No. 20-947

In the
Supreme Court of the United States

IDAHO STATE TAX COMMISSION,
Petitioner,
v.
NOELL INDUSTRIES, INC.,
Respondent.

On Petition for Writ of Certiorari
to the Supreme Court of Idaho

BRIEF OF *AMICUS CURIAE* MULTISTATE TAX COMMISSION IN SUPPORT OF PETITIONER

Gregory S. Matson
Executive Director
Multistate Tax Commission
444 North Capitol St., N.W., Suite 425
Washington, D.C. 20001
(202) 650-0300
bhamer@mtc.gov

Nancy L. Prosser
General Counsel
Brian A. Hamer
Counsel of Record
W. Christopher Barber
Lila D. Disque
Bruce J. Fort
Helen Hecht

Counsel for *Amicus Curiae* Multistate Tax Commission

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INTEREST OF THE *AMICUS CURIAE*

The Multistate Tax Commission ("MTC")[1] comprises the tax agency heads of the sixteen states that have adopted the Multistate Tax Compact by statute; all other states, except Nevada, participate as members on some level.[2] Our mission is to promote uniform and consistent tax policy and administration among the states, assist taxpayers in achieving compliance with existing tax laws, and advocate for state and local sovereignty in the development of tax policy.

The MTC has focused particularly on state taxation of multistate businesses and the proper application of this Court's guidance concerning the constitutional limitations on such taxation. The MTC's expertise in this area has been developed over more than fifty years through assisting states in applying income, franchise, sales, and use taxes to interstate businesses. We regularly work with states and taxpayers on complex tax issues and disputes, conduct joint state audits of large multistate businesses, and draft uniform and model tax laws and regulations.

Because of our unique multistate role, the MTC has

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[1] No counsel for any party authored this brief in whole or in part. Only *amicus curiae* MTC and its member states, through the payment of their membership fees, made any monetary contribution to the preparation or submission of this brief. This brief is filed by the MTC not on behalf of any particular member state other than Idaho. Counsel of record received timely notice of the intent to file the brief under Supreme Court Rule 37(2)(a) and granted consent.

[2] Information about the MTC, its member states, and its programs is available at *www.mtc.gov*.

filed numerous *amicus* briefs with this Court. We respectfully file this brief to explain (1) how the Idaho Supreme Court misapplied the Due Process Clause[3] in this case involving the taxation of income arising from the activities of a multistate business and (2) the need for this Court to address a gap in its Due Process Clause jurisprudence.

SUMMARY OF THE ARGUMENT

This case raises the important question of how the unitary business principle, a key element of this Court's Due Process Clause jurisprudence, applies to the now commonplace situation in which a holding company—a company whose sole purpose is to hold assets and not engage in income-producing operations—sells a controlling interest in a multistate business. The answer to this question in turn determines whether a state in which that multistate business operated may impose a fairly apportioned tax on any gain from that sale.[4]

Although this Court has considered the application of the unitary business principle on a number of occasions, it has never done so in a case involving a holding company. This gap in the Court's jurisprudence has resulted in uncertainty and confusion among state tax administrators, taxpayers,

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[3] U.S. Const. amend. XIV, § 1.

[4] All states that impose an income tax on multistate businesses employ a formulary apportionment system to approximate how much of a multistate business's income is properly attributable to in-state activities and therefore can be taxed. *See Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978).

and courts, as well as conflicting administrative decisions and state court decisions, including now a conflict between the highest courts of two states.

In this case, the Idaho Supreme Court held that Idaho could not tax a holding company on any portion of its gain from the sale of a multistate business that had operated in Idaho for almost two decades. *See Noell Indus., Inc. v. Idaho Tax Comm'n*, 470 P.3d 1176 (Idaho 2020). In doing so, the Idaho Supreme Court applied—in a highly formalistic way—certain language contained in this Court's prior decisions. The result is a decision that misapplies the Due Process Clause and potentially signals to taxpayers that they can easily employ a strategy to avoid certain state tax obligations. [5]

This Court should grant the petition in order to correct the Idaho Supreme Court's decision, resolve an emerging conflict among state courts and administrative tribunals, and provide needed guidance on how to apply the unitary business principle when a holding company sells a controlling interest in a multistate business.

BACKGROUND

In 1993, Mike Noell, a Virginia resident, incorporated Blackhawk Industries, Inc., now known as Noell Industries, Inc. ("Noell Industries"), under the laws of

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[5] The Due Process Clause may allow a state to tax an apportioned share of the gain from the sale of a non-unitary business based on the business's own contacts with the state. *See MeadWestvaco Corp. v. Ill. Dep't of Revenue,* 553 U.S. 16, 30 (2008). That issue is not before the Court in this case.

Virginia. Noell Industries is one hundred-percent owned by Mr. Noell.

In 2004, Mr. Noell transferred the assets of Noell Industries to Blackhawk Industries Products Group Unlimited, LLC ("Blackhawk") and in return Noell Industries received a 78.54 percent interest in Blackhawk. Mr. Noell became Blackhawk's president and CEO and a member of its board of directors.

Blackhawk is a manufacturer and retailer with activities in substantially all of the states. More than forty percent of its property and thirteen percent of its workforce were located in Idaho and it made substantial sales into the state. Noell Industries is a holding company. It engaged in no operations and had no employees in Idaho or elsewhere. In addition to owning Blackhawk, Noell Industries owned an entity which leased real estate to Blackhawk in Virginia; that entity produced only losses and is not relevant to this case.

In 2010, Noell Industries sold its entire interest in Blackhawk, generating a capital gain of $120 million. Although Noell Industries had paid income tax to Idaho since 2004 when it became a holding company, it did not apportion any of the gain from the sale to Idaho and therefore did not pay any Idaho income tax on that gain. Idaho assessed tax on a portion of Noell Industries' gain from the sale of Blackhawk based on the proportion of Blackhawk's business previously conducted in the state.

ARGUMENT

I. Idaho may tax the gain in this case because the state had a sufficient connection to the business activity that gave rise to that gain, and this connection was not affected by the formal structure of the business enterprise that recognized the gain.

This Court has long recognized that the Due Process Clause permits a state to tax interstate commerce when the tax is imposed on persons or activities purposefully directed at the state. *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). As will be discussed at greater length in the following two subsections, the Due Process Clause limitation on a state's ability to tax interstate commerce does not turn on a "formalistic test." *Quill*, 504 U.S. at 307. Rather, this Court has applied a "consistent and rational method of inquiry" to determine when a state has a sufficient due process connection to impose such a tax. *Id.* at 304.

In keeping with this rational method of inquiry, the Court has rejected the argument that a state may not tax a fairly apportioned share of income from interstate commerce simply because the particular source of the income is a separate legal entity (*e.g.*, a corporation) over which the state does not have jurisdiction. What is required, instead, is that the state have a connection to the "unitary business" of which the income is a part, regardless of the formal structure of that business or the particular source of the income. *See Mobil Oil Corp. v. Comm'r of Taxes of*

Vt., 445 U.S. 425, 438 (1980)(addressing the question of whether dividends from an entity with which the state had no direct connection could be taxed, on an apportioned basis, as part of a business that operated within the state).

In *Mobil*, and other cases, the Court has maintained this rational method of establishing the due process limits of state taxing authority. But, as with all such methods, its development by the Court has been in response to the particular facts raised in each case. So far, all of these cases involved operating companies, meaning separate legal entities that had their own income-producing business activities. The question in those cases was whether the various business activities of the different operating companies were part of the same unitary business. In deciding those cases, the Court has determined that a unitary business can be shown by various indicia. At the same time, the Court has recognized that when the income a state seeks to tax is part of the operational income of the taxpayer's business, rather than just an investment, it is not necessary for the particular source of that income to be unitary with the taxpayer.

Here, however, the facts involve not separate operating companies, but an operating company (Blackhawk) and a holding company (Noell Industries) that maintained a controlling ownership interest in Blackhawk and received the income that Blackhawk generated.

The Idaho Supreme Court's formalistic application of this Court's precedents, including the unitary business principle, focused on the fact that the

holding company, itself, essentially had no business, and lost sight of the real target—the minimum connection required by the Due Process Clause. By failing to properly apply this Court's precedents, the Idaho Supreme Court missed the mark.

A closer review of this Court's precedents demonstrates that the Court never intended the result reached by the Idaho Supreme Court. Rather, a rational method of inquiry here must conclude that Idaho had a sufficient due process connection with the gain from the sale of Blackhawk to tax an apportioned share of that gain.

A. Noell Industries and Blackhawk constituted a unitary business under this Court's precedents even though Noell Industries was a holding company.

The Due Process Clause prohibits states from taxing "extraterritorial values." *MeadWestvaco Corp. v. Ill. Dep't of Revenue*, 553 U.S. 16, 19 (2008). But a state may tax income arising out of interstate activities if there is a minimum connection between the interstate activities and the taxing state. *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 165-66 (1983). The "broad inquiry," the Court has explained, is "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state"—that is, "whether the state has given anything for which it can ask return." *ASARCO v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982).

To determine the extent to which a state may tax income received by a business operating in multiple

states, this Court has developed and applied the unitary business principle. Pursuant to this principle, a state may tax "an apportioned share of the value generated by the intrastate and extrastate activities of a multistate enterprise" but only if "those activities form a part of a unitary business." *MeadWestvaco,* 553 U.S. at 19 (internal quotation marks omitted). *See also Allied-Signal v. Dir., Div. of Taxation*, 504 U.S. 768, 778 (1992)("[W]e permit States to tax a corporation on an apportionable share of the multistate business carried on in part in the taxing State. That is the unitary business principle."). This Court has further expressed that states may apply the unitary business principle to tax not only an apportioned share of the net income and dividends of a multistate business but also an apportioned share of its capital gains. *See, e.g., MeadWestvaco*, 553 U.S. at 27.

In this case, the Idaho Supreme Court failed to address whether there was a minimum connection or nexus between Blackhawk's substantial activities in Idaho and the gain that Idaho sought to tax. Instead, the court attempted to apply existing precedent to the narrow inquiry: whether Noell Industries and Blackhawk had a unitary relationship. Citing *MeadWestvaco*, the most recent decision in which the Supreme Court discussed the unitary business principle, the Idaho Supreme Court concluded that a unitary relationship between business entities requires "functional integration, centralized management, and economies of scale." *Noell*, 470 P.3d at 1186, 1187. Finding that Noell Industries had "no shared control or operations over Blackhawk" and that Noell Industries "shared no centralized

management, oversight, or headquarters with Blackhawk," the court concluded that this three-part test was not met and that the two entities were not unitary. *Id.* at 1187. The Idaho Supreme Court explained that the two entities could not be unitary because "Noell Industries held no employees, payroll, or offices at all." *Id.* Consequently, the court held, Idaho could not tax the gain resulting from Noell Industries' sale of Blackhawk.

The Idaho Supreme Court's formalistic application of the *MeadWestvaco* language should be corrected by this Court. The difference between the business enterprise considered in *MeadWestvaco* (and all of this Court's prior decisions) and the one here, involving a holding company with no operations, was simply ignored by the Idaho Supreme Court. The court also ignored the business relationship between Noell Industries and Blackhawk.

Noell Industries began its life as the very business which later was transferred to Blackhawk. After Noell Industries became a holding company, it engaged in no separate activities and accrued income solely as a result of Blackhawk's operations in Idaho and other states. Indeed, Noell Industries existed only to channel the income generated from these operations to the enterprise's ultimate owner, Mr. Noell, who served as the president and CEO and was a Board member of Blackhawk. Noell Industries' value as a company derived from these operations. The holding company and Blackhawk were separate legal entities, to be sure, but they were parts of the same business enterprise.

In *MeadWestvaco*, this Court stated that when applying the unitary business principle a court "must determine whether intrastate and extrastate activities formed part of a single unitary business or whether the out-of-state values that the State seeks to tax derived from unrelated business activity which constitutes a discrete business enterprise." 553 U.S. at 25 (internal citation and punctuation omitted). In this case, there was no unrelated business activity. Noell Industries and Blackhawk were both dedicated to a single business activity. Noell Industries had no role other than to own Blackhawk and another entity that owned the real estate that Blackhawk leased, and, as a result, the two entities constituted a single unitary business.

This Court has applied or referenced the three-part unitary test, *i.e.*, functional integration, centralized management, and economies of scale, in six cases: *Mobil,* 445 U.S. 425; *Exxon Corp. v. Dep't of Revenue of Wis.,* 447 U.S. 207 (1980); *ASARCO,* 458 U.S. 307; *Container Corp.*, 463 U.S. 159; *F. W. Woolworth Co. v. Taxation and Revenue Dep't of N.M.,* 458 U.S. 354 (1982); *Allied-Signal,* 504 U.S. 768*;* and *MeadWestvaco,* 553 U.S. 16. Each of these cases considered whether two or more operating companies (*i.e.*, companies that engaged in actual income-generating operations) were part of the same unitary business. Under these circumstances, a test that employs factors focused on common or related operations makes sense. But, in all these six cases, this Court never indicated that the exact language it used must be applied to every situation in precisely the same way, as if its analysis was contained in a statutory code. *See Container Corp.* 463 U.S. at 179

(describing the three-part test as simply a "relevant question in the unitary business inquiry"). Indeed, the Court stated in *Container Corp.* that the unitary business principle "is not, so to speak, unitary; there are variations on the theme, and any number of them are logically consistent with the underlying principles motivating the approach." *Id.* at 168.

In contrast to *MeadWestvaco* and the other cases cited above, this case raises the question whether a holding company can be unitary with an operating company. Rather than acknowledging that a test that focuses on operations cannot accurately determine unity in this context, the Idaho Supreme Court concluded that Noell Industries' lack of operations and management meant that it simply flunked the test.

More importantly, applying the unitary business principle in this way ignores its fundamental purpose, which is to determine whether a state has the requisite connection under the Due Process Clause to the interstate activities giving rise to the income it seeks to tax. In this case, Idaho may tax the gain realized by Noell Industries because there was more than a minimum connection between the state and the gain from the sale. *See Container Corp.*, 463 U.S. at 165-66. And, given the business enterprise's substantial activities in Idaho, the enterprise certainly benefited from the services and protections provided by Idaho. *See ASARCO,* 458 U.S. at 315. *See also Allied-Signal,* 504 U.S. at 786 ("the unitary business principle is not so inflexible that as . . . new forms of business evolve it cannot be . . . supplemented where appropriate"); *Container Corp.,* 463 U.S. at 178, n.17 ("There is a wide range of

constitutionally acceptable variations on the unitary business theme. . . .").

B. Even if Noell Industries and Blackhawk did not have a unitary relationship, Idaho may tax an apportioned share of the gain from the sale of Blackhawk.

In *Allied-Signal*, a case that considered whether a state could tax the capital gain realized from the sale of an out-of-state business, this Court stated that the unitary business principle does not require that there be a unitary relationship between the two entities in order for a state to tax an apportioned share of the capital gain. "The existence of a unitary relation . . . is one justification for apportionment," the Court explained, "but not the only one." 504 U.S. at 787. The Court reaffirmed this principle in *MeadWestvaco* when it expressed that assets can be a part of a taxpayer's unitary business "even if what we may term a unitary relationship does not exist . . . ." 553 U.S. at 29.

When there is no unitary relationship between two entities, income realized by a business will be excluded from a state's apportioned tax base only if the business proves that "the income was earned in the course of activities unrelated to those carried out in the taxing state." *Allied-Signal*, 504 U.S. at 787 (internal brackets omitted). *Accord, id.* at 792 (O'Connor, J., dissenting) (explaining that, under Supreme Court precedent, income received from an out-of-state taxpayer's investment in another corporation requires "only that the investment income be sufficiently related to the taxpayer's in-

state business, not that the taxpayer's business and the corporation in which it invests be unitary").

Had the Idaho Supreme Court properly applied these principles in this case, it would have required Noell Industries to prove that the gain Idaho seeks to tax was unrelated to its holding of Blackhawk and the substantial activities that Blackhawk conducted in Idaho—a showing that was not made. It is also a showing that Noell Industries cannot make because: (1) all income received by Noell Industries was derived from Blackhawk's operations; (2) Noell Industries' only function was to serve as a conduit between Blackhawk and Mr. Noell; (3) Noell Industries owned more than fifty percent of Blackhawk; and (4) Mr. Noell—Noell Industries' sole owner—served as the president and CEO of Blackhawk.

This Court also has stated that, in the absence of a unitary relationship, an asset can be part of a taxpayer's unitary business if it serves "an operational rather than an investment function." *MeadWestvaco*. 553 U.S. at 28. *Accord, Allied-Signal*, 504 U.S. at 785 ("[T]he relevant unitary business inquiry" is "one which focuses on the objective characteristics of the asset's use and its relation to the taxpayer and its activities within the taxing State.").

In this case, Noell Industries' ownership of Blackhawk certainly served an operational rather than an investment function. This was not a situation where a company invested funds in a discrete enterprise in order to generate an income stream unrelated to its business. To the contrary, Noell

Industries originally operated the business itself and directly held all of the business's assets before it transferred those assets to Blackhawk. And, after that transfer, Noell Industries retained a majority interest in Blackhawk and Mr. Noell served as Blackhawk's president and CEO.

These facts demonstrate that Noell Industries' ownership of Blackhawk served an operational function and, therefore, its interest in Blackhawk was part of its unitary business. As a result, Idaho could tax an apportioned share of income received by that business—which is what happened without dispute prior to the sale of Blackhawk—and could also tax the capital gain realized by Noell Industries upon its sale of Blackhawk. *Cf. Allied-Signal*, 504 U.S. at 774 (concluding that income from the sale of a minority interest in an "unrelated business enterprise" where the activities of the two companies "had nothing to do with the other" did not constitute apportionable income).

II. The Idaho Supreme Court's decision contributes to a growing conflict among state courts and administrative tribunals regarding the application of the unitary business principle to holding companies.

The Idaho Supreme Court's decision in this case directly conflicts with a decision of the Tennessee Supreme Court. In *Blue Bell Creameries, LP v. Roberts*, 333 S.W. 3d 59, 70-72 (Tenn. 2011), the Tennessee Supreme Court held that a holding company was unitary with a limited partnership it owned, notwithstanding the fact that the entities

were not functionally integrated, did not have centralized management, and did not benefit from economies of scale. In contrast to the Idaho Supreme Court's reasoning in this case, the Tennessee Supreme Court stated that courts must "look beyond the superficial divisions between parent corporations and their subsidiaries to the underlying activity generating the income," and in the case before it the only "underlying activity" generating income for the holding company was the partnership's operations. *Id.* at 71 (*citing Mobil*, 445 U.S. 425, 440-41). Therefore, the court concluded, the holding company was unitary with the limited partnership's business.

The conflict between Idaho and Tennessee is by no means unique. Other judicial and administrative tribunals around the country have applied the unitary business principle in markedly different ways to business enterprises that include a holding company. For example, the New Jersey Superior Court, Appellate Division, held that a holding company whose "only or most substantial asset" was a ninety-nine percent interest in an operating partnership was not unitary with that partnership. *BIS LP, Inc. v. Dir., Div. of Taxation*, 26 N.J. Tax 489, 491, 498 (App. Div. 2011).

At the state administrative level, the California State Board of Equalization determined that a holding company and an operating subsidiary operated as a single unitary business after explaining that it was important "to carefully inquire into the nature of the benefits accruing to both the holding company and the operating subsidiaries as a result of the corporate structure." In the Matter of the Appeals of PBS

Building Systems, Inc. and PKH Building Systems, Inc., 94-SBE-008 (Nov. 17, 1994). But compare this to *Western Phoenix, N.V. v. Arizona Dep't of Revenue*, 1994 WL 143279 (Ariz. Bd. Tax. App. 1994), a case which the Idaho Supreme Court asserted "is similar to the situation here." *Noell*, 470 P.3d at 1187. In *Western Phoenix*, the Arizona Board of Tax Appeals held (when applying a state regulation rather than the Due Process Clause) that a holding company and an operating partnership in which it owned a minority interest were not unitary because the holding company "had no activity other than owning the partnership interest." *Id*. *Compare also* California Franchise Tax Board Legal Ruling 95-8 (Nov. 29, 1995)(finding that a holding company was part of the same unitary business as its parent and subsidiaries) *and* Indiana Letter of Findings 02-20200321 (Oct. 8, 2020)(finding that a holding company and an operating company were not unitary).

III. The Idaho Supreme Court's flawed application of the unitary business principle would appear to enable multistate businesses to easily avoid their state tax obligations by simply adding a holding company to their overall business structure.

If the Idaho court's analysis is correct, then the mere formality of creating a holding company can be used to undermine state tax jurisdiction in a way that raises a substantial threat to existing state tax systems.

When the MTC audits multistate taxpayers on behalf of multiple states, we often encounter organizational and business structures that have been put into place solely for the purpose of lowering state tax liabilities, some of which are legal and legitimate. In some cases, the expense or difficulty of creating these structures can be significant but is seen as justified by the potential tax savings.

The expense and difficulty of creating a holding company is minimal. It can easily be incorporated in any state. And, while we acknowledge there are legitimate reasons for creating holding companies, avoiding state income taxes should not be one of them.

We do not believe this is the result that this Court intended when it recognized that it is the connection to the unitary business that determines when a state can impose tax, rather than the formal business structure.

IV. In response to the proliferation of business arrangements involving holding companies, this Court should clarify that the unitary business principle applies to these entities to assist taxpayers and tax administrators across the country.

The Idaho Supreme Court's decision in this case serves as the latest example of the challenges that state courts and other adjudicatory tribunals face when attempting to apply the unitary business principle to cases involving a holding company. Tax administrators and taxpayers regularly face this same challenge as well.

Given the common use of holding companies in the modern economy, this Court should return to the subject of the unitary business principle and explain how it applies when a holding company sells an interest in another entity. *See South Dakota v. Wayfair, Inc.*, 585 U.S. ___, 138 S.Ct. 2080, 2086 (2018)(a case in which this Court updated constitutional jurisprudence "of this Court's own creation" where prior caselaw served to limit state taxing authority). Moreover, the last time that this Court addressed the unitary business principle, it acknowledged that questions relating to application of the principle to asset sales remained unanswered but concluded, given the procedural history of the case before it, that those questions were "best left for another day." *MeadWestvaco*, 553 U.S. at 31.

In the absence of such guidance, controversies will continue to arise between tax departments and taxpayers, states will face the possibility of losing tax revenue that in fact is due, and state courts will struggle to navigate this Court's Due Process Clause jurisprudence.

CONCLUSION

The capital gain at issue here was realized by a holding company after it sold a business operated in large part within the state of Idaho for almost two decades. Idaho should have the ability to tax a fairly apportioned share of that gain.

The Idaho Supreme Court's contrary decision, if left undisturbed, could result in an unwarranted restriction on all states' abilities to impose fairly

apportioned income taxes on businesses engaged in interstate commerce. It reveals a gap in this Court's Due Process Clause jurisprudence.

The Court now has an opportunity to clarify the application of the unitary business principle—a principle that it established—to holding companies and also to reaffirm the states' constitutional right to tax income generated within their borders.

Respectfully submitted,

Brian A. Hamer
Counsel of Record

Counsel for *Amicus Curiae* Multistate Tax Commission

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