



Insurance Company AIG Is Not Unitary with Wholly Owned Ski Resort

Determining whether related companies are “unitary businesses” requires a highly fact-intensive inquiry, often resulting in wildly different outcomes from state to state. Most state courts at least recite the three factors of “functional integration, centralized management, and economies of scale” established by the U.S. Supreme Court’s leading decision in *Container Corporation of America v. Franchise Tax Board*.¹ But what exactly do these vague terms mean in application? The application of these factors has often become the battleground for intense litigation in state courts across the country.

As a practical matter, the application of these ambiguous terms has resulted in state courts generally siding with the state department of revenue. Taxpayers’ difficulty in prevailing is due in part to the requirement that taxpayers establish their unitary business arguments with “clear and cogent” evidence. In short, fact-specific tests typically result in taxpayer losses.

The Vermont Supreme Court recently bucked that trend, however, in *AIG Insurance Management Services, Inc. v. Vermont Department of Taxes*.² There, the Vermont Supreme Court analyzed applicability of the unitary business principle

for the first time since 2006, when combined unitary reporting first took effect in Vermont.³

The court held that a ski resort (Mount Mansfield) wholly owned by multinational insurance company AIG was not a unitary business for Vermont income tax reporting purposes. Although the court weighed a variety of factors in its analysis, the court relied heavily on the fact that Mount Mansfield’s business was fundamentally different from AIG’s business of providing insurance and financial services.

In addition, the court pointed out that AIG first acquired Mount Mansfield as a “toy or hobby” of AIG’s CEO, and that no Mount Mansfield officers were current or former AIG employees. The court also reasoned that AIG did not impose actual control over Mount Mansfield’s operations—even though AIG appointed Mount Mansfield’s CEO, CFO, and its entire board of directors, and even though AIG provided substantial financial assistance to Mount Mansfield.

This case serves as a helpful reminder of the importance of carefully examining whether affiliated companies should actually be reporting as unitary businesses. In particular, the issue of whether related businesses are unitary is highly dependent on how each state’s courts view the

particular facts related to those businesses. For instance, the Vermont Supreme Court noted that AIG had included Mount Mansfield in its unitary combined reporting for each of the other 15 states that used unitary combined income tax reporting. In general, the validity of unitary reporting will rise and fall in each state on a case-by-case basis.

Ownership and procedural history.

AIG is a multinational insurance corporation with more than 700 subsidiaries worldwide that generally provides general insurance, life insurance, retirement services, financial services, and asset management.⁴

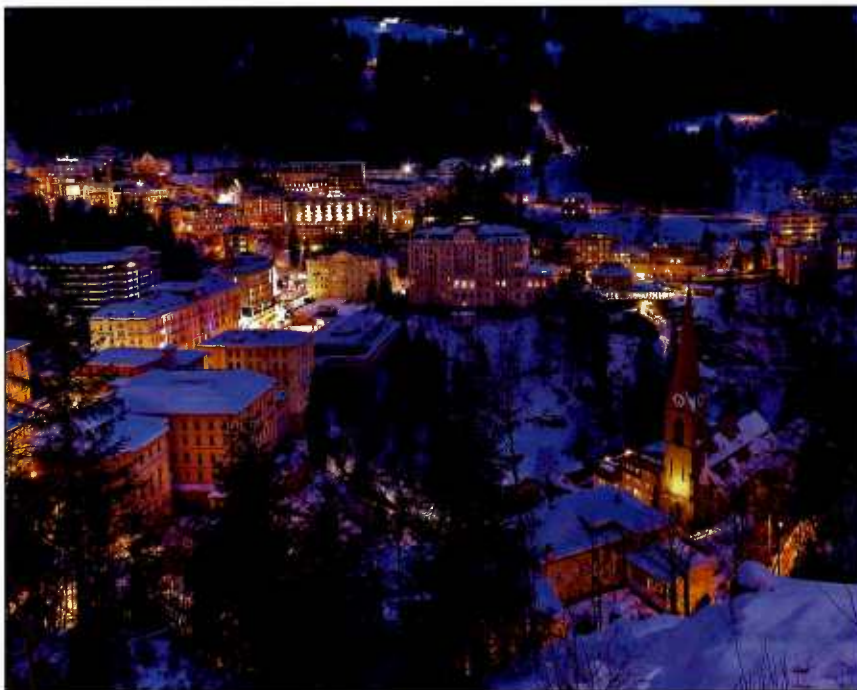
Mount Mansfield is wholly owned by AIG and maintains its principal place of business in Stowe, Vermont, where it operates and conducts business as the Stowe Mountain Resort. The Stowe Mountain Resort primarily operates as a ski resort but also offers summer activities.⁵

Vermont began requiring unitary combined reporting for state income tax purposes in 2006. In October 2007, AIG filed its 2006 tax return and included Mount Mansfield in its Vermont unitary business group. After the Vermont Department of Taxes (Department) discovered a mathematical error in the return, the Department assessed AIG for additional tax, which AIG paid without protest. In 2009, AIG filed an amended return for 2006 and removed Mount Mansfield from its unitary reporting group, resulting in a refund request of \$789,246 in income tax.⁶

The Department rejected AIG’s refund request in February 2011, imposing \$60,440 of additional tax plus interest and penalties. AIG appealed the assessment and, in September 2011, the Department formally denied the request. AIG appealed that denial and the Department’s Commissioner considered the 2009 refund request and the 2011 assessment in a combined hearing. AIG argued that the refund was improperly denied and that the Department’s assessment was barred by Vermont’s three-year statute of limitations.⁷

The Commissioner affirmed the Department’s denial of the refund request, concluding that Mount Mansfield was correctly included in AIG’s unitary business group and that the statute of limitations did not expire because it did not begin to run until the amended return was filed in 2009. AIG appealed, and the

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superior court affirmed on the statute of limitations issue but reversed on the unitary reporting issue, concluding that the Commissioner's findings regarding unity were not supported by the record.

The Commissioner appealed the superior court's decision to remove Mount Mansfield from AIG's unitary group to the Vermont Supreme Court. AIG cross-appealed on the statute of limitations issue, but the Vermont Supreme Court never addressed that issue because it held in favor of AIG in concluding that AIG and Mount Mansfield were not unitary businesses.⁸

Constitutional foundations. The Vermont statute at issue defined "unitary business" broadly as "one or more related business organizations engaged in business activity both within and without the State among which there exists a unity of ownership, operation, and use; or an interdependence in their functions."⁹ The Department's regulations interpreting the statute state that the "interdependence of functions" test "extends as far as, but no further than, the constitutional limits" set by the U.S. Supreme Court.¹⁰ As a result, the Vermont Supreme Court applied the U.S. Supreme Court's holdings on the unitary business principle.

As the Vermont high court first pointed out, the unitary business principle stems from the notion that when states impose income tax, they cannot "tax value earned outside their borders" without violating the Due Process Clause and Commerce

Clause.¹¹ However, the U.S. Supreme Court has held that states are permitted to tax income earned in another state "so long as the interstate and extrastate activities formed part of a single unitary business."¹²

In this case, the court stated that the key question to be decided was whether Mount Mansfield was part of a "functionally integrated enterprise with AIG such that an apportioned share of the income earned by the AIG unitary group out of state may be taxed by Vermont."¹³

Burden of proof. The court first addressed the burden of proof, noting that the parties did not dispute that AIG had the burden of proof to show that the assessment was incorrect.¹⁴ However, the parties disputed the level of proof that AIG was required to meet.

The Department argued that AIG was required to establish that Mount Mansfield was not a part of AIG's unitary group by "clear and cogent evidence," relying on language in the U.S. Supreme Court's decision in *Container Corporation* that AIG was required to show "by clear and cogent evidence that the state tax results in extraterritorial values being taxed."¹⁵ In contrast, AIG cited a California appellate case from 1991, *Tenneco West, Inc. v. Franchise Tax Board*, which held that the taxpayer's burden to establish its unitary business argument was by a "preponderance of the evidence."¹⁶

The Vermont Supreme Court agreed with the Department, holding that AIG

was required to establish its unitary business argument by clear and cogent evidence—a much higher standard than the typical "preponderance of the evidence" standard for other tax litigation.¹⁷ The court distinguished this case from *Tenneco* on the ground that the taxpayer in *Tenneco* was seeking a refund by establishing that its companies were part of the same unitary group.¹⁸ In contrast, the court reasoned, because AIG was seeking to establish that its companies were *not* unitary, AIG was required to establish a lack of unity based on clear and cogent evidence.¹⁹

However, the court in *Tenneco* did not make this distinction explicitly, and the language quoted from the U.S. Supreme Court's decision in *Container Corporation* is likewise not clear on this point.²⁰ In fact, the language in *Container Corporation* suggests that the "clear and cogent" burden applies where a taxpayer seeks to establish that an apportionment formula sweeps out-of-state income within its purview, not whether companies are considered unitary businesses in the first place.²¹

Regardless, placing such a high burden on taxpayers in the unitary business context does make some sense. For instance, courts generally presume that statutes are constitutional, which suggests that taxpayers bear a higher burden in establishing otherwise, and the U.S. Supreme Court noted in *Container Corporation* that states have fairly broad latitude in estab-

¹ 463 U.S. 159, 164, 103 S. Ct. 2933 (1983).

² 2015 WL 7356325 (Nov. 20, 2015).

³ 2003-2004 Legislative Session, Act No. 152.

⁴ The Vermont Supreme Court found that AIG has "approximately 700 subsidiaries," 2015 WL 7356325 at ¶ 4, but AIG's website lists more than 3,000 subsidiaries (http://www.aigcorporate.com/AIG_All_Entities.pdf).

⁵ 2015 WL 7356325 at ¶ 4.

⁶ *Id.* at ¶ 5.

⁷ *Id.* at ¶ ¶ 5-6.

⁸ *Id.* at ¶ ¶ 6-10, 45.

⁹ Vt. Stat. Ann. tit. 32, § 5811(18)(C).

¹⁰ 2015 WL 7356325 at ¶ 18.

¹¹ *Id.* at ¶ 2 (quoting *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 164, 103 S. Ct. 2933 (1983)).

¹² *Id.* at ¶ 2 (quoting *Mobil Oil Corp. v. Comm'r of Taxes of Vt.*, 445 U.S. 425, 436-37, 100 S. Ct. 1223 (1980)).

¹³ *Id.* at ¶ 2 (quoting *Mobil Oil Corp.*, 445 U.S. at 438).

¹⁴ *Id.* at ¶ 12.

¹⁵ *Id.* at ¶ ¶ 12-13 (quoting *Container Corp.*, 463 U.S. at 164).

¹⁶ *Id.* at ¶ 15 (citing *Tenneco West, Inc. v. Franchise Tax Board*, 234 Cal. App. 3d 1510, 286 Cal. Rptr. 354 (Cal. Ct. App. 1991)).

¹⁷ *Id.* at ¶ 15.

lishing apportionment formulas to tax multi-state businesses.²²

Indeed, many states have agreed with the Vermont Supreme Court that taxpayers must establish a lack of unitary business through clear and cogent evidence.²³ However, this question remains open to debate unless and until the U.S. Supreme Court definitively revisits this issue by clarifying the applicability of the burden established in *Container Corporation*.

The Vermont Supreme Court also noted that although the U.S. Supreme Court has not adopted a "bright-line test" for determining whether businesses are unitary for constitutional purposes, a company's out-of-state activities must be related to the in-state activities of the related business in "some concrete way."²⁴ The court then examined the various facts relating to AIG and Mount Mansfield to determine whether Mount Mansfield was part of AIG's unitary group.

No economies of scale: unrelated businesses. The court began its unitary business determination with a short analysis of whether the relationship between AIG and Mount Mansfield created economies of scale. Economies of scale refer to the ability of related companies to save costs by increasing their level of production. The court noted that where a subsidiary "engages in the same type of operation as the parent," then "there is

more probability that the businesses will become integrated through economies of scale or operational functions or the sharing of expertise."²⁵

The court in this case held that the relationship between AIG and Mount Mansfield did not create economies of scale, reasoning that Mount Mansfield and AIG were different business types because Mount Mansfield is a ski resort, while AIG is an insurance and financial service business.²⁶

As a result, the court held, the companies had "no opportunity for common centralized distribution or sales, and no economy of scale realized by their operations." This factor weighed in favor of AIG and against a finding that AIG and Mount Mansfield were unitary.²⁷

No centralization of management. In examining whether AIG and Mount Mansfield featured centralized management, the court noted that a Vermont Department regulation provided that centralized management is generally shown through centralized policymaking in areas such as purchasing, accounting, finance, legal services, tax compliance, human resources, health and retirement plans, product lines, capital investment, and marketing. The court also noted that the U.S. Supreme Court has emphasized the parent company's involvement in the subsidiary's daily operations as the key to this factor, based on "whether the management role the parent does play is grounded in its own operational expertise and its overall operational strategy."²⁸

Applying this factor, the court noted that AIG appointed the Mount Mansfield board of directors, CEO, and CFO. In addition, two of Mount Mansfield's board members were also AIG officers. The court noted that these factors were "significant" in analyzing AIG's control over Mount Mansfield.²⁹

On the other hand, the court noted, none of Mount Mansfield's officers were current or former employees of AIG or its other affiliates, and the U.S. Supreme Court has found this lack of "overlap" significant in determining whether centralized management exists. In addition, the court pointed out that "the evidence failed to show that AIG's control over appointments" to Mount Mansfield's board and management "manifested in actual control" over Mount Mansfield's operations. For instance, the AIG executives on Mount

Mansfield's board did not "contribute any operational expertise" to Mount Mansfield. Instead, Mount Mansfield made its own operational decisions.³⁰

The Department argued that AIG's involvement with Mount Mansfield on a real estate development project at the ski resort created centralized management. Mount Mansfield held a 99% ownership interest in the project, while a different AIG-owned business owned 1% of the project.

The court rejected the Department's argument, noting that although AIG was actively involved in the project in the early stages, Mount Mansfield primarily worked on the project because it was not in AIG's line of business. In short, the court said, "there is nothing to indicate that AIG lent expertise to the success of the project or integrated it with any of its other businesses."³¹

No functional integration. The court explained that functional integration "occurs where business segments pool resources or have integrated processes that affect the operations of the segments," such as through centralized processes or controlled interaction. In other words, functional integration occurs when "business functions are blended."³²

The court began examining various fact-driven factors in its analysis by noting several factors that clearly weighed against integration. For instance:

- The companies operated in different lines of business.
- The companies were not vertically integrated.
- The companies did not engage in joint purchasing.
- Mount Mansfield handled its own advertising and did not share offices or services with AIG.
- Although AIG held ten conferences and events at Mount Mansfield in 2006, AIG paid Mount Mansfield market prices for those events.
- Other than the ten conferences and certain discounts that Mount Mansfield provided to AIG employees, no other "exchange of goods or services" occurred between the companies.³³

The court then examined each of the Commissioner's grounds for finding that functional integration existed.

First, the Commissioner pointed out that Mount Mansfield "received substantial financial assistance" from AIG, pri-

¹⁸ *Id.* at ¶ 16.

¹⁹ *Id.* at ¶ 16.

²⁰ *Tenneco*, 234 Cal. App. 3d at 1520; *Container Corp.*, 463 U.S. at 170.

²¹ *Container Corp.*, 463 U.S. at 170-71.

²² *Container Corp.*, 463 U.S. at 164.

²³ See, e.g., *Geoffrey, Inc. v. Okla. Tax Comm'n*, 132 P.3d 632, 640 (Okla. 2006); *Alaska Gold Co. v. Dep't of Revenue*, 754 P.2d 247, 251 (Alaska 1988).

²⁴ *Id.* at ¶ 20 (quoting *Container Corp.*, 463 U.S. at 166).

²⁵ *Id.* at ¶ 23.

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.* at ¶ 24.

²⁹ *Id.* at ¶ 25.

³⁰ *Id.* at ¶¶ 27-28.

³¹ *Id.* at ¶ 29.

³² *Id.* at ¶ 30.

³³ *Id.* at ¶ 32.

³⁴ *Id.* at ¶¶ 33, 37.

³⁵ *Id.* at ¶ 35.

³⁶ *Id.* at ¶ 38.

³⁷ *Id.* at ¶ 39.

³⁸ *Id.* at ¶¶ 40-41.

³⁹ *Id.* at ¶ 42.

⁴⁰ *Id.* at ¶ 44.



marily as Mount Mansfield's only lender. For instance, in 2006, AIG provided lines of credit totaling \$32 million, which substantially surpassed Mount Mansfield's gross operating revenue for the year (\$20 million). The interest rates for AIG's loans were around three points above LIBOR, which the Commissioner found were "non-arm's-length."

However, the court held that the Commissioner's support for this finding was based solely on the Commissioner's own U.S. prime rate research at the time, not any evidence submitted by either party. As a result, the court held that the Commissioner's finding was not supported by the record.³⁴

In addition, the court concluded that AIG's financial assistance was actually an "investment" in Mount Mansfield—rather than an operational function—and thus did not provide AIG with any operational control. Accordingly, the court held that this factor weighed against functional integration.³⁵

Second, the Commissioner found that AIG utilized Mount Mansfield's brand to build AIG's own brand and develop business. Although the court noted that such a finding "would be significant if supported by the evidence" because it would demonstrate "substantial mutual interdependence," the record contained no evidence supporting the finding.³⁶

Third, the Commissioner found that AIG relied on Mount Mansfield to en-

hance its brand after the government bailout of AIG. However, the court pointed out that the government bailout occurred in 2008, which was two years after the 2006 tax year at issue.³⁷ This factual inconsistency in the Commissioner's findings may have caused the court to view the rest of the findings with more skepticism, although the court did not explicitly say so.

Summarizing these points, the court noted that, although deference to the Commissioner's findings is generally appropriate, the court cannot defer to the Commissioner "where there is no evidence in the record" to support the Commissioner's findings. As a result, and based on the strong evidence in the record against functional integration, the court held that this factor weighed against functional integration.³⁸

Reporting in other states. Finally, the court examined the impact of AIG's inclusion of Mount Mansfield in its unitary group in its tax returns filed in other states. Specifically, AIG included Mount Mansfield in its unitary group for income tax reporting in every other state that used combined income tax reporting in 2006. In other words, AIG reported Mount Mansfield as part of its unitary group in 15 out of 16 combined reporting states where it filed income tax returns, with Vermont as the sole exception.³⁹

The court acknowledged that "an entity's representations in other states can

be a factor." However, the court noted, such representations "cannot create a unitary operation where it does not otherwise exist." In this case, the evidence demonstrated a lack of unitary operations. As a result, Vermont was "still precluded from taxing AIG's operations outside the state by constitutional limitation."⁴⁰

Take-aways. A number of take-aways from this decision can be summarized as follows:

Facts matter. The issue of whether related companies are unitary businesses is highly fact-intensive. Details regarding this issue should be examined closely, as states and the courts will examine all factors relating to the issue and generally leave no stone unturned. As a consequence, this also means that litigation can be more expensive because it will likely require more factual development, such as through depositions and other live testimony, interrogatories, requests for production, and other related discovery.

Credibility is critical. Establishing credibility with the court is paramount in litigation. Here, the Commissioner improperly relied on events from 2008 to support findings regarding the 2006 tax year. Although the court did not expressly indicate that this inconsistency caused the court to view the Commissioner's findings more critically, it appears that is exactly what happened. Credibility is a key factor in determining which party receives the benefit of the doubt in a close case.

Big-picture persuasion can be powerful. Here, the court repeatedly referenced the distinction between AIG's insurance business, on the one hand, and Mount Mansfield's ski resort business, on the other. This stark, big-picture contrast between the businesses helped frame the entire case, provided powerful persuasion for the taxpayer, and appeared to drive the outcome. Framing the story with such basic high-level themes can be very helpful.

Building a strong record below is important. Appellate courts are confined to the record presented to them. Accordingly, many appellate decisions—particularly in fact-specific cases like this one—are made or broken based on the record below. As the case here showed, the lack of evidence supporting a point—even if the point may be true—can be fatal to a claim. ■