. § 401(b) ("If any person fails . . . to obey any order of the Commission . . . any party injured thereby may apply to the appropriate district court of the United States for the enforcement of such order."); Microwave Commc'ns, Inc. v. F.C.C., 515 F.2d 385, 388–89 (D.C. Cir. 1974) ("[F]ederal courts of appeals possess exclusive jurisdiction to enjoin, set aside, suspend (in whole or in part), or to determine the validity of . . . all final orders of the Federal

Communications Commission made reviewable by Section 402(a) of the Communications Act of 1934."); *see also, e.g.*, Havens v. Mobex Network Servs., LLC, 820 F.3d 80, 89–90 (3d Cir.), cert denied, 137 S. Ct. 496 (2016) (A person claiming damage by a common carrier under 47 U.S.C. § 207 may bring private action in Federal court only after obtaining an FCC determination.); Freeman v. Burlington Broadcasters. Inc., 204 F.3d 311, 320–21 (2d Cir. 2000), *cert. den.* 531 U.S. 917 (2000) (Local zoning authority had no jurisdiction to regulate the siting of a cellular tower to prevent interference with nearby household electrical devices; it was "clear that Congress intended the FCC to possess exclusive authority over technical matters related to radio broadcasting . . . This authority is embedded in the FCC's broad authority to develop a comprehensive national regulatory system governing telecommunications . . . federal law has preempted" state law in the field of radio frequency interference "either intentional or incidental.").

Taxpayer asserts that whether New York courts had jurisdiction over the Licenses or over Taxpayer is irrelevant to location, because, as in a noncompete agreement, parties to a contract may choose the state whose law will apply to their contract. It is not clear how this assertion advances Taxpayer' s argument for New York nexus. In any case, parties may not simply choose any state's laws; the state whose law is chosen must have some relationship to the agreement or a party:

> In a covenant not to compete, the parties' freedom to choose what jurisdiction's law will apply to their agreement cannot be unlimited. They cannot require that their contract be

> governed by the law of a jurisdiction which has no relation whatever to them or their agreement.

DeSantis v. Wackenhut Corp., 793 S.W.2d 670, 677 (Tex. 1990). So, if neither the parties nor the agreement has any connection to New York, the parties cannot create a connection simply by choosing New York law to apply to their agreement.

Most importantly, an FCC licensee has no choice of law with respect to its licensing rights. FCC licensing rights are governed exclusively by Federal law under the exclusive jurisdiction of the FCC and Federal courts, as noted above.

G. Uniform Division of Income for Tax Purposes Act

Taxpayer asserts that a proposed regulation from the Uniform Division of Income for Tax Purposes Act ("UDITPA") should apply to this case. Taxpayer cites a proposed UDITPA regulation which allocates receipts from the sale of an FCC license to the state where the license authorizes the holder to conduct business activity. TP Memo p. 37, *citing* "UDIPTA [*sic*] Reg. IV.17.(f)(l)(E), example (ii)"). But Taxpayer cites this UDITPA regulation out of context. As will be described below, the regulation cited by Taxpayer applies to business income, not to investment income; the regulation applies to a proposed new *apportionment* concept not adopted by Vermont; and the *allocation* rules in UDITPA continue to expressly allocate income from *non*business intangibles *only* to the owner's commercial domicile.

The Multistate Tax Compact ("Compact") was drafted in the 1960s by the Multistate Tax Commission ("MTC"). The Compact lays out model

rules for the apportionment and allocation of corporate income among the states. The goal of the MTC was for states to adopt the Compact and thus divide taxable corporate income among the states in a uniform, equitable manner, avoiding duplicate taxation. Article IV of the Compact provided general rules for this "Division of Income." UDITPA provided model regulations setting out details for division of income under the general scheme of the Compact. Vermont did not adopt UDITPA, though portions of Vermont's corporate tax law mirror the original UDITPA language.

The MTC in 2017 adopted proposed amendments to the Compact and the model UDITPA regulations to allow "market-based sourcing." These 2017 UDITPA proposed regulations will be referred to here as the "U/Regs." Market-based sourcing is a new apportionment concept (*see* Footnote 4, below), and applies only to business income. The MTC's market-based sourcing U/Regs do not change the UDITPA rule that income from intangible nonbusiness assets must be allocated to the taxpayer's commercial domicile. This is seen by a review of the entire text of the U/Regs:

The FCC license example (E)(ii) that Taxpayer quotes is from the proposed market-based sourcing section of the U/Regs. Proposed new Compact Article IV.1(g) defines "Receipts" as income "from transactions and activity in the regular course of the taxpayer's trade or business" - that is, it defines "Receipts" as business income. The corresponding U/Reg IV.17 is also entitled "Receipts," and relates to the Compact provisions regarding "Receipts," or business income. Subdivision (f)(l) of U/Reg IV.l7 is entitled "Assignment of Receipts," and is the rule for

assigning "Receipts" - business income - to the appropriate state. The FCC example in U/Reg IV.17(f)(l) which Taxpayer quotes is therefore within the "Assignment of Receipts" - business income - regulation, and reads:

(E) Examples.

* * *

> (ii) Wireless Corp . . . sells a license issued by the Federal Communications Commission (FCC) to operate wireless telecommunications services in a designated area in [state] to Buyer Corp, a corporation that is based outside [state]. The contract of sale is negotiated and signed outside of [state]. The receipts from the sale are in [state] because the intangible property sold is a government license that authorizes the holder to conduct business activity solely in (state].

U/Reg IV.17.(f).(l)(E)(ii). Since the governing Compact Article IV defines "Receipts" as income "from transactions and activity in the regular course of the taxpayer's trade or business," and the example Taxpayer quotes is addressing "Receipts" from the sale of an FCC license, the example applies only if the gain from Taxpayer's FCC license sale qualifies as "Receipts" from "transactions or activity in the regular course of the taxpayer's trade or business." But Taxpayer's Licenses were investments and their sale was not a transaction in the regular course of Taxpayer's trade or business. As a result, the FCC example in this regulation does not apply to Taxpayer's sale of the Licenses.

This conclusion is expressly supported by the 2017 U/Regs themselves, which provide that "Property that

is held merely for investment purposes" is "not related to the operation of the trade or business," and income from activities "for the taxpayer's mere financial betterment rather than for the operation of the trade or business" is not "apportionable," meaning it is *non*apportionable. U/Reg, IV.1.(a).(4)(B) and (5). The rule for nonapportionable income is in U/Reg IV.2.(b)(3):

> Application of Article IV: Allocation. Any taxpayer subject to the taxing jurisdiction of this state shall allocate all of its nonapportionable income or loss within or without this state in accordance with Article IV.4 to IV.8.

That reference is to Articles IV.4 to IV.8 of the Compact. Articles IV.4 and IV.6 provide:

> ARTICLE IV. Division of Income
>
> Section 4.
>
> Rents and royalties from real or tangible personal property, capital gains, interest, dividends, or patent or copyright royalties, to the extent that they constitute non-business income, shall be allocated as provided in sections 5 through 8 of this act.
>
> ***
>
> Section 6.
>
> (a) Capital gains and losses from sales of real property located in this state are allocable to this state.
>
> (b) Capital gains and losses from sales of tangible personal property are allocable to this state if

(1) the property had a situs in this state at the time of the sale, or

(2) the taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

(c) Capital gains and losses from sales of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

Compact, Uniform Law Commission, http://www.uniformlaws.org (italics added).

Taken as a whole, the 2017 proposed Compact and U/Regs provide that capital gain from sale of the intangible Licenses, which Taxpayer "held merely for investment purposes" and were "not related to the operation of Taxpayer's trade or business," and which gain was from activities "for Taxpayer's mere financial betterment rather than for the operation of the trade or business," was nonbusiness, nonapportionable income, and must be allocated to Taxpayer's commercial domicile.[4]

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[4] As noted earlier, the UDITPA model regulations were originally adopted for use with the Multistate Tax Compact drafted by the Multistate Tax Commission (MTC), in the 1960's. The UDITPA regulation Taxpayer cites is from the MTC's recently-proposed amendments to the UDITPA Regulations, published in 2015 and adopted by MTC in 2017, for use by states which adopt "market-based sourcing" for multistate corporate income tax apportionment. http://www.mtc.gov/Uniformity/Project-Teams/Section-17-Model-Market-Sourcing-Regulations.

Market-based sourcing is a recent apportionment concept, responding to the evolution of the economy from goods-based to services-based. The new market-based apportionment regulations apply to business income, now termed

"apportionable income." The new regulations do not change the UDITPA rule that income from intangible nonbusiness assets are nonapportionable and must be allocated to the taxpayer's commercial domicile.

Under market-based sourcing, business income from the sale of services is not assigned to the state where the services are performed (which is the traditional rule, and is Vermont' s rule, 32 V.S.A. § 5833(a)(3); Reg. § 1.5833-1(d)(3)). Instead, services income is assigned to the "market" state, where the customers are located. *See generally*, *Market-Based Sourcing on Cusp of Becoming General Rule*, J. Multistate Tax'n (May 25, 2015), 2015 WL 2088861.

Under the market-sourcing regulations, the receipts from the sale of a business asset such as an FCC license covering a New York area would be assigned to the "market" state of New York, because that is the market where the license will be used to generate business revenue - New York is the source of the revenue to be taxed. The market-based sourcing rules do not apply to an FCC license purchased as an investment asset and not used to generate business revenue.

Taxpayer also cites regulations from Massachusetts and Rhode Island with similar language regarding an FCC license sale. But these two states have expressly adopted market-based sourcing. *See, e.g.*, Massachusetts Department of Revenue, 830 CMR 63.38.1: *Apportionment of Income*; Rhode Island Department of Revenue, Division of Taxation *Apportionment of Net Income* Regulation CT 15-04, Rule 8.

There is no authority for applying market-based sourcing rules in Vermont, because that approach has not been legislated or adopted in regulations and would contradict Vermont's current apportionment laws. At least two state courts have invalidated application of market-based sourcing in the absence of any expressly authorizing statute or regulations. University of Phoenix, Inc. v. Indiana Department of State Revenue, 88 N.E.3d 805 (T.C. 2017); Quest Diagnostics Clinical Labs. Inc. v. Barfield, 2015-0926 (La. App. 1 Cir. 9/9/16). In *Quest* the Louisiana court also questioned whether market-based sourcing provides an adequate view of all costs of producing the business income, and questioned whether application of market-based sourcing alongside cost-of-performance of services would pass

Conclusion

Taxpayer has shown no legal basis for finding the Licenses to be located in New York. Taxpayer's Licenses were not located in New York by geographic or demographic factors, business activity, integral relation to buildings or land, court jurisdiction, or otherwise. The intangible Licenses had no situs and the nonbusiness income from their sale must be allocated to Taxpayer's commercial domicile.

III. Commercial Domicile

A. Preliminary

Each member corporation of a unitary group must individually account for any nonbusiness income allocated to Vermont. Reg.§ 1.5862(d)-7(c)(5). Since VNAT sold the Albany License, and Wireless sold the Glens Falls License, the commercial domicile of each corporation must be determined. Taxpayer asserts that the commercial domicile is Connecticut. The Department asserts that it is Vermont.

B. Commercial domicile case law

The concept of "commercial domicile" developed in the context of taxation of intangibles. A corporation is "legally domiciled" in "the place of its incorporation." First Bank Stock Corp. v. State of Minnesota, 301 U.S. 234, 237 (1937). When

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(Commerce Clause) muster under the *Complete Auto* "internal consistency" test. Id. at 11.

Even if Vermont were to adopt the new UDITPA market-based sourcing regulations, the new UDITPA regulations do not change the UDITPA regulations requiring allocation of *nonbusiness investment* income to the taxpayer's commercial domicile, as noted above, under U/Reg IV.2.(b)(3) and Compact Article IV, Sec. 6(c).

corporations did business only in the state of incorporation, the intangible "followed its owner" in the same way as tangible moveable property (*mobilia sequuntur personam*) for purposes of taxation. Jurisdiction over the owner was the sufficient due process link to allow taxation of the corporation's moveables and its intangibles.

With the rise of multistate business, the corporation might have no real relation to its state of incorporation, other than the fact of incorporation there. In that case, the legal domicile is merely a "paper domicile." For this reason, courts developed exceptions to the *mobilia* rule. A California court described the developing exceptions in Southern Pacific Co. v. McColgan, 156 P.2d 81 (1945): First, if the intangible is used in business, it is deemed to have a "business situs" there, and to be taxable by the business situs state, rather than "follow its owner" to the "paper domicile" state. If, however, the intangible is merely an investment, it can have no "business situs," and if the corporation also has no real link to its "paper domicile," the court determines which state has the sufficient link to support taxation of the intangible. This other state with the greater link is termed the "commercial domicile." This concept recognizes that domicile for tax purposes is in the state where the corporation is actually operating and has its "principal place of business." "Commercial domicile" is considered the domicile-in-fact, and supersedes the authority of the paper domicile to tax the corporation's intangibles:

> In recent years the doctrine that the state of the business situs of intangibles may tax has been greatly extended. It is extremely difficult to tell the exact limits of the doctrine. **Each**

> **case must turn upon its own facts**, and from those facts it must be determined whether in that case the business situs of the particular intangibles in fact and in law, is in the taxing state. One of the extensions of the business situs rule, or perhaps an independent exception to the *mobilia* rule, is to be found in those cases that hold that the foreign state where a corporation has established its 'commercial domicile,' at least in reference to the intangibles in question, has jurisdiction to tax those intangibles . . . [W]here the state of incorporation is a paper domicile, a mere technical legal domicile, in which the corporation carries on none of its activities, such corporation may be said to have its domicile in fact, its commercial domicile, in that state where it has its principal place of business, and that state, in return for the advantages, opportunities and protection accorded the corporation in the conduct of its business there, may tax the intangibles of such corporation.

Id. at 95 (bold typeface added), Although the court first describes the concept as an "extension of the business situs rule," the court's second description is more apt - that the concept is "perhaps an independent exception to the *mobilia* rule."

"Commercial domicile" is described variously as the location of the "general business offices" (Wheeling Steel Corp. v. Fox, 298 U.S. 193, 211 (1936)); the "principal place of business" (*Southern Pacific*, *supra*, 156 P.2d at 95, 99) the "principal business office" (Associated P'ship I, Inc. v. Huddleston, 889 S.W.2d 190, 197-198 (Tenn. 1994)

(*citing* Anniston Sportswear Corp. v. Alabama, 151 So.2d 778 (Ala. 1963)); or the "general office" (Smith v. Ajax Pipe Line Co.)., 87 F.2d 567 (8th Cir. 1937)). The general or principal business office is, however, only short-hand for "commercial domicile," as the court cases establish that "commercial domicile" is determined from a review of all the facts. In identifying the commercial domicile, the "true test must be to consider all the facts . . . to determine . . . which state . . . gives the greatest protection and benefits." *Southern Pacific*, *supra*, 156 P.2d at 99.

Southern Pacific cited the U.S. Supreme Court case of *Wheeling Steel* as "establishing this rule" of commercial domicile. Id. *Wheeling Steel* held that accounts receivable and bank deposits of a Delaware corporation, which had manufacturing plants in Ohio and sales offices in a number of other states, were taxable by West Virginia:

> The corporation established in West Virginia what has aptly been termed a 'commercial domicile.' It maintains its general business offices at Wheeling and there it keeps its books and accounting records. There its directors hold their meetings and its officers conduct the affairs of the corporation. There, as appellant's counsel well says, 'the management functioned.' The corporation has manufacturing plants and sales offices in other states. But what is done at those plants and offices is determined and controlled from the center of authority at Wheeling. The corporation has made that the actual seat of its corporate government.

Wheeling Steel Corp. v. Fox, 298 U.S. 193, 211-212 (1936). *Wheeling* established that commercial domicile is determined by the totality of the facts, including the location of the general business offices, where the books and records are kept, where checks are drawn, where the directors hold their meetings, where the officers conduct the business affairs of the corporation, and where management functions. Id. at 211-213.

Commercial domicile cases following *Wheeling* have all applied a factual analysis. In *Southern Pacific*, *supra*, the taxpayer was incorporated in Kentucky, operated in California and other Western states, but asserted that its commercial domicile was in New York, where its board of directors and executive committee met and where the intangible stock was held which generated the dividend income to be taxed. The court held that while the location of the directors' meetings was an important fact, it was not solely determinative. The commercial domicile was California, where the company had "substantially more business and property," where the majority of its employees worked, and where its legal, engineering and purchasing staffs operated. *Southern Pacific*, 156 P.2d at 90. The court held that where the board of directors meets is not conclusive if the evidence as a whole shows "the factual and realistic" business center is elsewhere:

> The fact that the board of directors of plaintiff meets in New York is an important, a very important factor, to be considered in determining whether California is in fact the commercial domicile of this company. But that factor is not conclusive . . . [T]he contention that, as a matter of law the only state that can

> possibly be held to be its commercial domicile is that state where its board of directors meets, is as unrealistic, unsound, and artificial as the concept that the corporation for all tax purposes is domiciled in the state of incorporation. It was to free the law from this last mentioned artificial and fictional concept that the concepts of business situs and commercial domicile were applied by the courts. *The true test must be to consider all the facts* relating to the particular corporation, and all the facts relating to the intangibles in question, and *to determine from those facts which state, among all the states involved, gives the greatest protection and benefits to the corporation*, which state, among all the states involved, from a factual and realistic standpoint is the domicile of the corporation.

Id. at 99 (italics added). The *Southern Pacific* court cited earlier cases, including *Wheeling*, to support its statements that commercial domicile may be "in a state other than the one in which the board met" and "That the state where ultimate control is exercised is not necessarily the commercial domicile." Id. The commercial domicile is the state where:

> . . . substantially more activities are carried on, more actual control is exercised, more protection is given this corporation, and more benefits conferred on it . . . than by any other state.

Id.

Similarly, the court in Pacific Western Oil Corporation v. Franchise Tax Board, State of California, 289 P.2d 287 (1955), looked at all the facts

to determine in which state "the taxpayer [corporation] received the greatest protection and benefits." Id. at 293. The court considered the number of employees in each state, where the books and records were kept, the location of its fixed assets, the sales volume in each state, where it filed its Federal tax returns, where the day- to-day production and sales activities occurred, where payroll payments were made, and other factors. Id. at 294.

A more recent case which expressly follows *Wheeling* reaffirmed that the location of board meetings is simply one factor and not alone determinative: "[E]ven if the 'high level management decisions'" are made elsewhere, the more important factors are where the "common officers of [the corporation]" execute "the detailed implementation and exercise of the policies." Pelto Oil Co. v. Collector of Revenue of State of La., 384 So. 2d 533, 539-540 (La. Ct. App. 1980). In that case, the court looked to the state where the corporation engaged in its main business activity, where it was "actually functioning from the headquarters." Id. at 538. The court considered where the taxpayer had an "office available to the general public," its mailing address, the location of its "books and records of day-to-day operations," the location of its "secretarial, bookkeeping, leasing, geological, and engineering staff," and where it "prepared budgets, made sales, contracted for services, collected money, paid bills, salaries, and other obligations." Id. at 539. The *Pelto* court held:

> The commercial domicile of a business cannot be at some remote location where an individual, or even two or three of the higher officers of a corporation, may be located,

> particularly if there is no office, staff, or other physical indicia of management functioning at that location.

Id. The court held that the "out-of-state formulation of policy and general influence of an out-of-state board of directors does not remove a commercial domicile" to that state. Id.

C. Vermont definition of "commercial domicile"

"Commercial domicile" is defined in Vermont's regulations as "the principle [*sic*] place from which the business is directed or managed." Reg. § 1.5833-l(e). Although Vermont has not adopted UDITPA, its definition of "commercial domicile" is identical with the UDITPA definition ("'Commercial domicile' means the principal place from which the trade or business of the taxpayer is directed or managed." UDITPA Sec. l(b)). The official Comment to the UDITPA definition states:

> Comment
>
> The phrase "directed or managed" is not intended to permit both the state where the board of directors meets and the state where the company is managed to claim the commercial domicile. The phrase "directed or managed" is intended as two words serving the same end; not as two separate concepts.

UDITPA Comment to Sec. 1(b). This Comment echoes the case law, that the place where the board of directors meets is not, by itself, the test of commercial domicile. Case law and commentary both indicate that the UDITPA definition is intended to follow the U.S. Supreme Court's reasoning in *Wheeling Steel*:

> The UDITPA definition of the phrase "commercial domicile," and the interpretation

> given the phrase by those courts considering the issue is consistent with the decisions from courts in other non-UDITPA jurisdictions that follow *Wheeling Steel Corp*. . . .

Associated P'ship I, Inc., *supra*, 889 S.W.2d at 198; "Factors to Be Considered in Determining a Corporation's Commercial Domicile," J. Multistate Tax'n 6, 10 (Oct. 2003) ("The UDITPA definition of commercial domicile follows the theory adopted by the U.S. Supreme Court in *Wheeling Steel*."). Since the Vermont definition of "commercial domicile" is identical with the UDITPA definition, and the UDITPA definition follows *Wheeling*, it is clear that the reasoning of *Wheeling* applies to analysis of Taxpayer's case under Vermont law. As noted, *Wheeling Steel* and its progeny hold "the true test must be to consider all the facts," to determine where the "actual conduct of business operations" occurs, and which state "gives the greatest protection and benefits to · the corporation."

E. Applying commercial domicile analysis to the facts of this case

All of the taxpayer corporations (other than FWF, not relevant here) were incorporated in Delaware, but there is no evidence of any office, employees, or activity in Delaware. Delaware was therefore a "paper domicile," and not the commercial domicile of any of the corporations.

l. Location of high-level decision-making

Taxpayer asserts that VNAT's commercial domicile is Connecticut, the location of Dr. Guite's office in his home in Greenwich, where he makes "high-level strategic decisions" for VNAT:

> VNAT's commercial domicile is clearly located in Connecticut. As VNAT's president, treasurer, chief executive officer, and a member of its board of directors, Dr. Michel Guite is ultimately responsible for making the high-level strategic decisions for VNAT . . . The record establishes that Dr. Guite makes these high-level decisions at *VNAT's principal office* located at 47 Glenville Road, Greenwich, Connecticut, and that the VNAT Board of Directors also typically meets in Greenwich or else via telephone . . . Meetings between Dr. Guite and high-level executive from other companies also generally occur in Greenwich because it is more easily accessible from major metropolitan areas and large airports than Springfield, Vermont. In addition, the Greenwich office is better suited to facilitate high-level discussion. Whereas the space allocated to Dr. Guite in the Springfield office consists of just an open desk in a shared work area, the Greenwich office is spacious and well-equipped for both private work and conferences. It was specifically designed as 'a place to think, to review documents, store confidential documents, host business guests in a warm and inviting setting, and to walk around during conference calls.'

TP Memo pp. 29-30 (italics added); *see also*, Dr. Guite's testimony, PF pp. 7-8.

Taxpayer asserts that "under *Wheeling*, it is the location of the high-level decision makers - the directors or managers - that matters the most, even if the majority of a company's assets, employees, and business activity and day-to-day implementation are

located elsewhere." TP Memo p. 29. This assertion is at odds with the U.S. Supreme Court's ruling in *Wheeling* and the state cases which follow it. It is not the high-level decision makers' location that matters the most, though it is one fact to be considered.

2. Principal office address

First, it is noted that although Taxpayer describes his Greenwich office as "VNAT's principal office," it is not owned by VNAT, but is owned personally by Dr. Guite and is a room in his personal residence. There is no evidence of any VNAT or Wireless or other corporate or business lease of the Greenwich home office.

There is no evidence that VNAT or Wireless, or the other members of the taxpayer group, owned or leased any office in Connecticut. The 2012 Connecticut corporate return was filed by Vtel alone, seeming to indicate no VNAT or Wireless property in Connecticut in 2012. In the 2013 combined VNAT-Vtel Connecticut corporate return, VNAT affirmatively stated that the "principal place of business" was not located Connecticut, and entered "Vermont" as the "principal place of business." Also in that return, VNAT reported no Connecticut intangible or tangible property, indicating no VNAT interest in any Connecticut office. Since Wireless was not included on either Connecticut return, it means Wireless reported no office - and no property - in Connecticut in 2012 or 2013.

All audited corporate tax returns were filed with the reporting taxpayer's address as the Springfield office address.

Wireless' 2012 and 2013 corporate annual reports to the Vermont Secretary of State report the mailing

and the principal office addresses as the Springfield office.

VNAT's 2012 and 2013 corporate annual reports to the Vermont Secretary of State report the mailing address as the Springfield office, but the principal office as the Greenwich address. This document is insufficient to overcome the evidence from the Connecticut corporate returns (above), which were submitted under penalties of perjury, and the multiple declarations of the Springfield office as the VNAT business address or principal office on all Federal and state tax returns for 2012 and 2013, also submitted under penalties of perjury.

3. Office location of conduct of day-to-day business

Frances Stocker, the Chief Financial Officer, Vice President of Finance, and Treasurer for VNAT, works in the Springfield office. That office is where she worked with the Auditor to provide records and answer questions, which is part of the ordinary conduct of a business, though the audit was not in 2012 or 2013.

Ms. Stocker signed all 2012 and 2013 Vermont non-income tax returns in evidence, a part of the ordinary conduct of business.

Ms. Stocker had check signing authority in 2012 and 2013 for VNAT, Vtel, Wireless and DATA. She signed the checks for payment of 2012 and 2013 Vermont sales tax and payroll withholding tax. These are day-to-day business activities which it may be presumed, in the absence of other evidence, took place where Ms. Stocker works, in the Springfield office.

In 2012 and 2013, using the Springfield office address, VNAT filed Vermont sales and use tax

returns and payroll withholding tax returns; Vtel filed Vermont employer withholding reconciliation returns; and Wireless enrolled in electronic funds transfer for Vermont taxes. These are all evidence of day-to-day VNAT and Wireless business activities of sales, purchasing, and payroll activities in the Springfield office.

There are no Connecticut sales and use tax returns or payroll withholding returns in evidence for any of the companies. There was no evidence of any purchases, sales, or payroll or payroll-withholding activities conducted from Dr. Guite's Greenwich office, or any office, in Connecticut.

VNAT was not on the 2012 Connecticut corporate tax return, indicating no VNAT business activities or property or employees in Connecticut in 2012; and VNAT was on the 2013 Connecticut return, but reported zero Connecticut sales, property or payroll.

4. Where the common officers implement and exercise corporate policies

Dr. Guite made the decision on how to bid for the FCC Licenses while he was in Connecticut, but he then "directed those decisions to an employee in Springfield, Vermont, who actually executed the bids." This is not 2013 evidence, but is evidence that his high-level decision to make the 2003 purchase was implemented by an employee in Vermont.

Dr. Guite testified that he made the decision to sell the FCC Licenses in 2013 while he was in Barcelona, Spain. There is no evidence of who implemented this decision or from what state.

There was no evidence of implementation in Connecticut of any of Dr. Guite's high-level decisions.

5. Location of secretarial, bookkeeping, and other staff

Taxpayer's CPA for 2012, 2013 and 2014 corporate income tax for the Taxpayer group is located in Maine and works for a Maine accounting firm.

In their Vermont annual corporate reports for 2012 and 2013, VNAT and Wireless both reported Dawn Tucker as their accountant. Ms. Tucker signed the Vtel 2012 and 2013 Vermont withholding tax reconciliation returns, showing her address as the Springfield office.

Since the 2012 through 2014 audit records, other than the non-Vermont corporate tax returns, were located in the Springfield office, it may reasonably be inferred that the secretarial and bookkeeping staff who created and maintained those sales, purchase and payroll records were in Vermont.

There was no evidence of secretarial, bookkeeping or other office staff working in Connecticut.

Somewhat analogous to location of staff is the location of the business' bank. VNAT's 2012 and 2013 Vermont corporate quarterly tax payments were paid with checks drawn on People's United Bank, and at least one of the checks was imprinted with "People's United Bank of Burlington, Vermont."

6. Where books and records are kept

Dr. Guite testified that VNAT's records, including its tax returns, are generally stored electronically and therefore accessible from his computer in Connecticut. This indicates that the original corporate records were not in Connecticut.

The Department Auditor testified that she conducted a full audit, of all tax types, for the years

2012 through 2014, and performed an on-site review at the Springfield office. There, she reviewed the 2012 through 2014 invoices, sales records financial statements, withholding tax filings, W2s and W3s, and supporting work papers for Vermont taxes, other than corporate income tax, for VNAT, Wireless and Vtel. This indicates that these 2012, 2013 and 2014 records were kept in the Springfield office in Vermont.

CPA Caouette, who is located in Portland, Maine, provided the Auditor with corporate tax returns and financial statements for the audit period. This indicates the corporate tax returns for 2012, 2013, and 2014 were kept in Maine.

As between Connecticut and Vermont, the greater number of books and records were kept in Vermont. In fact, then is no evidence that any records were kept in Connecticut, but only that VNAT's records could be viewed on Dr. Guite's computer there.

7. Where the majority of employees work

Vermont law requires that employers submit withholding tax for every payment subject to Vermont income tax. 32 V.S.A. § 5841(a). On its 2012 and 2013 Vermont withholding returns, Vtel reported 57 and 59 employees subject to Vermont withholding. This indicates that Vtel had over 50 employees in each year who were either resident in Vermont or working in Vermont. Although the employer was Vtel, the payments of the withholding taxes in evidence were made by VNAT on VNAT checks.

The evidence includes a VNAT Vermont employer withholding reconciliation filed in 2013 for 2012. There was no evidence of any Connecticut VNAT or Wireless employer-withholding tax returns or payments for 2012 or 2013.

The 2012 Vtel stand-alone Connecticut return reports Vtel "cost of operations" but reports no deduction for Connecticut payroll taxes. The 2012 Connecticut return indicates no VNAT or Wireless Connecticut employees in that year.

The 2013 combined Connecticut return of VNAT and Vtel reports nothing allocated to Connecticut for wages, and reports no deduction for Connecticut payroll taxes for VNAT, Vtel, Wireless or other subs.

8. Where the board of directors meets

Dr Guite testified that meetings of the VNAT board of directors "are typically" held in his home office, though he testified that when Walter Hewlett was on the board, they "would also have Directors' meetings at locations that were convenient for him," and "with [Dr. Guite's] daughters now on the Board of Directors, we are holding more meetings via telephone." Walter Hewlett was on the VNAT board "until approximately 2013," and Dr. Guite's daughters joined the board in 2013. Thus, it is unclear from the record how many board meetings were held in Connecticut in 2012 and 2013.

Even if all board meetings had been held in Connecticut, the location of board meetings is but one factor to consider.

9. Where greater protection is given and more benefits conferred

In 2012 and 2013, the taxpayer corporations' unitary group, which included VNAT and Wireless, reported its total business receipts and business property everywhere were close to, or over, 90 percent in Vermont. The various audited returns for the group reflect a majority of its employees were in Vermont in 2012 and 2013. Neither VNAT nor

Wireless reported any Connecticut business receipts, property or payroll in 2012 or 2013.

Vermont's contract laws, real property laws, employment laws, banking laws, and other laws provided protection and benefits to VNAT's and Wireless' Springfield office, bank account, office staff, business activities, business records, and employees in Vermont in 2012 and 2013. The lack of evidence of a Connecticut business office, office staff, day-to-day business activities or business records, and the lack of any VNAT or Wireless report of business receipts, property or wages in Connecticut in these years, indicate far less benefit and protection from, and far less taxable link, if any, to Connecticut.

Conclusion

Considering all the facts, there are many indicia that in 2012 and 2013, for VNAT, Wireless, and Vtel, Vermont was the location of the principal office, the place where high-level policy was implemented, where the conduct of day-to-day business operations occurred, where the greatest number of office staff and business employees worked, and where the business records were kept, and was the state that gave the greatest protection and benefits to these companies. There was evidence that the VNAT board of directors' meetings "are typically" held in Dr. Guite's home office in Connecticut, though there is no specific evidence of meetings in 2012 and 2013; that Dr. Guite's high-level business decisions are made in his Connecticut home office, though there is no specific evidence of decisions in Connecticut in 2012 and 2013, and his decision to sell the Licenses in 2013 was made while he was in Barcelona, Spain; and that VNAT's 2013 corporate annual report to the Vermont

Secretary of State reported a Connecticut principal office address. This scant Connecticut evidence is insufficient to overcome the more-detailed, documented, and far greater evidence, described above, that Vermont was the commercial domicile of these companies in 2012 and 2013.

IV. Allocation of Dr. Guite' s wages

Vermont taxes a multistate unitary corporate group doing business in Vermont on the Vermont share of its multistate business income. 32 V.S.A. § 5833. The Vermont share of taxable business income is apportioned by comparing the group members' Vermont sales, property, and payroll in the numerator to the group's total sales, property, and payroll in the denominator. The payroll numerator for the apportionment calculation is detailed in regulations:

(c) Payroll Factor

(1) The payroll factor is a fraction, the numerator of which includes the total compensation paid in Vermont during the tax period and the denominator of which includes the total compensation paid everywhere during the tax period. In addition to "normal" salary and wages, compensation shall include payments to employees for board, rent, housing, lodging, and any other benefits paid in exchange for labor. These amounts will be treated as compensation if they are considered as income under the Internal Revenue Code.

(2) The taxpayer's accounting method will determine the actual amounts that are to be included in the factors. If the taxpayer uses the accrual method of accounting, compensation that

has been properly accrued and deductible will be considered to have been paid during the taxable period.

(3) For purposes of this regulation, an employee is defined to be any person, including an officer of the corporation, who is included by the taxpayer as an employee for purposes of the payroll taxes imposed by the FICA.

(4) The payroll factor shall include only compensation that is related to the production of apportionable income. Compensation that is related to the operation, maintenance, protection or supervision of nonbusiness income is not included in the payroll factor. To the extent that employee services produce both business and nonbusiness income, proration is allowed .

(5) *Compensation will be considered to be paid in Vermont* and thus includable in the numerator of the payroll factor *if*:

(A) the individuals' services are performed entirely within Vermont;

(B) the individuals' services are performed both within and without Vermont, but the out-of-state services are incidental to the Vermont services;

(C) *some of the individuals' services are performed within Vermont and the company's base of operation or the place from where the service is controlled is within Vermont*; or

(D) some of the individual's services are performed within Vermont, which is his or her state of residence, and there is no base of operation or place from where the service is controlled in any of the other states where

> part of the individual's services are performed.

Reg. §1.5833-1(c) (italics added).

Taxpayer asserts that the compensation Dr. Guite received for time working in his home office in Connecticut is not includible in the Vermont payroll numerator.

The italicized portion of the regulation quoted above is the rule applicable here: "Compensation will be considered to be paid in Vermont . . . if . . . some of the individuals' services are performed within Vermont and the company's base of operation or the place from where the service is controlled is within Vermont."

Taxpayer does not dispute that Dr. Guite worked some portion of his time in Vermont in 2012 and 2013. TP Memo p. 38. This satisfies the first requirement in the regulation, that some of his services were performed within Vermont.

As discussed earlier, the commercial domicile, or base of operation, of VNAT, Vtel and Wireless was Vermont in 2012 and 2013. This satisfies the second requirement in the regulation, that either the base of operation or the place from where the service is controlled is within Vermont.

Since both requirements of the regulation are satisfied, the compensation paid to Dr. Guite for his time working in Connecticut "will be considered to be paid in Vermont" for purposes of apportionment.

The regulation provides that the payroll factor only includes compensation related to business income. If compensation is related to production of some business income and some nonbusiness income, the compensation may be prorated for calculating the

payroll factor. Reg. § 1.5833-l(c)(4). The Department's assessment is presumed correct, and the burden is on the taxpayer to demonstrate that a proration is required. Thinking Machines Corp. v. New Mexico Taxation and Revenue Dept., 211 B.R. 426, 428 (D.Mass. 1997) ("It is settled law that taxpayers bear the burden of proving that a tax deficiency assessment is erroneous . . . This rule is supported by 'the presumption of administrative regularity; the likelihood that the taxpayer will have access to the relevant information; and the desirability of bolstering the record-keeping requirements of the Code.'"). Taxpayer here has offered to no evidence to support a proration.

Conclusion

As a result, Dr. Guite's total compensation for 2012 and 2013 must be included in the Vermont numerator of the apportionment calculation.

V. Penalties

The Department assessed penalties under Section 3202(b)(3) for "failure to pay" taxes. The penalty for underpayment of income tax is one percent per month, up to a maximum of 25 percent of the outstanding tax liability. 32 V.S.A. § 3202(b)(3).

Taxpayer asserts that this penalty should be imposed only when the taxpayer has acted unreasonably, and asserts that in this case, Taxpayer "made no attempt to hide" the gain and was cooperative in the audit. Taxpayer also asserts that "the factual and legal issues at the heart of this dispute are complex," and that the complexity made it reasonable for Taxpayer to report the gain as New York gain based on its interpretation of the law. TP Memo pp. 40-41, TP Memo2 p. 16.

Section 3202 imposes interest and penalties for all taxes under the Commissioner's jurisdiction. It provides for three types of penalties: failure to pay, negligent failure to pay, and fraudulent failure to pay:

> § 3202. Interest and penalties
>
> . . .
>
> (b) Penalties . . .
>
> (3) Failure to pay. When a taxpayer fails to pay a tax liability imposed by this title . . . on the date prescribed therefor, then in addition to any interest payable pursuant to subsection (a) of this section, the Commissioner may assess and the taxpayer shall then pay a penalty which shall be equal to . . . five percent . . . provided, however, that in no event shall the amount of any penalty assessed under this subdivision exceed 25 percent . . . .
>
> (4) Negligent failure to pay. When a taxpayer fails to pay a tax liability imposed by this title and the failure is due to negligence or constitutes a substantial understatement of tax . . . "negligence" means any failure to make a reasonable attempt to comply with the provisions of the tax code and "substantial understatement" means an understatement of 20 percent or more of the tax.
>
> (5) Fraudulent failure to pay. When a taxpayer fraudulently or with willful intent to defeat or evade a tax liability imposed by this title, either fails to pay a tax liability on the date prescribed therefor . . . .

32 V.S.A. § 3202(b)(3), (4), (5).

The higher two penalties are for negligent and fraudulent failure to pay. The first level is a penalty

for simple "failure to pay," regardless of fault. The no-fault penalty does not require a showing of negligence, fraud, or any other state of mind; it is a strict-liability provision, meaning it is triggered by mere nonpayment. The presence of the negligence and fraud penalties in Subsections (4) and (5) indicates that the Legislature was aware of the concepts of fault and state of mind, and intended to create a penalty for simple failure to pay with no fault in Subsection (b)(3). The Legislature is presumed to have chosen the words of a statute advisedly. Wetterau, Inc. v. Department of Taxes, 141 Vt. 324, 330 (1982). That is, it is presumed that the Legislature was aware, when it created the no-fault penalty; that it would apply to a taxpayer who simply failed to pay a tax when due, for whatever reason.

While Taxpayer may have acted in good faith, lack of good faith is not the only reason for a penalty. Another reason is to encourage communication between a taxpayer and the Department prior to the taxpayer's taking a questionable position on a tax return. The risk of not only having to pay the tax deficiency, but also having to pay a penalty for underpayment, is intended either to dissuade a taxpayer from taking a questionable position or to persuade the taxpayer to first seek a formal ruling from the Department as to the tax consequences. Here, Taxpayer believed the legal issues to be complex, and in addition, had a Maine CPA preparing its Vermont corporate income tax returns. Taxpayer nonetheless did not request a ruling, but assumed the risk of omitting the capital gain from its Vermont taxable income and omitting a portion of Dr. Guite's wages from its Vermont apportionment calculation.

Though Taxpayer found the law to be complex, taxpayers are presumed to know the law. Longe v. Boise Cascade Corp., 171 Vt. 214, 226 (2000) ("[T]he time-honored principle that all persons are presumed to know the law" is "of unquestioned application in Vermont as elsewhere, both in civil and in criminal cases."); *see also* Wells v. C.I.R., T.C. Memo 2010-5, 3, 2010 WL 23333, (U.S.Tax Ct., 2011) ("[A] taxpayer is presumed to know the law, and a mistake of law does not excuse liability."). For this reason, and as a matter of fairness to all taxpayers, ignorance of the law is not considered sufficient reason to forbear or waive penalties. Use of the word "may" in the no-fault penalty statute, quoted above, provides the Commissioner with discretion to withhold the penalty in appropriate cases, but there were no circumstances here which warranted withholding the penalty. The Supreme Court recently affirmed that a mistake of law does not excuse liability for the tax or for the no-fault penalty. Citibank (S. Dakota), N.A. v. Dep' t of Taxes, 2016 VT 69, ¶¶ 27-28 ("Because penalties are authorized where a taxpayer has failed to pay any tax owed to the Department, the Commissioner acted well within her discretion in imposing a 5% monthly penalty . . . [R]etailer is essentially positing that it should not incur penalties because it was ignorant of the tax law, an untenable defense in any jurisdiction.").

Conclusion

The penalties should not be abated.

VI. Conclusion

Based on the foregoing analysis, the Department's assessments, including interest and penalties, are affirmed.

Dated this 27th day of August, 2018, at Montpelier, County of Washington, State of Vermont.

State of Vermont
Department of Taxes

s/ Emily J. Bergquist
Emily J. Bergquist
Hearing Officer

APPROVED BY:

s/ Kaj Samson   Date: 8/28/18
Kaj Samson
Commissioner of Taxes

STATE OF VERMONT

SUPERIOR COURT CIVIL DIVISION
Washington Unit Docket No. 528-9-18 Wncv

Vermont National Telephone Company
Taxpayer–Appellant
v.

State of Vermont Department of Taxes
Appellee

DECISION ON APPEAL

Taxpayer Vermont National Telephone Company (VNAT) appeals from the Commissioner of Taxes' determination that capital gain on its 2013 sale of two Federal Communications Commission (FCC) telecommunications licenses is properly allocated to, and thus taxable by, Vermont pursuant to Department of Taxes Regulation § 1.5833-1.[1] VNAT also appeals the assessment of an underpayment penalty imposed pursuant to 32 V.S.A. § 3202(b)(3).

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[1] At all times relevant to this case, VNAT was part of a "unitary group" doing business in Vermont and elsewhere that included subsidiaries VTel Wireless, Inc., Four Winds Farm, Inc., and VTel Data Networks, Inc. There is no dispute in this case about VNAT's unitary group reporting or other need to distinguish between VNAT and its subsidiaries or among the related corporations. For ease of reference, the court will refer to VNAT and its subsidiaries collectively as VNAT. While the unitary business principle provides crucial legal context to this case, there is no specific dispute about it presented. For more on the unitary business principle and unitary group reporting in Vermont generally, see 32 V.S.A. § 5862(d); Department of Taxes Regulation § 1.5862(d); *AIG Ins. Mgmt. Servs., Inc. v. Vermont Dep't of Taxes*, 2015 VT 137, 201 Vt. 9.

Regulation § 1.5833-1 addresses the apportionment and allocation, for tax purposes, of corporate income arising from business "conducted both within and outside this State." 32 V.S.A. § 5833(a).[2] Apportionment and allocation are processes for determining how much of the corporate taxpayer's income will be taxed. The parties agree that the gain on the sale of the licenses, which were held purely for investment purposes, is "nonbusiness" income for purposes of the rule. The principal issue is where the licenses are properly "located" if they can be located anywhere at all.[3]

VNAT argues that the licenses have a New York State location exclusively and thus the gain from their sale must be allocated to New York and cannot be taxed by Vermont. The Commissioner determined, and the State argues, that the licenses have *no location* and thus the gain from their sale is properly allocated to Vermont, VNAT's "commercial domicile."

The principal controversy is one of interpretation. The parties interpret Regulation § 1.5833-l(e), which describes how corporations should allocate nonbusiness income, to different effect. There is no

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[2] The legislature substantially amended 32 V.S.A. § 5833 in 2019. 2019, No. 51, § 8. The amendment "shall take effect on January 1, 2020, and apply to tax years starting after that date." *Id.* § 41(3). The amendment therefore does not apply to and has no bearing on this case.

[3] At issue before the Commissioner also was an issue related to VNAT's 2012 taxes. The Commissioner resolved that issue in favor of the Department, and VNAT has not raised any issue with that ruling on appeal. The court therefore treats that ruling as beyond the scope of review and will not address it. This case is limited to those parts of the Commissioner's Determination addressing VNAT's 2013 taxes.

dispute about the underlying facts, and VNAT is not challenging the constitutionality of Regulation § 1.5833-1 generally or the constitutionality of the Department's interpretation of it specifically.

Standard of Review

The Court has described the standard of review in tax appeals as follows:

> Courts presume that the actions of administrative agencies are correct, valid and reasonable, absent a clear and convincing showing to the contrary. Therefore, judicial review of agency findings is ordinarily limited to whether, on the record developed before the agency, there is any reasonable basis for the finding. Courts must remember that "(a)dministrative agencies belong to a different branch of government," and that "(t)hey are separately created and exercise executive power in administering legislative authority selectively delegated to them by statute."

State Dep't of Taxes v. Tri-State Indus. Laundries, Inc., 138 Vt. 292, 294 (1980) (citations omitted).

Regulation § 1.5833-l(e) income allocation

In 2003, VNAT purchased two FCC licenses granting it exclusive telecommunications use of a definite part of the electromagnetic spectrum covering two specific geographic areas each wholly within New York State. VNAT purchased and held the licenses purely for investment purposes. It never constructed the on-the-ground infrastructure necessary to use the rights granted by the licenses, and it did not otherwise use those rights in its regular

business operations.[4] VNAT sold both licenses in 2013 to AT&T Mobility Spectrum LLC, generating a substantial capital gain. VNAT treated the gain as having arisen from an asset located in New York State under Vermont Regulation § 1.5833-l(e) and thus paid no corporate income tax on the gain to Vermont. Following an audit, the Department assessed VNAT for unpaid tax on this gain, interest, and an underpayment penalty.

In the administrative case before the Commissioner, there was no dispute that the gain from the sale of the licenses is properly classified as *nonbusiness* income, meaning that it arose *not* from the taxpayer's regular business operations.[5] There also is no dispute that the licenses, which represent rights granted by a governmental entity, are *intangible* assets.

Regulation § 1.5833-1 prescribes methods for *apportioning business* income, Regulation § 1.5833-l(a)–(d), and *allocating nonbusiness* income, Regulation § 1.5833-1 (e). Apportionment—applicable to business income only—refers to the "fair" method of aggregating the taxpayer's Vermont and non-Vermont income and then calculating according to a formula the amount that will be used for Vermont tax purposes. Allocation—applicable to

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[4] VNAT claims that merely holding such licenses can be a business use of them insofar as ownership excludes competitors from using the licensed spectrum. However, there is no dispute in this case that these licenses were held exclusively for investment purposes and their sale generated nonbusiness income only.

[5] The court takes no position on whether the income may be better characterized as business or nonbusiness income and defers to the parties' agreement on the issue.

nonbusiness income only—refers to a method of assigning income from a specific asset wholly to the state where it is located or to the taxpayer's commercial domicile if the asset has no location. In either event, if the assigned state is Vermont, the income will be taxed by Vermont. If it is a state other than Vermont, the income will not be taxed by Vermont.

Regulation § 1.5833-l(a)(2) provides: "All items of nonbusiness income (income which is not includable in the apportionable tax base) shall be allocated as provided in Sec. 1.5833-1(d)(6)." Section 1.5833-l(d)(6) further provides:

> Nonbusiness receipts are all receipts other than business receipts resulting from operations unrelated to [the taxpayer's] regular business operations. Typically nonbusiness receipts are comprised of passive or portfolio income. Income from dividends, interest and capital gains will be considered nonbusiness income unless the acquisition, management, and disposition of the underlying property generating the income constitute an integral part of the taxpayer's regular business operations.

The allocation provision for nonbusiness income is as follows: "Nonbusiness income will be allocated to the state in which the income producing assets are located. If the income producing asset has no situs, the income be allocated to the state of commercial domicile, the principle [sic] place from which the business is directed or managed." Regulation § 1.5833-l(e).

There is no indication that "situs" is being used as a term of art (such as *tax situs* or *business situs)* in the second sentence of Regulation § 1.5833-l(e) to mean anything other than "location," the parallel term expressly used in the first sentence. See Merriam-Webster Online Dictionary, available at https://www.merriam-webster.com/dictionary/situs (defining *situs* as "the place where something exists or originates").

The licenses at issue in this case are *intangible* assets. An intangible asset is "[a]n asset that is not a physical object." Black's Law Dictionary 113 (7th ed. 1999). An intangible asset, not being a physical object, has no *intrinsic* location. See *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 445 (1980) (noting that locations of intangible assets are "fictions"); *First Bank Stock Corp. v. State of Minnesota*, 301 U.S. 234, 240 (1937) ("The rule that property is subject to taxation at its situs, within the territorial jurisdiction of the taxing state, readily understood and applied with respect to tangibles, is in itself meaningless when applied to intangibles which; since they are without physical characteristics, can have no location in space."); *Wheeling Steel Corp. v. Fox,* 298 U.S. 193, 209 (1936) ("When we deal with intangible property . . . , we encounter the difficulty that by reason of the absence of physical characteristics they have no situs in the physical sense."); see also Factors To Be Considered In Determining A Corporation's Commercial Domicile, J. Multistate Tax'n 6, 8 (Oct. 2003) ("Unlike tangible property, for tax purposes intangible property must be assigned a situs."

VNAT argues that because use of the licenses can only occur in New York and nowhere else, the licenses

should be deemed to be located in New York. An asset that comprises a land interest can be different, however, from an asset that is land. For example, one may own 500 acres of timberland in Montana as an investment asset. Such an asset has a location in Montana. Or, one may own 100% of the stock in the Montana Timberland Corporation, Inc., which is the owner of 500 acres of timberland in Montana. The stock certificate is an intangible asset with no location, even though any activity to generate income from the land would have to occur in Montana. It is akin to owning a share of stock in Weyerhaeuser: if the share is sold, any gain is taxed to the owner where the owner pays taxes, regardless of where the land is that Weyerhaeuser owns.

The U.S. Supreme Court has described this distinction as follows:

> [T]here are many legal interests other than conventional ownership which may be created with respect to land of such a character that they may be constitutionally subjected to taxation in states other than that where the land is situated. No one has doubted the constitutional power of a state to tax its domiciled residents on their shares of stock in a foreign corporation whose only property is real estate located elsewhere, or to tax a valuable contract for the purchase of land or chattels located in another state, or to tax a mortgage of real estate located without the state, even though the land affords the only source of payment. Each of these legal interests finds its only economic source in the value of the land, and the rights which are elsewhere subjected to the tax can be brought to their ultimate fruition

> only through some means of control of the land itself. But the means of control may be subjected to taxation in the state of its owner whether it be a share of stock or a contract or a mortgage. There is no want of jurisdiction to tax these interests where they are owned in the sense that the state lacks power to appropriate them to the payment of the tax. No court has condemned such action as so capricious, arbitrary or oppressive as to bring it within the prohibition of the Fourteenth Amendment, for it is universally recognized that these interests are of themselves in some measure clothed with the legal incidents of property enjoyed by their owner, in the state where he resides, through the benefit and protection of its laws.

Curry v. McCanless, 307 U.S. 357, 365 n.3 (1939) (citations omitted). An intangible asset, merely because it stands in some relation to a tangible asset, does not for that reason necessarily possess all the qualities of the tangible asset to which it relates. The same is true in this case when comparing the licenses, which have no location, with the business use of the licenses, which may be thought to have a discernible location.

Because the licenses that generated the disputed income have no intrinsic location, and Regulation § 1.5833-l(e) allocates such income for tax purposes to the state of commercial domicile, the only remaining issue relating to taxability is whether the Commissioner's determination that Vermont is VNAT's commercial domicile is error. That issue is addressed below.

VNAT arrives at a different result under Regulation § 1.5833-l(e), however. It argues essentially as follows. (1) Regulation § 1.5833-1 first distinguishes between business income and nonbusiness income. (2) The nonbusiness income provision, Regulation § 1.5833-l(e), further distinguishes between income-producing assets with a location and those without a location and does not expressly distinguish between tangible and intangible property. (3) The lack of express distinction between tangible and intangible nonbusiness assets means that Regulation § 1.5833-l(e) must include the possibility that both types of property can have a physical location. (4) Relevant case law, particularly *Whitney* v. *Graves,* 299 U.S. 366 (1937), demonstrates that intangible assets can have a physical location, and that the licenses at issue in this case can be "localized" to New York.

VNAT's argument does not lead to the conclusion that the disputed income should not be allocated to Vermont. There is no need to read Regulation § 1.5833-l(e) as including the unlikely (and unstated) proposition that an intangible asset can have a physical location in some intrinsic sense. The apportionment part of the regulation refers in several places expressly to tangible property, and Regulation § 1.5833-1(d)(5) expressly addresses business income from intangible assets and includes that income within the apportionable tax base. Regulation § 1.5833-l(e) does not expressly use the terms tangible or intangible, but by expressly allocating income from assets with no location it effectively addresses nonbusiness income from intangible assets. Nothing in the record implies that Regulation § 1.5833-l(e) must or should be interpreted to embrace the physical

impossibility that an intangible thing, which has no physical existence, nevertheless has some intrinsic geographic location.

Neither *Whitney* nor any other case supplied by VNAT stands for the proposition that an intangible asset has any intrinsic location. *Whitney* addressed the constitutionality of a tax imposed by New York State on "the profits realized by a nonresident upon the sale of a right appurtenant to membership in the New York Stock Exchange." *Whitney,* 299 U.S. at 369. The court found the New York tax constitutional because the intangible rights at issue could be "localized" to New York—that is, determined to have a tax situs in New *York—despite* being intangible rights otherwise without any intrinsic physical location. *Id.* at 372. In other words, assigning a tax situs of New York to the income did not violate the Constitution even though the owner of the asset was domiciled elsewhere. The Court clearly did not rule that the income could not also be taxed by the non-New York state of the taxpayer's domicile or commercial domicile. See *id.* at 373–74 (addressing this issue). The *Whitney* Court was simply addressing the constitutionality of the tax actually imposed.

Whitney and similar authorities are unhelpful to this case. The issue here is not whether New York State could have constitutionally imposed a tax on VNAT's sale of the licenses.[6] Regardless whether it

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[6] Certain of the Commissioner's conclusions are irrelevant to this case. For example, the Commissioner determined: "Since Taxpayer never charged or collected broadcast contract fees from New York residents for broadcast services and never engaged in any 'activities with respect to [its] intangibles so as to avail [itself] of the protection and benefit of the laws of' in [sic] New York, there was also nothing to create a tax situs in that state."

could, the question in this case is simply what Regulation § 1.5833-l(e) requires. Regulation § 1.5833-l(e) requires allocating the income to the state of VNAT's commercial domicile. No other issue regarding taxability is presented. If VNAT has a constitutional objection to this outcome, it was never raised.

VNAT's commercial domicile

The Commissioner determined that VNAT's commercial domicile is Vermont.[7] VNAT does not

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Commissioner's Determination at 22. There is no New York tax at issue in this case, however, and there is no reason under the Vermont rule to determine whether a New York tax situs could successfully be asserted. Also, an implied premise that seems to run throughout much of the Determination is that an intangible asset can have only one location for tax purposes. See *Curry v. McCanless,* 307 U.S. 357, 373–74 (1939) ("If we enjoyed the freedom of the framers it is possible that we might, in the light of experience, devise a more equitable system of taxation than that which they gave us. But we are convinced that that end cannot be attained by the device of ascribing to intangibles in every case a locus for taxation in a single state despite the multiple legal interests to which they may give rise and despite the control over them or their transmission by any other state and its legitimate interest in taxing the one or the other. While fictions are sometimes invented in order to realize the judicial conception of justice, we cannot define the constitutional guaranty in terms of a fiction so unrelated to reality without creating as many tax injustices as we would avoid and without exercising a power to remake constitutional provisions which the Constitution has not given to the courts.").

[7] Unitary combined reporting requires each member of the unitary group to separately account for its "nonbusiness income or loss allocable to this state." Vermont Department of Taxes Regulation § 1.5862(cl)-7(c)(5). The Commissioner thus analyzed the issue of commercial domicile with regard to each unitary group member-seller, VNAT and VTel Wireless, Inc. VNAT's objection to the Commissioner's Determination on these

contest the thrust of the Commissioner's analysis of what "commercial domicile" means and does not argue that any of the component findings by the Commissioner lacks substantial evidentiary support. Rather, VNAT argues that a proper weighting of relevant considerations shows that its commercial domicile is Connecticut because that is where its president, treasurer, chief executive officer, and board member, Dr. Michel Guite, has a residence with a home office that he sometimes uses for VNAT business and when making strategic business decisions, and the board sometimes meets there.

Regulation 1.5833-l(e) describes commercial domicile as the "principle [sic] place from which the business is directed or managed." There appears to be no more specific Vermont regulatory or statutory definition of the expression. Following a more detailed analysis of the concept, the Commissioner generally summarized that "'[T]he true test must be to consider all the facts,' to determine where the 'actual conduct of business operations' occurs, and which state 'gives the greatest protection and benefits to the corporation.'" Commissioner's Determination at 42; accord Factors To Be Considered In Determining A Corporation's Commercial Domicile, J. Multistate Tax'n 6 (Oct. 2003).

The Commissioner's detailed findings demonstrate that nearly all of VNAT's varied business operations and day-to-day direction and management occur in Vermont. Dr. Guite's home office in Connecticut and occasional board meetings

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matters is not dependent on the identity of the specific seller. Thus, the court will continue to refer to the unitary group member collectively as VNAT.

there are, by comparison, not significant and do not reveal an actual commercial domicile in Connecticut versus Vermont.

The gain at issue in this case is properly allocated to VNAT's commercial domicile pursuant to Regulation 1.5833-l(e). VNAT's commercial domicile is Vermont. The Department therefore properly included this income in the calculation of VNAT's taxes.

Discretion and Constitutionality of the penalty

The Department imposed a penalty due to VNAT's underpayment of taxes pursuant to 32 V.S.A. § 3202(b)(3). Subsection (b)(3) gives the Department discretion to impose a penalty due to mere underpayment, regardless of negligence or fraud, which are addressed in other provisions. VNAT argues that the Commissioner failed to exercise discretion by *automatically* imposing the penalty and that doing so resulted in an unconstitutionally excessive fine.

Subsection 3202(b)(3) allows, but does not require, the Commissioner to impose a penalty for mere underpayment of taxes. The penalty was automatically assessed due to VNAT's underpayment. However, the Vermont Supreme Court already has rejected an argument, substantially similarly to VNAT's, that automatic imposition of a penalty is an impermissible failure to exercise discretion. Addressing analogous circumstances, the Court explained, "The fact that the penalty was imposed automatically by the Department of Taxes when the delinquency was discovered does not negate the exercise of discretion on the part of the Commissioner, particularly when

any penalty assessed is subject to individual review upon appeal to the Commissioner. It merely represents the full extent to which the Commissioner has chosen to exercise his discretionary authority as granted under the statute." *Piche v. Dep't of Taxes,* 152 Vt. 229, 234 (1989) (citation omitted).

In this case, as in *Piche,* the penalty was imposed automatically and it was subject to individual review on appeal to the Commissioner. VNAT in fact objected to the Department's automatic imposition of the penalty in the course of review before the Commissioner. The Commissioner's Determination reflects consideration and rejection of VNAT's objection. Among other things, the Commissioner maintained that the penalty serves an important purpose of encouraging taxpayers with complex issues or close calls to affirmatively seek clarification from the Department rather than simply—as in this case—not paying the tax and hoping for the best. The Commissioner did not fail to exercise discretion.

The penalty also is not unconstitutionally disproportionate. The statute permitted a penalty equal to 1% of the outstanding tax liability per month and capped it at 25% of the initial deficiency. 32 V.S.A. § 3202(b)(3). There is no suggestion that the penalty imposed exceeded that permitted by statute. The penalty is a small percentage of the outstanding liability that only grows over time so long as it remains unpaid and until it reaches a statutory maximum that can go no higher than a quarter of the original deficiency. VNAP has cited no case in which a similar tax penalty has been found unconstitutional as an excessive fine. "[C]ivil tax penalties have repeatedly been held not to violate the 8th Amendment's Excessive Fines Clause:" 14A Mertens

Law of Fed. Income Tax'n § 55:3; see also the cases annotated at *id.* § 55:3 n.7 (describing permissible penalties of 40%, 50%, and 75%). VNAT has not demonstrated that the penalty is unconstitutional.

ORDER

For the foregoing reasons, the Determination of the Commissioner is *affirmed*.

Dated at Montpelier, Vermont this 31st day of July 2019.

s/ Mary Miles Teachout
Mary Miles Teachout
Superior Judge

ENTRY ORDER

SUPREME COURT DOCKET NO. 2019-280
OCTOBER TERM, 2020

VERMONT SUPREME COURT
FILED IN CLERK'S OFFICE
NOV 02 2020

Vermont National Telephone Company * v. Department of Taxes	}	APPEALED FROM:
	}	
	}	Superior Court, Washington Unit Civil Division
	}	
	}	DOCKET NO. 528-9-18 Wncv

In the above-entitled cause, the Clerk will enter:

Appellant's motion fails to identify points of law or fact overlooked or misapprehended by this Court. The motion is therefore denied. See V.R.A.P. 40.

BY THE COURT:

s/ Paul L. Reiber
Paul L. Reiber, Chief Justice

s/ Beth Robinson
Beth Robinson, Associate Justice

s/ Harold E. Eaton, Jr.
Harold E. Eaton, Jr., Associate Justice

s/ Karen R. Carroll

Karen R. Carroll, Associate Justice

s/ William D. Cohen

William D. Cohen, Associate Justice

Vt. Tax Reg. § 1.5833-1

Reg. § 1.5833 ALLOCATION AND APPORTIONMENT OF INCOME

Reg. § 1.5833-1 (Effective for tax years beginning on and after January 1, 1998) Allocation and apportionment of "Vermont net income" by corporations

(a) Computations of Vermont Apportionment Percentage

(1) If the income of a taxable corporation is derived from any trade, business, or activity conducted entirely within this state, the Vermont net income of the corporation shall be apportioned to this state in full. If the income of a taxable corporation is derived from any trade, business, or activity conducted both within and without this state, the amount of the corporation's Vermont Net Income apportioned to this state shall be determined by the arithmetic average of the following factors:

(A) The average of the value of all real and tangible property owned or rented by the taxpayer within Vermont expressed as a percentage of all such property both within and without Vermont.

(B) The total wages, salaries or other personal service compensation paid during the taxable year to employees or agents within Vermont expressed as a percentage of such payments both within and without Vermont.

(C) The gross sales or charges for services performed within Vermont expressed as a percentage of such sales or charges both within and without Vermont.

(2) All items of nonbusiness income (income which is not includable in the apportionable tax base) shall

be allocated as provided in Sec. 1.5833(d)(6) of this regulation.

(3) The apportionment percentage is computed by adding together the percentages of the taxpayer's real and tangible personal property, sales or receipts, and payrolls within Vermont during the period covered by the return, and dividing the total of such percentages by three. However, if any one of the factors (for property, receipts or payroll) is missing, the other two percentages are added and the sum is divided by two, and if two of the factors are missing, the remaining percentage is the apportionment percentage. (A factor is not missing merely because its numerator is zero, but it is missing if both its numerator and its denominator are zero).

> Example: A taxpayer owns no real or tangible personal property and rents no real property either within or without the state. The property factor being missing, the apportionment percentage may be computed by adding the percentages derived from the apportionment of its sales or receipts and payrolls, and dividing the total by two.

(b) <u>Property Factor</u>

(1) The property factor is a fraction, the numerator of which is the average value of all real and tangible property within this state based on original cost at the beginning of the taxable year and at the end of the taxable year; and the denominator of which is the average value of property based on original cost both within and without the state at the beginning and at the end of the taxable year.

(2) Tangible personal property is within Vermont if, and so long as, it is physically situated or located

here. Property of the taxpayer held in Vermont by an agent, consignee or factor is (and property held outside Vermont by an agent, consignee or factor is not) situated or located within Vermont.

Property in transit between locations of the taxpayer to which it belongs shall be considered to be at the destination for purposes of the property factor. Property in transit between a buyer and seller which is included by a taxpayer in the denominator of its property factor in accordance with its regular accounting practices shall be included in the numerator according to the state of destination. The value of mobile or movable property such as construction equipment, trucks or leased electronic equipment which are located within and without this state during the tax period shall be determined for purposes of the numerator of the factor on the basis of total time within the state during the tax period. An automobile assigned to a traveling employee shall be included in the numerator of the factor of the state to which the employee's compensation is assigned under the payroll factor or in the numerator of the state in which the automobile is licensed.

(3) Construction in progress will not be included in the factors until the asset constructed is placed in service.

(4) In determining the property factor, real and personal property rented or leased to the taxpayer, as well as real and personal property owned by it must be considered. The value of rented real and personal property both within and without the state is determined by multiplying the gross rent payable during the tax year by eight (8).

"Gross Rent" as used in this rule, is the actual sum of money payable or other consideration payable, directly or indirectly, by the taxpayer or for its benefit for the use or possession of the property and includes:

(A) Any amount payable for the use or possession of real or personal property, or any part thereof, whether designated as a fixed sum of money or as a percentage of sales, profits or otherwise.

Example: A taxpayer, pursuant to the terms of a lease, pays the lessor $1,000.00 per month and at the end of the year pays the lessor one percent of its gross sales of $400,000.00. Its gross rent is $16,000.00.

(B) Any amount payable as additional rent or in lieu of rent, such as interest, taxes, insurance, repairs or any other amount required to be paid by the terms of a lease or other arrangement;

Example: A taxpayer, pursuant to the terms of a lease, pays the lessor $24,000.00 per annum and also pays real estate taxes in the amount of $4,000.00 and interest on a mortgage in the amount of $2,000.00 Its gross rent is $30,000.00.

(C) Any other amount required to be paid by the terms of a lease or other arrangement, including the amount of amortization or depreciation allowed in computing the taxable income base for the taxable year of any improvement to real property made by or on behalf of the business organization which reverts to the owner or lessor upon termination of the lease or other arrangement.

Example: A taxpayer enters into a 21-year lease of certain premises at a rental of $20,000.00 per annum and after the expiration of one year installs a new store front at a cost of $10,000.00 which reverts to the owner upon expiration of the lease. Its gross rent for the first year is $20,000.00. However, for subsequent years its gross rent is $20,500.00 ($20,000.00 annual rent plus 1/20th of $10,000.00, the cost of the improvement apportioned on the basis of the unexpired term of the lease).

Example: A taxpayer leases a parcel of vacant land for 40 years at an annual rental of $5,000.00 and erects thereon a building which costs $600,000.00. The value of the land is determined by multiplying the annual rent of $5,000.00 by eight, and the value of the building is determined in the same manner as if owned by the taxpayer.

"Gross Rent" does not include:

(A) Intercompany rents if both the lessor and lessee are taxed on a consolidated basis.

(B) Amounts payable as separate charges for water and electric service furnished by the lessor.

(C) Amounts payable for storage provided no designated space under the control of the taxpayer as a tenant is rented for storage purposes.

(5) In exceptional cases use of the general method outlined above may result in inaccurate valuations. Accordingly, in such cases, any other method which will properly reflect value may be adopted by the Vermont Department of Taxes, either on its own motion or on request of a taxpayer. Such other

method of valuation may not be used by a taxpayer until approved in writing by the Department. Any such request shall set forth full information with respect to the property, together with the basis for the valuation proposed by the taxpayer. Such other method once approved by the Department may be used by the taxpayer in its reports for subsequent years until the facts upon which such other method is based are, in the judgment of the Department, materially changed.

(c) Payroll Factor

(1) The payroll factor is a fraction, the numerator of which includes the total compensation paid in Vermont during the tax period and the denominator of which includes the total compensation paid everywhere during the tax period. In addition to "normal" salary and wages, compensation shall include payments to employees for board, rent, housing, lodging, and any other benefits paid in exchange for labor. These amounts will be treated as compensation if they are considered as income under the Internal Revenue Code.

(2) The taxpayer's accounting method will determine the actual amounts that are to be included in the factors. If the taxpayer uses the accrual method of accounting, compensation that has been properly accrued and deductible will be considered to have been paid during the taxable period.

(3) For purposes of this regulation, an employee is defined to be any person, including an officer of the corporation, who is included by the taxpayer as an employee for purposes of the payroll taxes imposed by the FICA.

(4) The payroll factor shall include only compensation that is related to the production of apportionable income. Compensation that is related to the operation, maintenance, protection or supervision of nonbusiness income is not included in the payroll factor. To the extent that employee services produce both business and nonbusiness income, proration is allowed.

(5) Compensation will be considered to be paid in Vermont and thus includable in the numerator of the payroll factor if:

(A) the individuals' services are performed entirely within Vermont;

(B) the individuals' services are performed both within and without Vermont, but the out-of-state services are incidental to the Vermont services;

(C) some of the individuals' services are performed within Vermont and the company's base of operation or the place from where the service is controlled is within Vermont; or

(D) some of the individual's services are performed within Vermont, which is his or her state of residence, and there is no base of operation or place from where the service is controlled in any of the other states where part of the individual's services are performed.

(d) Sales and Receipts Factor

(1) The sales and receipt factor is a fraction, the numerator of which is the receipts of the taxpayer in this state during the taxable year and the denominator of which is the receipts of the taxpayer within and without this state during the taxable year. The method of calculating receipts for purposes of the denominator is the same method used in determining

receipts for purposes of the numerator. The receipts factor shall include only those receipts which constitute business income and are includable in the apportionable base for the tax year. Receipts from the following are allocable to Vermont:

(A) sales of tangible personal property in Vermont;

(B) services performed in Vermont;

(C) rentals from property situated in Vermont;

(D) royalties from the use in Vermont of patents and copyrights;

(E) all other business receipts earned in Vermont.

All such receipts of the period covered by the return (computed on the cash or accrual basis, in accordance with the method of accounting used in the computation of the taxpayers "Vermont net income") must be taken into account.

(2) Sales of Tangible Personal Property in Vermont Sales of tangible personal property are made in this state if the property is delivered or shipped to a purchaser, other than the United States government, who takes possession within this state, regardless of fob point or other conditions of sale, or the property is shipped from an office, store, warehouse, factory or other place of storage in this state and:

(A) the purchaser is the United States Government; or

(B) the corporation is not taxable in the state in which the purchaser takes possession.

If a seller in Vermont makes sales of tangible personal property to a purchaser who takes delivery

of the property at the seller's shipping dock, the sale is a Vermont sale if the purchaser transports the property to one of its in-state locations. If the purchaser transports the property to one of its out-of-state locations the sale is not a Vermont sale, unless the corporation is not taxable in the state to which the property is transported.

(3) Compensation for Services Receipts for services are apportioned to Vermont if the services are performed in Vermont. All amounts received for such services are apportionable irrespective of whether such services are performed by employees, agents, subcontractors or any other persons.

When compensation for services are in payment of services performed both within and without Vermont, sales are apportioned to this state if a greater proportion of the income producing activity is performed in Vermont. If this rule causes an inequitable apportionment of income, the amount attributable to Vermont shall be determined based on the cost of performance.

(4) Rents and Royalties Receipts from rentals of real and personal property situated in Vermont, royalties from the use in Vermont of patents or copyrights and receipts from the licensing of computer software used in Vermont and similar transactions are apportionable to Vermont.

Receipts from rentals include all amounts received directly or indirectly by the taxpayer for use of or occupancy of property, whether or not such property is owned by the taxpayers.

Receipts from royalties include all amounts received by the taxpayer for the use of patents or copyrights whether or not such patents or copyrights

were originally issued to or are owned by the taxpayer.

A patent or copyright is used in Vermont to the extent that activities thereunder are carried on in Vermont.

(5) Other Business Receipts All business receipts earned by the taxpayer within Vermont are apportionable to Vermont. Business receipts are not considered to have been earned in Vermont solely by reason of the fact that they were payable in Vermont or were received in Vermont. Business receipts include all income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible or intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

(6) Nonbusiness Receipts Nonbusiness receipts are all receipts other than business receipts resulting from operations unrelated to its regular business operations. Typically nonbusiness receipts are comprised of passive or portfolio income. Income from dividends, interest and capital gains will be considered nonbusiness income unless the acquisition, management, and disposition of the underlying property generating the income constitute an integral part of the taxpayer's regular business operations.

(e) Nonbusiness income will be allocated to the state in which the income producing assets are located. If the income producing asset has no situs, the income will be allocated to the state of commercial

domicile, the principle place from which the business is directed or managed.

(f) Discretionary Adjustment of Vermont Apportionment Percentage Generally the apportionment formula will result in a fair apportionment of the taxpayer's income within and without Vermont. However, due to the nature of certain businesses the formula may not result in an equitable allocation of income. In such cases, the taxpayer may petition for, or the commissioner may require:

(1) Separate accounting;

(2) the exclusion or modification of any or all of the factors;

(3) the inclusion of one or more additional factors which will fairly represent the taxpayers business activity in this state; or

(4) the employment of any other method to effect an equitable apportionment of the taxpayer's income.