

Ashland Inc. and Affiliates,

**ORDER ON CROSS-MOTIONS  
FOR SUMMARY JUDGMENT**

Appellants,

vs.

Commissioner of Revenue,

Docket No. 08819-R

Appellee.

Filed: June 6, 2016

This matter came before The Honorable Joanne H. Turner, Chief Judge of the Minnesota Tax Court, on the parties' cross-motions for summary judgment.

Walter A. Pickhardt, Faegre Baker Daniels LLP, Minneapolis, Minnesota, represented appellants Ashland Inc. and its affiliates.

Sara L. Bruggeman, Assistant Minnesota Attorney General, represented appellee Commissioner of Revenue.

At issue here are the Minnesota combined returns of Ashland Inc., and certain of its affiliates, including Hercules, Inc., for tax years 2009, 2010, and 2011. At the time, Minn. Stat. § 290.17, subd. 4(f) (2012), barred the inclusion of net income and apportionment factors of "foreign corporations and other foreign entities" in the net income and apportionment factors of the unitary business.<sup>1</sup> Hercules SARL, a wholly-owned subsidiary of Ashland subsidiary

<sup>1</sup> In 2013, after the tax years at issue here, Minn. Stat. § 290.17, subd. 4(f), was amended. Act of May 23, 2013, ch. 143, art. 6, § 28, 2013 Minn. Laws 2447, 2550-51 (effective for tax years beginning after December 31, 2012). Under subdivision 4(f), as amended, the income and apportionment factors of a foreign entity (other than an entity treated as a Subchapter C corporation) that are included in the federal taxable income of a domestic corporation or domestic entity "must be included" in the net income and apportionment factors of the unitary business:

Hercules, elected to be disregarded as a separate entity for federal income tax purposes. Reasoning that Hercules SARL was not a “foreign corporation” or “other foreign entity” because it had elected to be disregarded as a separate entity, Ashland included the income and apportionment factors of Hercules SARL in the income and apportionment factors of Hercules, Inc., and, by extension, itself. The Commissioner excluded the results of Hercules SARL from the income and apportionment factors of Hercules, Inc. We grant Ashland’s motion for summary judgment and reverse the Commissioner’s order on this point.

Based upon all the files, records, and proceedings herein, the court now makes the following:

#### **ORDER**

1. Ashland’s motion for summary judgment is granted.
2. The Commissioner’s motion for summary judgment is denied.
3. The Commissioner shall recalculate the amount of tax owed by (or the amount of refund due to) Appellants for the years at issue in light of this order and the parties’ previous settlement of other issues, and shall notify Appellants of the recalculation within 14 days of the date of filing of this order. The parties shall attempt to agree on the amount of tax owed or refund

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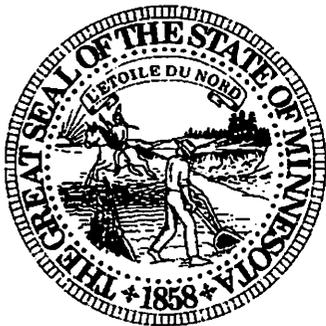
The net income and apportionment factors under section 290.191 or 290.20 of foreign corporations and other foreign entities which are part of a unitary business shall not be included in the net income or the apportionment factors of the unitary business; except that the income and apportionment factors of a foreign entity, other than an entity treated as a C corporation for federal income tax purposes, that are included in the federal taxable income, as defined in section 63 of the Internal Revenue Code as amended through the date named in section 290.01, subdivision 19, of a domestic corporation, domestic entity, or individual must be included in determining net income and the factors to be used in the apportionment of net income pursuant to section 290.191 or 290.20. A foreign corporation or other foreign entity which is not included on a combined report and which is required to file a return under this chapter shall file on a separate return basis.

Minn. Stat. § 290.17, subd. 4(f) (2014).

due and shall notify the court of that amount, or shall respectively move for approval of the amount, within 28 days of the date of filing of this order.

IT IS SO ORDERED.

BY THE COURT:



  
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Joanne H. Turner, Chief Judge  
MINNESOTA TAX COURT

DATED: June 6, 2016

**MEMORANDUM**

This dispute involves the tax treatment of a foreign subsidiary of a domestic corporation, specifically, whether the activities of a foreign subsidiary that has elected to be disregarded for federal income tax purposes should be included in the Minnesota reports of the combined entity. Relying on Minn. Stat. § 290.17, subd. 4(f) (2012), appellee Commissioner of Revenue Commissioner excluded the activities of a foreign subsidiary from the Minnesota combined reports of appellant and parent corporation Ashland Inc. and assessed Ashland a penalty for the resulting substantial understatement of its tax liability. Ashland appealed, asserting that because the foreign subsidiary elected to be disregarded for federal income tax purposes, it was properly included in Ashland's Minnesota combined reports. We agree with Ashland, and therefore grant its motion for summary judgment.

***Undisputed facts and procedural history***

Ashland is a Kentucky corporation headquartered in Covington, Kentucky.<sup>2</sup> Ashland's fiscal year-end is September 30.<sup>3</sup> In November 2008, Ashland acquired Hercules, Inc., a Delaware Subchapter C corporation, and Hercules became a wholly-owned subsidiary of Ashland.<sup>4</sup> Starting with the 2009 tax year, Ashland included Hercules in its consolidated federal income tax returns and in its combined report for Minnesota franchise tax purposes.<sup>5</sup>

During the years at issue here, Hercules owned 100 percent of Hercules Investments SARL, a *Société à Responsabilité Limitée* (SARL) organized under the laws of Luxembourg.<sup>6</sup> Under Treas. Reg. § 301.7701-3(a), Hercules SARL could elect to be classified as an “association” or “to be disregarded as an entity separate from its owner” for federal income tax purposes.<sup>7</sup> See Treas. Reg. § 301.7701-3(a). As of June 29, 1999, Hercules SARL elected the latter, that is, to be a “foreign eligible entity with a single owner electing to be disregarded as a separate entity.”<sup>8</sup>

The consequences of Hercules SARL's election are spelled out in Treas. Reg. § 301.7701- (g)(1)(iii):

If an eligible entity classified as an association elects . . . to be disregarded as an entity separate from its owner, the following is deemed to occur: The

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<sup>2</sup> Stip. ¶ 1 (filed Jan. 19, 2016).

<sup>3</sup> Stip. ¶ 2.

<sup>4</sup> Stip. ¶¶ 5, 6.

<sup>5</sup> Stip. ¶ 6.

<sup>6</sup> Stip. ¶ 8.

<sup>7</sup> Stip. ¶¶ 9, 11.

<sup>8</sup> Stip. ¶ 11; Stip. Ex. 2 (Form 8832: Entity Classification Election).

association distributes all of its assets and liabilities to its single owner in liquidation of the association.

The liquidation is deemed to have occurred “immediately before the close of the day before the election is effective.” Treas. Reg. § 301.7701-3(g)(3)(i). Beginning on June 29, 1999, Hercules therefore reported Hercules SARL’s income, loss, and deductions as its own income, loss, and deductions for federal income tax purposes.<sup>9</sup> Specifically, having acquired Hercules in November 2008, Ashland included Hercules in its Minnesota combined reports for tax years 2009, 2010, and 2011.<sup>10</sup>

On February 4, 2015, the Commissioner assessed Ashland \$1,167,218 in additional income tax, penalty, and interest for the three tax years at issue.<sup>11</sup> The Commissioner determined that the items included on Ashland’s Minnesota returns flowing from Hercules SARL were improperly included because Minn. Stat. § 290.17, subd. 4(f) (2012), “does not permit the net income of foreign corporations or foreign entities to be included in a combined report even though they may be part of a unitary business.”<sup>12</sup> The Commissioner cited Revenue Notice 98-08 and *Manpower, Inc. v. Commissioner of Revenue*, 724 N.W.2d 526 (Minn. 2006), as additional

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<sup>9</sup> Stip. ¶ 12, 13.

<sup>10</sup> Stip. ¶ 6. For fiscal 2009, Hercules SARL recognized a net loss of \$291,802,362. Stip. ¶ 14. For fiscal 2010, Hercules SARL recognized net income of \$150,746,670. Stip. ¶ 14. For fiscal 2011, Hercules SARL recognized a net loss of \$37,968,392. Stip. ¶ 14; *see also* Stip. Ex. 1 (Feb. 4, 2015 Order), at Sch. Income – 1.

<sup>11</sup> Stip. ¶ 3; Stip. Ex. 1 (Feb. 4, 2015 Order). The Commissioner’s Order made other adjustments as well to Ashland’s combined reports, which Ashland does not contest. Stip. ¶ 17. The uncontested adjustments resulted in additional tax of \$137,223. Stip. ¶ 17. The parties agree no penalty is due with respect to the uncontested adjustments. Stip. ¶ 17. In January 2016, Ashland paid \$154,478.79 in satisfaction of those portions of the assessment, with funds in excess of \$137,223 allocated to interest on the uncontested portion of the assessment. Stip. ¶ 17.

<sup>12</sup> Order (Feb. 4, 2015), at Sch. Income – 1 (adjustments to Federal Taxable Income).

authority for excluding Hercules SARL from the results of Ashland’s operations.<sup>13</sup> Accordingly, the Commissioner removed from Ashland’s Minnesota combined report the items of income, loss, and deduction flowing to Hercules (and hence to Ashland) from Hercules SARL.<sup>14</sup> In addition, the Commissioner assessed a penalty for substantial understatement of tax liability for fiscal years 2009 and 2011. *See* Minn. Stat. § 289A.60, subd. 4 (2014).

Ashland timely appealed to our court, foregoing an administrative appeal.<sup>15</sup> Because the parties “anticipate[d] that the matter could be resolved on cross-motions for summary judgment,” we issued a scheduling order to that effect.<sup>16</sup> The parties submitted their initial motions on January 19, 2016, and their final responsive memoranda on February 16, 2016. We heard oral argument on March 7, 2016.

***Legal standard: summary judgment***

Summary judgment is appropriate where there is no genuine issue of material fact and one party is entitled to judgment as a matter of law. Minn. R. Civ. P. 56.03; *DLH, Inc. v. Russ*, 566 N.W.2d 60, 69 (Minn. 1997) (noting that a court may “dispose of an action on the merits if there is no genuine dispute regarding the material facts, and a party is entitled to judgment under the law applicable to such facts.”). A legal issue can be determined on stipulated facts. *See, e.g., Harris v. Cty. of Hennepin*, 679 N.W.2d 728, 731 (Minn. 2004) (reviewing summary judgment ruling on stipulated facts); *see also Am. Family Mut. Ins. Co. v. Thiem*, 503 N.W.2d 789, 790

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<sup>13</sup> Order (Feb. 4, 2015), at Schedule Income – 1 (adjustments to Federal Taxable Income).

<sup>14</sup> Order (Feb. 4, 2015), at Schedule Income – 1 (adjustments to Federal Taxable Income).

<sup>15</sup> Notice of Appeal (filed April 3, 2015); *see* Minn. Stat. § 270C.33, subd. 4(d) (2014).

<sup>16</sup> Scheduling Order ¶ 2 (filed Aug. 4, 2015).

(Minn. 1993) (“The parties themselves, in their cross-motions for summary judgment, have tacitly agreed that there exist no genuine issues of material fact”).

*Applicable law*

Minnesota imposes an “annual franchise tax on the exercise of the corporate franchise to engage in contacts with this state that produce gross income attributable to sources within this state.” Minn. Stat. § 290.02 (2014). Minnesota’s franchise tax “is measured by the corporations’ [sic] taxable income and alternative minimum taxable income for the taxable year,” computed as provided in Minnesota Statutes chapter 290. Minn. Stat. § 290.02. Under chapter 290, “the term ‘net income’ means the federal taxable income” as defined in the Internal Revenue Code, “incorporating . . . any elections made by the taxpayer in accordance with the Internal Revenue Code in determining federal taxable income for federal income tax purposes” and various modifications specified in Minn. Stat. § 290.01, subs. 19c (additions to federal taxable income) and 19d (decreases to federal taxable income). Minn. Stat. § 290.01, subd. 19; *see also* Minn. R. 8001.9000 (2015) (“An incorporation by reference of the Internal Revenue Code in Minnesota Statutes, chapter 290 or 290A shall be interpreted in accordance with any regulations or rulings adopted or issued by the Internal Revenue Service which govern the reference provisions.”).

“In assessing the tax liability of a multistate business, Minnesota may not tax value earned outside its borders.” *Amoco Corp. v. Comm’r of Revenue*, 658 N.W.2d 859, 865 (Minn. 2003) (citing *Comm’r of Revenue v. Assoc. Dry Goods, Inc.*, 347 N.W.2d 36, 38 (Minn. 1984)); *see ASARCO Inc. v. Idaho State Tax Comm’n*, 458 U.S. 307 (1982). Because “it is sometimes unclear what portion of a multistate business’s income is earned within the state, Minnesota adopted the

unitary business principle.” *Amoco*, 658 N.W.2d at 865.<sup>17</sup> Under the unitary business principle, the state apportions the income of the unitary business to Minnesota using “an apportionment formula which considers the local business as part of the whole.” *Associated Dry Goods*, 347 N.W.2d at 38. That is, “if a trade or business conducted wholly within this state or partly without this state is part of a unitary business, the entire income of the unitary business is subject to apportionment” between Minnesota and other taxing jurisdictions. Minn. Stat. § 290.17, subd. 4(a).<sup>18</sup>

During the tax years at issue here, “[t]he net income and apportionment factors . . . of foreign corporations and other foreign entities which are part of a unitary business” could not be included in the net income and apportionment factors of the unitary business. Minn. Stat. § 290.17, subd. 4(f) (2012). The question before us is whether including the income and apportionment factors of Hercules SARL in the income and apportionment factors of Hercules (and, by extension, of Ashland itself) violated subdivision 4(f), as it read during the tax years at issue.

### *Analysis*

We first consider the effects of Hercules SARL’s election. As indicated, Hercules SARL is a *Société à Responsabilité Limitée*, “somewhat akin to a limited liability company under

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<sup>17</sup> “The term ‘unitary business’ means business activities or operations which result in a flow of value between them.” Minn. Stat. § 290.17, subd. 4(b) (2014). We understand there to be no dispute here that Ashland and its affiliates, including Hercules and its subsidiary Hercules SARL, are otherwise a unitary business.

<sup>18</sup> Apportionment considers the percentage of the unitary business’s total sales that are made in Minnesota; the percentage of the unitary business’s total tangible property that is used in Minnesota; and the percentage of the unitary business’s total payroll that is paid or incurred in Minnesota or paid with respect to labor performed in Minnesota. Minn. Stat. § 290.191, subd. 2 (2014). These three “factors” are given varying weights according to a statutory formula and then added together to determine the proportion of the unitary business’s net income apportioned to Minnesota. See Minn. Stat. § 290.191, subd. 2(b).

Minnesota law in that its shareholders (also called ‘associates’ or ‘members’) are not personally liable for the company’s debts.” *Manpower*, 724 N.W.2d at 527. Under Treas. Reg. § 301.7701- (a), a business entity that, like Hercules SARL, has a single owner “can elect its classification for federal tax purposes.” More specifically, an eligible foreign entity like Hercules SARL “can elect [1] to be classified as an association or [2] to be disregarded as an entity separate from its owner.” Treas. Reg. § 301.7701-3(a).<sup>19</sup> Absent such an election, Hercules SARL would be considered an “association.” Treas. Reg. § 301.7701-3(b)(2)(i)(B) (providing that, unless it elects otherwise, a foreign eligible entity is an “association if all members have limited liability.”).<sup>20</sup>

“If an eligible entity classified as an association elects . . . to be disregarded as an entity separate from its owner, the following is deemed to occur: The association distributes all of its assets and liabilities to its single owner in liquidation of the association.” Treas. Reg. § 301.7701- 3(g)(1)(iii).<sup>21</sup> Moreover, the distribution of assets and liquidation of the entity

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<sup>19</sup> Under Treas. Reg. § 301.7701-2(a), Hercules SARL is considered a “business entity” because it has a single owner and can be disregarded as an entity separate from its owner under Treas. Reg. § 301.7701-3. A business entity with only one owner is either classified as a “corporation” or is disregarded altogether. Treas. Reg. § 301.7701-2(a). The term “corporation” includes “associations” as determined under Treas. Reg. § 301.7701-3. See Treas. Reg. § 301.7701-2(b)(2). Under Treas. Reg. § 301.7701-3(a)(2), a foreign eligible entity is classified as an “association” if all of its members have limited liability, as sole shareholder Hercules does here. In sum, then, Hercules SARL would be considered an “association” under Treas. Reg. § 301.7701-3(a)(2), and therefore would be considered a “corporation” under Treas. Reg. § 301.7701-2(a), unless it elected otherwise.

<sup>20</sup> The parties here agree that Hercules, Inc., has the required limited liability. Stip. ¶ 9.

<sup>21</sup> According to Ashland, Hercules SARL’s election rendered it a “tax nothing.” See, e.g., Mem. Law Supp. Appellants’ Mot. Summ. J. 8; Tr. 4. Although colorful, the characterization is less than descriptive of the status of Hercules SARL as a result of its election.

is deemed to occur “immediately before the close of the day before the election is effective.”  
Treas. Reg. § 301.7701-3(g)(3)(i).<sup>22</sup>

Applied to the facts of this case, Hercules SARL is deemed to have distributed its assets and liabilities to its sole shareholder, Hercules, and to have liquidated as of the close of business on June 28, 1999, the day before the date on which its election became effective.<sup>23</sup> Thereafter, starting on June 29, 1999, Hercules SARL is deemed no longer an entity separate from Hercules and, accordingly, the income and apportionment factors of Hercules SARL are deemed to be part of the income and apportionment factors of Hercules itself, a domestic corporation. We therefore conclude that the inclusion of the income and apportionment factors of Hercules SARL in the income and apportionment factors of Hercules (and, by extension, of Ashland itself) did not violate Minn. Stat. § 290.17, subd. 4(f), and the Commissioner erred in concluding otherwise.

Because Hercules SARL elected to be disregarded as an entity (foreign or otherwise) and to be treated as one with its parent Hercules, its income and apportionment factors were not those of a foreign entity; they were those of its domestic parent Hercules. By recognizing the effect of Hercules SARL’s election under Treas. Reg. § 301.7701-3(g), our result harmonizes the legislature’s directive that Minnesota recognize the taxpayer’s elections for federal income tax reporting purposes (Minn. Stat. § 290.01, subd. 19) with the prohibition against including the net income and apportionment factors of “foreign corporations and other foreign entities” in the net income and apportionment factors of a unitary business (Minn. Stat. § 290.17, subd. 4(f)). In

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<sup>22</sup> Indeed, in certain circumstances, the eligible entity is deemed simply to never have existed at all. *See* Treas. Reg. § 301.7701-3(b)(3)(ii) (providing that a foreign eligible entity that elects to be disregarded is treated as being in existence before the effective date of the regulation only if its classification was “relevant” (within the meaning of Treas. Reg. § 301.7701-3(d)) during the five years prior to the effective date of the regulation).

<sup>23</sup> *See* Stip. Ex. 2 (Form 8832).

contrast, as will be seen, the Commissioner's position puts the applicable statutory provisions in conflict with each other, requiring us to ignore one statutory directive in favor of another.

The Commissioner offers a variety of reasons for affirming her Order, none of which persuade us. *First*, the Commissioner contends that Hercules SARL's election did not "nullify the existence of Hercules SARL as a separate, foreign, entity required to be excluded from the combined report."<sup>24</sup> We agree that Hercules SARL remained a separate legal entity under Luxembourg law during the years at issue, but that is irrelevant here. Treasury Regulation § 301.7701-3(g)(1)(iii) establishes that, by virtue of its election to become a disregarded entity, Hercules SARL is deemed to have distributed all of its assets and liabilities and to have liquidated in June 1999. In other words, Hercules SARL is deemed to have distributed all of its assets and liabilities to its sole shareholder and to have liquidated, long before the tax years at issue here. For federal income tax purposes, and by extension for Minnesota income tax purposes, Hercules SARL was *not* a "foreign corporation" or a "foreign entity" in tax year 2008, 2009 or 2010. Rather, deemed to have liquidated for income tax purposes as of June 29, 1999, it was no longer an entity at all. *See Hutchinson Tech. Inc., v. Comm'r of Revenue*, 698 N.W.2d 1, 13 (Minn. 2005) (explaining that to "deem" is to treat something as if it were really something else or had qualities that it does not actually have, and noting that "deemed" "appears to be treated as creating a conclusive presumption") (citations omitted).

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<sup>24</sup> Comm'r's' Mem. Supp. Mot. Summ. J. 2; *see also id.* at 6 ("Hercules SARL remained a foreign entity under Minnesota law after its election to be disregarded as an entity separate from its owner for federal tax purposes"), Comm'r's Resp. Appellant's Mot. Summ. J. 1 (asserting that the Commissioner "properly excluded Hercules SARL's net income and apportionment factors from Ashland's combined reports because the Minnesota law effective at the time excluded all foreign entities from the combined report of a unitary business.").

The Commissioner’s argument violates the statutory mandate that the definition of “net income” for Minnesota income tax purposes “incorporat[e] . . . any elections made by the taxpayer.” Minn. Stat. § 290.01, subd. 19. In her response to Ashland’s motion for summary judgment, the Commissioner argues that Minn. Stat. § 290.01, subd. 19, and Minn. Stat. § 290.17, subd. 4(f), cannot be reconciled.<sup>25</sup> She thus contends that because the statutory provisions cannot be reconciled, section 290.17, subdivision 4(f), as “the more specific rule,” should govern rather than “the general rule that all federal elections are incorporated in the calculation of income under Minn. Stat. § 290.01, subd. 19.”<sup>26</sup>

“The object of all interpretation . . . is to ascertain and effectuate the intention of the legislature. Every law shall be construed, if possible, to give effect to all its provisions.” Minn. Stat. § 645.16 (2014). “When a general provision in a law is in conflict with a special provision in the same or another law, the two shall be construed, if possible, so that effect may be given to both.” Minn. Stat. § 645.26, subd. 1 (2014). Only if the two cannot be reconciled does the special provision control. *Id.*

In this case, as we have demonstrated, Minn. Stat. § 290.01, subd. 19, and Minn. Stat. § 290.17, subd. 4(f), *can* be reconciled simply by giving effect to Treas. Reg. § 301.7701-3. The effect of Hercules SARL’s election under Treas. Reg. § 301.7701-3 is to conclusively presume that Hercules SARL distributed all of its assets and liabilities in June 1999 to sole shareholder and domestic corporation Hercules. Thereafter, the income and apportionment factors at issue here are those of Hercules (a domestic corporation) rather than of Hercules SARL (which is conclusively

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<sup>25</sup> Comm’r’s Resp. Appellant’s Mot. Summ. J. 5.

<sup>26</sup> Comm’r’s Resp. Appellant’s Mot. Summ. J. 5.

presumed to have ceased to exist as a separate entity in June 1999). The income and apportionment factors at issue here are therefore properly included in Ashland's combined return for the tax years at issue.

*Second*, the Commissioner contends that her position "is required by [the Minnesota Supreme Court's decision in] *Manpower*." <sup>27</sup> We disagree.

A brief review of the facts of *Manpower* is helpful. Manpower, Inc. (a Wisconsin corporation doing business in Minnesota) was the majority (but not the sole) shareholder of Manpower France, a French SARL. *Manpower*, 724 N.W.2d at 527 & 527 n.1 (noting that Manpower owned approximately 99% of Manpower France and Manpower UK owned the remaining one percent).<sup>28</sup> In July 1999, Manpower France elected to be classified as a partnership for federal income tax purposes by filing Form 8832. *Id.* at 527. For both 1999 and 2000, Manpower excluded the operating results of Manpower France from its Minnesota combined report. *Id.* The Commissioner determined that Manpower was required to include the operations of Manpower France on its Minnesota returns, reasoning that by virtue of its election to be classified as a partnership, Manpower France "changed from a foreign to a domestic entity." *Id.* This court affirmed the Commissioner's position, *Manpower, Inc. v. Comm'r of Revenue*, No. 7739 R, 2006 WL 89842, at \*5 (Minn. T.C. Jan. 12, 2006), and Manpower appealed to the Minnesota Supreme Court. *Manpower*, 724 N.W.2d at 527.

As the supreme court noted, the consequences of Manpower France's classification election were as follows:

(1) the assets and liabilities of [Manpower France] were deemed to have been distributed to its shareholders in liquidation of the corporation as of July 13, 1999

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<sup>27</sup> Comm'r's' Mem. Supp. Mot. Summ. J. 7.

<sup>28</sup> In contrast, here Hercules SARL has only one shareholder: Hercules, Inc. Stip. ¶ 8.

[the effective date of the election]; (2) the shareholders were deemed to have contributed all of the distributed assets and liabilities to a newly formed partnership as of July 13, 1999; and (3) Manpower, as a deemed partner, was thereafter required to include its distributive share of [Manpower France's] net income or losses in Manpower's federal income tax returns.

*Id.* at 527-28 (citations omitted). The question for the supreme court was the nationality of the newly formed partnership and, more specifically, whether the partnership was a "domestic entity" within the meaning of Minn. Stat. § 290.01, subd. 5, and Minn. Stat. § 290.17, subd. 4(f). *Manpower*, 724 N.W.2d at 529. The supreme court agreed with Manpower that despite Manpower France's election to be treated as a partnership, it "remained a foreign entity" that could not be included in Manpower's net income and apportionment factors under section 290.17, subdivision 4(f). 724 N.W.2d at 531-32. The court reasoned, in other words, that Manpower France's election pertained solely to entity type, not to the nationality of the chosen entity.

The Commissioner contends that the facts of this case are "indistinguishable" from those of *Manpower* with just one exception: in *Manpower* the SARL elected to be treated as a partnership; here, Hercules SARL elected to be a disregarded entity.<sup>29</sup> According to the Commissioner, this is a "slight factual distinction [] insufficient to justify a different result from *Manpower*." <sup>30</sup>

To the contrary, the facts of this case mandate a different result. In *Manpower*, because the SARL elected to be treated as a partnership (rather than a corporation) for U.S. federal income tax purposes, it remained an entity separate and distinct from its shareholders. *See Manpower*, 724 N.W.2d at 527-28 (explaining that by virtue of Manpower France's election, its assets and liabilities were deemed to have been distributed to its shareholders, then contributed by those

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<sup>29</sup> Comm'r's' Mem. Law Supp. Mot. Summ. J. 7; *see Manpower*, 724 N.W.2d at 527.

<sup>30</sup> Comm'r's' Mem. Law Supp. Mot. Summ. J. 7.

shareholders “to a newly formed partnership”); Treas. Reg. § 301.7701-3(g)(1)(ii) (providing that if an association elects to be classified as a partnership, “the following is deemed to occur: The association distributes all of its assets and liabilities to its shareholders in liquidation of the association, and immediately thereafter, the shareholders contribute all of the distributed assets and liabilities to a newly formed partnership.”).<sup>31</sup> As Ashland emphasizes, Manpower France’s status as an entity was not in dispute.<sup>32</sup> Here, in contrast, Hercules SARL is deemed to have distributed all of its assets and liabilities to its sole shareholder (Hercules) *in liquidation of the association*. Treas. Reg. § 301.7701-3(g)(1)(iii). The very purpose of the election is the elimination of Hercules SARL’s status as a separate entity for income tax purposes. We therefore reject the Commissioner’s argument that the supreme court’s decision in *Manpower* governs here, except insofar as it demonstrates that federal elections—and the effects deemed to flow from them—must be recognized under Minnesota law.

*Third*, the Commissioner argues that the result here is further dictated by the decision in *Manpower* because

Hercules SARL’s decision to be disregarded as a separate entity from its owner did not result in the ‘creation or organization’ of a domestic entity under the laws of the United States or any state. In fact, the election to be disregarded did not create

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<sup>31</sup> Indeed, because Manpower France had more than one shareholder, it did not have the option to be disregarded. See Treas. Reg. § 301.7701-2(a) (“A business entity with two or more members is classified for federal tax purposes as either a corporation or a partnership.”). A partnership is an entity for tax purposes: it files an annual information return (Form 1065) on which it reports the results of its operations, although it does not pay income tax itself. Rather, any profits or losses are passed through to its partners, who report their respective shares of those profits and losses on their individual income tax returns. See I.R.C. § 701.

<sup>32</sup> Reply Mem. Law Supp. Appellants’ Mot. Summ. J. 5; see *Manpower*, 724 N.W.2d at 528 (noting the Commissioner’s position that, after its election, Manpower France “was now a ‘domestic entity’ ” and Manpower’s position that Manpower France “continued to be a ‘foreign entity’ for Minnesota income tax purposes”).

or organize any entity at all. Thus, Hercules SARL did not become a domestic entity after electing to be disregarded as a separate entity.<sup>33</sup>

On this much, we agree: after electing to be disregarded as an entity separate from its sole shareholder, Hercules SARL did not become a domestic entity. The Commissioner's argument continues, however: "Because a foreign entity is any entity which is not a domestic entity, Hercules SARL remained a foreign entity."<sup>34</sup> This is just another way of refusing to honor Hercules SARL's election to be disregarded as a separate entity for income tax purposes. Contrary to the Commissioner's position (which assumes Hercules SARL remained an entity for tax purposes), the choice is not between "domestic" entity and "foreign" entity. Rather, as we have indicated, by electing to be disregarded for federal income tax purposes, Hercules SARL is deemed to have distributed all of its assets and liabilities in liquidation and *ceased to be an entity*. See Treas. Reg. § 301.7701-3(g).<sup>35 36</sup>

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<sup>33</sup> Comm'r's Mem. Law Supp. Mot. Summ. J. 8.

<sup>34</sup> Comm'r's Mem. Law Supp. Mot. Summ. J. 8 (citing Minn. Stat. § 290.01, subd. 5a (2011)); see also Comm'r's Resp. Appellant's Mot. Summ. J. 3 (arguing that the issue before us "is whether, by checking the box to be disregarded, Hercules SARL became created or organized under the laws of a political unit of the United States."), 4 ("the election by Hercules SARL . . . to be classified as a 'disregarded entity' did not change its nationality from a foreign entity to a domestic entity.").

<sup>35</sup> The Commissioner's reply as much as acknowledges this point: "Hercules SARL's election to be disregarded dictated only the change in form of Hercules SARL, not its nationality." Comm'r's Resp. Appellant's Mot. Summ. J. 4. The Commissioner refuses, however, to acknowledge the *effect* of "the change in form of Hercules SARL," namely, that Hercules SARL is deemed to no longer be an entity separate from its shareholder Hercules.

<sup>36</sup> The Minnesota Supreme Court's decision in *Manpower* cited, but did not rely on, Treas. Reg. § 301.7701-5. 724 N.W.2d at 531 n.5 (citing Treas. Reg. § 301.7701-5 as "confirm[ing]" its conclusion that Manpower France's election to be treated as a partnership did not mean that Manpower France was "created or organized under the laws of the United States") (citation omitted).

Treasury Regulation § 301.7701-5(a) defines a business entity (including an entity that is disregarded as separate from its owner under Treas. Reg. § 301.7701-2(c)) as "domestic" "if it is

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created or organized as any type of entity . . . in the United States, or under the law of the United States or of any State.” The regulation further defines a business entity (including an entity that is disregarded as separate from its owner under § 301.7701-2(c)) as “foreign” “if it is not domestic.” Treas. Reg. § 301.7701-5(a). Finally, the regulation provides that “[t]he determination of whether an entity is foreign or domestic is made independently from the determination of its corporate or non-corporate classification.” *Id.* The examples in the regulation address entities that are created or organized under the laws of both a foreign country and one of the United States. *See, e.g.*, Treas. Reg. § 301.7701-5(b), Example 1 (providing that an entity created or organized as a public limited company under the laws of Country A and as a limited liability company under the laws of State B is classified as a corporation for federal tax purposes).

Neither party addressed the applicability of Treas. Reg. § 301.7701-5 in its initial briefing. On April 5, 2016, we invited the parties to file supplemental letter briefs addressing the applicability (if any) of Treas. Reg. § 301.7701-5 to the facts of this case. The parties’ letter briefs were filed on April 22, 2016. Ashland responded that because Hercules SARL had elected to be disregarded for federal income tax purposes, its status as “domestic” or “foreign” is irrelevant here. Letter from Walter A. Pickhardt to Judge Joanne Turner (April 22, 2016) (on file with the Minnesota Tax Court). The Commissioner responded that the regulation “supports” her exclusion of the operations of Hercules SARL. Letter from Sara L. Bruggeman to Judge Joanne Turner (April 22, 2016) (on file with the Minnesota Tax Court).

Treasury Regulation § 301.7701-2(c)(iii) outlines three situations in which “[a]n entity that is otherwise disregarded as separate from its owner is [nevertheless] treated as an entity separate from its owner”:

- (1) Federal tax liabilities of the entity with respect to any taxable period for which the entity was not disregarded.
- (2) Federal tax liabilities of any other entity for which the entity is liable.
- (3) Refunds or credits of Federal tax.

Treas. Reg. § 301.7701-2(c)(iii)(A). The regulation provides two examples of its application. In one, a domestic corporation (X) merges with a wholly-owned LLC (Z) that is disregarded as an entity separate from its owner (Y). An issue later arises with respect to an assessment of tax against X for a period before its merger with Z. Under Treas. Reg. § 301.7701-2(c)(iii)(B), “Z is the proper party to sign the consent to extend the period of limitations” with respect to the assessment against X, even though Z is disregarded as an entity separate from Y for other purposes.

When an entity is treated as separate from its owner (rather than disregarded entirely), its nationality may be relevant. Treasury Regulation § 301.7701-5 therefore addresses the nationality of an entity that is *not* disregarded for the specifically enumerated situations. But none of these situations exists here. We agree with Ashland that Treas. Reg. § 301.7701-5 does not address this dispute.

The Commissioner relies on Minn. Stat. §§ 290.01, subds. 5 (2014) (defining “domestic corporation”) and 5a (2014) (defining “foreign”). Both subdivision 5 and 5a are, by their terms, limited to “corporations.” Minn. Stat. § 290.01, subd. 5 (“The term ‘domestic’ when applied to a corporation means a corporation . . . .”); Minn. Stat. § 290.01, subd. 5a (“The term ‘foreign,’ when applied to a corporation, means a corporation other than a domestic corporation.”). As we have indicated, under Treas. Reg. § 301.7701-3(g)(1)(iii), Hercules SARL is deemed to have distributed all of its assets and liabilities to Hercules and to have ceased to exist as a separate entity *of any kind* upon the effective date of its election. Moreover, Minnesota limits its definition of “corporation” to those entities which are corporations under I.R.C. § 7701(a)(3). Minn. Stat. § 290.01, subd. 4 (2014). Because Hercules SARL is not considered a corporation under I.R.C. § 7701(a)(3), it is not considered a corporation for purposes of Minnesota income tax. The Commissioner errs in applying the terms “domestic” and “foreign” to something that, under both Minnesota and federal law, is not considered a corporation in the first place.

*Fourth*, the Commissioner contends that “Hercules SARL’s election to be disregarded as a separate entity did not nullify the existence of Hercules SARL as a separate foreign entity.”<sup>37</sup> The Commissioner’s argument is mistaken on two grounds. First, it confuses what is deemed to be true for income tax purposes with what is true in the world. *Hutchinson Technology*, 698 N.W.2d at 13 (noting that “deemed” is “treated as creating a conclusive presumption”) (quoting *First Nat’l Bank of Mankato v. Wilson*, 234 Minn. 160, 164, 47 N.W.2d 764, 767 (1951)). Second, it confuses the status of an entity with its nationality. See Treas. Reg. § 301.7701-5(a) (providing that “[t]he determination of whether an entity is domestic or foreign is made independently from the

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<sup>37</sup> Comm’r’s Mem. Law Supp. Mot. Summ. J. 8.

determination of its corporate or non-corporate classification.”). We agree that after the effective date of its election, Hercules SARL continued—for other non-tax purposes—to be a *Société à Responsabilité Limitée* organized under the laws of Luxembourg. What is important here is that the SARL’s election to be disregarded as a separate entity “nullif[ied] [its] existence . . . as a separate [] entity” for federal income tax purposes.<sup>38</sup> We must similarly deem Hercules SARL to have ceased to be a separate entity as of June 29, 1999, for Minnesota franchise tax purposes, or run afoul of the statutory mandate to recognize “any elections made by the taxpayer in accordance with the Internal Revenue Code in determining federal taxable income for federal income tax purposes.”<sup>39</sup>

*Fifth*, the Commissioner contends we should defer to her “long standing position . . . that Minnesota did not ‘recognize the “check the box” election made by a foreign eligible entity with a single ‘C’ corporation owner which is electing to be disregarded as a separate entity for federal tax purposes.”<sup>40</sup> We disagree. As the Commissioner concedes, revenue notices “do not have the force and effect of law.”<sup>41</sup> Rather, “[a] revenue notice is meant to provide only general guidance

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<sup>38</sup> Comm’r’s Mem. Law Supp. Mot. Summ. J. 8.

<sup>39</sup> See Minn. Stat. § 290.01, subd. 19 (defining “net income” for Minnesota income tax purposes as “the federal taxable income . . . incorporating . . . any elections made by the taxpayer in accordance with the Internal Revenue Code in determining federal taxable income for federal income tax purposes”).

For the same reasons, we consider our result here consistent with Minn. R. 8019.0405 (2015), which provides that “only domestic corporations, as defined in [Minn. Stat. § 290.01, subd. 5] can file a combined report.” Ashland has filed a combined report with Hercules, both domestic corporations. That Hercules’ income and apportionment factors reflect those of Hercules SARL, which is not considered a separate entity for income tax purposes, does not mean that Hercules SARL has “filed a combined report” with Ashland.

<sup>40</sup> Comm’r’s Mem. Law Supp. Mot. Summ. J. 8 (quoting Revenue Notice 98-08).

<sup>41</sup> Comm’r’s Mem. Law Supp. Mot. Summ. J. 9 (quoting Minn. Stat. § 270C.07, subd. 2 (2014)).

to the public.” *Behavioral Health Services, Inc. v. Comm’r of Revenue*, No. 7521-R, 2004 WL 434362, at \*3 n.3 (Minn. T.C. Feb. 17, 2004); *see* Minn. Stat. § 270C.07, subd. 1 (2014) (“Revenue notices are published for the information and guidance of taxpayers, local government officials, the department, and others concerned.”). Accordingly, they “may be relied on by taxpayers until revoked or modified, . . . but may not be revoked or modified retroactively to the detriment of the taxpayers.” Minn. Stat. § 270C.07, subd. 2 (2014). Moreover, a revenue notice is deemed to have been revoked or modified to the extent affected by a change in the law or an interpretation of the law “whether in the form of a statute, court decision, administrative rule, or revenue notice.” *Id.*

We consult “[l]egislative and administrative interpretations” of a statute only when the statute is ambiguous. Minn. Stat. § 645.16 (2014); *see Hutchinson Technology*, 698 N.W.2d at 13- 14 (rejecting the taxpayer’s call to give weight to “the Commissioner’s long-standing interpretation” of the applicable statute). The Commissioner’s interpretation of an ambiguous statute, however, is only one of the things we consider: we are also to consider such things as “[t]he occasion and necessity for the law” and [t]he consequences of a particular interpretation.” Minn. Stat. § 645.16. Our deference to a revenue notice is therefore “commensurate with its inherent persuasiveness.” *Dexma, Inc. v. Comm’r of Revenue*, No. 7656-R, 2005 WL 626620, at \*4 (Minn. T.C. Mar. 8, 2005) (citing *In re Excess Surplus Status of Blue Cross and Blue Shield of Minnesota*, 624 N.W.2d 264, 278 (Minn. 2001)); *see also Behavioral Health Services, Inc. v. Comm’r of Revenue*, 2004 WL 434362, at \*3 n.3.

In this case, by virtue of its election on Form 8832 Hercules SARL is not a “foreign corporation” or “other foreign entity” for federal income tax purposes or, by extension, for Minnesota income tax purposes. It is deemed to have liquidated by distributing all of its assets

and liabilities to its sole shareholder, Hercules, as of June 28, 1999.<sup>42</sup> Its net income and apportionment factors are therefore those of its sole shareholder, Hercules, which is indisputedly a domestic corporation. We decline to defer to Revenue Notice 98-08.

*Finally*, the Commissioner contends “there is no evidence that the Minnesota Legislature intended that foreign eligible entities electing to be disregarded would be treated differently than foreign eligible entities electing to be classified as partnerships.”<sup>43</sup> To the contrary, there is no evidence that the legislature intended to recognize only certain elections made by the taxpayer in determining federal taxable income. The legislature has required that “net income” for Minnesota income tax purposes incorporate “any elections made by the taxpayer in accordance with the Internal Revenue Code in determining federal taxable income for federal income tax purposes.” Minn. Stat. § 290.01, subd. 19 (emphasis added). The legislature has further required that the net income and apportionment factors of a unitary business exclude only those of “foreign corporations and other foreign entities.” Minn. Stat. § 290.17, subd. 4(f). Ashland’s construction of the statutory scheme allows for compliance with both provisions, by recognizing that by virtue of its Form 8832 election, Hercules SARL is deemed to be no longer an entity of any kind. The Commissioner’s construction, on the other hand, denies recognition of the taxpayer’s election under Form 8832, contrary to Minn. Stat. § 290.01, subd. 19.

For these reasons, we grant Ashland’s motion for summary judgment and deny the Commissioner’s motion for summary judgment with respect to the inclusion of Hercules SARL’s

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<sup>42</sup> See Stip. Ex. 2 (Form 8832).

<sup>43</sup> Comm’r’s Mem. Law Supp. Mot. Summ. J. 9 (citing *Manpower*, 724 N.W.2d at 531). We see nothing on the cited page of the *Manpower* decision discussing legislative intent one way or the other.

net income and apportionment factors in Ashland's combined Minnesota reports for tax years 2009, 2010, and 2011.

***Substantial understatement penalty***

In addition to additional income tax, the order on appeal assesses Ashland and its affiliates a penalty for substantial understatement of tax. *See* Minn. Stat. § 289A.60, subd. 4 (2014). Tax is understated if “the amount of the tax required to be shown on the return for the period” exceeds “the amount of the tax imposed that is shown on the return.” *Id.*, subd. 4(d). Because we reverse the Commissioner's assessment of tax with respect to the net income and apportionment factors of Hercules SARL, there is necessarily no such excess: Ashland showed on its return the correct amount of tax related to this dispute. We therefore reverse the penalty for substantial understatement to the extent it related to the net income and apportionment factors of Hercules SARL.<sup>44</sup>

For all of the foregoing reasons, we grant appellant Ashland's motion for summary judgment and deny the Commissioner's motion for summary judgment. We instruct the Commissioner to recalculate the amount of tax owed by (or the amount of refund owed to) Appellants in light of this order and the parties' previous settlement of other issues.

J.H.T.

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<sup>44</sup> Because of our result, we consider it unnecessary to address whether there was substantial authority for Ashland's position here. Were we to reach the issue, we would agree with Ashland that there was substantial authority, for the reasons stated in Ashland's memoranda in support of its motion for summary judgment on the issue.