COMMONWEALTH OF MASSACHUSETTS

SUPREME JUDICIAL COURT

VAS HOLDINGS & INVESTMENTS LLC,	)	
	)	
Appellant,	)	APPEALS COURT
	)	DKT#2021-P-0359
v.	)	
	)	
COMMISSIONER OF REVENUE,	)	
	)	
Appellee.	)	
	)	

APPLICATION FOR DIRECT APPELLATE REVIEW

ON BEHALF OF VAS HOLDINGS & INVESTMENTS LLC

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REQUEST FOR DIRECT APPELLATE REVIEW

Appellant, VAS Holdings & Investments LLC ("VASHI"), respectfully requests that this Court grant direct appellate review of this case[1] pursuant to Rule 11 of the Massachusetts Rules of Appellate Procedure. This case presents a significant case of first impression: what is the proper constitutional test under the Due Process Clause and the Commerce Clause for determining the taxability of capital gains received by a nondomiciliary Corporation?

Until October 31, 2011, VASHI, a subchapter "S" corporation formed in Illinois, through its wholly-owned subsidiaries, operated call centers in Canada to facilitate hotel and travel reservations for the (hotel) hospitality industry. Richard Gray ("Gray") and Raymond Cohen ("Cohen"), serial investors in many different types of industries, provided the necessary "seed" money for VASHI to conduct its Canadian call center

[1] This appeal relates to two separate docketed matters before the Appellate Tax Board (the "Board") – Docket Nos. C332269 and C332270. These matters were consolidated for hearing and decision by the Appellate Tax Board. VASHI filed two separate appeals with the Court of Appeals – one for each docketed matter before the Appellate Tax Board. On May 4, 2021, the Court of Appeals consolidated the case under Docket No. 2021-P-0359.

operations. VASHI did not have employees, did not own property, and did not conduct business in Massachusetts.

Until October 31, 2011, Thing5, LLC ("Thing5"), a Massachusetts limited liability company ("LLC"), was in the business of providing hosted "PBX"[2] systems to the hospitality (hotel) industry. Thing5 was 100% owned by David Thor ("Thor"), the CEO of Thing5, and Maura Thor, his wife. At all times relevant to this appeal, David and Maura Thor were Massachusetts residents. Thing5 was headquartered and conducted all of its business through its offices located in Springfield and Longwood, Massachusetts.

Sometime prior to October 31, 2011, the shareholders of VASHI and Thor discussed a possible merger of VASHI and Thing5. The parties agreed that the combined value of VASHI and Thing5 was approximately $35 million. For purposes of this valuation, the parties agreed that VASHI and Thing5 were individually valued at $17.5 million.

Thor caused Cloud5, LLC ("Cloud5") to be formed on August 22, 2011 as a Massachusetts LLC. Cloud5 was

[2] "PBX" refers to "Private Branch Exchange." Generally speaking, a "hosted" PBX refers to a cloud-based virtual communications system that uses a customer's internet connection to make phone calls.

formed for the sole purpose of effecting the business combination of VASHI and Thing5.

On October 31, 2011, VASHI contributed 100% of the stock its operating subsidiary in exchange for 50% of the membership units of Cloud5. Simultaneously therewith, David and Maura Thor contributed 100% of their membership units in Thing5 in exchange for 50% of the membership units in Cloud5.

Post-merger, Thor was solely responsible for any and all business decisions relating to the operation of the Canadian call centers previously-owned by VASHI and the information technology business of Thing5.

Post-merger, VASHI had no employees or operations, and it did not own or lease any real or tangible personal property. VASHI became a holding company and its sole asset was its 50% ownership interest in Cloud5. Gray took on the role of overseeing VASHI's investment and would check in "every couple of weeks" with Thor to discuss the financial performance of Cloud5. VASHI had no active involvement whatsoever in the business operations of Cloud5 after the merger.

On October 11, 2013, an independent third-party, T5 Investment Vehicle, LLC, purchased 100% of the membership interests in Cloud5 for $85 million. As a

result of this acquisition, VASHI realized a capital gain on the sale of its 50% ownership interest in Cloud5.

The issue in dispute is whether the Due Process Clause and Commerce Clause of the United States Constitution prevent Massachusetts from taxing capital gain realized by VASHI.

The decisions of this Court have long-been clear that the Commonwealth is only permitted to tax value earned outside its borders if the nonresident taxpayer and the in-state entity form a "unitary business." *See e.g., W.R. Grace & Co. v. Commissioner of Revenue*, 378 Mass. 577 (1979). There is no constitutionally-permissible reason presented by this case to deviate from the battle-tested "unitary business" test.

STATEMENT OF PRIOR PROCEEDINGS IN CASE[3]

With respect to the 2013 tax year, VASHI made estimated payments of Massachusetts corporate excise taxes and nonresident composite taxes with a timely-filed request of an extension of time to file a Form 355S "S Corporation Excise Tax Return" and a Form MA NCR "Nonresident Composite Return."

[3] A certified copy of the docket entries is appended hereto. *See* Addendum ("Add.") 38.

On September 12, 2014, VASHI filed Form 355S and Form MA NCR reporting no tax due. In response, the Commissioner issued refunds to VASHI of the estimated tax amounts previously paid.

The Commissioner thereafter audited VASHI's receipt of refunds for the 2013 tax year and issued a Notice of Assessment dated September 7, 2016 for corporate excise tax and a Notice of Assessment dated September 12, 2016 for nonresident composite taxes (collectively, the "Assessments"). The Commissioner's position as reflected in the Assessments was that 100% of the capital gain earned by VASHI was taxable by Massachusetts.

On January 23, 2017, VASHI filed a Massachusetts Form ABT, Application for Abatement, challenging each of the Assessments. The Commissioner issued Notices of Abatement Determination rejecting VASHI's appeals on January 27, 2017.

On March 20, 2017, VASHI timely filed two petitions with the Appellate Tax Board (the "Board") appealing the Assessments. A trial was held by the Board on November 28, 2018. On April 29, 2019, the Board issued a decision upholding the Assessments. In response to requests from both VASHI and the Commissioner, on October 23, 2020, the Board issued its findings of fact and report.

STATEMENT OF FACTS RELEVANT TO THE APPEAL

A. Business Operations of VASHI Prior to October 31, 2011

Prior to October 31, 2011, VASHI was a corporation organized under the laws of Illinois. Ad. 50. VASHI, through its wholly-owned subsidiaries, operated call centers in Canada to facilitate hotel and travel reservations for the hospitality (hotel) industry. Ad. 51. The "seed" money needed to conduct VASHI's call center operations came from Gray and Cohen. Ad. 92. Gray and Cohen were strategic investors in several other industries at this time. Ad. 92, 156-157.

The corporate headquarters of VASHI, a subchapter S corporation for federal and Illinois tax purposes, was located in Schaumburg, Illinois. Ad. 50-51. VASHI was the sole shareholder of Virtual-Agent Services Canada, Inc. ("VAS USA"), also an Illinois corporation. Ad. 51. VAS USA was a holding company without employees or any active business activity. *Id.*

VAS USA was the sole shareholder of Virtual-Agent Services Canada Corp. ("VAS CANADA"), a Canadian unlimited liability corporation. Ad. 51. VAS CANADA operated approximately twenty telephone call centers at offices located throughout New Brunswick, Prince Edward

Island and Ontario, Canada for a variety of industries, with a majority of clients being in the hospitality (hotel) industry. *Id.* All employees and property of VAS CANADA were located in Canada. *Id.* Neither VASHI, VAS USA, nor VAS CANADA had clients or business connections in Massachusetts. Ad. 93-94.

David Coler ("Coler"), a New York resident during all periods relevant to this appeal, was hired by Robert Camastro ("Camastro"), the CEO of VASHI, to provide IT consulting services. Ad. 54. Coler also provided value to VASHI based on his connections to the Blackstone Group ("Blackstone"). Ad. 96. Coler's relationship with Blackstone "was instrumental in steering or otherwise causing Blackstone to engage [VASHI] for call center services for some of their … hotel properties." *Id.*

B. Business Operations of Thing5 Prior to October 31, 2011

Thing5 was formed as a Massachusetts LLC under G.L. c. 156C. Ad. 51. Thing5 was 100% owned by Thor, its CEO, and his wife, Maura Thor, who were both Massachusetts residents. *Id.* Thing5 was in the business of providing hosted PBX, mobile applications for guests, and support of legacy PBX systems to clients primarily in the hospitality (hotel) industry. *Id.* Thing5 was

headquartered and conducted all of its business through its offices located in Springfield, Massachusetts and Longmeadow, Massachusetts. *Id.*

Thor had known Coler for several years and was aware of his IT consulting business and his relationship with Blackstone. Ad. 132, 173-174.

C. 2011 Merger of VASHI and Thing5

Sometime prior to October 31, 2011, Coler approached the shareholders of VASHI about a possible merger of VASHI and Thing5. Ad. 54. Coler had knowledge that both VASHI and Thing5 were providing services to Blackstone hotel properties and suggested that there may be certain business synergies between the two companies. Ad. 98. Coler introduced the shareholders of VASHI to Thor to facilitate discussions of a business combination. Ad. 54.

The shareholders of VASHI and Thor explored the idea of a merger of VASHI and Cloud5. After exchange of financial information, Thor and Cohen came to an agreement that the value of VASHI and Thing5 were roughly equal at $17.5 million each and, therefore, that a 50/50 split of the equity of the resulting merged entity was appropriate. Ad. 143. Accordingly, the total value of the merged businesses was believed to be $35 million.

Cloud5 was formed on or about August 22, 2011 as a Massachusetts LLC under G.L. c. 156C. Ad. 52. Cloud5 was formed for the sole purpose of effectuating the merger of VASHI and Thing5. Ad. 53. On October 31, 2011, as part of a single integrated transaction (the "2011 merger"), VASHI contributed all of its shares of stock in its subsidiary, VAS USA to Cloud5 in exchange for 50% of the membership units of Cloud5 and David and Maura Thor contributed all of their membership units in Thing5 to Cloud5 in exchange for 50% of the membership units of Cloud5. Ad. 52.

After the 2011 merger, VAS USA and Thing5 were wholly-owned subsidiaries of Cloud5. VAS CANADA remained a wholly-owned subsidiary of VAS USA. Ad. 52. Thor became CEO of Cloud5 and assumed responsibility for the call center operations of VAS CANADA, in addition to his former responsibilities at Thing5. *Id.* Employees of Thing5 in Massachusetts performed all of the functions previously conducted by the VASHI out of its Illinois offices. *Id.*

D. Business Operations of Cloud5 Prior to October 11, 2013

The parties entered into an Operating Agreement (the "Agreement") relating to the operation and

management of Cloud5. *See* Ad. 52. The "business and affairs" of Cloud5 were to be managed under the direction of a Board of Managers. However, between October 31, 2011 and October 11, 2013, the Board of Cloud5 was neither functional nor active. Ad. 128. Thor, as CEO of Cloud5, did not consult with the Board regarding the operation of Cloud5. Ad. 175, 182-183.

The Board provided no instruction or direction to Thor with respect to the duties he was to perform as CEO of Cloud5. Ad. 101, 103. The Board also failed to assign any powers or duties to Cohen in his role as Chairman of the Board. Ad. 125. Moreover, despite being designated as the "tax matters partner" of Cloud5, Cohen never performed in that capacity. Ad. 127.

E. Business Operations of VAS CANADA After the 2011 Merger

Prior to the merger, the profitability of the call center operations conducted by VAS CANADA was "flat." Ad. 175-176. VAS CANADA was not generating income. *Id.* Thor had no understanding of the call center business and relied on the skill of Rupal Patel ("Patel") (the only employee of VASHI retained by Cloud5) to oversee the operations of VAS CANADA. Ad. 181. Patel was

analytical, a "numbers person," and knew how the call center business worked. *Id.*

Thor and Patel each visited the Canadian call center operations of VAS CANADA about three-to-four times a year. Ad. 180. In addition, John Kerry, a resident of Connecticut and COO of Cloud5, also routinely traveled to Canada to help Cloud5 maintain VAS CANADA. Ad. 218.

The day-to-day management of the VAS CANADA call center operations was handled by Canadian management and employees. Ad. 213-214. All hiring and firing of call center staff was handled by Canadian management and employees of VAS CANADA. Canadian management and employees of VAS CANADA received their direction from Thor and Patel. Ad. 214.

In the months following the 2011 merger, the staffing model of VAS CANADA was changed based on data and tools available to Thing5 that had not been available to VASHI, the number of employees of VAS CANADA was reduced, certain unprofitable client contracts of VAS CANADA were not renewed, and the total number of VAS CANADA clients was reduced. Ad. 52. As a result of these changes, VAS CANADA's profitability (*i.e.*, EBITDA) increased. *Id.*

F. Business Operations of Thing5 After the 2011 Merger

Thing5's headquarters and all of its operations remained in Springfield and Longmeadow, Massachusetts after the 2011 Merger. Ad. 52. Within six months after the 2011 Merger, Thing5 established a call center in Springfield, Massachusetts. *Id.* The Thing5 call center was a "satellite" to the several call centers operated by VAS CANADA in Canada. Ad. 220. The operation and activity of the Springfield call center fluctuated depending on the U.S./Canada exchange rate. *Id.*

The number of Thing5 employees working in its outsourcing and PBX hosting technology business increased after the 2011 Merger. Ad. 52. Thing5's technology product offerings also increased. *Id.* Due to the efforts of Coler, Thing5's customer base also grew following the 2011 Merger. Ad. 183-184.

G. Business Operations of VASHI After the 2011 Merger

Following the 2011 merger, VASHI had no employees or operations, and did not own or lease any real or tangible property. Ad. 52. VASHI's only material asset, other than bank accounts, was its 50% ownership interest in Cloud5 LLC. *Id.* Gray and Cohen viewed VASHI's investment in Cloud5 no different than any other passive

private equity investment. Ad. 100. Specifically, although both Gray and Cohen anticipated that VASHI would eventually sell its ownership interests in Cloud5, no specific "sell" date was anticipated. Ad. 155.

H. Relationship Between VASHI and Cloud5 After the 2011 Merger

VASHI provided no services to Cloud5 following the 2011 Merger. Ad. 112, 189. After the 2011 Merger, VASHI also did not loan or advance funds to Cloud5. Ad. 189. In fact, VASHI had no involvement whatsoever in the business operations of Cloud5 after the merger. Ad. 114, 124. Thor, the CEO of Cloud5, sought no advice from Gray or Cohen on how to run the operating businesses. Ad. 182-183.

Gray, a strategic investor with similar investments across several industries, considered VASHI's passive investment in Cloud5 to be no different than any other private equity deal. Ad. 100. Cohen, also a strategic investor with diverse holdings, did not anticipate a specific "sell date" for VASHI's ownership interest in Cloud5. Ad. 155. Thor agreed stating that he believed that a "liquidity event was … far in the future." Ad. 223. At the time of the 2011 Merger, there was no

"preconceived notion" of when and for how much to sell the merged entity. Ad. 182.

Gray was primarily responsible for overseeing VASHI's investment in Cloud5. Ad. 109. Gray communicated with Thor "every couple of weeks" to check on VASHI's investment in Cloud5. Ad. 106. Gray and Thor discussed "big picture" topics. Ad. 188. Gray asked Thor about how the company was doing from a revenue standpoint and about the costs of operations. *Id.*

I. Facts Relating to the Sale of the Ownership Interests in Cloud5

VASHI was not actively seeking to sell its interest in Cloud5 prior to October 11, 2013. Ad. 115. Thor initiated the effort to sell Cloud5 because, in part, he did not like having "lots of employees." Ad. 190. There was a point, according to Thor, when the number of employees "became a problem" and he considered exiting the business. *Id.* Thor was "very involved" in marketing the sale of Cloud5 and participated in "road shows" with would-be investors. Ad. 190-192.

On October 11, 2013, VASHI, Thor, T5 Investment Vehicle, LLC (an independent third party) and certain of VASHI's shareholders entered into a Membership Interest Purchase Agreement (the "Purchase Agreement"). Ad. 54.

Under the terms of the Purchase Agreement, the value of Cloud5 was approximately $85 million. *Id.* VASHI realized a taxable gain on the sale of its membership interest in Cloud5 (the "2013 Sale"). *Id.* VASHI, a pass-through entity for federal tax reporting purposes, was not required to pay tax to the federal government with respect to the taxable gain on the 2013 Sale. *Id.* Instead, the shareholders of VASHI each paid personal income tax to the federal government. *Id.*

The shareholders of VASHI who were required by state law to report and pay tax to their state of residence did so with respect to the gain realized on the 2013 Sale. Ad. 54. Several shareholders of VASHI paid income tax to their state of residence (outside of Massachusetts) on the gain realized on the 2013 Sale. Ad. 121-122. Specifically, state law required that tax be paid and tax was paid on the gain by Cohen's ex-wife and two sons in Illinois and by John Luth in New Jersey. Ad. 54, 158. In total, shareholders owning more than 35% of the ownership interests in VASHI were required by state law to pay and did pay state tax on the gain realized on the 2013 Sale. Ad. 54, 158-159. The other shareholders of VASHI resided in the state of Florida. *See* Ad. 50, 54, 88-89.

STATEMENT OF ISSUES OF LAW RAISED BY APPEAL

This appeal raises the following issues of law, all of which were raised and properly preserved before the Board.

1. Does the "unitary business" doctrine as explained in *MeadWestvaco Corp. v. Illinois Dep't of Revenue*, 553 U.S. 16 (2008), provide the proper test for determining whether Massachusetts is constitutionally permitted to tax capital gain realized by a nondomiciliary corporation from the sale of its membership interests in a Massachusetts LLC?

2. Did VASHI and Cloud5 comprise a "unitary business" such that Massachusetts' taxation of the capital gain realized by VASHI on the sale of its membership interests in Cloud5 survives scrutiny under the Due Process Clause and Commerce Clause of the United States Constitution?

3. Did the membership interests of Cloud5 serve an "investment" function in the business of VASHI such that Massachusetts' taxation of the capital gain realized by VASHI on the sale of its membership interests in Cloud5 violates the Due Process Clause and Commerce Clause of the United States Constitution?

BRIEF STATEMENT OF ARGUMENT

I. THE BOARD ERRED BY ADOPTING A NOVEL AND UNTESTED CONSTITUTIONAL THEORY OF TAXATION DISREGARDING THE CLEAR INSTRUCTION OF THIS COURT AND CONTROLLING AUTHORITY FROM THE UNITED STATES SUPREME COURT

The constitutional principles implicated by the taxation of income received by a nondomiciliary corporation with respect to its investment in an in-state subsidiary have long-been understood in Massachusetts. The case of *General Mills, Inc. v. Commissioner*, 440 Mass. 154 (2003), reflects this Court's most recent substantive discussion of these principles.

In *General Mills*, this Court was asked to decide whether capital gain received by a nondomiciliary corporation from the sale of stock in a Massachusetts subsidiary was subject to corporate excise tax. This Court began its analysis by stating that, "[a]s a general rule, the commerce clause and the due process clause of the United States Constitution prohibit a state from imposing a tax on value earned outside its borders." *Id.* at 161 (citing *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982)). A state is permitted to impose tax on an apportioned share of the interstate

business of a nondomiciliary corporation, this Court continued, where

> "there is a 'minimal connection' or 'nexus' between the interstate activities and the taxing State, and a 'rational relationship between the income attributed to the State and the interstate values of the enterprise.' [internal citations omitted] This is known as the unitary business principle."

Id. (emphasis added). There is no ambiguity in the language used by the Court in *General Mills*.

The *General Mills* Court further explained that the test for determining the existence of a unitary business, "focuses on whether 'contributions to income result[ ] from functional integration, centralization of management, and economies of scale.'" *Id.* at 162 (citing *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 438 (1980)). This Court's unwavering understanding of the "unitary business" doctrine spans decades. *See e.g.*, *W.R. Grace & Co. v. Commissioner*, 378 Mass. 577 (1979).

In this case, the Board "turned a blind eye" to the required constitutional analysis as outlined in seminal cases such as *Mobil Oil* and *General Mills*. In in its place, the Board debuted a brand new constitutional theory of extraterritorial taxation. A theory wholly-

unsupported by any decision of the United States Supreme Court or the courts of Massachusetts. The Board referred to its novel constitutional test as "investee apportionment."

According to the Board, "investee apportionment" is concerned with the "taxation of a taxpayer's income that is derived from another entity, via investment or otherwise, which is based on the other entity's property and activities in the taxing state." In other words, the taxation of income realized by a nondomiciliary corporation with respect to stock in a subsidiary is determined by the nexus between the in-state subsidiary and the taxing state.

The Board found that VASHI's focus on the unitary business principle was "too narrow" because it only considered the relationship between the "payor" and "payee" of the income. According to the Board, the holding in *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768 (1992), intimates that there may be other types of unitary relationships that pass constitutional muster. However, the Board misunderstood the guidance from the Court in *Allied-Signal*.

In *Allied-Signal*, the Court stated:

> "We agree that the payee and payor need not be engaged in the same unitary business as a prerequisite in all cases. [*Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159 (1983)] says as much. What is required instead is that the capital transaction serve an operational rather than an investment function."
>
> To be sure, the existence of a unitary relation between the payor and payee is one means of meeting the constitutional requirement. Thus, in *ASARCO* and [*F.W. Woolworth Co. v. Taxation and Revenue Dep't of New Mexico*, 458 U.S. 354 (1982)] we focused on the question whether there was such a relation. We did not purport, however, to establish a general requirement that there be a unitary relation between the payor and payee to justify apportionment, nor do we do so today."

504 U.S. at 787.[4] This passage from *Allied-Signal* outlines two different unitary relationships. If the income is a payment from an in-state subsidiary, the "payor" and "payee" analysis applies requiring a review of functional integration, centralization of management, and economies of scale.[5] If the income is capital gains, then the "operational" or "investment" function test is in play.[6]

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[4] In the Findings of Fact and Report of the Board, only the second paragraph is quoted.

[5] This test is sometimes referred to as "enterprise unity."

[6] This test is sometimes referred to as "asset unity."

In *MeadWestvaco*, the issue was whether Illinois could impose tax on capital gain realized by an Ohio corporation from the sale of its Illinois-based subsidiary. *See id.* at 19. The courts of Illinois had determined that the taxpayer and its Illinois-based subsidiary were not a unitary, but affirmed the corporate income tax assessment because – under *Allied-Signal* – the Illinois-based subsidiary served an "operational purpose" in the taxpayer's business.

The Court in *MeadWestvaco* noted that the Illinois' courts erroneously interpreted its "unitary business" precedent. The Court made clear that its reference to "operational function" in *Allied-Signal* was not intended to modify the unitary business principle by adding a new test. The Court further reasoned that the "operational function" analysis merely recognizes that an asset "can be a part of a taxpayer's unitary business even if what we may term a 'unitary relationship' does not exist between the 'payor and payee.'" *Id.* at 29 (quoting *Allied-Signal*, 504 U.S. at 791-792 (O'Connor, J., dissenting)."

Post-*MeadWestvaco*, there are two Court-approved "unitary business" tests. The first test focuses on the relationship between the "payor" and "payee" by

analyzing functional integration, centralization of management, and economies of scale. The second test focuses on the connection between the nondomiciliary corporation and the asset giving rise to the income by evaluating whether the asset serves an "operational" or "investment" function.

The U.S. Supreme Court has never upheld a state's imposition of tax against a nondomiciliary corporation based on the relationship between the in-state subsidiary and the taxing state.

The Board also erroneously relied on the holding in *International Harvester v. Wisconsin Dep't of Taxation*, 322 U.S. 435 (1944), to advance its "investee apportionment" position.[7] In that case, the Court upheld a tax imposed on Wisconsin corporations that distributed dividends from corporate earnings. *Id.* at 438. The Court sustained the Wisconsin tax in the face of a challenge under the Due Process Clause, because Wisconsin afforded "protections and benefits" to the in-state corporation's business activities and these very

[7] The only other substantive case relied on by the Board in support of its decision was *Allied-Signal, Inc. v. Commissioner of Finance*, 79 N.Y.2d 73 (1991) ("*Allied-Signal NY*"). The Court of Appeals of New York also based its holding on *International Harvester*.

activities generated the dividends subject to the withholding tax. *Id.* at 442.

International Harvester does not support the Board's "investee apportionment" approach. In *International Harvester*, Wisconsin sought to impose tax on corporate earnings in the "hands" of the in-state corporation prior to distribution to nonresident shareholders. The Court held that the tax was constitutional because Wisconsin provided "benefits" to the in-state corporation that distributed the dividends. By contrast, in this case, Massachusetts imposed tax on capital gain income realized by VASHI – a nondomiciliary corporation – based on the "benefits" provided by Massachusetts to Cloud5 – a Massachusetts entity.

II. VASHI AND CLOUD5 DID NOT COMPRISE A "UNITARY BUSINESS" BECAUSE THE TRADITIONAL HALLMARKS OF FUNCTIONAL INTEGRATION, CENTRALIZATION OF MANAGEMENT, AND ECONOMIES OF SCALE ARE LACKING IN THIS CASE

The U.S. Supreme Court has made clear that a "unitary business" is characterized by "functional integration, centralization of management, and economies of scale." *See e.g.*, *Mobil Oil*, 445 U.S. at 438. The proper inquiry looks to the "underlying unity or diversity of business enterprise," and not simply to whether the non-domiciliary entity derives "some

economic benefit – at it virtually always will – from its ownership in stock in another corporation." *W.R. Grace & Co. – Conn. v. Commissioner* ("*Grace*"), Mass. ATB Findings of Fact and Report 2009-261, 281 (quoting *Woolworth*, 458 U.S. at 363-64).

Functional integration refers to the extent a subsidiary is integrated into the business of the non-domiciliary parent. There is no evidence that VASHI and Cloud5 were ever "functionally integrated." Following the 2011 Merger, VASHI was a passive investment holding company. Ad. 52. VASHI's primary activity, primarily through the efforts of Gray, was to monitor its investment in Cloud5. Ad. 109. There is simply no basis for a finding that VASHI and Cloud5 were each part of a "functionally integrated" business.

VASHI and Cloud5 also did not benefit from any form of "centralized management." In *General Mills*, this Court found no "centralization of management" despite the fact that the parent provided administrative support to its retailing subsidiaries. *General Mills*, 440 Mass. at 162-63. No "centralization of management" existed between VASHI and Cloud5 in this case. After the 2011 Merger, VASHI provided no services to Cloud5 and did not loan or otherwise advance funds to Cloud5. Ad. 112,

189. Gray communicated with Thor "every couple of weeks" to check on VASHI's investment in Cloud5. Ad. 106-107. For these reasons, there are no facts that support a finding of "centralization of management."

Finally, no "economies of scale" existed between VASHI and Cloud5. Where, as in this case, two unrelated business enterprises "[have] nothing to do with the other," there can be no finding of "economies of scale." *Allied-Signal*, 504 U.S. at 788. VASHI did not participate in or contribute to the business operations of Cloud5. Ad. 182-183. For these reasons, the relationship between VASHI and Cloud5 did not give rise to "economies of scale."

III. BECAUSE THE CLOUD5 MEMBERSHIP INTERESTS SERVED AN "INVESTMENT" FUNCTION IN VASHI'S BUSINESS, NO UNITARY RELATIONSHIP EXISTED

In *MeadWestvaco*, the Court made clear that "operational" v. "investment" function analysis was an alternative test under the unitary business principle. The Court in *MeadWestvaco* explained that the "operational function" analysis requires independent consideration of the connection between the asset and the taxpayer's business operations. *Id.* at 29. The hallmarks of unity – *i.e.*, "functional integration, centralization of management, and economies of scale" –

are not relevant in concluding whether an asset served an "operational function." *See id.*

In *Sasol North America, Inc. v. Commissioner*, Mass. ATB Findings of Fact and Report 2007-942, the Board addressed the taxpayer's claim that its limited partnership interest in a Massachusetts-based private equity fund served an "operational function" in its business. ATB 2007-942, 958. After its review of the relevant case law, the Board held that the "operational function" test considers (1) whether "working capital" was used to purchase the intangible asset and (2) if the investment gave rise to an "operational benefit to the ongoing business of the corporation, beyond a passive monetary return to the corporate treasury." ATB 2007-942, 971.

VASHI's ownership interest in Cloud5 served an investment function. VASHI had no active business operations and, therefore, there is no basis for concluding that the asset served an "operational function." Ad. 52, 100.

WHY DIRECT APPELLATE REVIEW IS APPROPRIATE

Direct appellate review is appropriate where an appeal presents (1) questions of first impression or novel questions of law; (2) state of federal

constitutional questions; or (3) questions of substantial public interest. See Mass. R. App. P. 11(a). This case presents all three types of questions.

First, this is a question of first impression. The Board's adoption of a novel constitutional test in place of the "tried-and-true" unitary business approach of this Court represents a monumental doctrinal shift. This Court has long-followed the clear guidance of the U.S. Supreme Court regarding the application of the "unitary business" doctrine. That this is a question of first impression is further supported by the fact that the Board does not cite to a single Massachusetts case to buttress its decision. There is simply no authoritative support for the concept of "investee apportionment" in Massachusetts.

Second, this case presents questions concerning the United States Constitution. Specifically, this appeal asks whether the Due Process Clause and Commerce Clause are violated where Massachusetts has imposed tax against a nondomiciliary corporation – VASHI – based on the nexus between an in-state subsidiary – Cloud5 - and Massachusetts. These are important constitutional questions relating to the boundaries of Massachusetts' taxing powers.

Third, the public interest in these questions is substantial. The public should have a clear expectation of the constitutional test required to determine whether the income they receive – interest, dividends, capital gain, etc. – is subject to tax when received from an out-of-state investment. This is especially true where – as in this case – out-of-state investment is held through a passive holding company. To date, under substantially similar circumstances, several states have confirmed that a state is precluded by the constitution from taxing income received by a nondomiciliary passive holding company – such as VASHI – under the U.S. Supreme Court's unitary business guidance.[8] Following the Board's opinion in this case, Massachusetts is an outlier on the jurisprudential spectrum.

Respectfully submitted,

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[8] *See e.g.*, *Noell Industries, Inc. v. Idaho State Tax Comm'n*, 167 Idaho 367 (2020), *cert. denied*, 209 L. Ed. 2d 130 (2021) and *Corrigan v. Testa*, 149 Ohio St.3d 18 (2016).

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Dated: May 24, 2021

CERTIFICATE OF COMPLIANCE

I hereby certify, under penalties of perjury, that this brief complies with Massachusetts Rules of Appellate Procedure that pertain to the filing of briefs and appendices, including, but not limited to:

Rule 11(b) (applications for direct appellate review);
Rule 16(a)(13) (addendum);
Rule 16(e) (references to record);
Rule 18 (appendix to briefs); and
Rule 20 (form and length of briefs, appendices, and other documents).

Specifically, this brief was written in Courier New, 12 point font, and created on Microsoft Word (v. 2010). The number of non-excludable words contained in this application for direct appellate review is 5,269.

/s/ Michael J. Bowen
Michael J. Bowen

May 24, 2021

CERTIFICATE OF SERVICE

Pursuant to Massachusetts Rule of Appellate Procedure 13(e), I hereby certify under penalties of perjury, that on May 24, 2021, I have made service of this Application for Direct Appellate Review filed in the matter entitled VAS Holdings & Investments LLC v. Commissioner of Revenue, 2021-P-0359, currently pending in the Appeals Court via the Court's Electronic Filing System upon counsel for the Commissioner of Revenue:

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