COMMONWEALTH OF MASSACHUSETTS

APPELLATE TAX BOARD

SMITHFIELD PACKAGED MEATS CORP. AND COMBINED AFFILIATES	**v.**	**COMMISSIONER OF REVENUE**

Docket No. C344811	Promulgated: July 22, 2026

This is an appeal filed by Smithfield Packaged Meats Corp. and Combined Affiliates ("Combined Group" or "appellant") under the formal procedure pursuant to G.L. c. 62C, § 39(c) from the refusal of the Commissioner of Revenue ("Commissioner" or "appellee") to abate corporate excise, penalties, and interest assessed against the appellant for the tax years ended January 3, 2016 ("tax year 2015"), January 1, 2017 ("tax year 2016"), and December 31, 2017 ("tax year 2017) (collectively, "tax years at issue").

The parties submitted the appeal to the Appellate Tax Board ("Board") for decision without a hearing based on a Statement of Agreed Facts with Exhibits and Briefs in accordance with 831 CMR 1.31.[1] Subsequently on its own motion, the Board held a hearing relating to procedural aspects of the contested assessment. Copies of three Consents Extending the Time for Assessment of Taxes on Forms A-37 signed by the parties ("Consents"), as well as Supplemental Briefs, were entered into the evidentiary record of the appeal. There were two witnesses at the hearing: Kenneth Wright, State Tax Senior Director of Smithfield Foods, Inc., Director of State Tax when the subject audit

[1] This citation is to the regulation in effect prior to January 5, 2024.

began, and Michael Johnson, former Bureau Chief of the Department of Revenue's Multistate Audit Bureau.

Chairman DeFrancisco and Commissioners Good, Elliott, Metzer, and Bernier joined in a decision in part for the appellant and in part for the appellee, which is described in detail below.

These findings of fact and report are made at the requests of the appellant and the appellee pursuant to G.L. c. 58A, § 13 and 831 CMR 1.34.[2]

Michael A. Jacobs, Esq. and *Brent K. Biessel, Esq.* for the appellant.

Celine E. de la Foscade-Condon, Esq. and *Jodi Meade, Esq.* for the appellee.

FINDINGS OF FACT AND REPORT

The substantive issues presented in this appeal are the propriety of: (i) classification by the Commissioner of certain members of the Combined Group as manufacturing corporations within the meaning of G.L. c. 63, § 38(*l*)(1) (each a "§ 38 manufacturer") during the tax years at issue; (ii) for the tax year 2017, reallocation by the Commissioner to the taxable members of the Combined Group of receipts from Massachusetts sales made by a member of the Combined Group that was not taxable in Massachusetts in light of P.L. 86-272;[3] and (iii) assessment of an underpayment penalty pursuant to G.L. c. 62C, § 35A ("§ 35A") for each of the tax years at issue.

[2] This citation is to the regulation in effect on and after January 5, 2024.
[3] 15 U.S.C. § 381-384.

On the basis of the evidence of record, the Board made the following findings of fact and rulings of law.

I. Structural Overview of the Appellant

For each of the tax years at issue, the appellant filed Form 355U, Excise for Taxpayers Subject to Combined Reporting ("Form 355U").[4] The principal reporting corporation of the Combined Group was John Morrell and Co., later known as Smithfield Packaged Meats Corp. ("Morrell"). Smithfield Foods, Inc. was the parent company of the members of the Combined Group and of multiple vertically integrated subsidiaries which, during the tax years at issue, had three principal domestic business lines: hog production, fresh pork products, and packaged meats.

Morrell produced a variety of value-added products, such as hot dogs and deli meats. Through a disregarded, single-member limited liability company, it also produced hogs at company-owned farms, none of which was located in Massachusetts. The packaged meat segment operated plants across the United States, including one in Springfield, Massachusetts. The parties agreed that Morrell was a § 38 manufacturer.

II. Jurisdiction

A. Notices and Appeals

By Notice of Selection for Audit dated April 22, 2019, issued to "Smithfield Packaged Meats Corp.," the Commissioner notified the appellant that its Massachusetts corporate combined excise returns for the periods commencing January 1, 2015, and ending December 31, 2017, had been selected for verification and audit. By Notice of Intent to Assess dated June 25, 2020, the Commissioner indicated his intent to assess

[4] The appellant referenced a calendar year rather than the dates of the tax years at issue as defined above in its Forms 355U, including the tax year 2015.

tax of $402,170 for these periods, together with penalties and interest. Tax, penalties, and interest were subsequently assessed by Notice of Assessment dated August 10, 2020, indicating a total amount due of $563,624.91, comprised of the following: for the "Period End Date" December 31, 2015 – tax of $103,260, penalty of $20,652, and interest of $29,362.02 (a total of $153,274.02); for the "Period End Date" December 31, 2016 – tax of $71,984, penalty of $14,397, and interest of $16,011.54 (a total of $102,392.54); and for the "Period End Date" December 31, 2017 – tax of $226,926, penalty of $45,385, and interest of $35,647.35 (a total of $307,958.35).

The appellant filed a Massachusetts Form ABT, Application for Abatement ("Form ABT"), on August 12, 2020, contesting the tax, penalties, and interest indicated in the Notice of Assessment for the periods ending on December 31, 2015, 2016, and 2017. Following a telephonic hearing on December 10, 2020, the Commissioner's Office of Appeals granted a partial abatement by Letter of Determination dated February 9, 2022. By Notice of Abatement Determination dated February 10, 2022, the assessed tax and penalties for the periods commencing January 1, 2015, and ending December 31, 2017, were reduced by $116,717, resulting in a total amount due of $503,312.67, comprised of the following (including interest calculated as of October 17, 2023): for the tax year 2015 – tax of $79,172, penalty of $15,834, and interest of $44,252.17 (a total of $139,258.17); for the tax year 2016 – tax of $13,481, penalty of $2,696, and interest of $6,545.85 (a total of $22,722.85); and for the tax year 2017 – tax of $212,253, penalty of $42,451, and interest of $86,627.65 (a total of $341,331.65).

The appellant timely filed a Petition Under Formal Procedure with the Board on March 11, 2022, appealing the refusal of the Commissioner to grant an abatement of corporate excise “for the tax years ending December 31, 2015 through December 31, 2017.”

B. Timeliness and Validity of the Contested Assessments

Upon review of the jurisdictional documents of record, the Board noted a disparity between the Statement of Agreed Facts and the Commissioner’s assessments with respect to the tax years at issue. More specifically, for the tax years 2015 through 2017, the Combined Group reported on a 52-53-week fiscal year basis for both federal income tax and Massachusetts corporate excise purposes. *See* G.L. c. 63, § 30(6). The Statement of Agreed Facts states that (i) the tax year 2015 ended on January 3, 2016; (ii) the tax year 2016 ended on January 1, 2017; and (iii) the tax year 2017 ended on December 31, 2017. The Smithfield Foods, Inc. Form 10-K for the twelve months ended January 3, 2016, filed with the federal Securities and Exchange Commission, indicates that the tax year 2015 began on December 29, 2014.

Entries in the Commissioner’s GeniSys system reflect the Commissioner’s treatment of the appellant from the outset as a calendar year taxpayer. Consistent with this treatment, the Commissioner’s Notice of Intent to Assess and Notice of Assessment, as well as the appellant’s Form ABT and Petition Under Formal Procedure, indicate deficiency assessments for calendar year tax periods. Also, the Commissioner prepared, and the appellant signed, three Consents on Form A-37 extending the time for assessment “for the taxable period(s) 1/1/2015–12/31/2017.” The first Consent - signed by the appellant on April 30, 2019, and by the appellee on June 12, 2019 – extended the time for assessment to on or before March 31, 2020. The second Consent - signed by the appellant on December 19, 2019, and by the appellee on December 20, 2019 – extended the time for assessment to on or before June 30, 2020. The final Consent - signed by the appellant on March 6, 2020, and by the appellee on March 19, 2020 – extended the time for assessment to on or before September 30, 2020. *See* G.L. c. 62C, § 27.

The Consents did not become operative with respect to the tax years 2016 and 2017 because deficiencies for those years were assessed on August 10, 2020, in each case before the respective assessment due dates for those years. However, the Consents were required to extend the assessment due date of October 13, 2019, for the tax year 2015, as the assessment was made on August 10, 2020. *See* G.L. c. 62C, §26 and § 27.

Seeking clarification, the Board held a hearing to review the disparities and determine their potential impact on the validity of the contested assessments. During the hearing, the Commissioner contended that the contested assessments were timely and otherwise valid. The appellant did not contest the validity of the assessments for the tax years 2016 and 2017. The appellant, however, maintained that for the tax year 2015, the assessment was made beyond the statute of limitations and hence was invalid, emphasizing that the Consents extending the statute of limitations referenced a period beginning on January 1, 2015, and ending on December 31, 2017, and thus did not include the entirety of the tax year 2015, which began on December 29, 2014.

During the hearing at the Board, the State Tax Senior Director of Smithfield Foods, Inc. credibly testified that, as a matter of practice, December 31 dates were often used by 52-53-week fiscal year filers, and that the appellant was not misled during the course of the audit as to the tax periods at issue. He further testified that (i) he understood from the Notice of Selection for Audit that the Department of Revenue was going to audit for the year ending January 3, 2016, and the other two fiscal years, and (ii) he understood that the Notice of Intent to Assess, the Notice of Assessment, and the Consents referenced the 52-53-week fiscal years. Also, the former Bureau Chief of the Department of Revenue's Multistate Audit Bureau credibly testified that the Commissioner had determined that the statute (G.L. c. 63, § 30(12)) authorized calendar-year references for the actual tax years at issue and that the Department of Revenue's Audit Workbench system in place at the time could not accommodate 52-53-week tax years.

For the reasons set forth in the Opinion below, the Board found and ruled that the contested assessments for the tax years at issue were valid.

III. Commissioner's Application of the "Combination Provision"

Pursuant to G.L. c. 63, § 32B ("§ 32B"), corporations engaged in a unitary business must file a combined report, and each member of the unitary group must calculate its taxable net income derived from the unitary business determined under regulations adopted by the Commissioner, addressing the computation of the member's share, attributable to the Commonwealth, of the apportionable income or loss of the combined group. In computing the apportionable income or loss of the combined group and of each member of the group, items of income, deductions, and receipts from transactions between or among members of the combined group must be eliminated, subject to regulations as may be adopted by the Commissioner. ***Id.*** A tax on each member's apportioned share of the taxable net income of the unitary group is separately computed and reported on the combined report. ***Id.***

The statute directs the Commissioner to adopt regulations that implement combined reporting and coordinate it with the other provisions of Chapter 63 dealing with the taxation of corporations. ***Id.*** The regulations must include rules that address, in relevant part, the elimination of intercompany transactions, including the elimination or deferral of income, expenses, apportionment factors, or other tax items associated with those transactions. ***Id.***

Pursuant to this statutory authority, the Commissioner promulgated what the parties refer to as the "Combination Provision" at 830 CMR 63.32B.2(7)(g)2.a, which addresses how a member of a unitary group is required to determine its own apportionment formula when, although itself not a manufacturer, it sells to a third party outside the unitary group a product that it buys from another member of the group that itself engages in manufacturing. The Combination Provision provides, in relevant part, that if a combined group member making a sale to a purchaser that is not a member of the group previously acquired the sold property from another combined group member, the activities of both the member producing the property and the member making the sale to the nonmember must be considered jointly for purposes of determining the appropriate apportionment formula of the member making the sale. ***Id.***

For the tax year 2015, the Combined Group included, as a member taxable in Massachusetts ("taxable member"), Smithfield Farmland Sales Corp., later known as Smithfield Fresh Meats Sales Corp. ("Fresh Meats Sales"), a subsidiary of Smithfield Farmland Corp. ("Farmland") and also an affiliate of Morrell. Farmland, which was a member of the Combined Group not taxable in Massachusetts ("non-taxable member") for all of the tax years at issue, processed a wide variety of fresh, unprocessed pork cuts. Fresh Meats Sales sold products produced by affiliated members of the Combined Group. Farmland sold its pork cuts to Fresh Meats Sales.

On audit, the Commissioner applied the Combination Provision, aggregating the activities of Fresh Meats Sales with those of Farmland and reclassifying Fresh Meats Sales as a § 38 manufacturer, having found Fresh Meats Sales to be engaged in substantial manufacturing activities after: (i) combining the property, payroll, and sales receipts of both entities; (ii) eliminating any intercompany transactions between them; and (iii) treating the receipts derived by Fresh Meats Sales from property manufactured by Farmland as manufacturing receipts.

For the tax year 2016, the Combined Group included one other taxable member – Smithfield Packaged Meats Sales Corp., a subsidiary of Morrell ("Packaged Meats Sales"). Packaged Meats Sales sold products produced by affiliated members of the Combined Group. Morrell sold its value-added products to Packaged Meats Sales. On audit, the Commissioner reclassified Packaged Meats Sales as a § 38 manufacturer, applying the Combination Provision to aggregate the activities of Morrell and Packaged Meats Sales. The Commissioner again reclassified Fresh Meats Sales as a § 38 manufacturer for the tax year 2016 applying the Combination Provision.

For the tax year 2017, the taxable members of the Combined Group included only Morrell and Packaged Meats Sales. On audit, the Commissioner again reclassified Packaged Meats Sales as a § 38 manufacturer, for the same reasons as for the tax year 2016.

The Board found and ruled that the Commissioner's application of the Combination Provision was proper and: (i) for the tax year 2015, Fresh Meats Sales was properly classified as a § 38 manufacturer; (ii) for the tax year 2016, Packaged Meats Sales and

Fresh Meats Sales were properly classified as § 38 manufacturers; and (iii) for the tax year 2017, Packaged Meats Sales was properly classified as a § 38 manufacturer.

IV. The "Reallocation Rule"

For the tax year 2017, Fresh Meats Sales ceased to be a taxable member of the Combined Group due to the application of P.L. 86-272 because: (i) it had no employees permanently based in, and no real or personal property located in, Massachusetts; and (ii) its employees were engaged exclusively in the solicitation of orders for pork products, which were accepted or rejected at locations outside of the Commonwealth and, if approved, were filled by shipments or delivery from points outside of Massachusetts.

However, because Fresh Meats Sales derived receipts from sales to purchasers in Massachusetts, the appellant initially filed its Form 355U for the tax year 2017 reflecting the application of the so-called "Finnigan" adjustment, which is described in 830 CMR 63.32B.2(7)(b)(the "Reallocation Rule").

Under the Reallocation Rule, Massachusetts may assign sales to Massachusetts (the state of destination) for apportionment purposes where at least one member of a unitary group is taxable in Massachusetts, but where the actual seller is not. ***Id.*** Applying the Reallocation Rule, the appellant initially assigned to taxable members of the Combined Group, Massachusetts sales receipts derived by Fresh Meats Sales totaling $85,708,777, an amount equal to approximately 47 percent of the Massachusetts sales reported by the appellant for apportionment purposes on its composite Schedule U-MSI, Member's Apportioned Share of Group Income. Of this amount, the appellant apportioned $78,932,063 to Packaged Meats Sales and the balance to Morrell. The apportioned total derived from sales made by Fresh Meats Sales during 2017 that would otherwise have been includible in the numerator of the sales factor of Fresh Meats Sales had it been a taxable member of the Combined Group for the year. As a result, the numerator of the Massachusetts sales factor applied to the combined group taxable income by each taxable member of the Combined Group increased; the denominator remained unchanged, as did the combined group taxable income to which the apportionment factors were applied.

Although the appellant applied the Reallocation Rule in its original 2017 Form 355U, on audit the appellant argued that the "Finnigan" adjustment resulted in distorted apportionment for the tax year 2017 and improperly frustrated the objectives of P.L. 86-272 in violation of the Supremacy Clause of the U.S. Constitution.

The appellant continued to dispute application of the Reallocation Rule on appeal to the Board emphasizing that, given Morrell's classification as a § 38 manufacturer and viewing Packaged Meats Sales and Fresh Meats Sales as § 38 manufacturers for the tax year 2017, the increase in the Combined Group's Massachusetts excise caused by an application of the Reallocation Rule equaled the tax that Fresh Meats Sales would have incurred had it been a taxable member of the Combined Group and treated as a § 38 manufacturer. In fact, the Statement of Agreed Facts indicates that if Fresh Meats Sales had been treated as a taxable member of the Combined Group for the tax year 2017, and if all taxable members were determined to be § 38 manufacturers, (A) Fresh Meats Sales' Massachusetts sales factor would have been 0.006296, (B) Morrell's Massachusetts sales factor would have been 0.000556, and (C) Packaged Meats Sales' Massachusetts sales factor would have been 0.006475; and their respective apportionment percentages, based only on sales, would have been the same. On audit, the Commissioner computed

Massachusetts sales factors of 0.001054 and 0.012273 for Morrell and Packaged Meats Sales, respectively – a total of 0.013327, the sum of the three individual Massachusetts sales factors agreed upon by the parties.[5]

For the reasons set forth in the Opinion below, the Board found and ruled that inclusion of a pro-rata portion of the Massachusetts sales of Fresh Meats Sales in the numerator of the sales apportionment factors of each of the taxable members of the Combined Group violated the Supremacy Clause of the U.S. Constitution, and was therefore improper.

V. Underpayment Penalties

A. Background

Pursuant to § 35A, the Commissioner assessed an underpayment penalty ("§ 35A penalty") for each of the tax years at issue. The appellant incorporated the "Finnigan" adjustment when computing the Combined Group's tax liability on its Form 355U for the tax year 2017. However, the appellant – though aware of the Combination Provision – did not apply it for any of the tax years at issue, as a result of which the Commissioner determined that the appellant's reported tax liability was understated.

The Summary of Tax Due provided to the appellant at the completion of the audit included § 35A penalties, based on underpayments of 22.73 percent for the tax year 2015, 28.75 percent for the tax year 2016, and 42.40 percent for the tax year 2017. Following the administrative appeal referenced above, investment tax credits were allowed for each year, reducing the deficiencies by $24,088, $58,503, and $14,673,

[5] If Fresh Meats Sales were not treated as a § 38 manufacturer, the Statement of Agreed Facts indicates that its apportionment percentage would have been lower (0.003148), causing the impact of the "Finnigan" adjustment to be an increase in the tax liability of the Combined Group.

respectively. As a result, the underpayments determined by the Commissioner ultimately fell to 18.41 percent for the tax year 2015, 7.03 percent for the tax year 2016, and 40.78 percent for the tax year 2017.

The appellant disputed the assessment of § 35A penalties, asserting variously that there was no underpayment of tax for any of the tax years at issue, and that the appellant acted in good faith, was not negligent, and did not disregard the tax laws of the Commonwealth because its position was supported by substantial authority. Though aware it acted in contravention of the Combination Provision, the appellant did not attach a disclosure statement to its Forms 355U or otherwise disclose the position it had taken.

B. Application of § 35A to the Tax Years at issue

Consistent with the findings of the Board regarding the Combination Provision, the tax year 2015 involved a substantial understatement of tax liability. At the conclusion of the audit proceedings, the underpayment was 18.41 percent – more than 10 percent of the tax determined by the Commissioner to be due.

The tax year 2016 involved an underpayment of tax liability, but it was not a substantial understatement within the meaning of § 35A. Following the administrative appeal, the understatement for the tax year 2016 was reduced to 7.03 percent – less than 10 percent of the tax determined by the Commissioner to be due.

For the reasons discussed in the Opinion below, the Board found and ruled that the Commissioner properly imposed § 35A penalties for the tax years 2015 and 2016.

While the Commissioner assessed a § 35A penalty for the tax year 2017, as discussed below, the Board found and ruled that there was no underpayment for the tax year 2017.

VI. The Board's Decision

Based on the foregoing, and for the reasons more fully set forth in the Opinion below, the Board found and ruled that: (i) for the tax year 2015, Fresh Meats Sales was properly classified as a § 38 manufacturer; for the tax year 2016, Packaged Meats Sales and Fresh Meats Sales were properly classified as § 38 manufacturers; and for the tax year 2017, Packaged Meats Sales was properly classified as a § 38 manufacturer; (ii) none of the sales made by Fresh Meats Sales for the tax year 2017 were properly reallocated to Morrell and Packaged Meats Sales for purposes of determining the total Massachusetts sales includible in the numerator of their respective sales apportionment factors; and (iii) § 35A penalties were properly assessed for the tax years 2015 and 2016, but not for the tax year 2017.

Accordingly, decisions were rendered for the appellee with respect to the corporate excise and the § 35A penalties assessed against the appellant for each of the tax years 2015 and 2016.

Regarding the tax year 2017, the Board, pursuant to Rule 33 of its Rules of Practice and Procedure (831 CMR 1.33) ("Rule 33"), ordered the parties to determine the amount to be abated based upon the tax liability of the appellant for the tax year 2017 determined without the application of the "Finnigan" adjustment, but with the inclusion of Packaged Meats Sales as a § 38 manufacturer.

On the basis of the calculation submitted by the parties pursuant to the Rule 33 Order, the Board (i) granted an abatement in the amount of $239,719 for the tax year 2017, and (ii) found and ruled that a § 35A penalty was not properly assessed for that year because there was no underpayment.

OPINION

I. Timeliness and Validity of the Contested Assessments

Though the Board found and ruled, and the parties agreed, that the assessments for the tax years 2016 and 2017 were valid, a disagreement remained with respect to the assessment for the tax year 2015. This disagreement focused on the timeliness of the assessment, which was undermined, in the appellant's view, by Consents that were rendered invalid because they did not include the entirety of the tax year 2015.

The appellant maintained that, for the tax year 2015, the assessment was made beyond the statute of limitations, noting strict judicial adherence to statutory time periods. *See, e.g.,* ***Nissan Motor Corp. v. Commissioner of Revenue***, 407 Mass. 153 (1990). Without regard to whether the Notice of Intent to Assess and the Notice of Assessment were in valid form, the appellant argued that the Consents were incorrect in their description of the tax year 2015, unambiguous on their face, and therefore could not operate to extend the statutory deadline for assessing additional tax for the tax year 2015.

The Board, however, viewed the understanding of the parties to be dispositive. *See, e.g.,* ***Robert & Ardis James Foundation v. Meyers***, 474 Mass. 181, 188 (2015). Both parties knew from the outset the tax periods to which the audit and assessment applied. Yes, the 2015 tax year at issue diverged slightly from the calendar year identified by the Commissioner, but this divergence did not alter the parties' full understanding of the tax periods that were the subject of examination, extension for assessment by virtue of the Consents, and the assessment itself.

The appellant's own State Tax Senior Director credibly testified that the appellant was not misled during the course of the audit as to the tax periods at issue. He also testified that (i) he understood from the Notice of Selection for Audit that the Department of Revenue was going to audit for the year ending January 3, 2016, and the other two fiscal years, and (ii) he understood that the Notice of Intent to Assess, the Notice of Assessment, and the Consents referenced the 52-53-week fiscal years. Also, the former Bureau Chief of the Department of Revenue's Multistate Audit Bureau testified that while the Department of Revenue's Audit Workbench system in place at the time could not accommodate 52-53-week tax years, the Commissioner had determined that statutory authority (G.L. c. 63, § 30(12)) authorized the Department of Revenue's use of calendar-year references for the actual tax years at issue.

Notably, the appellant identified calendar years in its Forms 355U, its Form ABT, and its petition to the Board, indicating that it viewed technical precision of the manner in which the tax years at issue were identified to be of little or no consequence. What mattered most was that the parties both understood and agreed to the periods to which the audit, its attendant notices, and the Consents applied – and that understanding was made plain by the evidence of record.

Neither party was misled or prejudiced by the Commissioner's drafting convention in the Consents, which the appellant executed without objection. Thus, the Board found no basis on which to conclude that the assessment for the tax year 2015 was invalid because it was made beyond the statute of limitations. The three fully and timely executed Consents extending the statute of limitations accomplished their intended purpose, as did the Notice of Intent to Assess and the Notice of Assessment that placed the taxpayer on notice of the tax deficiency assessment for each of the tax years at issue.

Accordingly, the Board found and ruled that the contested assessment with respect to each of the tax years was valid.

II. The Combination Provision

As previously noted, under G.L. c. 63, § 32B, corporations engaged in a unitary business are required to file a combined report in Massachusetts, indicating the taxable net income of the group derived from the group's business attributable to the Commonwealth and each corporation's share of the apportionable income or loss of the group. G.L. c. 63, § 32B(a). The term "unitary business" is defined to mean:

> the activities of a group of 2 or more corporations under common ownership that are sufficiently interdependent, integrated or interrelated through their activities so as to provide mutual benefit and produce a significant sharing or exchange of value among them or a significant flow of value between the separate parts.

G.L. c. 63, § 32B(b)(1).

Although part of a unitary group, each taxable member determines its apportionment percentage based on its own statutorily prescribed apportionment formula. G.L. c. 63, § 32B(d)(2)(i). In general terms, each taxable member of a unitary group must: (i) compute the numerator of its apportionment factors pursuant to the statutory apportionment provisions applicable to that member; and (ii) calculate its apportionment factor denominators by determining and aggregating the apportionment factor denominators of every member of the group, regardless of whether any particular member is taxable in the commonwealth. G.L. c. 63, § 32B(d)(2)(ii), (iii). A tax on each member's apportioned share of the taxable net income of the unitary group is separately computed and reported on the combined report. G.L. c. 63, § 32B(d)(3), (4).

Each member of a unitary group determined to be a § 38 manufacturer, as in the present appeal, is required to use a single sales factor apportionment formula, representing its share of the sales receipts of the unitary group assigned to Massachusetts.[6] The statute defines a § 38 manufacturer as a corporation:

> engaged, in substantial part, in transforming raw or finished physical materials by hand or machinery, and through human skill and knowledge, into a new product possessing a new name, nature and adapted to a new use[,]

and states that "[a]ny operation manufacturing, in substantial part, value-added agricultural products shall be considered a manufacturing corporation." G.L. c. 63, § 38(*l*)(1) ("§ 38(*l*)(1)"). The corporation's manufacturing activities must satisfy any one of the following five substantiality tests:

> (i) 25 percent or more of its gross receipts must derive from the sale of manufactured goods that it manufactures;
>
> (ii) 25 percent or more of its payroll must be paid to employees working in its manufacturing operations and 15 percent or more of its gross receipts must be derived from the sale of manufactured goods that it manufactures;
>
> (iii) 25 percent or more of its tangible property must be used in its manufacturing operations and 15 percent or more of its gross receipts must be derived from the sale of manufactured goods that it manufactures;
>
> (iv) 25 percent or more of its tangible property must be used in its manufacturing operations; or
>
> (v) the corporation's manufacturing activities must be deemed substantial under relevant regulations promulgated by the commissioner.

Id.

[6] Effective January 1, 2025, G.L. c. 63, § 38 was rewritten to require that all corporations subject to the corporate excise determine their taxable net income apportionable to Massachusetts by applying only a single sales factor apportionment formula. *See* 2023 Mass. Acts 50, §§ 31, 47. Hence, application of the Combination Provision during the tax years at issue, which resulted in the contested assessments, would be of no consequence under current law.

A group member that did not quality as a § 38 manufacturer was required to determine its apportionable percentage of the unitary group's taxable net income by applying a three factor apportionment fraction based on the portion of the group member's real and tangible property owned or rented and used in Massachusetts ("the property factor"), its compensation paid for employee services deemed to be performed in Massachusetts ("the payroll factor"), and its sales receipts assigned to Massachusetts ("the sales factor"). G.L. c. 63, § 38(d)-(f). The numerator of a group member's three-factor apportionment fraction was the property factor plus the payroll factor plus twice the sales factor, and the denominator was four. G.L. c. 63, § 38(c).

In determining the net income of a unitary group subject to taxation in any year, the statute mandates elimination of intercompany transactions occurring during the year, and the deferral of any income attendant thereto, subject to regulations that may be promulgated by the Commissioner. Chapter 63, § 32B(f) ("§ 32B(f)") directs the Commissioner to:

> adopt regulations to implement [§ 32B] and to coordinate the application of [§ 32B] with the other provisions of [Chapter 63]. The regulations shall include rules to address without limitation . . . (i) the elimination of intercompany transactions, including but not limited to the payments of dividends, between or among combined group members, and the elimination or deferral of income, expenses, apportionment factors or other tax items associated with those transactions and including any exceptions to such eliminations or deferrals under rules analogous to those under section 1502 of the [U.S. Internal Revenue] Code . . . .

Pursuant to this authority, the Commissioner promulgated a regulation addressing the treatment of receipts from intercompany transactions between or among unitary group members. The regulation provides that income from an intercompany transaction between members of the same combined group that relates to the unitary business of the group must be deferred, and when the object of the transaction is disposed of by the buying member to an unrelated third party, the deferred income must be restored to the income of the seller and apportioned as income earned immediately before the event. 830 CMR 63.32B.2(6)(c)5. *See also* 830 CMR 63.31N.1(c)1., 2. When the object of the transaction leaves the combined group, the buying member realizes apportionable income as well. *See* 830 CMR 63.32B.2(7)(g)1., 2.

Recognizing the "distortion of applicable apportionment formulas in the case of intra-group sales" (830 CMR 63.32B.2(7)(g)2.), the Commissioner promulgated the Combination Provision, addressing the computation of the apportionment formula to be applied by a member of a unitary group that sells a product to a third party that it previously bought, in an intra-company transaction, from a member of the group that produced the product. The regulation provides that when a combined group member sells, to an unrelated third party, a product that it previously purchased from another member of the combined group that produced the product, the activities of both the member producing the product and the member making the sale to the nonmember must be considered jointly for purposes of determining the appropriate apportionment formula of the member making the sale. 830 CMR 63.32B.2(7)(g)2.a. The following example illustrates the basic rule:

> [W]here a combined group member (A) manufactures property and sells all of the manufactured property, directly or indirectly, to member (B), which, in turn, resells the property to a purchaser that is not a member of the combined group, both the activities of A and the activities of B must be considered jointly to determine whether B must use the single sales factor apportionment formula applicable to manufacturers or the three-factor apportionment formula applicable to non-manufacturers. In this example, both A and B are considered to be engaged in manufacturing and the joint property, payroll, and receipts of A and B will be considered to determine whether the manufacturing activity attributed to B is substantial. For

> purposes of this determination, B's receipts from the sales of property manufactured by A are considered to be manufacturing receipts. If the activities of A and B considered jointly involve substantial manufacturing, as provided under M.G.L. c. 63, § 38, then B must use a single sales factor apportionment formula.

830 CMR 63.32B.2(7)(g)2.a. Another example deals with a manufacturer without nexus in Massachusetts, that sells to another group member with nexus in Massachusetts. The example concludes that, here too, the member that resells the manufactured product to a purchaser who is not a member of the combined group must use a single sales factor apportionment formula determined based upon the facts in the second example. 830 CMR 63.32B.2(7)(g)2.b., *Example 3*.

In the present appeal, the appellant disputed the validity of the Combination Provision that the Commissioner applied to aggregate the activities of Fresh Meats Sales with those of Farmland for the tax years 2015 and 2016, and to aggregate the activities of Packaged Meats Sales with those of Morrell for the tax years 2016 and 2017, allowing the Commissioner to characterize both Fresh Meats Sales and Packaged Meats Sales as § 38 manufacturers required to use single sales factor apportionment to determine their respective shares of the Combined Group's income for those years.

The parties agreed that the members of the Combined Group that produced value-added products or pork cuts were engaged in manufacturing, but the appellant maintained that the selling members of the Combined Group – Fresh Meats Sales and Packaged Meats Sales – that were not engaged in any manufacturing activities could not be deemed to be so engaged by application of the Combination Provision.

The Board was mindful of Massachusetts case law that addresses the deference given to regulations promulgated by the Commissioner pursuant to a valid regulatory grant of authority. The Supreme Judicial Court has stated that a court "must apply all rational presumptions in favor of the validity of . . . administrative action and not declare it void unless its provisions cannot by any reasonable construction be interpreted in harmony with the legislative mandate." ***Purity Supreme, Inc. v. Attorney General***, 380 Mass. 762, 776 (1980); *see also* ***White Dove, Inc. v. Director of Div. of Marine Fisheries***, 380 Mass. 471, 477 (1980) ("no more need be discerned than some rational relation between the regulation and the empowering statute"); ***Zoning Board of Appeals of Wellesley v. Housing Appeals Committee***, 385 Mass. 651, 654 (1982). Later cases are to the same effect where a statute expressly grants broad regulatory authority, including ***Cliff House Nursing Home, Inc. v. Rate Setting Commission***, 16 Mass. App. Ct. 300, 303 (1983) (finding a regulation promulgated by an agency with specific and general authority to make regulations to be valid if it has a reasonable relation to the goal advanced by the statute), and ***Massachusetts Federation of Teachers, AFT, AFL-CIO v. Board of Education***, 436 Mass, 763, 774 (2002) (giving deference where the Legislature had delegated to an administrative agency broad authority to implement a statutory provision, particularly where the focus of the statutory enactment was reform).

However, the Commissioner may not rely on a limited grant of regulatory authority to adopt substantive provisions of law not contemplated by the statute. *See* ***Polaroid Corp. v. Commissioner of Revenue***, 393 Mass. 490 (1984), which addresses the Commissioner's attempt to require a unitary business approach to determining a corporation's taxable net income apportioned to Massachusetts absent express statutory authority for the approach. Notably, the statutory provision relevant to the matter before the Board differs in one pivotal respect from the statutory language that the Supreme

Judicial Court found to be deficient in the ***Polaroid*** case. Lacking there was language analogous to that found in § 32B(f), which gives the Commissioner the express authority to promulgate regulations: (i) implementing § 32B and coordinating the application of § 32B with the other provisions of Chapter 63; and (ii) addressing the elimination of intercompany transactions, including the elimination or deferral of income or apportionment factors associated with such transactions.

In this appeal, the Commissioner maintained that as a policy matter, "[i]ntercompany transactions between Massachusetts group members are disregarded and therefore the activities of a Massachusetts sales company selling the products manufactured by a related entity logically should be jointly considered for purposes of determining the appropriate apportionment formula of the member making the sale." Absent the Combination Provision, the Massachusetts corporate excise could be artificially reduced and would be open to manipulation.

The Commissioner found support for the Combination Provision in authorities that have recognized the validity of the unitary method of reporting. He cited the decision of the U.S. Supreme Court in ***Mobil Oil Corp. v. Commissioner of Taxes***, 445 U.S. 425, 441 (1980), where the Court indicated that unitary businesses should be taxed on the basis of economic activity, not the form of investment. The Commissioner also cited the decision of the New York Court of Appeals in ***Matter of Disney Enterprises, Inc. v. Tax Appeals Tribunal of the State of New York***, 10 N.Y. 3d 392, 408 (Ct. App. 2008), noting the Court's view that to exclude in the apportionment formula the receipts of entities whose in-state income might be the result of synergistic relationships with their sister companies would permit corporate groups to avoid taxes by moving income to such entities from other members of the group.

The issue before the Board differs in certain respects from those addressed by these court decisions. The question at hand relates to whether a state can combine the activities of separate entities, thus requiring a member of a unitary group to use a single sales factor apportionment formula that on a stand-alone basis would not have applied – when under the state's approach to combined reporting each group member is required to apply its own apportionment formula and tax rate.

While it is true that as a general matter each member of a combined group must separately determine its tax liability by applying its own apportionment factor or factors and rate to its share of the taxable net income of the group – *i.e.,* each group member must determine its tax liability on a stand-alone basis, this overlooks the fact that the Commissioner was given explicit authority to promulgate regulations that address the elimination of intercompany transactions. G.L. c. 63, § 32B(f). This authority is not limited just to the elimination and deferral of income when, for example, a manufacturer sells its manufactured products to a unitary group member (a sales company) that later sells them to unrelated parties. The authority extends to the elimination or deferral of apportionment factors associated with intercompany transactions. ***Id***. This is a broad grant of regulatory authority that gives the Commissioner the discretion to address the appropriate apportionment methodology after an intercompany transaction between unitary group members (one a manufacturer and the other a sales entity) has been eliminated.

The Board found and ruled that the Commissioner's promulgation of the Combination Provision was within not only the express authority granted under G.L. c.

63, § 32B, but also within the more general authority given to the Commissioner pursuant to G.L. c. 62C, § 3 to prescribe regulations "to carry into effect the provisions of [Chapter 63, which] when reasonably designed to carry out the intent and purposes of said provisions, shall be prima facie evidence of their proper interpretation." *See also* G.L. c. 14, § 6(1).

It is due to the operation of the statutory provision directing the elimination of intercompany transactions that receipts from a manufacturer's sale of its manufactured products to another unitary group member are required to be excluded in determining the numerator and the denominator of the manufacturer's own apportionment percentage to be applied to the unitary group's combined group taxable income in the year of sale. But, it is not unreasonable to ascribe to the purchasing entity the apportionment attributes of the manufacturer for purposes of determining the purchasing entity's share of the unitary group's combined income for a year in which the purchasing entity sells to unrelated parties the manufactured products it bought from the manufacturer, treating the receipts from those sales as sales attributable to manufacturing activities as they would have been had the manufacturer made the sales directly to unrelated parties.

The statute gives the Commissioner the power to do so – through the exercise of broad regulatory authority. G.L. c. 63, § 32B(f). This is nothing like the Commissioner's efforts by regulation to require combined reporting without express statutory authority to do so – the situation addressed in the ***Polaroid*** case.

The appellant also argued that the Combination Provision contravened the statutory provision directing that manufacturing corporation status be determined on a single-corporation basis. The regulation, however, simply coordinates the combined reporting provisions of § 32B with those provisions of § 38(*l*)(1) defining a § 38 manufacturer. The regulation does not apply the substantiality tests in § 38(*l*)(1) on a combined basis – each member of a combined group must still separately determine whether its "manufacturing activities" are substantial. Before the substantiality tests are applied at the selling entity level, the regulation simply (i) assigns the manufacturer's apportionment factors to the selling entity, (ii) deems the selling entity to have engaged in manufacturing, and (iii) treats the selling entity's receipts from the sale of property manufactured by the manufacturer as manufacturing receipts. This is for a limited purpose – *i.e.*, to determine whether the selling entity should be treated as a § 38 manufacturer.

Based on the foregoing, the Board found and ruled that the Combination Provision appropriately applied the statutory mandate to develop regulations implementing § 32B, coordinating the application of § 32B with other provisions in Chapter 63, and addressing the elimination of intercompany transactions, including but not limited to the elimination or deferral of income or apportionment factors associated with those transactions. Accordingly, the Board ruled that (i) for the tax year 2015, Fresh Meats Sales was properly classified as a § 38 manufacturer; (ii) for the tax year 2016, Packaged Meats Sales and Fresh Meats Sales were properly classified as § 38 manufacturers; and (iii) for the tax year 2017, Packaged Meats Sales was properly classified as a § 38 manufacturer.

III. The "Reallocation Rule"

Each taxable member of a unitary group is required to increase the numerator of its sales apportionment factor by its proportionate share of the aggregate Massachusetts sales of nontaxable members of the group. The statute provides that:

> Each taxable member of the group shall include in its sales factor numerator a portion of the aggregate Massachusetts sales of nontaxable members

> based on a ratio, the numerator of which is such taxable member's Massachusetts sales taking into account its applicable sales factor provisions and the denominator of which is the aggregate Massachusetts sales of all the taxable members of the group taking into account their respective sales factor provisions. For purposes of determining whether sales are in the commonwealth and included in the numerator of the sales factor, a taxpayer is considered taxable in any state in which any member of its combined group is subject to tax.

G.L. c. 63, § 32B(d)(2)(iv); *see also* G.L. c. 63, § 32B(d)(2)(ii).

The Commissioner's combined reporting regulations provide, in the section titled "Determination of Factor Numerators; Sales Factor 'Finnigan Adjustment,' " that:

> The numerator of the apportionment factor or factors that apply to each taxable member of a combined group shall include the property, payroll, and sales/receipts, as applicable, of such member as sourced to Massachusetts . . . . Where a combined group includes one or more taxable members and one or more nontaxable members, the sales/receipts factor numerator(s) of the taxable member or members are increased in the following manner:
>
> > 1.The total amount of sales or receipts sourced to Massachusetts under [the relevant provisions of Chapter 63] is determined for all nontaxable members;
> >
> > 2. Each taxable member determines a fraction, the numerator of which is the sales/receipts factor numerator of such member, determined without [certain adjustments], and the denominator of which is the sum of the sales/receipts factor numerators of all taxable members, as determined without [certain] adjustments . . . [the "Fraction"]; and
> >
> > 3. For each taxable member, the total Massachusetts receipts of the nontaxable members is multiplied by the Fraction, and the resulting product is added to the sales factor numerator, as otherwise determined, of the taxable member.

830 CMR 63.32B.2(7)(b) (the "Reallocation Rule").

The issue before the Board is whether the "Finnigan" adjustment applied under the circumstances of this appeal frustrated the objectives of P.L. 86-272 and hence violated the Supremacy Clause of the U.S. Constitution.

Section 101 of Title I of P.L. 86-272, as amended through P.L. 94-455, states (emphasis added):

> (a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after the date of the enactment of this Act**, a net income tax on the income derived within such State by any** *person* **from interstate commerce** if the only business activities within such State by or on behalf of such person during such taxable year are . . . [in relevant part]:
>
> > (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State . . . .
>
> (b) The provisions of subsection (a) shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to —
>
> > (1) any corporation which is incorporated under the laws of such State; or
> >
> > (2) any individual who, under the laws of such State, is domiciled in, or a resident of, such State.

For purposes of Title I of P.L. 86-272, the term "net income tax" means any tax imposed on, or measured by, net income (P.L. 86-272, § 103), and hence the term includes the portion of the Massachusetts corporate excise determined on the basis of net income.

The Supremacy Clause of the U.S. Constitution (Article VI, Clause 2) provides that (emphasis added):

> This Constitution, and **the Laws of the United States** which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, **shall be the supreme Law of the Land**; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

To determine the separate Massachusetts corporate excise liability of each taxable member of the Combined Group for the tax year 2017, it was first necessary to determine

(i) the combined group taxable income of the Combined Group, including that of both taxable and nontaxable members of the group, and (ii) the group's total Massachusetts sales receipts. As a final step, the two taxable members of the Combined Group – Morrell and Packages Meats Sale (both § 38 manufacturers based upon the findings and rulings of the Board) were required to determine their share of the Combined Group's combined group taxable income using a single sales factor apportionment formula. Applying the "Finnigan" adjustment, the numerator of the sales apportionment fraction of each of these taxable members included not only its own Massachusetts sales receipts but also a proportionate share of the Massachusetts sales receipts of Fresh Meats Sales. Accordingly, treating both Fresh Meats Sales and Packaged Meats Sales as § 38 manufacturers, the "Finnigan" adjustment produced sales apportionment fractions for the two taxable members of the Combined Group equal to the sum of the sales apportionment fractions for each of Morrell, Packaged Meats Sales, and Fresh Meats Sales, had each been a taxable member of the Combined Group.

Put simply, the "Finnigan" adjustment had the effect of taxing in Massachusetts income fully reflective of the Massachusetts sales of Fresh Meats Sales by including in the numerator of the sales apportionment fractions used by taxable members of the Combined Group, the Massachusetts sales of a nontaxable member of the group whose income was protected from taxation by P.L. 86-272. The dispositive question is whether this was proper.

To answer this question, two subsidiary questions must be addressed. First, does P.L. 86-272 prevent a state only from *directly* taxing an out-of-state entity protected from taxation by P.L. 86-272? Second, is the "person" referenced in P.L. 86-272, the subject of the statute, intended to include an entire unitary group, so that if one member of a unitary group is taxable in Massachusetts due to its nexus within the state, all members of the group will be deemed to have nexus – even a P.L. 86-272 protected entity?

If the answer is "yes" to either of these questions, the Board must rule that the state's apportionment methodology is permissible under P.L. 86-272. The analysis that follows indicates that the answer to both questions is "no."

Regarding the second question, support cannot be found in the wording of P.L. 86-272 or its legislative history for the proposition that the term "person" includes the multiple entities that make up a combined group. The statute includes no definition of the term "person," but it notably contains no language indicating that the term is intended to refer to a group of entities rather than one. Enacted at a time when the unitary business principle had already been recognized,[7] it speaks in terms of a "person" whose only business activities within a state are the solicitation in the state of orders of the type described therein – a unitary group *per se* does not solicit orders in a state, only an individual member of the group can.

The Senate Report (S. Rep. No. 658, 86th Cong., 1st Sess. 8 (1959)) on S. 2524 – the bill on which P.L. 86-272 was based – states tersely that the meaning of the word "person" was to be found in Title 1, Section 1 of the United States Code. While Title 1, Section 1 states that the word "person" includes "corporations, companies, associations, firms, partnerships, societies, and joint stock companies, as well as individuals," there is

[7] In ***Allied-Signal, Inc. v. Director, Division of Taxation***, 504 U.S. 768, 779 (1992), the Supreme Court indicated that, as early as 1920, the unitary business principle had been recognized for state corporate tax purposes. The Court states that "the unitary business rule is a recognition of two imperatives: the States' wide authority to devise formulae for an accurate assessment of a corporation's intrastate value or income; and the necessary limit on the States' authority to tax value or income that cannot in fairness be attributed to the taxpayer's activities within the State."

no indication in the Senate Report that the word "person," appearing in the singular in the legislation, was intended to be read to include a group of corporations under the circumstances addressed by the legislation. Indeed, the exception in the law itself for "any corporation" incorporated in a particular state (*see* § 101(b)(1) of P.L. 86-272) reflects Congress's focus on the activities of a single entity – not a conglomerate of entities required by state law to file a combined return. What the Senate Report does indicate is that adherence to the provisions of P.L. 86-272 was required, whatever a person's form of legal entity.

Regarding the first question, the statute does not simply limit a state's ability to tax an out-of-state entity by asserting taxing jurisdiction *directly* over that entity. The income earned by a P.L. 86-272 protected entity is tax exempt, without qualification. On whose tax return that income is reportable is not relevant. In fact, the Conference Report accompanying P.L. 86-272 (H. Rep. 1103, 86th Cong. 1st Sess. 3, dated September 1, 1959) expressly amends the title of the legislation to read, in relevant part: "An Act relating to the power of the States to impose *net income taxes on income derived from interstate commerce*." (emphasis added). Moreover, by enacting P.L. 86-272, Congress rejected an earlier version of the legislation, which focused on the taxation of a person rather than on the taxation of income.[8]

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[8] House Joint Resolutions 431 and 473, 86th Cong., 1st Sess., dated June 16, 1959, and July 22, 1959, respectively, provided:

> [A] person, as defined in section 1 of title 1, shall not be liable to taxation by a State or political subdivision thereof on income derived exclusively from interstate commerce when the only activity within said State is sales solicitation and where no office, warehouse, stock of goods, or other place of business is maintained therein.

In the instant case, the combined group taxable income reported on the appellant's combined return for the tax year 2017 included that of the P.L. 86-272 protected entity and, through an apportionment formula whose numerator included the Massachusetts sales receipts of Fresh Meats Sales, more income was taxable in Massachusetts than would have been the case had those sales been omitted from the numerator of each taxable member's sales apportionment fraction.

The Commissioner maintained that the Reallocation Rule is not invalid under the Supremacy Clause of the U.S. Constitution because none of the prerequisites for preemption were present, citing the decision of the Massachusetts Superior Court in ***National Private Truck Council v. Commissioner of Revenue***, 1997 Mass. Super. LEXIS 580, *aff'd,* 426 Mass. 324 (1997). In particular, the Commissioner pointed out that: (i) the text of P.L. 86-272 did not explicitly provide that all state laws to the contrary were preempted; (ii) based on the totality of the circumstances, it could not be implied that Congress had occupied the field leaving no room for state legislation; and (iii) the state regulation in question did not actually conflict with federal law because compliance with both statutes was both possible and feasible. To the contrary, however, the federal statute expressly states that no state shall have the taxing power described therein, and compliance with the Reallocation Rule, unlike what the Commissioner maintains, would stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.

The Commissioner also asserted that "a number of courts have defended the 'Finnigan' rule from Public Law 86-272 attacks, finding no federal law violation, as utilizing the apportionment attributes of a non-taxable entity to apportion income of other related entities does not result in the imposition of a tax on the entity that shares these attributes." Similarly, in this case, the Commissioner argued that Massachusetts was not taxing a nontaxable member but rather was applying an apportionment formula in the context of combined reporting that fairly reflected income attributable to Massachusetts.

In particular, the Commissioner cited and discussed two out-of-state court decisions that specifically address the meaning of P.L. 86-272 – ***Arizona Department of Revenue v. Central Newspapers, Inc***., 222 Ariz. 626 (Ct. App. Ariz. 2009), and ***Matter of Disney Enterprises***, *supra*. In ***Central Newspapers***, the sole income of three members of a consolidated group derived from a partnership whose only business activities within Arizona consisted of the solicitation of sales. The Arizona Appeals Court found that receipts from those sales were not excludible from the numerator of the group's apportionment formula because one member of the corporate group operated a newspaper in Arizona and had significant property, payroll, and sales within the state. The Appeals Court maintained that the focus of P.L. 86-272 was on jurisdiction over certain taxpayers, not the income itself, so that if one person's activities exceeded the solicitation of orders, any barrier to apportioned state taxation of that person was removed.

In ***Matter of Disney Enterprises***, the taxpayer filed a combined report that included one of its out-of-state subsidiaries. However, it omitted the subsidiary's gross receipts from New York destination sales from the combined group's apportionment calculation. On audit, the New York Department of Taxation and Finance added the subsidiary's New York sales receipts to the numerator of the combined group's business allocation percentage, increasing its overall New York tax liability. The New York Appeals

Court ruled, *inter alia*, that thereby no New York tax was imposed on a nontaxpayer. The Appeals Court found no violation of P.L. 86-272, noting that the "person" in the matter before it was the taxpayer and not the subsidiary, and that apportionment did not amount to tax.

Importantly, the Appeals Court in ***Matter of Disney Enterprises*** found no indication in the legislative history regarding the intended scope of the term "person" in P.L. 86-272 to support the conclusion that the term "person" therein should be read to include a unitary group – though the Appeals Court ultimately reached the conclusion that it did, stating: "No authority persuades us otherwise." Moreover, in his concurring opinion in ***Matter of Disney Enterprises,*** Judge Smith correctly observed, citing ***Shell Oil Co. v. Iowa Department of Revenue***, 488 U.S. 19, 31 (1988), that including a company's receipts in the numerator of the apportionment formula "would be to increase the tax in proportion to those receipts – and thus in substance to tax the income associated with those receipts." The same can be said of Massachusetts' "Finnigan" adjustment.

The Board found that neither ***Central Newspapers*** nor ***Matter of Disney Enterprises*** was persuasive. Both take positions that are not consistent with the federal statute or its legislative history. In effect, both subsume the activities of a P.L. 86-272 protected entity within the activities of a combined or consolidated reporting group as a whole – placing combined and consolidated reporting, and concepts of apportionment, ahead of the constitutional principles embedded in the Supremacy Clause of the U.S. Constitution. Apportionment principles have appropriately been found to pass muster under the Due Process, Equal Protection, and Commerce Clauses of the U.S.

Constitution – but the Supremacy Clause raises a different concern – one now before the Board.

The Commissioner cited two other cases in support of his position that the "Finnigan" adjustment was not violative of P.L. 86-272 – ***Citicorp North America, Inc. v. Franchise Tax Board,*** 83 Cal. App. 4th 1403 (Ct. App. 2000), and ***Deluxe Corporation v. Franchise Tax Board***, 2001 Cal. App. Unpub. LEXIS 2789 (Ct. App. 2001). ***Citicorp*** and ***Deluxe Corporation*** viewed the issue as one of apportionment – not the taxation of the income of a nontaxable member of a unitary group, which incorrectly frames the issue where P.L. 86-272 is relevant under the circumstances of the present appeal. Both cases reflect the conclusion of the U.S. Supreme Court that appropriately crafted apportionment formula clauses do not unconstitutionally result in extraterritorial taxation. *See* ***Allied-Signal, Inc.***, note 7, *supra*. However, these decisions do not address the question before the Board – namely, can apportionment formulas (assuming them otherwise to be properly crafted) be applied where P.L. 86-272 is operative as in the present appeal.

On more than one occasion, the U.S. Supreme Court has indicated that a state cannot do indirectly what it is precluded from doing directly. ***Frick v. Pennsylvania***, 268 U.S. 473 (1925), cited by the appellant, is relevant to the matter before the Board, though it addresses a different constitutional provision. In ***Frick***, Pennsylvania included the value of tangible personalty having an actual situs in New York and Massachusetts in determining the "clear value" on which the Pennsylvania inheritance tax was computed. The Supreme Court of Pennsylvania agreed with Pennsylvania. On appeal to the U.S. Supreme Court, the executors maintained that the taxation of tangible personal property having an actual situs outside of Pennsylvania transcended the power of the state and therefore contravened the Due Process Clause of the Fourteenth Amendment to the U.S. Constitution.

While Pennsylvania argued that it was not taxing the transfer of the property at issue – rather, it was simply using that property as a basis for computing the tax on the combined value of the property owned by the decedent in Pennsylvania, New York, and Massachusetts, the Court responded:

> Of course, this was but the equivalent of saying that it was admissible to measure the tax by a standard which took no account of the distinction between what the State had power to tax and what it had no power to tax . . . . It would open the way for easily doing indirectly what is forbidden to be done directly, and would render important constitutional limitations of no avail.

Frick, 268 U.S. at 494-95.

In the present appeal, Massachusetts has done indirectly what it cannot do directly. While not directly taxing Fresh Meats Sales (such as Pennsylvania's not directly taxing the transfer of out-of-state property), Massachusetts indirectly imposed a tax on the income of Fresh Meats Sales in violation of P.L. 86-272, – apportioning the Massachusetts sales of Fresh Meats Sales to taxable members of the Combined Group while not directly taxing Fresh Meats Sales (such as Pennsylvania's taking into account out-of-state property when computing its inheritance tax, while not directly taxing the transfer of that property).

While not precedential, an unpublished decision of the Tax Court of New Jersey cited by the appellant is illustrative. In ***Stanislaus Food Products Co. v. Director, Division of Taxation***, 2021 N.J. Tax Unpub. LEXIS 14 (Tax Court of New Jersey 2021), the Tax Court addressed whether P.L. 86-272 precluded New Jersey from imposing its alternative minimum tax on income derived by an out-of-state seller of tomato products.

In 2002, New Jersey enacted a statute initially requiring all businesses to pay the greater of a corporate business tax or an alternative minimum assessment ("AMA"). During the tax years at issue in the case, a P.L. 86-272 protected corporation was allowed to choose to pay the corporate business tax, as a result of which its AMA was zero. The facts of the case indicate that, in those years, the appellant paid the corporate business tax but then, after the Director issued a deficiency assessment, filed amended returns claiming that it qualified as an exempt P.L. 86-272 entity. The Director agreed that the appellant could not be assessed the corporate business tax, but the AMA was assessed – reducing the appellant's claimed refund. The Tax Court of New Jersey disagreed.

The Tax Court, discussing the situation leading up to the enactment of P.L. 86-272 and the conceptual framework of the Commerce Clause, held that the AMA was preempted by P.L. 86-272. Finding the issue to be a form of choice-of-law determination under the Supremacy Clause, it observed:

> Congress has exercised its powers under the Commerce Clause and enacted P.L. 86-272 to set certain minimum standards below which a state cannot impose net income taxation. Once Congress acts, courts are not free to review state taxes under the dormant Commerce Clause since it is Congress, and not the courts, that has struck the balance that it deems appropriate.
>
> . . .
>
> When Congress has spoken, and there is tension with a state enactment, the Supremacy Clause provides the vehicle for resolving this tension.

Stanislaus Food, 2021 N.J. Tax Unpub. LEXIS at 17-19.

In summary, the answer to each of the two subsidiary questions posed above relative to the "Finnigan" adjustment is "no." The term "person" in P.L. 86-272 does not encompass an entire unitary group, and P.L. 86-272 does not prevent a state only from *directly* taxing an out-of-state entity protected from taxation by P.L. 86-272. Application of the Reallocation Rule in the present appeal has the effect of imposing a tax on the entirety of income that P.L. 86-272 states to be immune from taxation; the fact that this result was achieved indirectly rather than by direct taxation does not validate Massachusetts' action.

It is well settled that "when a federal statute unambiguously forbids the States to impose a particular kind of tax . . ., courts need not look beyond the plain language of the federal statute to determine whether a state statute that imposes such a tax is pre-empted." ***Shell Oil***, 488 U.S. at 25 (*citing* ***Aloha Airlines, Inc. v. Director of Taxation of Hawaii***, 464 U.S. 7, 12 (1983)). *See also* **Hines v. Davidowitz**, 312 U.S. 52, 67 (1941) (if a state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress," the state law is void).[9]

The present appeal involves an attempt by Massachusetts to impose a particular kind of tax that federal law unambiguously forbids Massachusetts from imposing. To invalidate the "Finnigan" adjustment in this matter denotes "a permissibly small preclusion of State taxing power to protect interstate commerce" mandated by the Supremacy Clause of the U.S. Constitution. *See* ***National Private Truck Council v. Commissioner of Revenue,*** 426 Mass. 324, 331 (1997).

Accordingly, reconciling the unitary principles accepted by the U.S. Supreme Court with the mandate of P.L. 86-272, the Board found and ruled that inclusion of a pro-rata portion of the Massachusetts sales of Fresh Meats Sales in the numerator of the sales

[9] In ***Hines***, because the federal government had already enacted a comprehensive scheme for registering aliens living in the U.S., the Pennsylvania Alien Registration Act of 1939 was found to be unenforceable.

apportionment fractions of each of the taxable members of the Combined Group violated the Supremacy Clause of the U.S. Constitution, and was therefore improper.

IV. Underpayment Penalties

Pursuant to § 35A, if the amount of tax required to be shown on a return for a tax period exceeds the amount reported by the taxpayer – *i.e.*, there is an "underpayment," the Commissioner is directed to add to the tax liability a penalty equal to 20 per cent of the portion of the underpayment attributable to (i) negligence or disregard of the tax laws of the Commonwealth, or of public written statements issued by the Commissioner, and/or (ii) any substantial understatement of tax liability. G.L. c. 62C, § 35A(a), (b). A "substantial understatement" of liability will exist if it exceeds the greater of 10 percent of the tax required to be shown on the return or $1,000. G.L. c. 62C, § 35A(c); G.L. c. 62C, § 35A(d).

The Commissioner is directed to reduce any "understatement" by the portion thereof attributable to (i) the tax treatment of any item by the taxpayer if there is or was substantial authority for the treatment, or (ii) any item if the relevant facts affecting the tax treatment of the item are adequately disclosed in the return or in a statement attached to the return, and there is a reasonable basis for the tax treatment of the item by the taxpayer. G.L. c. 62C, § 35A(d).

Technical Information Release 06-5, New Penalties under G.L. c. 62C, §§ 35A-35E, dated April 13, 2006, explains that "[s]ubmission of a written statement setting out the relevant facts including, without limitation, the basis for the challenge and identifying the tax law or public written statement being challenged will constitute adequate disclosure."

More generally, an exception to § 35A is found in G.L. c. 62C, § 35B(a) ("§ 35B"), which provides, in relevant part, that:

> [a] penalty shall not be imposed under section 35A with respect to any portion of an underpayment if it is shown that there was reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.

Directive 12-7, Section 35A Penalty for Underpayment of Tax Required to be Shown on Return, dated December 19, 2012 ("Directive"), addresses the meaning of critical terms appearing in §§ 35A and 35B – *i.e.,* what is meant by negligence, disregard of the tax laws, substantial authority, adequate disclosure, reasonable basis, reasonable cause, and good faith. The term "negligence" is defined in the Directive to include any failure to make a reasonable attempt to comply with the laws of the Commonwealth or public written statements issued by the Department of Revenue. *See also* § 35A(c). The term "disregard" is stated in the Directive to include any careless, reckless, or intentional disregard of the Department of Revenue's rules, regulations, or other public written statements, which may be evidenced by knowingly taking a position that is incorrect. *See also* § 35A(c).

Relative to the exceptions to the imposition of a § 35A penalty, the Directive states that "substantial authority" for the tax treatment of an item will be found only if the weight of the authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary treatment, and explains that "adequate disclosure" pertains to the relevant facts affecting the tax treatment of an item and requires that such facts be adequately disclosed in the return or in a statement submitted with the return. The Directive states that the "reasonable basis" standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim. The Directive further provides that whether a taxpayer acts with "reasonable cause and in good faith" will be determined by the Commissioner on a case-by-case basis, taking into account all pertinent facts and circumstances, the most important commonly being the extent of the taxpayer's effort to determine and report its proper tax liability.

In the present appeal, the tax year 2015 involved a "substantial understatement" of tax liability – *i.e.*, an underpayment of more than 10 percent of the tax determined by the Commissioner to be due. Unlike 2015, the tax year 2016 involved an underpayment of tax liability that was not substantial within the meaning of § 35A.

As a threshold matter, the appellant argued that given what it viewed as a correct application of the law, there could be no underpayment; but assuming an underpayment of tax liability resulting from adverse findings at the Board, the appellant argued that no penalty should be imposed because it had substantial authority for its failure to apply the Combination Provision, it was not negligent, and it did not disregard the tax laws of the Commonwealth.

In support of its argument, the appellant cited the decision of the Supreme Judicial Court in ***Oracle USA, Inc. v. Commissioner of Revenue***, 487 Mass. 518 (2021), for its position that the provisions of a taxing statute govern where there is language in a regulation that conflicts with the plain language and policy choices of the Legislature in enacting the statute. In particular, the appellant argued that the plain language of the combined reporting statute required each corporation included in a combined group to determine its applicable apportionment formula (*i.e.*, its apportionment as a manufacturing corporation) on a stand-alone basis, while the Combination Provision impermissibly frustrated this explicit mandate. In choosing to follow the statute rather than a conflicting regulation, the appellant merely applied the canons of statutory interpretation to resolve the conflict between the combined reporting statute and the Combination Provision.

In the Board's view, the Combination Provision is not in conflict with the statute, which gives the Commissioner the express authority by regulation to address the impact of the elimination of intercompany transactions in the context of combined returns. The Commissioner exercised this authority, in relevant part, by promulgating the Combination Provision as part of its regulation.

The appellant may well have believed that its interpretation of the law was correct and that the Combination Provision should be deemed improper at some level of adjudication. Regardless, the appellant knowingly, and to its own financial benefit, took a position on its Forms 355U in direct contravention of the Combination Provision. Aware that it had rejected the explicit terms of a regulation, the appellant chose not to disclose its position and left its discovery a mere possibility in the case of an audit.

Taken together, the facts indicate that the provisions of § 35A and relevant public written statements issued by the Commissioner offer no relief from penalties for the tax year 2015, which involved a "substantial understatement" of tax liability. The appellant took a position that directly contravened a public written statement, thereby substantially reducing its tax liability. The appellant could not reasonably have thought that the Commissioner would agree with its view, yet it chose not to disclose its rejection of a duly promulgated regulation. Such rejection constituted disregard of a public written statement, which by itself justified imposition of a § 35A penalty. Moreover, its legal argument that the Combination Provision exceeded the authority granted by the Legislature to the

Commissioner is simply that. Under relevant authority, it cannot be said to rise to the level of substantial authority. Nor was there any demonstrated reasonable cause for the appellant's position within the meaning of § 35B(a).

Though the tax year 2016 involved an underpayment of tax liability that was not substantial within the meaning of § 35A, the operative facts were the same as in 2015, inevitably leading to the conclusion that imposition of a § 35A penalty was proper

Accordingly, the Board found and ruled that § 35A penalties for the tax years 2015 and 2016 were properly imposed.

The tax year 2017 did not involve an underpayment of tax liability, taking into account the findings of the Board relating to the Reallocation Rule and the Rule 33 computation submitted by the parties. The Board therefore found and ruled that a § 35A penalty could not be sustained for the tax year 2017.

V. Summary of the Board's Findings and Rulings

The Board found and ruled that: (i) for the tax year 2015, Fresh Meats Sales was properly classified a § 38 manufacturer, for the tax year 2016, Packaged Meats Sales and Fresh Meats Sales were properly classified as § 38 manufacturers, and for the tax year 2017, Packaged Meats Sales was properly classified as a § 38 manufacturer; (ii) application of the "Finnigan" adjustment in this appeal violated the Supremacy Clause of the U.S. Constitution and therefore none of the sales made by Fresh Meats Sales for the tax year 2017 were properly reallocated to Morrell and Packaged Meats Sales and included in the numerator of their respective sales apportionment factors; and (iii) § 35A penalties were properly assessed for the tax years 2015 and 2016, but not for the tax year 2017.

Accordingly, decisions were issued for the appellee with respect to the corporate excise and the § 35A penalties assessed against the appellant for each of the tax years 2015 and 2016. Regarding the tax year 2017, the Board granted an abatement in the amount of $239,719 based on calculations submitted by the parties pursuant to the Board's Rule 33 Order, and the § 35A penalty assessed against the appellant was not sustained.

THE APPELLATE TAX BOARD

By: ______________________________
Mark J. DeFrancisco, Chairman

A true copy,

Attest: ______________________________
Clerk of the Board