STATE OF MINNESOTA | TAX COURT
COUNTY OF RAMSEY | REGULAR DIVISION

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Cities Management, Inc.,

Appellant,

vs.

Commissioner of Revenue,

Appellee.

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

Docket No. 9484-R

Filed: December 20, 2022

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This matter came on before the Honorable Jane N. Bowman, Chief Judge of the Minnesota Tax Court, on the parties' cross-motions for summary judgment.

Masha M. Yevzelman and Jennifer R. Pusch, Fredrikson & Byron, P.A., represent appellant Cities Management, Inc.

Jennifer A. Kitchak, Assistant Minnesota Attorney General, represents appellee Commissioner of Revenue.

The parties brought cross-motions for summary judgment. Cities Management, Inc. asks us to rule that gain from the sale of goodwill attributed to a nonresident individual should be considered income not derived from the conduct of a trade or business and allocated accordingly. For his part, the Commissioner asks us to rule that the gain should be considered income of a unitary business and apportioned to Minnesota. Because we agree with the Commissioner, we grant his motion for summary judgment and deny the Appellant's.

The court, having heard and considered the evidence adduced at trial and the arguments of counsel, and upon all the files, records, and proceedings herein, now makes the following:

## CONCLUSIONS OF LAW

1. Kim Carlson's 2015 individual income stemming from the goodwill generated by the sale of her stock ownership interests in Cities Management, Inc. constitutes income of a unitary business and is thus subject to apportionment under Minn. Stat. § 290.17, subds. 3-4.

2. Because Ms. Carlson's income from the CMI Transaction is income of a trade or business, it is not income "not derived from the conduct of a trade or business" and thus is not subject to assignment under Minn. Stat. § 290.17, subd. 2.

## ORDER

1. The Commissioner's Notice of Determination on [Administrative] Appeal with a notice date of April 21, 2021, is affirmed.

2. Counts I-IV of Cities Management, Inc.'s Notice of Appeal are dismissed.

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

BY THE COURT:

Jane N. Bowman, Chief Judge
MINNESOTA TAX COURT

Dated: December 20, 2022

## MEMORANDUM

## I. FACTUAL AND PROCEDURAL BACKGROUND

### Cities Management, Inc.

Kim Carlson founded Cities Management, Inc. ("CMI") in 1988 as a Minnesota corporation with its principal place of business in Minnesota.[1] Until September 1, 2015, CMI was primarily engaged in the business of managing community associations in Minnesota and Wisconsin.[2] CMI handled communications, collections, financial reporting, and service contract negotiations.[3]

In 2000, the owners of CMI incorporated a separate entity, Under Construction Services, Inc., d/b/a Cities Maintenance ("UCS"), which provided maintenance for the community associations managed by CMI.[4] At all times relevant, CMI and UCS were both S Corporations.[5] Prior to the 2015 sale of CMI, described below, CMI filed returns and paid income tax apportioned in part to Minnesota.[6]

### CMI Transaction and Reporting

As of August 31, 2015, Ms. Carlson owned 80% of the stock in both CMI and UCS.[7] Michael Egelston owned the remaining 20% of the entities' stock.[8] On September 1, 2015,

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[1] Partial Stip. Material Facts ¶ 1 (filed May 31, 2022).

[2] Stip. Facts ¶ 2.

[3] Aff. Kim Carlson ¶ 3 (signed July 19, 2022).

[4] Stip. Facts ¶ 3.

[5] Carlson Aff. ¶ 2.

[6] *See* Stip. Facts ¶ 11.

[7] Stip. Facts ¶ 4; Carlson Aff. ¶ 6.

[8] Stip. Facts ¶ 4; Carlson Aff. ¶ 6 (Mr. Egelston was CMI's Chief Executive Officer and was responsible for the company's day-to-day operations. Ms. Carlson was not involved in the day-to-day management or operations of CMI.).

Ms. Carlson and Mr. Egelston sold their stock ownership interests in CMI and UCS to PMG Holdings, Inc. ("PMG Holdings"), an unrelated third party, pursuant to a Stock Purchase Agreement (the "CMI Transaction").[9] The Agreement stated that CMI was selling its entire "[r]ight, title, and interest in, to, and under the Business," including all tangible assets and intangible assets, such as goodwill.[10]

PMG Holdings requested that Ms. Carlson and Mr. Egelston agree to make an election under I.R.C. § 388(h)(10) (2018) (a "§ 338(h)(10) election") to treat the sale of the CMI stock as a sale of the entity's assets.[11] Pursuant to a § 338(h)(10) election, when one corporation purchases another corporation (here, PMG Holdings purchasing CMI and UCS), the parties to the sale may elect to treat the *stock* purchase as an *asset* purchase, which allows the purchaser (PMG Holdings) to obtain a stepped-up basis in the acquired corporations' (CMI and UCS) assets. Jerome R. Hellerstein & Walter Hellerstein, *State Taxation* ¶ 7.14, at 1 (3d ed. 2022) 2007 WL 1687512.

After consulting with public accounting firm HG&K, Ltd. ("HG&K"), Ms. Carlson received advice concerning the impact of making a § 338(h)(10) election.[12] In estimating the state tax impact of the CMI Transaction for Ms. Carlson, who is a nonresident of Minnesota,[13] HG&K followed and relied on the Minnesota Tax Court's 2006 decision in *Nadler v. Comm'r of Revenue*, No. 7736-R, 2006 WL 1084260 (Minn. T.C. Apr. 21, 2006).[14] HG&K advised Ms. Carlson that,

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[9] Stip. Facts ¶ 5.

[10] Stip. Facts ¶ 5, Ex. J1, at 19-21.

[11] Carlson Aff. ¶ 12; Aff. Jennifer R. Pusch ¶ 2, Ex. 1, at 29 (signed July 20, 2022).

[12] Carlson Aff. ¶¶ 13-14; Aff. Loran Hillesheim ¶¶ 5-7 (signed July 19, 2022).

[13] Stip. Facts ¶ 6. At the time of the sale, Ms. Carlson was a nonresident of Minnesota and Mr. Egelston was a Minnesota resident. *See* Minn. Stat. § 290.17, subd. 1(a) (stating that income of a resident individual is not subject to allocation outside of Minnesota).

[14] Hillesheim Aff. ¶ 7.

under *Nadler's* interpretation of Minnesota tax law, gain on that portion of sale proceeds considered goodwill would be taxed under Minn. Stat. § 290.17, subd. 2.[15] In reliance on HG&K's advice,[16] Ms. Carlson agreed to treat the sale of CMI and UCS stock as a sale of assets under Internal Revenue Code § 338(h)(10), rather than treating it as a sale of stock.[17]

The agreed upon purchase price was $8,763,041.[18] Proceeds from the CMI Transaction were paid directly by PMG Holdings to Ms. Carlson and Mr. Egelston.[19] CMI never received or held the proceeds of the sale transaction.[20]

With the help of HG&K,[21] CMI timely filed a 2015 Form M8 Minnesota S Corporation Return ("2015 Return") for the period January 1, 2015, through September 1, 2015.[22] CMI's 2015 Return included one Schedule KS for Ms. Carlson and another for Mr. Egelston showing each owner's share of income, credits, and modifications for the 2015 tax year.[23] For Ms. Carlson, a nonresident of Minnesota, CMI reported gain from the deemed sale of assets in the CMI Transaction, including goodwill, as income *not* derived from the conduct of a trade or business

[15] *See* Stip. Facts ¶ 8; Hillesheim Aff. ¶ 7; Carlson Aff. ¶ 15.

[16] Carlson Aff. ¶ 15.

[17] Stip. Facts ¶ 5, Ex. J1, at 26 ("The Seller and the Buyer shall join in making an election under Section 338(h)(10) of the [Internal Revenue Code] …."). The seller requested, and Ms. Carlson agreed to, the § 338(h)(10) election. Decl. Jennifer Kitchak ¶ 3, Ex. B, at 29 (signed July 21, 2022).

[18] Stip. Facts ¶ 5, Ex. J1, at 25.

[19] Stip. Facts ¶ 7.

[20] Carlson Aff. ¶ 9. Further, the proceeds of the CMI Transaction were not reinvested in CMI. *Id.* ¶ 10.

[21] Carlson Aff. ¶ 18; Hillesheim Aff. ¶ 8.

[22] Stip. Facts ¶ 9.

[23] Stip. Facts ¶ 10.

pursuant to Minn. Stat. § 290.17, subd. 2.[24] This characterization is a significant part of the parties' dispute. On this basis, Ms. Carlson's 2015 Schedule KS reported $333,844 in net Minnesota long-term capital gain for 2015 from the CMI Transaction.[25] This amount is equal to the amount of income CMI apportioned to Minnesota for Ms. Carlson in the year preceding the sale (January 1, 2014 through December 31, 2014).[26] This quantification is another important part of the parties' dispute.

Also with the help of HG&K, Ms. Carlson timely filed her 2015 individual income tax return—Minnesota Form M1 in 2016 ("2015 MN Tax Return").[27] Ms. Carlson's 2015 Minnesota Tax Return included a Schedule M1NR, the schedule for nonresidents.[28] In accordance with the 2015 Schedule KS issued to Ms. Carlson by CMI, Ms. Carlson's Schedule M1NR reported $333,844 in capital gain from Minnesota sources.[29] This amount is equal to the amount of income CMI apportioned to Minnesota for Ms. Carlson in the year preceding the sale (January 1, 2014, through December 31, 2014).[30] Ms. Carlson timely paid all tax then shown as due on her 2015 MN Tax Return.[31]

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[24] Stip. Facts ¶ 11.

[25] Stip. Facts ¶ 11.

[26] Stip. Facts ¶ 11.

[27] Carlson Aff. ¶¶ 20-22; Hillesheim Aff. ¶ 10.

[28] Carlson Aff. ¶ 21; Hillesheim Aff. ¶ 10.

[29] Carlson Aff. ¶ 21; Hillesheim Aff. ¶ 11; Stip. Facts ¶ 11, Ex. J2, at 7.

[30] Stip. Facts. ¶ 11.

[31] Carlson Aff. ¶ 22.

**Commissioner's Response and Revenue Notice #17-02 Disavowing Nadler**

Within a year after the tax court's 2006 issuance of *Nadler*, the Commissioner began circulating internal communications advising Department personnel not to follow *Nadler*.[32] For example, the Commissioner drafted a Technical Advice Memorandum for auditors dated May 4, 2007, stating:

> [T]he Department of Revenue decided not to appeal the Tax Court decision in *Nadler v. Comm'r of Revenue*, … but does not acquiesce to that decision regarding the treatment of goodwill under Minn. Stat. § 290.17 in that case. The Tax Court is a non-precedential administrative court that is an executive branch agency.[33]

Relevant here, the Department internally decided it would continue to take the position to:

> 1. only recognize two types of income – business income and non-business income.
> 2. take the position that if the sale of "goodwill" is determined to be derived from the conduct of a trade or business, then the gain or loss will be apportioned as its other business income is.
> 3. Allocate non-business goodwill income to Minnesota based on the preceding year's sales percentage.[34]

There is no dispute that the Department internally circulated several documents showing its disagreement with the tax court's *Nadler* decision.[35]

On July 3, 2017, the Commissioner publicly issued Revenue Notice 17-02: Individual Income and Corporate Franchise Tax – *Nadler v. Commissioner* – Minnesota Allocation Policy.[36]

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[32] Pusch Aff. ¶¶ 6-11, Exs. 4-9, at COR0314, COR0403, COR0408, COR0761, COR0592-93, COR0313.

[33] Pusch Aff. ¶ 5, Ex. 3, at COR0409-10. The Department does recognize, however, that if the gain on the sale of goodwill is found to be "nonbusiness income," Minn. Stat. § 290.17, subd. 2(c) would apply. *See id.* at COR0410.

[34] Pusch Aff. ¶ 6, Ex. 4, at COR0761-2.

[35] Pusch Aff. ¶¶ 6-11, Exs. 4-9, at COR0314, COR0403, COR0408, COR0761, COR0592-93, COR0313.

[36] Stip. Facts ¶ 13, Ex. J4 (citing *Nadler*, 2006 WL 1084260). The Commissioner did not appeal the *Nadler* decision to the Minnesota Supreme Court. Stip. Facts ¶ 12.

Notice 17-02 identifies two aspects of *Nadler* with which the Commissioner does not agree and "advises non-resident individuals that the department does *not* administer the income allocation provisions in Chapter 290 of the *Minnesota Statutes* … using the Minnesota Tax Court's reasoning in *Nadler v. Commissioner* …." [37]

First, Notice 17-02 states the Department recognizes "*two* categories of income for the purpose of determining the correct method of allocation under Chapter 290: 1) Business income – that must be apportioned to Minnesota. 2) Nonbusiness income – that cannot be apportioned to Minnesota because of [constitutional] limitations on state taxing authority …. Nonbusiness income must be assigned." [38] This contrasts with the three categories of income recognized in *Nadler*, which—in addition to business income apportionable to Minnesota—splits the nonbusiness income category in two, differentiating between nonbusiness income that is derived from a trade or business and nonbusiness income that is not derived from a trade or business.[39]

Next, Notice 17-02 disagrees with the way *Nadler* calculated allocable gains following the sale of goodwill.[40] The Department indicates that the correct way is to "multiply the taxpayer's gain by the business's prior year apportionment factor," as opposed to a fixed number, which in *Nadler* was "the actual amount of the income apportioned to Minnesota in the preceding year." [41]

Relevant to the arguments here, the Commissioner issued Revenue Notice 17-02 *after* CMI made its § 338(h)(10) election based on *Nadler*.[42]

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[37] Stip. Facts ¶ 13, Ex. J4 (emphasis added).

[38] Stip. Facts ¶ 13, Ex. J4 (emphasis added).

[39] Stip. Facts ¶ 13, Ex. J4.

[40] Stip. Facts ¶ 13, Ex. J4.

[41] Stip. Facts ¶ 13, Ex. J4 (quoting *Nadler*, 2006 WL 1084260, at *9).

[42] Stip. Facts ¶¶ 5, 8, 13, Ex. J1, at 26, Ex. J4.

**CMI Audit and Administrative Appeal**

Following an audit of CMI's 2015 Return, the Commissioner issued a tax order to CMI with a notice date of September 17, 2018,[43] determining that gain from the CMI Transaction was "business income" subject to apportionment under Minnesota Statutes section 290.17, subdivision 3, and assessing CMI $433,017 in nonresident withholding tax.[44] As to goodwill, the Commissioner asserted that, even if the gain at issue were instead assignable under Minnesota Statutes section 290.17, subdivision 2, CMI should not have limited the amount of assigned income to the dollar amount of CMI's Minnesota apportioned income for tax year 2014 (the year preceding the CMI Transaction).[45] Finally, the Commissioner assessed CMI a penalty of $86,603 for substantial understatement of tax payable.[46]

CMI timely filed an administrative appeal with the Commissioner.[47] Following review of CMI's administrative appeal, the Commissioner issued a Notice of Determination on Appeal with a notice date of April 21, 2021 (the "4/21/2021 Order"),[48] affirming the assessment of tax in the amount of $433,017.[49] The Commissioner, however, removed the penalty for substantial understatement of tax.[50]

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[43] Stip. Facts ¶ 14.

[44] Stip. Facts ¶ 15.

[45] Stip. Facts ¶ 16.

[46] Stip. Facts ¶ 17.

[47] Stip. Facts ¶ 18.

[48] Stip. Facts ¶ 19.

[49] Stip. Facts ¶ 20.

[50] Stip. Facts ¶ 20.

**Tax Court Appeal**

CMI timely filed an appeal to this court from the 4/21/2021 Order.[51] On the parties' joint motion, the court ordered that any portion of the above-captioned matter involving constitutional issues be referred to the district court.[52] On October 19, 2021, the Second Judicial District transferred any portion of the above-captioned matter involving constitutional issues back to this court for decision.[53] On September 20, 2022, the court heard the parties' cross-motions for summary judgment.[54] For the following reasons, the court holds the Commissioner is entitled to summary judgment.

## II. GOVERNING LAW

### A. Summary Judgment Standard

A court "shall grant summary judgment 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." Minn. R. Civ. P. 56.01. The parties have stipulated to certain relevant facts, and any additional facts presented by the parties are uncontested.[55] When parties file cross motions for summary judgment, they implicitly agree there are no disputed material facts. *Am. Fam. Mut. Ins. Co. v. Thiem*, 503 N.W.2d 789, 790 (Minn. 1993). The court agrees with the parties that this matter is ripe for summary judgment.

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[51] Stip. Facts ¶ 21; Not. Appeal (filed June 14, 2021).

[52] Stip. Facts ¶ 22; Jt. Mot. & Stip. (filed Oct. 19, 2021).

[53] Stip. Facts ¶ 23; Order of Transfer (filed Oct. 19, 2021).

[54] Comm'r's Not. Mot. & Mot. Summ. J. (filed July 21, 2022); Appellant's Not. Mot. & Mot. Summ. J. (filed July 21, 2022).

[55] Comm'r's Mem. Law Supp. Mot. Summ. J. (filed July 21, 2022); Appellant's Mem. Law Supp. Mot. Summ. J. (filed July 21, 2022).

### B. Relevant Taxing Provisions

The principal issue in this case is how much of Ms. Carlson's income from the CMI Transaction is taxable under Minnesota law. The parties agree that—since Ms. Carlson is a nonresident of Minnesota—the proceeds from the CMI Transaction should be allocated under Minnesota Statute section 290.17.[56] Minn. Stat. § 290.17 (2022). The disagreement turns on *which allocation provisions* of section 290.17 apply to the contested sale proceeds.

Section 290.17 governs "gross income, allocation to state" and includes "allocation rules [that] apply to … nonresident shareholders of corporations treated as 'S' corporations," as was CMI. Minn. Stat. § 290.17, subd. 1(a). The Commissioner contends that allocation rules contained in subdivisions 3 and 4 govern here and that the CMI Transaction proceeds are "business income" that must be *apportioned* to Minnesota.[57] CMI, in contrast, argues that gain generated from the CMI Transaction is income "not derived from the conduct of a trade or business" and must be allocated according to a rule contained in subdivision 2.[58] To understand this disagreement, we "begin[] by examining the relevant portions of Minn. Stat. § 290.17 that outline the tax treatment of business and nonbusiness income." *Firstar Corp. v. Comm'r of Revenue*, 575 N.W.2d 835, 837 (Minn. 1998).

"All income of a trade or business is subject to apportionment except nonbusiness income." Minn. Stat. § 290.17, subd. 3; *see also YAM Special Holdings, Inc. v. Comm'r of Revenue*, 947 N.W.2d 438, 442 (Minn. 2020). Income derived from carrying on a trade or business—business income—must be "*apportioned* between this state and other states and countries … if conducted

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[56] *See* Stip. Facts ¶¶ 15-16.

[57] Comm'r's Mem. Law Supp. 6-10.

[58] Appellant's Mem. Law Supp. 19-32.

partly within and partly without this state." Minn. Stat. § 290.17, subd. 3 (emphasis added). Separate provisions of Chapter 290 set forth apportionment formulas for businesses generally, for financial institutions, and for special circumstances. *See* Minn. Stat. §§ 290.191-.20 (2022). The Commissioner argues that the CMI Transaction proceeds must be apportioned under subdivisions 3 and 4 as the business income of a unitary business operating partly within and partly without Minnesota.[59]

If income qualifies as *nonbusiness* income, it may not be apportioned under subdivision 3. *See* Minn. Stat. § 290.17, subd. 3 ("All income of a trade or business is subject to apportionment except nonbusiness income."). Nonbusiness income is defined as "income of the trade or business that cannot be [constitutionally] apportioned … 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." Minn. Stat. § 290.17, subd. 6. Nonbusiness income "must be allocated under subdivision 2." *Id.*

[59] Comm'r's Mem. Law Supp. 6-10. Under due process principles, a state may not impose an income tax on "value earned outside its borders." *YAM Special Holdings*, 947 N.W.2d at 442 (citing *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 164 (1983)). "A State may, however, tax an apportioned share of the value generated by the intrastate and extrastate activities of a multistate enterprise if those activities form part of a 'unitary business.' " *MeadWestvaco Corp. ex rel. Mead Corp. v. Ill. Dep't of Revenue*, 553 U.S. 16, 19 (2008) (citation omitted).

To tax businesses operating in Minnesota and beyond (like CMI), the legislature adopted "the unitary business principle and apportionment approach to determine the portion of the income that is subject to tax." *YAM Special Holdings*, 947 N.W.2d at 442; Minn. Stat. §§ 290.17, subds. 2-4; Minn. Stat. § 290.191, subd. 1(a). The Minnesota Supreme Court has held that the state's corporate taxing structure—using the unitary business principle—passes constitutional muster so long as the business has a sufficient business connection to Minnesota. *YAM Special Holdings*, 947 N.W.2d at 446. Here, CMI neither challenges the constitutionality of Minnesota's corporate taxing structure, *see* Appellant's Mem. Law Supp. 19 (arguing section 290.17 is the governing taxing statute), nor disputes that it had a sufficient connection to Minnesota to satisfy due process principles, *see* Stip. Facts ¶ 1 (indicating that CMI "was founded in 1988 by Kim Carlson as a Minnesota corporation with its principal place of business in Minnesota"). The question presented, therefore, is purely one of statutory interpretation.

Subdivision 2 provides that income is *assigned* or *allocated* as described therein. Minn. Stat. § 290.17, subd. 2. The subdivision 2 allocation rule applicable here provides that gain on the sale of goodwill that is "not derived from the conduct of a trade or business," but 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[60] to Minnesota under subdivision 3." *Id*.

Here, Ms. Carlson reported $333,844 as the "net Minnesota long-term capital gain … from the CMI Transaction. This amount is equal to the amount of income CMI apportioned to Minnesota for Ms. Carlson" in 2014.[61] Ms. Carlson urges us to treat gain from the sale of CMI goodwill as nonbusiness income and to adopt her view that the amount of her long-term capital gain from the CMI Transaction should be capped by the dollar amount of CMI's 2014 business income that was apportioned to Minnesota.

## III. ANALYSIS

The parties agree that Minnesota Statutes section 290.17 governs.[62] There is also no dispute that the income in question—gain on the sale of CMI goodwill[63]—was derived from the disposition of an asset integral to the success of CMI's business.[64] The parties ask the court to

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[60] *See infra* note 68.

[61] Stip. Facts ¶ 11.

[62] *See* Stip. Facts ¶¶ 15-16.

[63] Tr. 7-8 ("[T]here were gains allocated to tangible property as well, and that's just not an issue before this court, only the goodwill allocation is at issue."). The court notes, however, that nearly the entire purchase price of the $8,763,041 sale was allocated to intangible assets, including goodwill. *See* Stip. Facts ¶ 5, Ex. J1, at 25-26 (allocating $180,000 to equipment, an unspecified amount to the value of security deposits, and "[t]he remainder of the Purchase Price to intangible assets"). CMI has not attempted to separate the value of goodwill from other intangible assets, such as proprietary rights, contracts, and leases. *See id.*

[64] Kitchak Decl. ¶ 3, Ex. B, at 28-29.

determine which subdivisions of section 290.17 apply.[65] The Minnesota Supreme Court recently ruled that "[w]hen a taxpayer realizes a gain from the sale of an asset, 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." *YAM Special Holdings*, 947 N.W.2d at 443 (cleaned up).

**A. Gain on the sale of CMI's goodwill generated "income of a trade or business"**

The fundamental disagreement between the parties is whether gain on the sale of goodwill from the CMI Transaction is business or nonbusiness income. Minn. Stat. § 290.17, subd. 3 ("All income of a trade or business is subject to apportionment except nonbusiness income."); *see also* *YAM Special Holdings*, 947 N.W.2d at 442. Based directly on guidance the supreme court provided in *YAM*, we find that the CMI Transaction generated business income subject to apportionment.

In *YAM*, the supreme court addressed whether—and to what extent—Minnesota could tax gain on the sale of a partial interest in twelve operating subsidiaries (including gain from goodwill).[66] *YAM Special Holdings*, 947 N.W.2d at 443. In *YAM*, "the undisputed facts show[ed] that the operating subsidiaries—the asset—had a sufficient connection to Minnesota" and "formed a unitary business at the time of the sale." *Id*. The court further noted that YAM's unitary business "received approximately 1 percent of its revenue from transactions with Minnesota customers" and that "YAM paid Minnesota income taxes on this revenue." *Id.* Sale of a partial interest in the subsidiaries "generated income for the unitary business" that Minnesota sought to tax. *Id.* at 444.

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[65] *See* Stip. Facts ¶¶ 15-16.

[66] The tax court characterized the gain at issue as "goodwill." *YAM Special Holdings, Inc. v. Comm'r of Revenue*, 2019 WL 6213168, at *5, *12 (Minn. T.C. Nov. 12, 2019).

The supreme court rejected YAM's argument "that Minnesota cannot tax the income from the sale because that income is nonbusiness income." *Id.* at 441. The court reasoned that "[t]he value of the operating subsidiaries was based, in part, on the success of YAM's business operations, which includes YAM's revenue generated from Minnesota sales." *Id.* at 444. The court thus affirmed the tax court's conclusion that "the income generated from the sale of the partial interest in the operating subsidiaries was business income subject to apportionment." *Id.* "Minnesota may therefore impose a tax on an apportioned share of the gain from the 2011 transaction." *Id.* The court noted that Minnesota had previously taxed—without YAM's objection—an apportioned share of its operating income, *id*. at 442 n.4, and that "an apportioned share of the gain from the transaction is approximately 1 percent, which is comparable to the percentage of YAM's 2011 revenue from transactions with Minnesota customers," *id*. at 444 n.6.

We conclude that the supreme court's reasoning in *YAM* is directly applicable in the present case. The pertinent asset here is CMI goodwill. CMI does not challenge the connection between the goodwill and Minnesota, and has without objection paid tax on an apportioned share of the net income of CMI's unitary business. In addition, there can be no doubt that the value of CMI goodwill is "based, in part, on the success of [CMI's] business operations, which includes [CMI's] revenue generated from Minnesota sales." *Id.* at 444. Finally, there is no dispute that the goodwill at issue was an integral asset of CMI's unitary business. Minn. Stat. § 290.17, subd. 4 ("The term " 'unitary business' means business activities or operations which result in a flow of value between them" and may apply to a single legal entity or between multiple entities.). Accordingly, we conclude that income generated from the sale of CMI goodwill was business income subject to apportionment.

Based on guidance provided by *YAM*, the Commissioner was correct to assess a tax on the business income from the sale of CMI's goodwill as a unitary business under Minn. Stat. § 290.17, subd. 4. Similarly, because the gain generated from the CMI Transaction is business income of a unitary business, Minnesota may tax that income through apportionment. Minn. Stat. § 290.17, subd. 3, 4(a); *YAM Special Holdings*, 947 N.W.2d at 447-48.[67]

**B. Even if the gain from the CMI Transaction were considered "nonbusiness income," it would still be allocable to Minnesota as a ratio or percentage**

Even if this court were to determine that gain from the CMI Transaction was properly considered nonbusiness income, that gain would still be allocable to Minnesota as a ratio or percentage. Section 290.17, subdivision 6 provides that "[n]onbusiness 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 "must be allocated under subdivision 2." Subdivision 2, in turn, provides in part:

> Gain on the sale of goodwill … 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 assignable[[68]] to Minnesota under subdivision 3.

Minn. Stat. § 290.17, subd. 2(c) (2014) (emphasis added).

[67] CMI invites us to use the "transactional" test found in *Firstar*, 575 N.W.2d at 838. Appellant's Mem. Law Supp. 24-26. We decline to do so for two reasons: first, the highly relevant *YAM Special Holdings* decision is a more recent Minnesota Supreme Court decision; and second, *Firstar* was published prior to the United States Supreme Court's reaffirmance of the importance of a unitary business determination when assessing business tax in *MeadWestvaco*, 553 U.S. at 24-25, thereby highlighting the legislature's definition of unitary business in Minn. Stat. § 290.17, subd. 4.

[68] In 2017, the legislature amended this subdivision to replace the term "assignable" with "allocable." Act of May 30, 2017, ch. 1, art. 13, § 11, subd. 2(c), 2017 Minn. Laws 189-90 (1st Spec. Sess.).

Were the court to determine that CMI Transaction proceeds were nonbusiness income, CMI would ask us to hold that the long-term capital gain amount allocable to Minnesota is limited to the specific dollar amount of net income CMI apportioned to Minnesota in 2014.[69] The Commissioner, in contrast, would have us rule that the gain amount allocable to Minnesota is determined by CMI's apportionment percentage from its "business in the year preceding the year of sale." [70] Minn. Stat. § 290.17, subd. 2(c).

Our conclusion that the CMI Transaction proceeds were apportionable business income under subdivisions 3 and 4 makes it unnecessary for us to address this question. Were we to do so, however, we would agree with the court's previous ruling in *YAM* that subdivision 2(c) requires use of CMI's apportionment percentage from 2014, the year preceding the sale. *YAM Special Holdings*, 2019 WL 6213168, at *12 & n.69 (reasoning that the legislature's use of the phrase "to the extent that" in 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").

**C. CMI's arguments are not applicable**

Seeking to avoid the outcome plainly required by *YAM*, CMI makes a series of arguments in support of its motion for summary judgment, beginning by asserting that Minn. Stat. § 290.17, subd. 2, would be superfluous were it not applied here. Next, CMI argues the tax court's decision in *Nadler* is "binding on the Commissioner because this Court is the 'final authority' on all questions of law …." [71] Finally, CMI argues the Commissioner should be barred by collateral

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[69] Appellant's Mem. Law Supp. 26.

[70] Comm'r's Mem. Law Supp. 7-8.

[71] Appellant's Mem. Law Supp. 19 (citing Minn. Stat. § 271.01, subd. 5).

estoppel from assessing the additional nonresident withholding tax.[72] We are not persuaded by CMI's arguments as discussed below. We examine each in turn.

**i. Subdivision 2 is not superfluous**

First, CMI argues it correctly assigned income from the CMI Transaction under Minn. Stat. § 290.17, subd. 2, based on the plain language of the statute,[73] and that to conclude otherwise would render subdivision 2 superfluous; that if gain from the sale of goodwill could be "business income" under subdivision 3, there would be no need for the specific subdivision 2 language directing how to allocate goodwill gain.[74] We disagree, as it is possible for goodwill income from the sale of an asset to be apportioned under subdivision 3, as in this case, or to be allocated under subdivision 2.[75] As *YAM* indicates, the resolution of which subdivision applies turns on "the objective characteristics of the asset's use and its relation to the taxpayer and its activities within the taxing State." *YAM Special Holdings*, 947 N.W.2d at 443 (cleaned up). We rejected the same argument in *YAM*, *see YAM Special Holdings*, 2019 WL 6213168, at *11 n.61 ("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."), and the supreme court affirmed. As described above, *see supra* § III.A, and because subdivision 2 is not superfluous, this court concludes that—based on the statute as analyzed by case law—the Commissioner was correct to categorize goodwill income from the CMI Transaction as income of a unitary business to be apportioned to Minnesota.

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[72] Appellant's Mem. Law Supp. 19.

[73] Appellant's Mem. Law Supp. 19-21.

[74] Tr. 9-12.

[75] *See* Tr. 40-41.

**ii. CMI incorrectly relied on *Nadler***

CMI argues the Commissioner is bound by decisions of this court[76] and contends the Commissioner's 4/21/2021 Order is invalid as inconsistent with *Nadler* because (1) Minn. Stat. § 271.01, subd. 5 (2022), provides the tax court is the "sole, exclusive, and final authority" on tax matters,[77] and (2) the supreme court's decision in *Kmart Corp. v. Cnty. of Stearns*, 710 N.W.2d 761 (Minn. 2006), commenting that tax court decisions have "little, if any, precedential effect," *id.* at 769, is not relevant here.[78]

As an initial matter, we are not persuaded by CMI's arguments as its underlying and unspoken premise—that *Nadler* was not called into question by this court before CMI and Ms. Carlson filed their Minnesota income tax returns—is not true. Inherent in the argument that a case has precedential value is the notion that no subsequent rulings override or contradict the precedential case's holding. Here, the tax court openly distinguished the holding in *Nadler* well before CMI relied on it. In *Aird v. Comm'r of Revenue*, Nos. 8301-R & 8302-R, 2012 WL 2945909 (Minn. T.C. July 16, 2012), this court noted that *Nadler* did not deal with the unitary business principle, specifically Minn. Stat. § 290.17, subd. 4's directive to apportion income of a unitary business pursuant to Minn. Stat. § 290.191. *Aird*, 2012 WL 2945909, at *3. Here, both parties agree the unitary business principle applies. We are not persuaded by CMI's argument, as *Aird* points out that Minn. Stat. § 290.17, subd. 4 highlights the need for a unitary business analysis,

[76] Appellant's Mem. Law Supp. 33.

[77] Appellant's Mem. Law Supp. 35 ("Because the Commissioner chose not to appeal the *Nadler* decision, he cannot disregard it. By doing so in the 4/21/2021 Order, the Commissioner defied Minnesota Statutes § 271.01, subdivision 5, rendering the 4/21/2021 Order invalid.").

[78] Appellant's Mem. Law Supp. 36-38.

which *Nadler* did not do.[79] *Id.* In the present matter, CMI cannot argue the *Nadler* decision is binding upon the Commissioner, while ignoring tax court language calling into question *Nadler*'s applicability here. In any event, CMI's argument is unavailing because, in presently resolving this appeal, we are plainly bound by the supreme court's decision in *YAM*.

**iii. The Commissioner is not collaterally estopped from reaching a different result than espoused in *Nadler***

Finally, CMI argues the Commissioner is collaterally estopped, under the theory of non-mutual collateral estoppel, from "relitigating the legal conclusions reached in *Nadler*." [80] For his part, the Commissioner argues CMI cannot meet its burden to show each element of collateral estoppel is present.[81]

Non-mutual offensive collateral estoppel occurs when a different plaintiff (here, CMI) seeks to preclude a defendant (the Commissioner) from relitigating an issue that the defendant had previously litigated and lost in a prior action (*Nadler*). *U.S. v. Mendoza*, 464 U.S. 154, 159 n.4 (1984).[82]

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[79] CMI distinguishes the holding in *Aird* and the current facts by noting the former dealt with "enterprise unity," while this court is presented with "asset unity." Tr. 22-25. We are not persuaded this is a distinction with a difference. First, the asset of goodwill inherent in a single business entity is squarely within the definition of a "unitary business," which does not differentiate between asset unity and enterprise unity. Minn. Stat. § 290.17, subd. 4 (defining "unitary business" to mean "business activities or operations which result in a flow of value between them" and noting the term may be "applied within a single legal entity"). Second, even if asset unity were distinguishable, enterprise unity is present here too, as the CMI Transaction included the sale of two entities, CMI and UCS. Stip. Facts ¶¶ 3-5; Ex. J1, at 6 (defining the "company" for purposes of the sale as CMI and UCS).

[80] Appellant's Mem. Law Supp. 42.

[81] Comm'r's Mem. Law Supp. 12-15.

[82] The Commissioner raises the question of whether this court has the authority to rule under a non-mutual collateral estoppel theory. Comm'r's Mem. Law Supp. 13-14 (citing *Mendoza*, 464 U.S. at 158 (noting nonmutual offensive collateral estoppel may not be applied as against the federal government)); *cf. United States v. Stauffer Chem. Co.*, 464 U.S. 165, 174 (1984)

Collateral estoppel applies when the following elements are satisfied:

> (1) [T]he issue was identical to one in a prior adjudication; (2) there was a final judgment on the merits; (3) the estopped party was a party or in privity with a party to the prior adjudication; and (4) the estopped party was given a full and fair opportunity to be heard on the adjudicated issue.

*Tarutis v. Comm'r of Revenue*, 393 N.W.2d 667, 669 (Minn. 1986) (citing *Willems v. Comm'r of Pub. Safety*, 333 N.W.2d 619, 621 (Minn. 1983)). Collateral estoppel in income tax cases "must be confined to situations where the matter raised in the second suit is identical in all respects with that decided in the first proceeding and where the controlling facts and applicable legal principles remain unchanged." *Comm'r of Internal Revenue v. Sunnen*, 333 U.S. 591, 599-600 (1948). "The party invoking collateral estoppel has the burden of proof." *Barth v. Stenwick*, 761 N.W.2d 502, 508 (Minn. App. 2009) (citing *Wolfson v. N. States Mgmt. Co.*, 22 N.W.2d 545, 548 (Minn. 1946)).

We find CMI has not met its burden to establish the first element because the intervening *Aird* and *MeadWestvaco* decisions threw into doubt the applicability of the *Nadler* decision. As we noted above, *Aird*—a tax court decision published prior to the CMI Transaction—called into question *Nadler's* lack of analysis involving a unitary business. *See supra* § III.C.ii. Additionally, the United Stated Supreme Court had the opportunity to review states' ability to tax a unitary business and confirmed that intangible assets can be unitary with a business. *MeadWestvaco*, 553 U.S. at 19 ("A State may, however, tax an apportioned share of the value generated by the intrastate and extrastate activities of a multistate enterprise if those activities form part of a 'unitary business.' "); *see also* Minn. Stat. § 290.17, subd. 4 (noting the Legislature's directive to apportion the "entire income of the unitary business"). Given this intervening case law, we cannot conclude

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(holding that mutual (identical party) defensive collateral estoppel may be asserted against the government). Since we hold CMI did not meet its burden to show the issue raised is identical in any event, we need not address this court's authority to rule under such a theory.

this second case is "identical in all respects with that decided in the first proceeding and where the controlling facts and *applicable legal principles* remain unchanged." *A&H Vending Co. v. Comm'r of Revenue*, 608 N.W.2d 544, 547 (Minn. 2000) (citations omitted and emphasis added).

J.N.B.H.