STATE OF MINNESOTA | TAX COURT

COUNTY OF RAMSEY | REGULAR DIVISION

YAM Special Holdings, Inc.,

Appellant,

vs.

Commissioner of Revenue,

Appellee.

ORDER ON CROSS-MOTIONS FOR SUMMARY JUDGMENT (AMENDED)

Docket No. 9122-R

Filed: November 12, 2019

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

Barry A. Gersick and Susan J. Markey, Maslon LLP, Minneapolis, Minnesota; and Andrew T. Bernknopf and Michael C. Cohen, De Castro, West, Chodrow, Mendler & Glickfeld, Inc., Los Angeles, California, represent appellant YAM Special Holdings Inc.

Wendy S. Tien, Assistant Minnesota Attorney General, represents appellee Commissioner of Revenue.

At issue in this case is whether and to what extent gains realized by appellant YAM Special Holdings, Inc., on the 2011 sale of a majority interest in the operations of its Go Daddy business are subject to Minnesota corporate income tax. Although the parties stipulated to certain facts and filed cross-motions for summary judgment, we concluded that the record was insufficient to support all aspects of their stipulation and to resolve all genuine issues of material fact. We granted the parties additional time in which to supplement the record on certain points. *YAM Special Holdings, Inc. v. Comm'r of Revenue*, Docket No. 9122-R, 2019 WL 2519414 (Minn. T.C. June 12, 2019). The parties responded with a supplemental stipulation of facts and renewed

motions for summary judgment. On the augmented record, we conclude that the gains realized by YAM Special Holdings are subject to Minnesota tax. We deny YAM's motion for summary judgment and grant the Commissioner's motion for summary judgment.

ORDER FOR JUDGMENT

1. The motion of appellant YAM Special Holdings, Inc., for summary judgment is denied.

2. The motion of appellee Commissioner of Revenue for summary judgment is granted.

IT IS SO ORDERED. THIS IS A FINAL ORDER. LET JUDGMENT BE ENTERED ACCORDINGLY.

BY THE COURT:

Joanne H. Turner, Judge
MINNESOTA TAX COURT

DATED: November 12, 2019

MEMORANDUM

Appellant YAM Special Holdings, Inc., operated Go Daddy, a provider of Internet domain names and web hosting services. In 2011, Holdings sold 71.39% of its interest in the GoDaddy.com business to a consortium of investors through a complex series of transactions worth more than $2.4 billion. Holdings' sole shareholder, Robert Parsons, received $1.168 billion of the transaction proceeds. Holdings reported the sale on its 2011 Minnesota income tax return as a transaction not subject to Minnesota tax. The Commissioner determined that a portion of

Holdings' gain on the sale was subject to Minnesota tax and assessed Holdings accordingly. On Holdings' appeal from that determination, both parties moved for summary judgment on stipulated facts.[1] We concluded that the parties' stipulation failed to address certain material facts about the sale transactions, and gave the parties the opportunity to supplement the record and renew their respective motions. Order Den. Cross-Motions Summ. J. (filed June 12, 2019). The parties did so[2] and, on the basis of the augmented record, we grant the Commissioner's motion and deny appellant Holdings' motion.

Background

Appellant YAM Special Holdings, Inc., is an Arizona Subchapter S corporation that, at all relevant times, was doing business as Go Daddy.[3] Holdings was founded by Robert R. Parsons, a resident of Arizona.[4] Until the events described here, Mr. Parsons was Holdings' sole shareholder, although certain Holdings employees held unvested restricted stock units and stock options in Holdings' authorized but unissued shares.[5]

Through twelve domestic and nine foreign subsidiaries, Holdings registered Internet domain names and provided website hosting and other ancillary sales and services, such as security

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1 Appellant's Notice Mot. Mot. Summary J. (filed Jan. 15, 2019); Comm'r's Notice Mot. Mot. Summary J. (filed Jan. 15, 2019); Jt. Stip. Facts (filed Jan. 15, 2019). The Commissioner's 2017 order affirmed a determination that YAM was liable for additional Minnesota income tax, penalties, and interest for the 2009, 2010, and 2011 taxable years. The parties subsequently stipulated that YAM owes no tax, penalty, or interest with respect to the 2009 and 2010 taxable years. Jt. Stip. Settled Issues (filed Jan. 15, 2019).

2 Appellant's Suppl. Mem. Supp. Renewed Mot. Summ. J. (filed Oct. 8, 2019); [Comm'r's] Mem. Law Supp. Renewed Mot. Summ. J. (filed Oct. 8, 2019); Appellant's Reply Mem. Supp. Renewed Mot. Summ. J. (filed Oct. 10, 2019); Comm'r's Reply Appellant's Mem. Supp. Renewed Mot. Summ. J. (filed Oct. 11, 2019).

3 Stip. ¶¶ 5, 7.

4 Stip. ¶ 6.

5 Stip. ¶¶ 6, 9.

and privacy features, email accounts, and website design tools.[6] Holdings' twelve domestic subsidiaries were disregarded for tax purposes, each having elected to be treated as a qualified Subchapter S subsidiary or Qsub under I.R.C. § 1361(b)(3) (2012).[7] Holdings' principal place of business and commercial domicile was in Arizona.[8] At all relevant times, Holdings neither owned nor rented real or tangible personal property located in Minnesota, nor did Holdings have any employees in Minnesota or any interest in any business entities or assets (whether tangible or intangible) physically located in Minnesota.[9]

Customers accessed Holdings' services through the GoDaddy.com website, which was hosted on computer servers in Arizona and elsewhere outside Minnesota, and through telephone calls to Holdings' service centers in Arizona and elsewhere outside Minnesota.[10] In 2010 and again in 2011, approximately 1% of Holdings' revenues were derived from customers in Minnesota.[11]

On July 1, 2011, Holdings announced it had "signed a definitive agreement to receive a strategic investment" from a consortium of investors led by KKR, Silver Lake, and Technology Crossover Ventures.[12] According to Mr. Parsons, Holdings was "partnering with KKR, Silver

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6 Stip. ¶ 10.

7 Stip. ¶ 7. A qualified Subchapter S subsidiary must be a domestic corporation and be wholly owned. I.R.C. § 1361(b)(3)(B) (2012). The separate status of the Qsub is disregarded in the sense that its assets, liabilities, and income are treated as assets, liabilities, and income of the Qsub's parent. I.R.C. § 1361(b)(3)(A) (2012). Holdings' nine foreign subsidiaries were also disregarded for tax purposes as a result of entity classification selections under Treas. Reg. § 301.7701-3. Stip. ¶ 7.

8 Stip. ¶ 5.

9 Stip. ¶¶ 13-14.

10 Stip. ¶ 11.

11 Stip. ¶ 12.

12 Stip. ¶ 11 & Ex. J-5, at 1 (July 1, 2011 press release).

Lake, and TCV because of their technology expertise, their understanding of Web based businesses and because their values align with ours." [13] Mr. Parsons indicated that together, Holdings and the investors would "take the company to the next level, especially when it comes to accelerating international growth." [14] Comments from the investors echoed Mr. Parsons' remarks.[15]

In preparation for the investment, in December 2011 Holdings first formed two Delaware limited liability companies (Newco and Go Daddy Operating Company LLC or GDO/Opco) as wholly owned subsidiaries, then converted its twelve domestic operating subsidiaries into wholly owned limited liability companies.[16] As the closing date approached, Holdings paid off its bank debt of approximately $15.5 million and paid approximately $3.1 million in transaction costs, both using its own funds.[17]

On December 15, 2011, Holdings contributed its interest in the twelve operating subsidiaries (now wholly owned LLCs), most of its other assets, and most of its remaining liabilities to its wholly owned subsidiary GDO/Opco.[18] Holdings retained its sole membership

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13 Ex. J-5, at 1.

14 Ex. J-5, at 1.

15 According to KKR's head of software and Internet group, "there is significant opportunity to expand [Holdings'] current portfolio of products and services" and to "accelerate growth internationally." Ex. J-5, at 2. According to Silver Lake's managing director, it "plan[ned] to maintain and augment all of the attributes that have made Go Daddy a clear market leader today." *Id.* at 1. According to the general partner of TCV, the company was "excited to invest in [Holdings] and contribute to its continued success." *Id.* at 2.

16 Suppl. Stip. ¶¶ 4.A. & 4.D. GDO was first called Desert Opco LLC, and the record sometimes refers to GDO as Opco. *Id.* ¶ 4.A. Converting the twelve Qsubs into limited liability companies allowed them to retain their tax-disregarded status after their contribution to a limited liability company. Suppl. Stip. ¶ 4.D.

17 Suppl. Stip. ¶ 4.E. The parties originally stipulated that Holdings' bank debt was $51 million. Stip. ¶ 17.D.

18 Suppl. Stip. ¶¶ 4.F. & 4.H.

interest in Newco; $38.5 million in cash; and certain assets relating to the name "Bob Parsons." [19] Holdings then contributed its sole interest in GDO/Opco to Newco.[20] As a result of these preparatory transactions, at the end of the day on December 15, 2011, Holdings was the sole owner of Newco (a tax-disregarded LLC); Newco was the sole owner of GDO/Opco (also a tax-disregarded LLC); and GDO/Opco was the sole owner of the twelve domestic subsidiaries through which the GoDaddy business operated.[21]

On December 16, 2011, the consortium of investors paid Holdings a total of $899.5 million in cash for 71.39% of the LLC membership interests in Newco.[22] The same day, GDO/Opco borrowed $750 million from a consortium of banks led by Barclays, receiving net proceeds after fees and expenses of approximately $708.7 million.[23] Of those funds, approximately $46 million was used to pay the buyers' transaction costs and approximately $21.5 million was used to pay Holdings' transaction costs.[24] In addition, approximately $368 million was used to purchase restricted stock units and stock options previously issued to Holdings' employees.[25] After transferring approximately $279.8 million to Holdings, GDO/Opco was left with approximately $31.8 million in cash for its "balance sheet needs," as determined by the buyers.[26]

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19 Stip. ¶ 17.E.; Suppl. Stip. ¶¶ 4.F., 4.G. & 4.H. The parties originally stipulated that Holdings' transaction costs were $31 million. Stip. ¶ 17.E. Holdings actually retained $57.066 million but was obligated to make certain payments from that amount, including debt payoffs and transaction costs. Suppl. Stip. ¶ 4.G. After those payments, approximately $38.5 million remained. *Id.*, ¶ 4.G.

20 Suppl. Stip. ¶ 4.I. Exhibit J-1 outlines the steps of the various transactions.

21 Suppl. Stip. ¶ 4.J; *see* Ex. J-1, at 3155.

22 Suppl. Stip. ¶ 4.K; *see* Ex. J-1, at 3159.

23 Suppl. Stip. ¶ 4.L; *see* Ex. J-1, at 3156.

24 Suppl. Stip. ¶ 4.N.

25 Suppl. Stip. ¶ 4.N.

26 Suppl. Stip. ¶ 4.N.

The net cash proceeds of the sale—totaling $1.168 billion—were wired to the accounts of Mr. Parsons.[27]

The buyers were unrelated to Mr. Parsons and owned no prior interests in the GoDaddy business.[28] Neither the buyers nor Holdings was under any compulsion to enter into the transaction, and all parties had access to all relevant information.[29] Following the sale, the GoDaddy business continued as it had before.[30] Holdings' former employees continued their employment uninterrupted.[31] There was no interruption in services and no changes in customers' terms of service or of use.[32] In fact, neither customers nor vendors were informed of the transaction.[33]

After the sale, Newco was managed by a three-member Executive Committee: one member designated by KKR, one member designated by Silver Lake, and one member—Mr. Parsons—designated by Holdings.[34] Newco's Board of Directors was comprised of two members chosen by KKR; two members chosen by Silver Lake; one member chosen by TCV; one independent member (a member of Holdings' board before the sale); the chief executive officer of Newco (Warren Adelman, Holdings' former president);[35] and one member—Mr. Parsons—chosen

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27 Suppl. Stip. ¶ 4.S.

28 Suppl. Stip. ¶ 1.

29 Suppl. Stip. ¶ 1.

30 Stip. ¶ 23.

31 Stip. ¶ 24.

32 Stip. ¶ 23.

33 Stip. ¶ 23.

34 Stip. ¶ 18.

35 Mr. Adelman was removed as Newco's CEO in July 2012 and replaced by a former executive of KKR. Suppl. Stip. ¶ 10.

by Holdings.[36] Mr. Parsons was also one of three members on Newco's compensation committee.[37] Newco's five officers (CEO and four executive vice presidents) were all former officers of Holdings.[38]

The Restated Newco Operating Agreement required KKR and Silver Lake to approve all of Newco's "major" decisions, such as initial public offerings and the sale of the company or its assets.[39] Holdings' approval was required for certain transactions between Newco and any of the buyers; for a sale of the company if the buyers were to receive disproportionate consideration; and for the revocation of certain tax elections.[40]

Between December 16, 2011, and April 1, 2015, Newco made seven corporate acquisitions with a total acquisition price of $230,670,000 in entities whose business ranged from online accounting software to content digitization to email marketing.[41] In 2012, the GoDaddy business generated approximately $106.1 million in cash.[42] Of that, $59.4 million was used for investments.[43] During 2012, Holdings also acquired a $50 million interest in GDO/Opco's credit facility.[44] In 2013, the GoDaddy business invested $208.5 million in various acquisitions, financed by proceeds of operations ($153.3 million) and $91.1 million in additional borrowing.[45] In 2014,

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36 Stip. ¶ 19.

37 Suppl. Stip. ¶ 7.

38 Stip. ¶ 20.

39 Restated Newco Operating Agreement (Ex. J12), at 35.

40 Suppl. Stip. ¶ 9.

41 Stip. ¶ 27.

42 Suppl. Stip. ¶ 11.

43 Suppl. Stip. ¶ 11.

44 Suppl. Stip. ¶ 17.

45 Suppl. Stip. ¶ 12.

GDO/Opco refinanced its credit facility to increase the amount borrowed from $850 million to $1.1 billion, doubled the capacity under the revolving credit line to $150 million, and drew $75 million on that credit line.[46] That year, the GoDaddy business spent $51.6 million on various acquisitions; its proceeds of operations were $180.6 million.[47]

On April 1, 2015, a newly formed Delaware corporation (GoDaddy, Inc.) made an initial public offering and, with the proceeds, acquired a managing membership interest in Newco.[48]

Holdings reported the December 2011 transactions as a sale of a proportionate share of the assets that comprised the GoDaddy business, in accordance with Rev. Rul. 99-5, Situation 1, 1999-1 C.B. 434.[49] This resulted in the recognition of long-term capital gain of approximately $1.353 billion, offset by a long-term capital loss of approximately $1.664 million, and recognition of ordinary gain, depreciation recapture, and qualified dividend income.[50] On its 2011 Minnesota income tax return, Holdings reported the gain as not subject to Minnesota tax.[51] The Commissioner assessed Holdings additional Minnesota income tax for the 2011 tax year on a portion of the gain, plus penalty and interest for a total of $1,639,940.[52] Holdings administratively appealed the Commissioner's assessment.[53] On August 24, 2017, the Commissioner affirmed her

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46 Suppl. Stip. ¶¶ 4.L., 15.

47 Suppl. Stip. ¶ 13.

48 Stip. ¶ 26.

49 Stip. ¶ 28.

50 Stip. ¶ 28.

51 Stip. ¶ 29; Ex. J-18.

52 Order (June 29, 2015).

53 Notice Administrative Appeal (filed Aug. 25, 2015) (Ex. J-19).

assessment in full.[54] Holdings appealed the Commissioner's determination on appeal to this court on October 17, 2017.[55]

Summary judgment standard

The Commissioner's assessment is prima facie correct and valid. Minn. Stat. § 270C.33, subd. 6 (2018); Minn. Stat. § 271.06, subd. 6 (2018). The appellant bears the "burden of going forward with evidence to rebut or meet the presumption." *Conga Corp. v. Comm'r of Revenue*, 868 N.W.2d 41, 53 (Minn. 2015) (citing *S. Minn. Beet Sugar Coop v. Cty. of Renville*, 737 NW.2d 545, 558 (Minn. 2007)). When the taxpayer presents substantial evidence that the Commissioner's assessment is invalid, the presumption is overcome and "the case is decided by the trier of fact the same as if the presumption had never existed." *Id.* at 53 (internal quotation omitted).

Under Minn. R. Civ. P. 56.01, summary judgment is to be granted "if the movant shows that there is no genuine issue as to any material fact and the movant is entitled to judgment as a matter of law." Our function in ruling on a motion for summary judgment is first to determine whether there is an issue of fact to be tried. *Anderson v. Twin City Rapid Transit Co.*, 250 Minn. 167, 186, 84 N.W.2d 593, 605 (1957). A fact dispute is material, for summary judgment purposes, "if its resolution will affect the outcome of the case." *O'Malley v. Ulland Bros.*, 549 N.W.2d 889, 892 (Minn. 1996). The substantive law identifies which facts are material. *Bond v. Comm'r of Revenue*, 691 N.W.2d 831, 836 (Minn. 2005). Accordingly, to determine whether there remains any genuine issues of material fact that would preclude entry of judgment for either party, we review the law governing this matter.

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54 Notice Determination Appeal (Aug. 24, 2017).

55 Notice Appeal Order Comm'r of Revenue (filed Oct. 17, 2017).

Analysis

Applicable law. Minnesota law 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 (2018). 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 Minn. Stat. ch. 290 (2018). Minn. Stat. § 290.02.

For nonresident corporations like Holdings, whether and to what extent income is apportioned to Minnesota depends on whether the income was "derived from the conduct of a trade or business." Minn. Stat. § 290.17, subd. 2. "All income of a trade or business is subject to apportionment [between Minnesota and other states] *except nonbusiness income.*" *Id.*, subd. 3 (emphasis added). Nonbusiness income is assigned to this state or to another, depending on the nature of the income. *See id.*, subd. 2.[56] For example, income from wages is assigned to Minnesota

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[56] Section 290.17 uses three terms: apportionment, assignment, and allocation. "[T]he net income from a trade or business carried on partly within and partly without [Minnesota] must be *apportioned*" to Minnesota using one of the formulas found in Minn. Stat. § 290.191 (2018). Minn. Stat. § 290.17, subd. 1(a) (emphasis added). For the 2011 taxable year, income was generally apportioned to Minnesota by taking into consideration the proportion of sales made in Minnesota, the proportion of tangible property used in Minnesota, and the percentage of the taxpayer's payroll paid in Minnesota. *Id.*, subd. 2.

Income that is not apportioned using the statutory formula is either *assigned* to one state or another or *allocated* between Minnesota and another state using something *other than* the statutory apportionment formulas. For example, "[i]ncome or gains from tangible property located in [Minnesota] that is not employed in the business of the recipient of the income or gains must be *assigned* to [Minnesota]," *id.*, subd. 2(b) (emphasis added), meaning that all of the income or gain is subject to Minnesota tax. Similarly, "[i]ncome or gains from intangible personal property not employed in the business of the recipient of the income or gains must be *assigned* to [Minnesota] if the recipient of the income or gains is a resident of [Minnesota] or is a resident trust or estate." *Id.*, subd. 2(c) (emphasis added).

In contrast, "[g]ain on the sale of a partnership interest is *allocable* to [Minnesota]" in the ratio of the original cost of partnership tangible property in [Minnesota] to the original cost of partnership tangible property everywhere, determined at the time of the sale." *Id.* In other words,

"if, and to the extent that, the work of the employee is performed within it." *Id.*, subd. 2(a)(1). Gains on the sale of tangible property "not employed in the business of the recipient of the [] gains" are assigned to Minnesota if the property is located in Minnesota. *Id.*, subd. 2(b). Significantly for this dispute:

> Gain on the sale of an interest in a single member limited liability company that is disregarded for federal income tax purposes is allocable to this state as if the single member limited liability company did not exist and the assets of the limited liability company are personally owned by the sole member.
>
> Gain on the sale of goodwill or income from a covenant not to compete that is connected with a business operating all or partially in Minnesota is allocated to this state to the extent that the income from the business in the year preceding the year of sale was allocable to Minnesota under [Minn. Stat. § 290.17] subdivision 3.

Id., subd. 2(c).

Chapter 290 does not define "income of a trade or business"—the income that is subject to apportionment—but it does define "nonbusiness income":

> Nonbusiness income is income of the trade or business that cannot be apportioned by this state because of the United States Constitution or the Constitution of the state of Minnesota and includes income that cannot constitutionally be apportioned to this state because it is derived from a capital transaction that solely serves an investment function.

Id., subd. 6. Section 290.17 therefore sets out both a definition of nonbusiness income and a specific example of nonbusiness income. The definition: nonbusiness income is income of a trade or business that, because of constitutional principles, cannot be apportioned to Minnesota. The specific example: income "derived from a capital transaction that solely serves an investment function." *Id.* We begin by briefly explaining the definition of nonbusiness income, namely, the constitutional principles governing apportionment of income to a taxing state.

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a gain on the sale of a partnership interest is divided between Minnesota and other state[s], but using something *other than* the apportionment factors and formula found in Minn. Stat. § 290.191.

A state may tax income generated in that state, regardless of where the taxpayer is located. *See Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 441 (1940). A state may not, however, tax "corporate income derived from corporate activities beyond the State's borders." *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 317 (1982). When the corporation does business in multiple states, the problem comes in determining whether and to what extent its income is derived from activities in any particular state. "[S]eparate geographical accounting" is not constitutionally required if "the intrastate and extrastate activities formed part of a single unitary business." *Mobil Oil Corp. v. Comm'r of Taxes of Vermont*, 445 U.S. 425, 438 (1980) (citing *Butler Bros. v. McColgan*, 315 U.S. 501, 506-08 (1942)). Indeed, such separate accounting "may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale." *Id.* In fact, when "factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable 'source.' " *Id.*

Therefore, it is constitutionally permissible to apportion the income of a multistate business among the states in which it operates, *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 460 (1959), provided that the apportionment satisfies the Due Process Clause of the Fourteenth Amendment of the United States Constitution. To satisfy the Due Process Clause, there must be, first, "some minimal connection between [the activities of the interstate business] and the taxing State." *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272-73 (1978) (citing *Nat'l Bellas Hess, Inc. v. Dep't of Revenue*, 386 U.S. 753, 756 (1967)). That minimal connection or "nexus" exists if the corporation "avails itself of the substantial privilege of carrying on business within the State." *Mobil Oil*, 445 U.S. at 437 (internal quotation marks omitted). "Second, the income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State.' "

Moorman Mfg., 437 U.S. at 273 (quoting *Norfolk & Western R. Co. v. State Tax Comm'n*, 390 U.S. 317, 325 (1968)). In addition, the Commerce Clause of the United States Constitution requires that the tax imposed apply to an activity with a substantial nexus with the taxing state, that the tax be fairly apportioned and fairly related to the services the state provides, and that the tax not discriminate against interstate commerce. *South Dakota v. Wayfair, Inc.*, ___ U.S. ___, ___, 138 S. Ct. 2080, 2091 (2018).

The Supreme Court applied these principles in *Allied-Signal, Inc. v. Director, Division of Taxation*, to a gain generated by Bendix's sale of stock in ASARCO, another publicly traded corporation—a gain that New Jersey sought to tax. 504 U.S. 768 (1982).[57] The parties stipulated that "Bendix and ASARCO were unrelated business enterprises each of whose activities had nothing to do with the other." *Id.* at 774. Nevertheless, the New Jersey Supreme Court concluded that Bendix and ASARCO formed a unitary business based, in part, on the fact that Bendix intended to use the proceeds of the sale to acquire an interest in another corporation (Martin Marietta), "whose aerospace business, it was hoped, would complement Bendix's aerospace/electronics business." *Id.* at 776-77.

At the Supreme Court, New Jersey urged the court to abandon the unitary business rule altogether and permit the apportionment of all income earned by a nondomiciliary corporation by any state in which the corporation does business. *Id.* at 777, 784. In support of that argument, New Jersey argued "that multistate corporations like Bendix regard all of their holdings as pools of assets, used for maximum long-term profitability, and that any distinction between operational and investment assets is artificial." *Id.* at 784. The Court disagreed, indicating that apportionment

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[57] Allied-Signal was the successor-in-interest to Bendix Corporation. 504 U.S. at 773. We follow the Supreme Court's lead and refer to the taxpayer as Bendix.

was permissible in two situations. The Court first affirmed that apportionment was permissible in the case of a unitary business. The Court indicated that "the 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." *Id.* at 785. The Court next made clear that the existence of a unitary business was not essential: "the existence of a unitary relation between the payor and the payee is one means of meeting the constitutional requirement." *Id.* at 787. The Court then explained that apportionment is permissible even in the absence of a unitary relationship between entities:

> [F]or example, a State may include within the apportionable income of a nondomiciliary corporation the interest earned on short-term deposits in a bank located in another State if that income forms part of the working capital of the corporation's unitary business, notwithstanding the absence of a unitary relationship between the corporation and the bank.

Id. at 787-88. In short, under *Allied-Signal* income can be subject to tax by Minnesota if the asset that generated the income was a part of a unitary business being conducted in whole or in part in Minnesota, even though the payee and payor are not part of a unitary business.

Application of the law. In this case, Holdings and the outside investors (KKR, Silver Lake, and TCV) were not a unitary business in December 2011. However, Holdings and the twelve domestic subsidiaries through which Holdings operated were a unitary business.[58] Accordingly, the gain generated by the sale of a partial interest in those subsidiaries is subject to apportionment. We grant the Commissioner's motion, and deny Holdings' motion, on that basis.

Holdings relies, not on the statutory definition of nonbusiness income, but on the specific example of "nonbusiness income," found in Minn. Stat. § 290.17, subdivision 6: "income that ...

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[58] Tr. 36 (Mar. 22, 2019).

is derived from a capital transaction that solely serves an investment function." [59] Neither the term "capital transaction" nor the term "investment function" is defined in chapter 290, although there is no dispute here that the December 2011 transactions were "capital transactions." Nor can we say that the term "investment function" finds meaning in everyday usage. Accordingly, we turn to legislative history to understand the meaning of the phrase.

Subdivision 6 of section 290.17 was amended to its current form in 1999, *see* Act of May 25, 1999, ch. 243, art. 2, § 23, 1999 Minn. Laws 2054, 2078, shortly after the Minnesota Supreme Court pointed out that Minnesota law provided only "minimal statutory guidance as to what it means for an intangible asset to be connected to a trade or business." *Hercules, Inc. v. Comm'r of Revenue*, 575 N.W.2d 111, 114-15 (Minn. 1998). Before the 1999 amendment, Minnesota law provided for the apportionment between states of income of a trade or business and the assignment of nonbusiness income to the taxpayer's state of domicile. Minn. Stat. § 290.17, subds. 2(f), 6 (1988). The definition of "nonbusiness" income read as follows:

> For a trade or business for which allocation of income within and without this state is required, if the taxpayer has any income not connected with the trade or business carried on partly within and partly without this state that income must be allocated under [Minn. Stat. § 290.17] subdivision 2. Intangible property is employed in a trade or business if the owner of the property holds it as a means of furthering the trade or business.

Minn. Stat. § 290.17, subd. 6 (Supp. 1987). Minnesota law did not, however, define "business" income. In two decisions filed on the same day, the Minnesota Supreme Court interpreted subdivision 6 in two different ways.

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[59] Appellant's Mem. Supp. Summ. J. 15 (filed Jan. 15, 2019) ("The determination of whether the income from the sale of the Sold Newco Units gives rise to business income or nonbusiness income is fundamentally a question of whether this income is 'derived from a capital transaction that solely serves an investment function.'").

In *Hercules*, the issue was the apportionment of a gain realized by Hercules on the sale of stock in a company to which Hercules had spun off part of its business, and with which Hercules then did business on an arm's-length basis. 575 N.W.2d at 113-14. The Minnesota Supreme Court concluded that the gain on the sale of stock was apportionable, rather than assignable, because neither the stock itself nor the proceeds of the sale were used in Hercules' "day-to-day business operations." 575 N.W.2d at 115-16 (Minn. 1998).

In *Firstar Corp. v. Commissioner of Revenue*, a case involving the apportionment of the gain on the sale of an out-of-state office tower, the court applied a different test. 575 N.W.2d 835, 839 (Minn. 1998). Firstar's executive and administrative offices and one of its branches were located in the tower, but the supreme court did not consider whether the property was used in Firstar's day-to-day business operations—although obviously it was. In fact, the court specifically rejected what it called a "functional test" that examined "whether the asset produced business income while it was owned by the taxpayer." *Id.* at 838 (quoting *Union Carbide Corp. v. Huddleston*, 854 S.W.2d 87, 92 (Tenn. 1993)).[60] The court instead adopted what it called a "transactional test," in which the "controlling factor" is "the nature of the particular transaction giving rise to the income," specifically, "the frequency and regularity of similar transactions, former business practices, and subsequent use of the proceeds." *Id.* Applying those factors, the court concluded that the gain on the sale of Firstar's headquarters was nonbusiness income not subject to apportionment. *Id.*

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[60] Although filed on the same day and authored by the same justice, the supreme court's *Hercules* and *Firstar* decisions do not mention each other, much less attempt to reconcile their approaches. Were we to attempt to do so, we might say that the *Hercules* or functional test applied to intangible assets and the *Firstar* or transactional test applied to tangible assets.

As we have noted, after the filing of these decisions the legislature amended subdivision 6 to its current form. At the time, the U.S. Supreme Court's most recent pronouncement on the existence of a unitary business was *Allied-Signal*, which used the operational function/investment function dichotomy:

> We agree that the payee and the payor need not be engaged in the same unitary business as a prerequisite to apportionment in all cases. *Container Corp.* says as much. What is required instead is that *the capital transaction serve an operational rather than an investment function*. . . .
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> Indeed, in *Container Corp.* we noted the important distinction between *a capital transaction that serves an investment function* and one that serves an operational function. . . .

504 U.S. at 787-88 (emphases added) (citing *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 180 n.19 (1983)). *Container Corp.*, in turn, provides this explanation:

> Two of the factors relied on by the state court deserve particular mention. The first of these is the flow of capital resources from appellant to its subsidiaries through loans and loan guarantees. There is no indication that any of these capital transactions were conducted at arm's-length, and the resulting flow of value is obvious. . . . [C]apital transactions can serve either an investment function or an operational function. In this case, appellant's loans and loan guarantees were clearly part of an effort to insure that "[t]he overseas operations of [appellant] continue to grow and to become a more substantial part of the company's strength and profitability."

463 U.S. at 180 n.19 (alterations in original).

After the amendment of subdivision 6 in 1999, however, the U.S. Supreme Court issued further guidance on the apportionment of income. In *MeadWestvaco Corp. ex rel. Mead Corp. v. Illinois Department of Revenue*, the Court specifically rejected the notion that the operational/investment dichotomy was a test of apportionability *separate from* the concept of unitariness.

> [O]ur references to "operational function" in *Container Corp.* and *Allied-Signal* were not intended to modify the unitary business principle by adding a new

> ground for apportionment. The concept of operational function simply recognizes that *an asset can be a part of a taxpayer's unitary business even if what we may term a "unitary relationship" does not exist between the "payor and payee."*

553 U.S. 16, 29 (2008) (emphasis added). The *MeadWestvaco* court cited an example from *Allied-Signal*:

> [A] State may include within the apportionable income of a nondomiciliary corporation the interest earned on short-term deposits in a bank located in another State if that income forms part of the working capital of the corporation's unitary business, notwithstanding the absence of a unitary relationship between the corporation and the bank.

Id. at 28-29 (citing *Allied-Signal*, 504 U.S. at 787-88). In that case, the *MeadWestvaco* court explained, "the taxpayer was not unitary with its banker, but the taxpayer's deposits (which represented working capital and thus operational *assets*) were clearly unitary with the taxpayer's business." *Id.* at 29 (emphasis added). Similarly, futures contracts used as a hedge against increases in corn prices "were likewise clearly unitary with the taxpayer's business," even though "the taxpayer was not unitary with the counterparty to its hedge." *Id.* (citing *Corn Prods. Ref. Co. v. Comm'r*, 350 U.S. 46 (1955)). In both of these examples, the *MeadWestvaco* court explained,

> the "payor" was not a unitary part of the taxpayer's business, but the relevant *asset* was. The conclusion that the asset served an operational function was merely instrumental to the constitutionally relevant conclusion that *the asset was a unitary part of the business* being conducted in the taxing State rather than a discrete asset to which the State had no claim. Our decisions in *Container Corp.* and *Allied-Signal* did not announce a new ground for the constitutional apportionment of extrastate values in the absence of a unitary business.

Id. at 29-30 (emphases added).

In other words, under *Allied-Signal* and *MeadWestvaco*, income can be constitutionally allocated to this state if the *asset* that generated the income "was a unitary part of the business being conducted in" Minnesota. Hellerstein has termed this concept "asset unity," and compared it to "enterprise unity." Walter A. Hellerstein, Jerome R. Hellerstein & John A. Swain, *State*

Taxation § 8.07 (3d ed. 2019). In the latter, according to Hellerstein, "the question is whether a single enterprise exists." *Id.*, ¶ 8.07[2][a][i]. In the former, the question is "whether an asset is an integral part of an enterprise." *Id.*, ¶ 8.07[2][a][ii].

> While there is only one unitary business principle, the application of the principle gives rise to two discrete inquiries in two different contexts. In one context, the question is whether a single enterprise exists. The question may be whether a corporate payor of dividends is engaged in a single enterprise with a corporate payee of dividends, and the answer will determine whether the dividends are includable in the payee's apportionable tax base. Alternatively, the question may be whether one division of a single corporation is engaged in a single enterprise with another division of the same enterprise, and the answer will determine whether the income from all of the divisions (or from a sale of one of the divisions) is includable in the taxpayer's apportionable tax base.
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> A different unitary business inquiry arises when the question is not whether a single enterprise exists but rather whether an asset is an integral part of an enterprise. The question may be whether assets, such as bonds, stocks, or other investments, are part of the single "unit" of property that has an "organic connection" to the taxpayer's business, and the answer will determine whether the property is included in the taxpayer's apportionable property tax base along with other property used in the taxpayer's operations. Alternatively, the question may be whether a minority investment in another company has an "operational" connection with the taxpayer's business (e.g., the investment guarantees a source of supply), and the answer will determine whether the income from that investment (whether in the form of dividends or in the form of gain upon disposition) is includable in the taxpayer's apportionable tax base.
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> Enterprise unity and asset unity are independent concepts. Enterprise unity may exist without asset unity, and asset unity may exist without enterprise unity. . . . Enterprise unity and asset unity can also coexist.

Hellerstein, § 8.07[2][a][i]-[iii] (footnotes omitted); *see also* Walter Hellerstein, *State Taxation of Corporate Income From Intangibles: Allied-Signal and Beyond*, 48 Tax L. Rev. 739, 791 (1993) (cited in *MeadWestvaco*, 553 U.S. at 29) ("the Court squarely grounded the analysis of whether a corporate taxpayer's income from an intangible is apportionable on the inquiry into whether the intangible served an operational function").

Here, there is no dispute that Holdings and the twelve domestic operating subsidiaries in which the outside investors purchased a majority interest were part of the same unitary business.

Nor is there a dispute that the assets of the operating subsidiaries are an integral part of the Go Daddy business. Whether viewed as "asset unity" or "enterprise unity," the domestic operating subsidiaries served an "operational," not merely an "investment," function in the Go Daddy business.[61]

Even if we adopted Holdings' focus on the nature of the December 2011 transactions alone, we could not say that Holdings has sustained its burden to show that the sale of a majority interest in the operating subsidiaries served "solely" an investment function. If nothing else, the parties agree the sale provided GDO and the operating subsidiaries with $31.8 million in additional cash

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[61] Appellant's Mem. Supp. Summ. J. 16-17. Holdings also relies on the Minnesota Supreme Court's decision in *Firstar Corp. v. Commissioner of Revenue*, 575 N.W.2d 835 (Minn. 1998), and our decision in *Nadler v. Commissioner of Revenue*, Docket No. 7736-R, 2006 WL 1084260 (Minn. T.C. Apr. 21, 2006). Neither of these cases involved a transaction between parts of a unitary business, and both were decided before the Supreme Court's decision in *MeadWestvaco*.

In *Nadler*, this court parsed Minn. Stat. § 290.17 to create three, rather than two, separate categories of income: business income, nonbusiness income derived from a trade or business, and nonbusiness income not derived from a trade or business. 2006 WL 1084260, at *7. The *Nadler* court held that the phrase "income of a trade or business" in subdivision 6 meant "income derived from the conduct of a trade or business." *Id.* Relying on *Firstar*, the *Nadler* court concluded that the sale of the business at issue in *Nadler* was not "income of the trade or business" and therefore not subject to apportionment. *Id.*, at *8.

After careful consideration of the statutory scheme, we reach a different conclusion. Section 290.17 creates only two categories of income: that which is subject to apportionment, and that which is not. Minn. Stat. § 290.17, subd. 6. Under subdivision 6, the difference between the two is purely constitutional: "Nonbusiness income is income of the trade or business that cannot be apportioned by this state because of the United States Constitution or the Constitution of the state of Minnesota." Income "derived from a capital transaction that solely serves an investment function" is an *example* of income that cannot, for constitutional reasons, be apportioned—not an additional category of nonbusiness income.

Income that cannot be *apportioned* may be either *allocated* or *assigned* under subdivision 2. We do not find the provisions of subdivision 2 superfluous, given that they apply only to income that cannot be apportioned in the first place.

The Commissioner contends that nonbusiness income must be "assigned." Rev. Notice #17-02 (July 3, 2017). Under Minn. Stat. § 290.17, subd. 6, nonbusiness income may be either allocated or assigned, depending on the type of income, as provided in subdivision 2.

for their " 'balance sheet needs,' as determined by the Buyers in their sole discretion as to " 'adequate working capital.' " [62] But the December 2011 transactions did more than that: for example, they also allowed Holdings to eliminate the restricted stock units and stock options previously granted to its employees and, indeed, changed the very structure of the Go Daddy business.[63]

We therefore conclude that the December 2011 sale resulted in gains apportionable to Minnesota. That does not, however, address all of Holdings' arguments. Under Minn. Stat. § 290.17, subd. 2(c):

> Gain on the sale of goodwill or income from a covenant not to compete that is connected with a business operating all or partially in Minnesota is allocated to this state to the extent that the income from the business in the year preceding the year of sale was allocable to Minnesota under [Minn. Stat. § 290.17], subdivision 3.

Holdings asserts that, even if we conclude that the gain on the sale to the investors is apportionable, it is not apportionable to Minnesota because Holdings did not "operate a business" in Minnesota.[64] Citing to various dictionary definitions, Holdings posits that to "operate" a business requires "the performance of a function or work in a particular place, via people or machines, and not merely to

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62 Suppl. Stip. ¶ 4.N.(iv); *see* Ex. J-7, Part III, at 1646; Ex. J-2, at 0012. Holdings argues that these funds were "not an infusion of capital to GDO" but "only partially replace the $38.5 million of cash that Holdings retained and did not transfer to GDO." Appellant's Suppl. Mem. Supp. Renewed Mot. Summ. J. 3. Holdings further argues that the December 2011 sale "resulted in a net reduction of $6.7 million of GDO's cash on hand," and therefore "did not provide funds to be used in GDO's business." *Id.* We view Holdings as arguing for a de minimis exception to the statutory requirement that the capital transaction have "solely served" an investment function—an exception contravened by the plain language of subdivision 6.

63 We therefore need not resolve the parties' dispute over whether, as the Commissioner contends, GDO's growth and subsequent acquisitions were made possible by the December 2011 transactions or whether, as Holdings contend, they resulted solely from operations of the Go Daddy business after December 2011. *See* [Comm'r's] Mem. Law Supp. Cross-Motion Summ. J. 20-25; Appellant's Resp. Opp'n Appellee's Cross-Motion Summ. J. Reply Supp. Mot. Summ. J. 5-7.

64 Appellant's Mem. Law 18-19.

have an effect." [65] Holdings contends that because it had no employees or property in Minnesota, it "cannot be deemed to have been 'operating' in Minnesota." [66] But the need to allocate gain on the sale of goodwill arises only if the income is nonbusiness income, and we have determined otherwise. We therefore do not reach the question of whether Holdings was "operating" in Minnesota.

Moreover, were we to reach the question, we would conclude that Holdings was indeed "operating" a business in Minnesota in 2011. The American Heritage College Dictionary, for example, defines "operate" much more generally than the dictionaries to which Holdings cites—as meaning to "perform a function; work" or to "exert an influence." *The American Heritage College Dictionary* 956 (3d ed. 1997). Holdings' argument conflates a sufficient condition with a necessary one. A business with employees, assets, and property in Minnesota surely "operates" in Minnesota, but a business can "operate" in Minnesota without those things, as demonstrated by the simple fact that Holdings generated revenues from customers located in Minnesota. *See* Minn. Stat. § 290.191, subd. 2(a) (allowing Minnesota to apportion income to Minnesota based solely on "the percentage which the sales made within this state in connection with the trade or business during the tax period are of the total sales wherever made in connection with the trade or business during the tax period").[67]

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65 Appellant's Mem. Law 19 (citing *Black's Law Dictionary*, *Merriam-Webster Dictionary*, and *Dictionary.com*).

66 Appellant's Mem. Law. 19.

67 Apportionment requires that the trade or business be "carried on partly within and partly without" Minnesota. Minn. Stat. § 290.17, subd. 1(a). It would be incongruous to conclude that a business is subject to tax in Minnesota because it is "carried on partly" in Minnesota, but gains on the disposition of the assets of the business are not subject to tax because the business did not also "operate" in Minnesota.

Holdings also challenges the amount of gain to be allocated to Minnesota. Again, Minn. Stat. § 290.17, subd. 2(c), provides:

> Gain on the sale of goodwill or income from a covenant not to compete that is connected with a business operating all or partially in Minnesota is allocated to this state *to the extent that the income from the business in the year preceding the year of sale was allocable to Minnesota* under [Minn. Stat. § 290.17], subdivision 3.

(Emphasis added.) Holdings argues that the phrase "to the extent that" means the precise dollar amount of the preceding year's income allocated to Minnesota—in this case, $56,829.[68] Because the question of the amount of gain allocated to Minnesota under subdivision 2(c) arises only if the gain is considered nonbusiness income, and because we have determined otherwise, we do not reach this issue either. Nevertheless, we conclude that had the legislature intended to limit the allocation of gain on the sale of goodwill to a specific dollar amount, it would have promulgated a different statute—one that reads as follows:

> Gain on the sale of goodwill or income from a covenant not to compete that is connected with a business operating all or partially in Minnesota is allocated to this state *in the same amount as* the income from the business in the year preceding the year of sale was allocable to Minnesota under subdivision 3.

(Emphasis added.) Instead, the legislature used the phrase "to the extent that." Were we to reach the question, we would conclude that subdivision 2(c) refers to the allocation *percentage* or *ratio* applied to the previous year's business income, rather than to the actual dollar amount of the previous year's income allocated to Minnesota.[69]

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[68] Appellant's Mem. Law 22-24 ("[I]f the court were to find that Appellant was operating in Minnesota, the amount of income from the sale of goodwill allocable to Minnesota would be $56,829.").

[69] We differ from *Nadler* on this point as well. In *Nadler* the court concluded that the amount of gain on goodwill allocable to Minnesota was limited to the dollar amount of the Nadlers' share of the corporation's income apportioned to Minnesota for the previous year. 2006 WL 1084260, at *9. The court so concluded, at least in in part, on the principle that ambiguity in a tax statute must be construed against the taxing authority and in favor of the taxpayer. *Id.* (quoting *Breda v. Girard*, 592 N.W.2d 452, 455 (Minn. 1999)). That principle seems particularly inapplicable to

For the foregoing reasons, we deny Holdings' motion for summary judgment and grant the Commissioner's motion for summary judgment.

J.H.T.

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subdivision 2(c), where it may not necessarily work in the taxpayer's favor depending on the amount of income apportioned in the previous year as compared to the current year.