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**GORE ENTERPRISE HOLDINGS, INC. v. COMPTROLLER OF THE
TREASURY: A MISSED OPPORTUNITY TO REMEDY
MARYLAND’S DISCONNECTED TAXATION POLICY AND
INIMICAL CORPORATE ATMOSPHERE**

SKYLAR LUDWICK*

On March 24, 2014, the Maryland Court of Appeals approved the collection of nearly thirty million dollars in taxes resulting from an audit spanning more than twenty years.¹ This windfall was the result of the State’s victory in *Gore Enterprise Holdings, Inc. v. Comptroller of the Treasury*,² a case that had been litigated fiercely for nearly eight years. While the Court of Appeals’ decision was correct,³ this holding represents the latest tensions between big business and the State. Ranked forty-second among the nation’s most business-friendly states,⁴ Maryland noticeably has lost all but one of the eleven Fortune 500 companies previously located in the State, and in addition, a large number of smaller businesses moved to neighboring states that are viewed as more accommodating to the corporate agenda.⁵ Maryland’s most recent gubernatorial election embodied the conflict regarding the State’s increased taxation of its residents, as the under-funded Republican candidate, Larry Hogan, surprisingly defeated the Democratic candidate, former Lieutenant Governor Anthony Brown, by running on a tax-driven platform.⁶ *Gore Enterprise Holdings, Inc. v. Comptroller of the Treasury* is a compilation of these critically important issues and presents a unique opportunity to study the future of Maryland’s economy.

In *Gore Enterprise Holdings, Inc. v. Comptroller of the Treasury*, the Court of Appeals applied its holding from *Comptroller of the Treasury v.*

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1. *Gore Enter. Holdings, Inc. v. Comptroller of the Treasury*, 437 Md. 492, 87 A.3d 1263 (2014).

2. *Id.*

3. *See infra* Part IV.A.

4. Dennis W. Evans, *Maryland’s Fiscal Decline Can Be Tracked*, DELMARVA NOW (Sept. 14, 2014), <http://www.delmarvanow.com/story/opinion/columnists/2014/09/14/dennis-w-evans-opinion/15624571/>.

5. *Id.*

6. *See infra* Part IV.B.

*SYL, Inc.*⁷ to determine the constitutionality of the State's taxation of an out-of-state holding company that did not conduct business in Maryland. The Court of Appeals concluded that the subsidiaries' lack of real economic substance under *Comptroller of the Treasury v. SYL, Inc.* sufficiently aggregated the holding companies with their parent company and thus allayed any constitutional concerns.⁸ The Court of Appeals then concluded that the State had the authority to tax the subsidiaries because they lacked real economic substance and were part of a unitary business that profited from activities conducted in the State.⁹

The Court of Appeals' extension of the confounded real economic substance standard perpetuates the perception that Maryland is hostile to big business. Although the Court of Appeals arrived at the correct result, the *Gore* court should have given more weight to the unitary business principle rather than relying on an incorrect application of the real economic substance test. The *Gore* court expended a great deal of effort differentiating the unitary business principle and real economic substance standard only to use the same factors in each analysis. Rather than create a meaningful distinction between the two tests, the Court of Appeals further muddled the criteria for state taxation of an out-of-state subsidiary.

I. THE CASE

Gore Enterprise Holdings, Inc. v. Comptroller began when W.L. Gore, a Delaware corporation founded in 1958,¹⁰ challenged the Comptroller's 2006 audits of its subsidiaries, Gore Enterprise Holdings, Inc. ("GEH") and Future Value, Inc. ("FVI").¹¹ Established in Delaware in 1983 and 1996, respectively, Gore Enterprise Holdings, Inc. and Future Value, Inc. functioned as holding companies for W.L. Gore's patents and financial assets.¹² Gore paid royalties and interest to the companies in return for patent licenses from GEH and loans from FVI.¹³ In 2006, the Comptroller issued tax

7. 375 Md. 78, 825 A.2d 399 (2003).

8. *Gore Enter. Holdings, Inc. v. Comptroller of the Treasury*, 437 Md. 492, 533, 87 A.3d 1263, 1287 (2014).

9. *Id.*

10. *Comptroller of the Treasury v. Gore Enter. Holdings, Inc.*, 209 Md. App. 524, 529, 60 A.3d 107, 110 (2013), *aff'd*, 437 Md. 492, 87 A.3d 1263 (2014). "[W.L.] Gore is known for its patented 'ePTFE' material, which it uses to manufacture industrial and electronic products, as well as fabrics and medical devices." *Id.* Gore has manufacturing facilities in Maryland and sells its products in the State. *Id.*

11. *Id.* at 532, 60 A.3d at 112.

12. *Id.* at 530–32, 60 A.3d at 111–12. "Gore formed Gore Enterprise Holdings, Inc. ('GEH') in 1983, contributing all Gore patents in exchange for all of GEH's stock. . . . In 1996, Gore exchanged its financial assets in return for all outstanding stock of its newly-formed subsidiary, Future Value, Inc. ('FVI')." *Id.*

13. *Id.* at 531–32, 60 A.3d at 111–12. "Delaware amended its income taxation statute to exempt '[c]orporations whose activities within Delaware are confined to the maintenance and man-

assessments against GEH, FVI, and Gore, levying over \$26.4 million against GEH, over \$2.6 million against FVI, and almost \$200 thousand against Gore.¹⁴ After the 2006 audit, the Comptroller “determined that GEH and FVI were required to apportion income to Maryland,” even though neither company had a physical presence in the State.¹⁵ One of the Comptroller’s hearing officers upheld the assessments against GEH and FVI in January 2007;¹⁶ the companies then appealed to the Maryland Tax Court.¹⁷

After a three-day hearing in October 2008, the Maryland Tax Court upheld the Comptroller’s assessments, but abated the penalties, finding that a “substantial nexus” existed between the companies and the State and that the apportionment formula used to arrive at the assessment was fair.¹⁸ The Tax Court relied on Maryland precedent to address the constitutional concerns surrounding the tax assessments and determined that the required nexus between the State and the company is “the economic reality of the fact that the parent’s business in Maryland was what produced the income of the subsidiar[ies].”¹⁹ On appeal, the Circuit Court for Cecil County reversed the Tax Court’s judgment²⁰ because the circuit court disagreed with the Tax Court’s determination that GEH and FVI were part of Gore’s unitary business.²¹

Upon the Comptroller’s October 6, 2011 appeal of the circuit court’s decision,²² the Court of Special Appeals upheld the Tax Court’s decision. The Court of Special Appeals held that the Tax Court neither erred in as-

agement of their intangible investments and the collection and distribution of the income from such investments or from tangible property physically located outside of Delaware.” *Id.* at 529, 60 A.3d at 110 (alteration in original) (citation omitted). This amendment provided Gore with the incentive to create its subsidiaries because GEH’s and FVI’s income would be exempted from taxation under the Delaware statute. *Id.*

14. *Id.* at 532–33, 60 A.3d at 112.

15. *Id.*

16. *Id.* at 533, 60 A.3d at 112.

17. *Id.* Although nominally described as a court, “the Tax Court is not a court; instead, it is an adjudicatory administrative agency in the executive branch of state government.” *Id.* at 535, 60 A.3d at 113–14.

18. *W.L. Gore & Assocs. v. Comptroller of the Treasury*, No. 07-IN-OO-0084, 2010 Md. Tax LEXIS 3, at *14–15 (Md. T.C. Nov. 9, 2010), *aff’d sub nom.* *Comptroller of the Treasury v. Gore Enter. Holdings, Inc.*, 209 Md. App. 524, 60 A.3d 107 (2013), *aff’d*, 437 Md. 492, 87 A.3d 1263 (2014).

19. *Id.* at *13. The Tax Court held that “[t]here is a circular flow of money through royalties, dividends and loans which support the unitary business of W. L. Gore and its wholly owned subsidiaries, GEH and FVI.” *Id.* at *14.

20. *Gore*, 209 Md. App. at 534, 60 A.3d at 113.

21. *Id.* at 534 n.9, 60 A.3d at 113 n.9. The circuit court characterized GEH as an “independent company” that engaged in “‘its own independent business dealings.’” Similarly, the circuit court held that each loan between FVI and Gore was “an arm’s length transaction between two Delaware residents; and therefore it, shouldn’t be subject to Maryland tax.” *Id.*

22. *Id.* at 534, 60 A.3d at 113.

sessing GEH and FVI as taxable entities part of Gore's unitary business, nor erred in apportioning the subsidiaries' income based on the expenses of the parent corporation.²³ Deferring to the Tax Court,²⁴ the Court of Special Appeals focused on the constraints imposed by the Commerce and Due Process Clauses as limiting Maryland's ability to tax GEH and FVI under Tax-General Article, section 10-402.²⁵

The Court of Special Appeals applied Maryland precedent to dismiss the constitutional concerns, namely through the application of the unitary business principle.²⁶ The unitary business principle was developed by the Supreme Court of the United States to determine whether an out-of-state business had a sufficient nexus with the state to allow for taxation under the Due Process Clause of the Fourteenth Amendment and the Commerce Clause of Article One, Section Eight.²⁷ While applying Maryland precedent, the Court of Special Appeals relied on the Supreme Court's determination that "[a] state may tax an apportioned sum of [a] corporation's multi-state business if the business is 'unitary.'"²⁸ Noting that "GEH and FVI demonstrate the 'hallmarks' of a unitary business relationship,"²⁹ the court reasoned that the subsidiaries' complete dependence on their parent company satisfied both constitutional concerns, given Gore's history of activity in Maryland.³⁰ The court also resolved Gore's ancillary argument that the Tax Court erred by applying trademark precedent to its patent holding company, stating that the origin of intellectual property law has no effect on how or where intellectual property is used for state income taxation purposes.³¹ The Court of Special Appeals closed by expounding on the impracticability

23. *Id.* at 528-29, 60 A.3d at 110.

24. *See id.* at 535, 60 A.3d at 114 ("It is not our job to substitute our judgment for that of the Tax Court.") (quoting *Classics Chi., Inc. v. Comptroller of the Treasury*, 189 Md. App. 695, 706, 985 A.2d 593, 599 (2010)). While the Court of Special Appeals reviewed the conclusions of law de novo, the agency's decision could only "be affirmed only on the basis of the grounds on which it decided the case." *Id.* (quoting *Classics*, 189 Md. App. at 707, 985 A.2d at 600).

25. *Id.* at 536, 60 A.3d at 114. "The Due Process Clause demands that there exist some definite link . . . between a state and the person . . . it seeks to tax The Commerce Clause forbids the States to levy taxes that discriminate against interstate commerce . . ." *Id.*

26. *Id.* at 537 & n.11, 60 A.3d at 115 & n.11 ("[I]n a parent-subsidy case, the 'three key elements necessary for constitutional nexus' are that the parent is engaged in business in Maryland, the parent is unitary with the subsidiary, and the apportionment formula is fair." (quoting *Comptroller of the Treasury v. SYL, Inc.*, 375 Md. 78, 104, 825 A.2d 399, 414 (2003))).

27. *See infra* Part II.A.

28. *Gore*, 209 Md. App. at 537, 60 A.3d at 115 (quoting *MeadWestvaco Corp. v. Ill. Dep't of Revenue*, 553 U.S. 16, 25 (2008)).

29. *Id.* at 538, 60 A.3d at 115-16 (noting that, to qualify as a unitary business, the subsidiary must demonstrate functional integration, centralized management, and economies of scale with the parent company).

30. *Id.*, 60 A.3d at 115 ("Gore generated income in Maryland and deducted payments to GEH and FVI, which recognized those payments as their income—an accounting identity that reflects their unified business.").

31. *Id.* at 539, 60 A.3d at 116.

of ignoring “the fact that the ‘expenses’ Gore deducts in Maryland are simultaneous gains to assets on its own balance sheets.”³² The Maryland Court of Appeals granted certiorari to decide whether the Comptroller had the authority to tax GEH and FVI under the precedent of *Comptroller of the Treasury v. SYL, Inc.*,³³ and whether the Tax Court erred when it upheld the apportionment formula used in the assessment of the companies.³⁴

II. LEGAL BACKGROUND

There is extensive national and state precedent surrounding state taxation of multistate corporations, with the fundamental constitutional tests set forth by the United States Supreme Court. Part II.A of this Note discusses the establishment of the unitary business principle and the Supreme Court’s blessing of apportionment formulas for calculating corporate taxes.³⁵ Part II.B addresses the application of these precedents by Maryland courts.³⁶

A state’s ability to tax corporations that conduct business within its boundaries is sanctioned by the constitutionally protected right of state sovereignty.³⁷ Before a state may apportion a company’s income, the entity must have the requisite nexus with the state to overcome constitutional hurdles imposed by the Commerce Clause³⁸ and the Due Process Clause.³⁹ Nexus is established when an entity has a sufficient presence or connection with the state, although the exact standard for measuring this nexus has varied over time.⁴⁰ Increasingly, states are using apportionment formulas to calculate corporate taxation.⁴¹ Apportioning allows a state to weigh a company’s operations within the state against its overall operations to better

32. *Id.* at 540, 60 A.3d at 117.

33. 375 Md. 78, 825 A.2d 399 (2003).

34. *Gore Enter. Holdings, Inc. v. Comptroller of the Treasury*, 437 Md. 492, 502–03, 87 A.3d 1263, 1268–69 (2014).

35. *See infra* Part II.A.

36. *See infra* Part II.B.

37. U.S. CONST. art. IV, § 4; U.S. CONST. amend. X; Brian T. Diamond, Comment, *Maryland’s Corporate Income Taxation Approach for Multi-Jurisdictional Companies: Moving Toward Uniformity, Yet Still Lacking Ultimate Effectiveness*, 63 MD. L. REV. 1071, 1074 (2004).

38. U.S. CONST. art. 1, § 8, cl. 3.

39. U.S. CONST. amend. XIV, § 1.

40. Diamond, *supra* note 37, at 1075 (noting that, while a number of states still adhere to the physical presence rule established in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the need to tax multi-jurisdictional corporations has prompted the creation of constructive nexus standards).

41. Laura J. Waterland, Note, *Container Corporation of America v. Franchise Tax Board: The Supreme Court Encourages Apportionment Taxation*, 26 WM. & MARY L. REV. 683, 684 (1985). Corporate taxes also can be calculated using the separate accounting or geographical allocation methods. *Id.* The federal government uses the separate accounting method, which treats parent corporations and subsidiaries as separate entities for tax purposes so long as the transactions between the two companies were at arm’s length. *Id.* The geographical allocation method allows a state to tax in full all income attributed to that state. *Id.*

gauge the business's taxable income.⁴² The United States Supreme Court has had a number of occasions to consider the complexities and controversies surrounding corporate taxation, particularly those associated with apportionment formulas and nexus requirements.⁴³

A. *The United States Supreme Court Developed the Unitary Business Principle and Approved the Use of Apportionment Formulas to Account for a Changing Commercial Landscape*

The United States Supreme Court has produced an impressive jurisprudence with respect to the constitutionality of state taxation on out-of-state assets.⁴⁴ The Court's consideration of state taxation boundaries has been driven by technological advancements, as conventional tax principles prevented states from taxing their fair share of multistate business enterprises, such as telegraph companies and railroads.⁴⁵ These technological advancements led the Supreme Court to establish two principles of state taxation that continue to control the parameters of interstate corporate taxation: the unitary business principle and apportionment formulas.⁴⁶

1. *The Supreme Court Devised the Unitary Business Principle to Measure the Relationship Between Parent Companies and Their Subsidiaries*

The Due Process Clause of the Fourteenth Amendment and the Commerce Clause of Article I, Section 8 of the United States Constitution prohibit a state from taxing value earned outside of its borders.⁴⁷ The Supreme Court realized that this prohibition produced inequalities in taxation, particularly for an integrated business operating in multiple states where "arriving at precise territorial allocations of 'value' is often an elusive goal, both in theory and in practice."⁴⁸ In *Mobil Oil Corp.* and its progeny, the Court de-

42. *Id.* The author also notes that "[t]he unitary business principle is the foundation of the apportionment scheme because this principle defines the operations that factor into the apportionment formula." *Id.*

43. *See infra* Part II.A.

44. *See, e.g.,* *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159 (1983); *Asarco, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982); *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425 (1980). The Supreme Court produced a series of similar opinions in the *Mobil Oil Corp.* line of cases. Generally, the Court upheld the constitutionality of a tax assessment so long as the assets sought by the state were part of a unitary business and the state apportioned the tax properly.

45. *See MeadWestvaco Corp. v. Ill. Dep't of Revenue*, 553 U.S. 16, 25–26 (2008).

46. *See Mobil Oil Corp.*, 445 U.S. at 438 (rejecting geographical accounting in favor of a system that accounts for the unitary nature of the business entity); *Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 784 (1992) (authorizing the use of states' individual apportionment formulas to approximate the in-state portion of truly multistate activity).

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

48. *Id.*

vised the unitary business principle to “shift the constitutional inquiry from the niceties of geographic accounting to the determination of the taxpayer’s business unit.”⁴⁹ This shift allowed a state to tax an apportioned share of a business’s value instead of isolating the value attributable to that business’s intrastate operations.⁵⁰

Mobil Oil Corp. and its progeny relied on a long line of Supreme Court precedent that established that an interstate business “is not immune from fairly apportioned state taxation.”⁵¹ In particular, this line of jurisprudence drew heavily from *Moorman Manufacturing Co. v. Bair*⁵² to identify the hurdles that a state must clear before it may constitutionally tax an out-of-state corporation.⁵³ Governmental activity must be fair to satisfy the fair warning requirement imposed by the Due Process Clause;⁵⁴ as such, there must be a minimal connection between a multistate business’s interstate activity and the taxing state and a rational relationship between the income generated in the state and the original business enterprise.⁵⁵ The Supreme Court found the Commerce Clause⁵⁶ to impose additional requirements pertaining to “the effects of state regulation on the national economy.”⁵⁷ The Court has sustained state taxation against Commerce Clause challenges so long as “the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State.”⁵⁸

Without further guidance, the constitutional hurdles imposed on state taxation could have resulted in an array of fact-specific precedents lacking uniformity. The Supreme Court established early on that a business’s income generated in interstate commerce was not immune from state taxation.⁵⁹ The Court’s decision in *Mobil Oil Corp. v. Commissioner of Taxes* expanded this line of precedent by creating the unitary business principle. This principle provides both states and interstate businesses with a list of discrete factors to determine whether the state may tax the business’s activity within that state.⁶⁰

49. *MeadWestvaco Corp.*, 553 U.S. at 26.

50. *Id.*

51. *Mobil Oil Corp.*, 445 U.S. at 436.

52. 437 U.S. 267 (1978).

53. *Mobil Oil Corp.*, 445 U.S. at 436–37.

54. U.S. CONST. amend. XIV; *see Quill Corp. v. North Dakota*, 504 U.S. 298, 312 (1992).

55. *Moorman Mfg. Co.*, 437 U.S. at 272–73.

56. U.S. CONST. art. 1, § 8, cl. 3.

57. *Quill Corp.*, 504 U.S. at 312.

58. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

59. *Mobil Oil Corp. v. Comm’r of Taxes*, 445 U.S. 425, 436 (1980).

60. *Id.* at 438. The Court established the unitary business principle to provide objectivity to a rather subjective and fact-specific inquiry. *See Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 785 (1992) (noting that “the relevant unitary business inquiry [is] one which focuses on the objective characteristics of [an] asset’s use and its relation to the taxpayer and its activities

To constitute a unitary business, the business must exhibit “contributions to income resulting from functional integration, centralization of management, and economies of scale.”⁶¹ The Court has not wavered in its application of this test, both in upholding state taxation⁶² and in rejecting state taxation.⁶³ Where the business entity contests the state’s ability to tax its income, the taxpayer bears the burden of demonstrating the unconstitutionality of the tax.⁶⁴ Both *Mobil Oil Corp.*⁶⁵ and *Container Corp. of America*⁶⁶ presented circumstances in which the Court applied the unitary business principle to uphold a state’s taxation of a multistate enterprise. In *Mobil Oil Corp.*, the Court faced a petroleum business that conducted its operations in over forty states and abroad.⁶⁷ Establishing and applying the unitary business principle, the Court reasoned that a corporation’s attempt to classify its subsidiaries as separate businesses must fail when the income generated by those entities is “derived from a functionally integrated enterprise.”⁶⁸ In *Container Corp. of America*, under similar circumstances, the Court found that the corporation’s assistance to its subsidiaries merited state taxation as a unitary business, despite the salient differences in the companies’ operations.⁶⁹

On other occasions, the Court’s application of the unitary business principle found state taxation had fallen short of satisfying the required constitutional hurdles.⁷⁰ While the Court has long held that the Constitution imposes no single formula on states for evaluating the activity of an integrated business enterprise,⁷¹ the Court historically has assessed those for-

within the taxing State”). By establishing definite criteria qualifying a business as unitary or otherwise, the Court provided clarity to a complex area of jurisprudence.

61. *Mobil Oil Corp.*, 445 U.S. at 438 (noting “that separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income” generated through a unitary business).

62. *Id.* at 439 (finding that Mobil “has made no effort to demonstrate that the foreign operations of its subsidiaries and affiliates are distinct in any business or economic sense from its petroleum sales activities in Vermont” to defeat the unitary business principle).

63. *Asarco, Inc. v. Idaho State Tax Comm’n*, 458 U.S. 307, 322 (1982) (holding that ASARCO’s subsidiaries were not sufficiently under the parent’s control to qualify as a unitary business); *see also id.* at 327 (declining to accept “a definition of ‘unitary business’ that would permit nondomiciliary States to apportion and tax dividends ‘[w]here the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State’” (alteration in original) (quoting *Mobil Oil Corp.*, 445 U.S. at 442)).

64. *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 175 (1983).

65. 445 U.S. at 439–40.

66. 463 U.S. at 179–80.

67. *Mobil Oil Corp.*, 445 U.S. at 428.

68. *Id.* at 440 (acknowledging that “[o]ne must look principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability”).

69. *Container Corp.*, 463 U.S. at 179–80.

70. *See Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 790 (1992); *Quill Corp. v. North Dakota*, 504 U.S. 298, 301–02 (1992).

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

mulas using the unitary business principle.⁷² In *Asarco, Inc.*, the Court held that the unitary business principle could not successfully be applied where the subsidiary and parent companies are not sufficiently connected.⁷³

While the Court has been unwilling to find the existence of a unitary business “[w]here the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State,”⁷⁴ the Court made clear in *Container Corp. of America* that a unitary business may exist even when the relationship between the parent and subsidiary is less conventional and more distanced or abstract.⁷⁵ *Mobil Oil Corp.* and its progeny affirm that “the linchpin of apportionability in the field of state income taxation is the unitary-business principle.”⁷⁶

2. *The Court Allowed the Use of Apportionment Formulas to Determine the Amount of Taxable Activity that an Entity Conducted in the State*

While the unitary business principle provides the requisite nexus with the taxing state to satisfy the Due Process and Commerce Clauses,⁷⁷ the apportionment formula used by the state to determine the taxable amount also must meet the constitutional requirement of fairness.⁷⁸ Outside of the insistence on fairness, the Court largely leaves the states free to fashion the substance of their apportionment formula.⁷⁹ In *Allied-Signal, Inc.*, the Court blessed the use of individualized apportionment formulas by the states.⁸⁰ But, the Court went on to draw a slight restriction on the composition of the formula in *Container Corp. of America*.⁸¹ In *Container Corp. of America*, the Court noted its disapproval of a one-factor apportionment

72. See *Allied-Signal, Inc.*, 504 U.S. at 784; *Quill Corp.*, 504 U.S. at 312; *Container Corp.*, 463 U.S. 159; *Asarco, Inc. v. Idaho State Tax Comm’n*, 458 U.S. 307 (1982); *Mobil Oil Corp.*, 445 U.S. 425.

73. *Asarco, Inc.*, 458 U.S. at 322.

74. *Mobil Oil Corp.*, 445 U.S. at 442.

75. *Container Corp.*, 463 U.S. at 178 (“The prerequisite to a constitutionally acceptable finding of unitary business is a flow of *value*, not a flow of goods.”).

76. *Mobil Oil Corp.*, 445 U.S. at 439.

77. *Id.* at 442 (“Where the business activities . . . have nothing to do with the activities . . . in the taxing State, due process considerations might well preclude apportionability, because there would be no underlying unitary business.”).

78. *Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 780 (1992). The Court recognized that while states have “wide authority to devise formulae for an accurate assessment of a corporation’s intrastate value or income,” there also is a “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.” *Id.*

79. *Id.* at 784 (“To be sure, our cases give States wide latitude to fashion formulae designed to approximate the in-state portion of value produced by a corporation’s truly multistate activity.”).

80. *Id.*

81. *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 183 (1983).

formula.⁸² According to the Court, one-factor formulas, based on things like the ownership of tangible property,⁸³ may appear fair on its face, but in practice “operates so as to reach profits which are in no just sense attributed to transactions within its jurisdiction.”⁸⁴ Instead, the Court advocated the use of three-factor apportionment formulas, noting that these types of calculations were more likely to avoid the sort of distortions presented by one-factor methods.⁸⁵

B. The Maryland Courts Expanded upon the Precedents Established by the United States Supreme Court, Namely by Inquiring into the Real Economic Substance of a Subsidiary

The Maryland Court of Appeals has had many occasions to evaluate the constitutionality of state taxation of out-of-state assets using the unitary business principle and apportionment formula.⁸⁶ The Court of Appeals’ use of the unitary business principle and the apportionment formula guidelines has colored its discussion of the state taxation statute.⁸⁷ In particular, the Court of Appeals has applied the Supreme Court’s discussion of three-factor apportionment formulas⁸⁸ as a way to discuss the formula used by the State and the fluctuations that occur when attempting to levy additional taxes.⁸⁹

82. *Id.*

83. *See* *Hans Rees’ Sons, Inc. v. North Carolina ex rel. Maxwell* 283 U.S. 123, 129 (1931).

84. *Container Corp.*, 463 U.S. at 183 (quoting *Hans Rees’ Sons, Inc.*, 283 U.S. at 134). In citing *Hans Rees’*, the Court notes that it struck down an apportionment method based entirely on ownership of tangible property. *Id.* According to the Court, one-factor apportionment formula are “purposely skewed to resolve all doubts in favor of the State,” and thus do not represent a fair accounting of the corporation’s taxable intrastate activities. *Id.*

85. *Id.* at 183–84. Specifically, the Court approved of California’s three-factor formula, which includes a corporation’s payroll, property, and sales. *Id.* at 183. The Court held that these factors in combination “reflect a very large share of the activities by which value is generated.” *Id.*

86. *See, e.g.*, *Comptroller of the Treasury v. SYL, Inc.*, 375 Md. 78, 825 A.2d 399 (2003); *Hercules, Inc. v. Comptroller of the Treasury*, 351 Md. 101, 716 A.2d 276 (1998); *NCR Corp. v. Comptroller of the Treasury*, 313 Md. 118, 544 A.2d 764 (1988); *Comptroller of the Treasury v. Atlantic Supply Co.*, 294 Md. 213, 448 A.2d 955 (1982); *Xerox Corp. v. Comptroller of the Treasury*, 290 Md. 126, 428 A.2d 1208 (1981).

87. *See, e.g.*, *Xerox Corp.*, 290 Md. at 127–128, 428 A.2d at 1210 (“This case presents the question whether Maryland taxation of an apportioned amount of certain interest and royalty income earned by a corporation engaged in both interstate and intrastate commerce was proper under relevant statutory and constitutional standards.”).

88. *See supra* Part II.A.

89. *Xerox Corp.*, 290 Md. at 130, 428 A.2d at 1211 (“[A] corporation must compute its Maryland tax liability by using a three-factor (sales, property and payroll) apportionment formula The numerator of the sales factor . . . is the amount of a corporation’s in-state sales; the denominator of the sales factor is the total amount of a corporation’s in-state and out-of-state sales. The property and payroll factors are computed in the same manner. The three factors are averaged and the resulting fraction, expressed as a percentage, is multiplied by the corporation’s business income. The resulting dollar amount constitutes the business income apportioned to this State.”).

While the Court of Appeals has attempted to reconcile the actions of the State with the Supreme Court's decisions, the nature of the inquiry has led to the creation of a very fact-specific set of precedents.⁹⁰ Deciding its cases based on factors incident and unique to the business in question, the Court of Appeals has been unwilling to sanction taxation in cases where income stemmed from out-of-state investment decisions;⁹¹ yet the Court of Appeals has proven to be more flexible in cases where the income produced out-of-state is related to the business's activities within Maryland.⁹² The Court of Appeals' earlier decisions were focused largely on independently operating subsidiaries or investment corporations, allowing the court to apply the unitary business analysis and apportionment formulas set out by the Supreme Court.⁹³

As the court began to deal with "phantom" entities,⁹⁴ it was forced to redesign the constitutional inquiry once served by the unitary business principle and the apportionment formula.⁹⁵ The Court of Special Appeals, in *Comptroller of the Treasury v. Armco Export Sales Corp.*, tailored the constitutional inquiry to incorporate a finding of real economic substance, because the former consideration of a corporation's property, payroll, and sales was "flawed due to the very nature of a [phantom corporation], which has no tangible property or employees and can only conduct its activity and do business through branches of its unitary affiliated parent."⁹⁶

The Court of Appeals adopted and broadened this standard in *Comptroller of the Treasury v. SYL, Inc.*, where it rejected the corporation's contention that *Armco* "applies only where the subsidiary lacks all substance or

90. *Id.* at 142–144, 428 A.2d at 1217–18. The Maryland Court recognizes that the taxation statute "prescribes taxation of so much of a corporation's net income as is constitutionally permissible." *Id.* at 142, 428 A.2d at 1217. To determine that amount, the court must engage in a piecemeal investigation of the corporation's intra- and interstate activities. *Id.* at 142–44, 428 A.2d 1217–18. This type of investigation lends itself to the creation of a fact-specific opinion, since every corporation is likely to engage in different behaviors and operate under a different set of factors. *Id.*

91. *Hercules, Inc.*, 351 Md. at 114–15, 716 A.2d at 282–83 ("Seemingly the strategic decision to discontinue an investment in one area of activity in order to concentrate resources elsewhere is no more an operating function in the case before us than was the strategic decision in *Allied-Signal*.").

92. *Xerox Corp.*, 290 Md. at 144, 428 A.2d at 1218.

93. *See Hercules, Inc.*, 351 Md. at 111, 716 A.2d at 280 (concerning the creation and subsequent liquidation of a separate chemical company, particularly the capital gains realized from the sale of Hercules's stock in the company); *NCR Corp. v. Comptroller of the Treasury*, 313 Md. 118, 122, 544 A.2d 764, 765 (1988) (assessing the income produced by the worldwide sale of NCR's products); *Xerox Corp.*, 290 Md. at 130, 428 A.2d at 1211 (addressing the corporation's foreign subsidiaries and the royalty income produced by the licensing of the Xerox name and products).

94. *Comptroller of the Treasury v. Armco Export Sales Corp.*, 82 Md. App. 429, 430, 572 A.2d 562, 563 (1990).

95. *Comptroller of the Treasury v. SYL, Inc.*, 375 Md. 78, 84, 825 A.2d 399, 402 (2003).

96. *Armco Export Sales Corp.*, 82 Md. App. at 435, 572 A.2d at 566.

is a ‘phantom’ corporation.”⁹⁷ Instead, the Court of Appeals found that a company’s real economic substance may be challenged even when it appears to have a “touch of ‘window dressing.’”⁹⁸ The Court of Appeals also adopted the tailored test for the application of the unitary business principle and apportionment formula to entities whose economic substance is in question: “‘The three key elements necessary for constitutional nexus were affirmatively established in [*Armco*]. They are: 1) The parent is engaged in business in Maryland. 2) The parent is unitary with the [company in question]. 3) The apportionment formula is fair.’”⁹⁹

III. THE COURT’S REASONING

In *Gore Enterprise Holdings, Inc. v. Comptroller*, the Court of Appeals upheld the judgment of the Court of Special Appeals, affirming the Tax Court’s decision to allow the Comptroller to tax Gore Enterprise Holdings, Inc., and Future Value, Inc., as part of a unitary business through the use of an apportionment formula.¹⁰⁰ In addressing the State’s authority to tax GEH and FVI, the court looked to Maryland precedent, particularly *Comptroller of the Treasury v. SYL, Inc.*,¹⁰¹ to both determine the constitutionality of the Comptroller’s actions and address the petitioners’ peripheral arguments.¹⁰² The court’s analysis of the apportionment formula used by the Comptroller departed from Maryland precedent, and instead upheld the formula based on the statutes allowing for this type of taxation.¹⁰³

A. Maryland Precedent Concerning Taxation of Out of State Subsidiaries

Before introducing the reasoning behind its decision, the Court of Appeals narrowed the breadth and scope of its analysis; openly announcing its deference to the Tax Court’s holding.¹⁰⁴ First addressing the federal consti-

97. *SYL, Inc.*, 375 Md. at 105, 825 A.2d at 414.

98. *Id.* at 106, 825 A.2d at 415.

99. *Id.* at 104, 825 A.2d at 414 (quoting *Armco Export Sales Corp.*, 82 Md. App at 436, 572 A.2d at 566).

100. *Gore Enter. Holdings, Inc. v. Comptroller of the Treasury*, 437 Md. 492, 503, 87 A.3d 1263, 1269 (2014).

101. 375 Md. 28, 825 A.2d 399 (2003).

102. *See infra* Part II.A.

103. *See infra* Part II.B.

104. *Gore*, 437 Md. at 503–04, 87 A.3d at 1269; *see also* *Frey v. Comptroller of the Treasury*, 422 Md. 111, 136–37, 29 A.3d 475, 489–90 (2011). The Court of Appeals notes that the Tax Court receives the same judicial review as other agencies, however, in this context, the court looks through the decisions of the circuit court and Court of Special Appeals to evaluate the decision of the agency. *Gore*, 437 Md. at 503–04, 87 A.3d at 1269. Noting that they cannot uphold the decision “on grounds other than the findings and reasons set forth by [the Tax Court],” the Court of Appeals is careful not to overstep the “expertise of those persons who constitute the administrative agency.” *Id.*

tutional issues surrounding the Comptroller's authority to tax GEH and FVI, the court employed Maryland precedent to guide its analysis.¹⁰⁵ Responding to the petitioners' contention that GEH and FVI lacked the sufficient nexus with Maryland for the Comptroller's taxes to be constitutional, the court reasoned that the "distinct but parallel limitations" imposed by the Due Process and Commerce Clauses were satisfied by the Unitary Business test.¹⁰⁶

While the court acknowledged that the unitary business principle determines the portion of out-of-state revenue that may be taxed,¹⁰⁷ the court drew on Maryland precedent to add the caveat that the unitary business principle may not be used to clear the hurdles established by the Due Process and Commerce Clauses when a taxpayer disputes his or her nexus with the State.¹⁰⁸ Having reasoned that a constitutional analysis must precede the use of the unitary business principle, the *Gore* court arrived at its desired starting point: a comparison between the current petitioners and the petitioners involved in *Comptroller of the Treasury v. SYL, Inc.*¹⁰⁹

A discussion of the prominent precedent of *Comptroller of the Treasury v. SYL* preceded the court's factual discussion of *Gore*, where the court reminded the petitioner that "Maryland's ability to tax two distinct companies that had little obvious connection to Maryland, but were subsidiaries of parent companies that had significant business ties with the State," already had been affirmed.¹¹⁰ Discussing the facts of *SYL*, the court detailed the subsidiaries' complete dependence on their parent company, drawing similarities between the *SYL* subsidiaries' management of patents and financial

105. *Gore*, 437 Md. at 506, 87 A.3d at 1271. The Court of Appeals underscores its ability to decide on the constitutionality of the tax by noting that "[a]gency decisions premised upon case law, however, are not entitled to deference." *Id.* at 505, 87 A.3d at 1270 (citing *Frey*, 422 Md. at 138, 29 A.3d at 490). Because the Tax Court used the reasoning of *Comptroller of the Treasury v. SYL, Inc.*, 375 Md. 78, 825 A.2d 399 (2003), to guide its decision regarding the constitutionality of the tax, the Court of Appeals is able to conduct an independent review without granting deference to the Tax Court. *Id.*

106. *Id.* at 508, 87 A.3d at 1271 (quoting *MeadWestvaco Corp. v. Ill. Dep't of Revenue*, 553 U.S. 16, 24 (2008)). The Court of Appeals notes that the Due Process Clause requires that an entity has "fair warning" before it is taxed by the State whereas the Commerce Clause dictates a four-part test that must be followed: the tax must be applied to an entity "with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Id.* at 507-08, 87 A.3d 1271 (quoting *Quill Corp. v. North Dakota*, 504 U.S. 298, 308, 312 (1992)).

107. *Id.* at 508, 87 A.3d at 1272.

108. *Id.* at 509-10, 87 A.3d at 1272 (noting that "NCR made clear that the unitary business principle cannot satisfy the constitutional requirements of the Due Process and Commerce Clauses; rather, it is a principle that allows apportionment of entities already deemed taxable").

109. *Id.* at 510, 87 A.3d at 1273 (noting the factual similarities between *Gore* and *SYL*, the court uses this precedent as their vehicle of constitutional analysis).

110. *Id.* at 511, 87 A.3d at 1273 (footnote omitted) (citing *SYL, Inc.*, 375 Md. at 80, 825 A.2d at 400).

assets to the comparable functions performed by FVI and GEH.¹¹¹ Given the parallel structure and operation of the *Gore* and *SYL* subsidiaries, the court reasoned that the Tax Court was correct in applying the *SYL* standard to evaluate the constitutional requirements for state taxation of GEH and FVI.¹¹²

Reviewing the Tax Court's findings,¹¹³ the *Gore* court employed the *Comptroller of the Treasury v. SYL* standard¹¹⁴ of "real economic substance" to transition to a discussion of the unitary business principle.¹¹⁵ Although the court previously shied away from the use of the unitary business principle,¹¹⁶ it suggested that "there is no reason—based either in case law or logic—for holding that the factors that indicate a unitary business cannot also be relevant in determining whether subsidiaries have no real economic substance as separate business entities."¹¹⁷ The court agreed with the Tax Court's finding that, although GEH and FVI may have been created for legitimate business reasons and conducted arm's-length transactions with their parent company,¹¹⁸ the subsidiaries lacked real economic substance under *Comptroller of the Treasury v. SYL*, which required the court "to determine whether the subsidiaries have economic substance as separate entities."¹¹⁹ This reasoning illustrated that the court held GEH and FVI's alleged business functions to be little more than "window dressing" that did "not imbue GEH and FVI with substance as separate entities."¹²⁰

111. *Id.* at 511–13, 87 A.3d at 1273–74.

112. *Id.* at 515–16, 87 A.3d at 1276 ("Thus, the Tax Court identified the correct legal standard, inquiring whether GEH and FVI were subsidiaries with 'no real economic substance as separate business entities' under *SYL*." (quoting *SYL, Inc.*, 375 Md. at 106, 825 A.2d at 415)).

113. *Id.* at 517, 87 A.3d at 1277 ("From these findings, the Tax Court highlighted the subsidiaries' dependence on *Gore* for their income, the circular flow of money between the subsidiaries and *Gore*, the subsidiaries' reliance on *Gore* for core functions and services, and the general absence of substantive activity . . .").

114. *Id.* at 519, 87 A.3d at 1278 ("[O]ur inquiry under *SYL* requires us to determine whether the subsidiaries have economic substance as separate entities.").

115. *Id.* at 518, 87 A.3d at 1278.

116. *Id.* at 509, 87 A.3d at 1272 ("Where, as here, the taxpayer disputes its nexus with Maryland, the unitary business principle cannot be used to clear the constitutional hurdles of the Due Process and Commerce Clauses.").

117. *Id.* at 518, 87 A.3d at 1278. Previously, the Court of Appeals had distinguished between "real economic substance" and the "unitary business principle," asserting that only the former satisfied constitutional requirements presented by the Commerce and Due Process Clauses. *Id.* Here, however, the court chose to incorporate the unitary business features of "functional integration, centralized management, and economies of scale," to indicate lack of real economic substance. *Id.* at 531, 87 A.3d at 1285 (quoting *Mead Westvaco Corp. v. Ill. Dep't of Revenue*, 553 U.S. 16, 30 (2008)).

118. *Id.* at 519, 87 A.3d at 1278.

119. *Id.*

120. *Id.*, 87 A.3d at 1278–79. While the petitioners tried to distance themselves from the subsidiaries in *SYL*, the court found that their arguments fell flat. *Id.* The Court of Appeals reasoned that while GEH and FVI may have been created for legitimate business purposes, the companies' motivation is much less dispositive than the subsidiaries' lack of substantive activities. *Id.* The

The *Gore* court stretched *Comptroller of the Treasury v. SYL* precedent beyond its initial constitutional inquiry to address the petitioners' "peripheral arguments."¹²¹ Dismissing a claim that the Comptroller usurped legislative function and improperly aggregated *Gore* and its subsidiaries in order to create nexus, the court fell back on its argument under *Comptroller of the Treasury v. SYL* and held that the unitary business principle cannot be used to establish nexus where one does not exist.¹²² The court reaffirmed that nexus had been properly established under the *SYL* standards as "the entities' lack[ed] . . . economic substance as separate business entities."¹²³ Because the subsidiaries in *Comptroller of the Treasury v. SYL* were found to lack substance as separate entities, the *Gore* court rested on the aforementioned similarities between the two sets of subsidiaries to establish that GEH and FVI possessed the required nexus with the state.¹²⁴

The court found the petitioners' second argument, concerning "an improper disregard for the corporate form under Maryland law,"¹²⁵ equally unavailing, noting that acceptance of this argument would prohibit the court from looking to "the realities of the relationship between a parent and subsidiary" when determining the amount of income traceable to Maryland.¹²⁶ As such a principle would "require an outright rejection of *SYL*," the court maintained that overturning the *Comptroller of the Treasury v. SYL* precedent is something that "we shall not do."¹²⁷ Finally, the court rebuffed the petitioners' argument that the use of *Comptroller of the Treasury v. SYL* improperly transforms federal patent law from a negative right into a positive right, thereby creating ties to Maryland where such ties do not exist.¹²⁸ The court reasoned that the patents between *Gore* and GEH contain the positive language that permits *Gore* to "make, use and sell any patented inventions," owned by GEH.¹²⁹ Ultimately, the court was unconvinced that the

court places a heavy emphasis on *Gore*'s permeation of both companies, describing the relationship as "so intertwined with *Gore* as to be almost inseparable." *Id.*, 87 A.3d at 1279–80.

121. *Id.* at 522–28, 87 A.3d at 1280–84.

122. *Id.* at 522–23, 87 A.3d at 1280–81.

123. *Id.* at 523, 87 A.3d at 1281.

124. *Id.* ("In this case, nexus has been satisfied, under *SYL*, by the entities' lack of economic substance as separate business entities. Another way of viewing the *SYL* standard is the recognition that the parent's activity is what generates the subsidiary's income.").

125. *Id.* at 523, 87 A.3d at 1281 ("Petitioners invoke Maryland's long-settled precedent that '[t]he corporate entity will be disregarded only when necessary to prevent fraud or to enforce a paramount equity.'" (alteration in original) (quoting *Stein v. Smith*, 358 Md. 670, 682, 751 A.2d 505, 510 (2000))).

126. *Id.* at 524, 87 A.3d at 1281.

127. *Id.*

128. *Id.* at 525–27, 87 A.3d at 1282–83 ("Petitioners claim that trademarks are inseparable from their covered product . . . requir[ing] contact with the forum state that a patent license simply does not.").

129. *Id.* at 527, 87 A.3d at 1283.

intellectual property distinction “is a distinction with a difference when it comes to taxation.”¹³⁰

B. Statutes Authorizing the Apportionment Formula

The court’s treatment of the apportionment formula rests largely on its interpretation of the specific taxation statutes.¹³¹ While the petitioners argued that the Comptroller both ignored a binding regulation and applied a fundamentally unfair apportionment formula, the court reasoned that the language of the statute and the regulation alone merit rejection of that argument.¹³² The court noted that both the statute and the regulation operate with exceptions that allow the Comptroller to alter the formula when it “does not fairly represent the extent of a corporation’s activity in [the] State.”¹³³

As to the alleged unfairness of the apportionment formula, the court reasoned away the petitioners’ argument, noting that the use of an apportionment formula is authorized by the unitary business principle and constrained by the Due Process and Commerce Clauses.¹³⁴ As such, according to the *Gore* court, the Comptroller’s actions were permissible so long as the existence of a unitary business had been shown and a rational relationship between the taxing state and the taxpayer’s enterprise was established.¹³⁵ Given that the court already had decided on the existence of a unitary business, it shifted its review of apportionment schemes to follow the Supreme Court’s analysis in *Container Corp. of Am. v. Franchise Tax Bd.*,¹³⁶ in which the court evaluated the internal and external consistency of the ap-

130. *Id.*

131. *Id.* at 528, 87 A.3d at 1284 (focusing on the interplay between Tax-General Article, section 10-402(a) and Regulation 03.04.03.08(C)(3)(d)). Section 10-402(a) requires a corporation to allocate to the State the part of the corporation’s income that is reasonably attributable to the trade or business carried on in the State. MD. CODE ANN., TAX-GEN. § 10-402(a)(2) (LexisNexis 2010). Regulation 03.04.03.08(C)(3)(d) refers to income derived from intangibles, requiring a taxpayer earning this type of income to be subject to a three-factor payroll and property formula. MD. CODE REGS. 03.04.03.08(C)(3)(d) (2014)

132. *Id.* at 529, 87 A.3d at 1284.

133. *Id.* (alterations in original) (quoting Md. CODE REGS. 03.04.03.08(F)(1) (2014)). “As Respondent correctly points out, the three factor formula set forth by [the statute and regulation] would have yielded an apportionment factor of zero, which did not fairly represent the subsidiaries’ activity in Maryland.” *Id.*

134. *Id.* at 529–30, 87 A.3d at 1284–85.

135. *Id.* at 530–31, 87 A.3d at 1285. According to the court, “[a] unitary business features functional integration, centralized management, and economies of scale.” *Id.* at 531, 87 A.3d at 1285. Noting that the Tax Court found that GEH and FVI demonstrated each of these components, the court is left to conclude that “the Tax Court did not err in concluding that *Gore*, GEH, and FVI were engaged in a unitary business.” *Id.*, 87 A.3d at 1286.

136. 463 U.S. 159 (1983).

portionment formula.¹³⁷ While the court followed the reasoning of the Court of Special Appeals in holding the formula internally consistent,¹³⁸ the court reasoned that the apportionment formula was also externally consistent as it fairly captured “Gore’s expenses in Maryland—expenses that simultaneously constituted income for GEH and FVI.”¹³⁹

IV. ANALYSIS

In *Gore Enterprise Holdings, Inc. v. Comptroller*¹⁴⁰ the Maryland Court of Appeals held that the Comptroller had the authority to tax out-of-state holding companies under *Comptroller of the Treasury v. SYL*¹⁴¹ without violating the Due Process Clause of the Fourteenth Amendment or the Commerce Clause of Article One of the United States Constitution. Although the court arrived at the correct result, the Court of Appeals’ extenuation of the confounded real economic substance standard perpetuates the perception that Maryland is hostile to big business. The *Gore* court should have given more weight to the unitary business principle rather than relying on an incorrect application of the real economic substance test. The *Gore* court expended great effort differentiating the unitary business principle and the real economic substance test only to use the same factors in each determination. Rather than create a meaningful distinction between the two tests, the Court of Appeals further muddled the criteria for state taxation of out-of-state subsidiaries.

A. *The Court of Appeals Erred in Its Reliance on the Real Economic Substance Standard and Its Misuse of the Unitary Business Principle*

The Court of Appeals reached the correct holding in *Gore Enterprise Holdings v. Comptroller* because it would have been detrimental to deprive

137. *Gore*, 437 Md. at 532, 87 A.3d at 1286. For an apportionment formula to be constitutional, it must be internally and externally consistent. *Id.* Internal consistency dictates that the “formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business’s income being taxed.” *Id.* (quoting *Container Corp.*, 463 U.S. at 169). External consistency, the more difficult requirement, requires that the “factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated.” *Id.* (quoting *Container Corp.*, 463 U.S. at 169).

138. *Id.*

139. *Id.* at 533, 87 A.3d at 1287.

140. 437 Md. 492, 87 A.3d 1263 (2014). The Court of Appeals ruled that the Comptroller’s taxation of two of W.L. Gore and Associates’ subsidiaries was constitutional under the Due Process Clause and the Commerce Clause. The Court of Appeals found that the subsidiaries’ lack of separate business identities created a sufficient nexus with the state to allow for taxation.

141. 375 Md. 78, 825 A.2d 399 (2003). The Court of Appeals upheld the taxation of a Syms, Inc., subsidiary on the grounds that the holding company lacked substantial economic substance. The Court of Appeals pointed to the subsidiary’s dependence on its parent company as creating a sufficient nexus with the State.

the State of taxes it was properly due. However, the court's reasoning does little to clarify an already complicated assortment of Maryland precedent.¹⁴² As much as the court relied on its reasoning in *Comptroller of the Treasury v. SYL, Inc.*, the court may have felt as though it was simply extending established precedent to resolve the case.¹⁴³ In reality, the court's actions pulled Maryland further away from establishing a clear test to determine attributional nexus between the State and the out-of-state corporation.¹⁴⁴

The *Gore* court erred when it attempted to create a constitutional nexus between the *Gore* subsidiaries and the State by layering the unitary business principle and the real economic substance test. The United States Supreme Court has advocated the use of the unitary business principle as an effective means to address Due Process and Commerce Clause concerns stemming from taxation of out-of-state entities.¹⁴⁵ While the unitary business principle does not fully satisfy all constitutional concerns,¹⁴⁶ it is considered "the linchpin of apportionability in the field of state income taxation."¹⁴⁷ Although the *Gore* court acknowledged that the unitary business principle allows a state to calculate the portion of out-of-state revenue it may tax, the court confusingly dismisses the unitary business principle as insufficient to clear the constitutional hurdles where the taxpayer disputes its nexus with Maryland.¹⁴⁸ The Court of Appeals is correct in its understanding that the unitary business principle is not the sole factor in determining the constitutionality of a tax,¹⁴⁹ however its use of the real economic substance test to

142. Diamond, *supra* note 37, at 1081 (noting that, although "Maryland began to consider the limits of permissible income taxation on multi-jurisdictional corporations" in the 1980s, "the evaluation method to establish attributional nexus remained underdeveloped, as no single theory prevailed").

143. *Gore*, 437 Md. at 517, 87 A.3d at 1277 (noting that there are "indisputable parallels" between *Gore* and *SYL, Inc.*).

144. Diamond, *supra* note 37, at 1091 ("Instead of applying a single nexus theory, the Court of Appeals in *SYL* employed components from several different methods to reach its decision, which likely will cause confusion for courts and businesses in the future."). The *Gore* court's reliance on *Comptroller of the Treasury v. SYL, Inc.*, 375 Md. 78, 825 A.2d 399 (2003), thus promotes rather than quells the confusion, as the court in the present case builds on, rather than condenses, the several theories used in *SYL*.

145. See *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 438-39 (1980) (noting that an out-of-state entity may be considered part of a unitary business if it demonstrates "functional integration, centralization of management, and economies of scale").

146. See *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 164 (1983).

147. *Mobil Oil Corp.*, 445 U.S. at 439.

148. *Gore*, 437 Md. at 509, 87 A.3d 1272 ("But the [unitary business] principle does not confer nexus to allow a state to directly tax a subsidiary based on the fact that the parent company is taxable and that the parent and subsidiary are unitary.").

149. Walter Hellerstein, *MeadWestvaco and the Scope of the Unitary Business Principle*, 108 J. TAX'N 261, 261 (2008).

perform essentially the same function as the unitary business principle is misguided.¹⁵⁰

The Court of Appeals began using the real economic substance test when the transient nature of an entity did not allow for traditional apportionment of the company's property, payroll, or sales.¹⁵¹ As set forth in *Comptroller of the Treasury v. Armco Export Sales Corp.*, the real economic substance test consists of "three key elements necessary for constitutional nexus:" whether the parent is engaged in business in Maryland, whether the parent is unitary with the entity in question, and whether the apportionment formula is fair.¹⁵² The *Gore* court goes to great lengths to distinguish the real economic substance test from the unitary business principle.¹⁵³ But, the distinction is all but erased when the court holds that "there is no reason—based either in case law or logic—for holding that the factors that indicate a unitary business cannot also be relevant in determining whether subsidiaries have no real economic substance as separate business entities."¹⁵⁴

The Court of Appeals' unexplained reliance on the real economic substance test promoted by *Comptroller of the Treasury v. SYL*¹⁵⁵ and *Armco* undermines the time-tested Supreme Court precedent in favor of a standard established by the Court of Special Appeals.¹⁵⁶ The real economic substance test was crafted to address the emergence of domestic international sales corporations, or DISCs,¹⁵⁷ which allowed multistate enterprises to export their otherwise taxable profits and thus receive a tax exemption.¹⁵⁸ In its effort to gauge the existence of the requisite constitutional nexus between the DISC and the state, the Court of Special Appeals established the aforementioned three key elements.¹⁵⁹ The origin of these factors is glaringly vague, as the Court of Special Appeals claims they were affirmatively established in prior DISC cases¹⁶⁰ without specifying the precise rationale for their creation. Neither the Court of Special Appeals nor the Court of Appeals explained the advantages or constitutional benefits associated with

150. *Gore*, 437 Md. at 515–16, 87 A.3d at 1276 (finding that "the Tax Court identified the correct legal standard, inquiring whether GEH and FVI were subsidiaries with 'no real economic substance as *separate business entities*' under *SYL*" (quoting *Comptroller of the Treasury v. SYL, Inc.*, 375 Md. 78, 106, 825 A.2d 399, 415 (2003))).

151. *Comptroller of the Treasury v. Armco Export Sales Corp.*, 82 Md. App. 429, 435, 572 A.2d 562, 566 (1990).

152. *Id.* at 436, 572 A.2d at 566.

153. *Gore*, 437 Md. at 509, 87 A.3d at 1272 (noting that the unitary business principle is not a jurisdictional principle and does not have the power to clear constitutional hurdles).

154. *Id.* at 518, 87 A.3d at 1278.

155. 375 Md. at 106, 825 A.2d at 415.

156. *See Armco*, 82 Md. App at 436, 572 A.2d at 566.

157. *Id.* at 430, 572 A.2d at 563.

158. *Id.*

159. *Id.* at 436, 572 A.2d at 566.

160. *Id.*

using the real economic substance standard, as opposed to the unitary business principle, to evaluate a company's vulnerability of being taxed in Maryland.¹⁶¹

The *Gore* court's reliance on the *SYL* court's decision to use the real economic business standard is misguided.¹⁶² The court in *Comptroller of the Treasury v. SYL* makes an unexplained logical leap, spending a length of time exploring the Supreme Court's unitary business formula before discarding those considerations in favor of the *Armco* real economic substance test.¹⁶³ The *Gore* court erred in building its opinion around a similar logical leap, conflating the unitary business principle and economic substance test.¹⁶⁴ In its attempt to rationalize this heavy-handed reliance on the precedent of *Comptroller of the Treasury v. SYL* and the real economic substance standard, the *Gore* court insisted that the unitary business principle was insufficient to satisfy the constitutional concerns at play.¹⁶⁵

Instead of explaining the alleged insufficiencies of the unitary business principle, the *Gore* court moves to an errant discussion of the facts and holding in *Comptroller of the Treasury v. SYL*.¹⁶⁶ While the two cases certainly are factually similar,¹⁶⁷ the shared circumstances should not have prevented the *Gore* court from examining the merits of the case independently and without the heavy influence from the prior decision in *Comptroller of the Treasury v. SYL*. Prefacing its analysis of the case at hand on the holding and facts of *SYL*, the *Gore* court departed from the fact-specific inquiry that the Supreme Court encouraged in matters of state taxation.¹⁶⁸

161. See *Comptroller of the Treasury v. SYL, Inc.*, 375 Md. 78, 825 A.2d 399 (2003); *Armco*, 82 Md. App. 429, 572 A.2d 562.

162. See *Gore Enter. Holdings, Inc. v. Comptroller of the Treasury*, 437 Md. 492, 510, 87 A.3d 1263, 1273 (2014).

163. *SYL, Inc.*, 375 Md. at 103, 825 A.2d at 413 (transitioning from its discussion of the unitary business principle and concluding that the opinion of the Court of Special Appeals in *Armco* is "more pertinent" to the resolution of the case, without explaining how or why that decision is more important than Supreme Court precedent).

164. *Gore*, 437 Md. at 509, 87 A.3d at 1272 ("Where, as here, the taxpayer disputes its nexus with Maryland, the unitary business principle cannot be used to clear the constitutional hurdles of the Due Process and Commerce Clauses.").

165. *Id.* It is unclear how the court arrived at the conclusion that the unitary business principle cannot be used to clear the Due Process and Commerce Clause hurdles, as Supreme Court precedent makes it clear that the unitary business principle was established for that precise purpose. See *Asarco, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 316-317 (1982).

166. *Gore*, 437 Md. at 510, 87 A.3d at 1273 ("One of our more recent cases, *Comptroller of the Treasury v. SYL, Inc.*, shares many factual similarities to the present case. Thus, we will now examine *SYL* and its applicability to this case." (citation omitted)).

167. *Id.* at 511, 87 A.3d at 1273 (observing that *SYL* involved the taxation of "two distinct companies that had little obvious connection to Maryland, but were subsidiaries of parent companies that had significant business ties with the State" (footnote omitted)).

168. *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 164 (1983) ("In the case of a more-or-less integrated business enterprise operating in more than one State, however, arriving at precise territorial allocations of 'value' is often an elusive goal, both in theory and in practice.").

The *Gore* court appeared to engage in a comparison between the present case and *Comptroller of the Treasury v. SYL*, rather than an independent analysis, admitting that it relied on “indisputable parallels between GEH, FVI and the SYL subsidiaries to hold that [they] lacked substance . . . and consequently satisfied the constitutional requirements for taxation in Maryland.”¹⁶⁹

The *Gore* court’s deference to *Comptroller of the Treasury v. SYL* in using the real economic substance standard demonstrates a disregard for Supreme Court precedent and further clouds the standard for commercial taxation in Maryland. In justifying its use of the real economic substance standard, the court classified it as separate from the unitary business principle in both inquiry and purpose.¹⁷⁰ This justification is overshadowed by the court’s most glaring logical misstep, for just as the court distinguished one standard from the other, it goes on to hold that “there is no reason—based either in case law or logic—for holding that the factors that indicate a unitary business cannot also be relevant in determining . . . real economic substance.”¹⁷¹ After its attempts to distinguish the two taxation principles, the court quickly blurs any true difference between the concepts. Most notably, the court fails to clarify why a factor that is unable to merit constitutional consideration under the unitary business principle is suddenly capable of clearing those same constitutional hurdles when relabeled as part of the real economic substance test.

Thus, the standard for establishing nexus is now even foggier because the court not only failed to clearly differentiate between the unitary business standard and the real economic substance test, but also inexplicably attempted to layer the unitary business principle on top of the real economic substance test. While *Armco* and *SYL* both confirm that the real economic substance test considers whether the parent is unitary with the out-of-state subsidiary, neither the prior case law nor the *Gore* court clarify how much weight that factor is given. As such, the court’s contention that the unitary business principle factors also are relevant in deciding real economic substance is troubling.

The court’s decision, particularly the uncertainty involving the “confusing mix of economic substance and unitary business analysis . . . [,] will inevitably spawn more litigation” as out-of-state companies attempt to riddle out which transactions will be taxed by the State and which transactions are protected.¹⁷² One practitioner frustrated by the decision, Don Griswold of Crowell & Moring LLP, argued that the court “‘did [not] get nexus by

169. *Gore*, 437 Md. at 517–18, 87 A.3d at 1277.

170. *Id.* at 518, 87 A.3d at 1278.

171. *Id.*

172. Mary C. Alexander & Jeffrey A. Friedman, *Maryland’s Gore-y Nexus Standard: Out-of-State Holding Companies Subject to Tax*, 72 STATE TAX NOTES 97, 97 (2014).

any standard that has ever existed in any court.”¹⁷³ While this broad declaration may be exaggerated, one can certainly argue that the court used a piecemeal approach when deciding this case stringing together some parts of the unitary business principle with other parts of the real economic substance test.¹⁷⁴

Alexander and Friedman make a critically important observation, pointing out that “[t]he ramifications of the Court of Appeals inconsistently treating GEH and FVI as lacking substance for nexus purposes but treating them as separate companies for assessment purposes results in Maryland receiving many more years of tax assessments than it would otherwise receive.”¹⁷⁵ GEH and FVI’s parent company, W.L. Gore Enterprises, has consistently filed a Maryland tax return, while the subsidiaries had never have filed Maryland tax returns.¹⁷⁶ Because the statute of limitations on Maryland tax returns is generally three years, the State can only recover but so much from the parent company.¹⁷⁷ Therefore, even though W.L. Gore had been making royalty payments to GEH since its founding in 1983,¹⁷⁸ and likely deducting those royalty payments from its state tax returns, the Comptroller’s 2006 audit was only about to reach Gore’s 2001–2003 tax returns.¹⁷⁹ Conversely, the Comptroller was able to assess taxes, interest, and penalties against GEH for tax years 1983 to 2003 and against FVI for tax years 1996 to 2003.¹⁸⁰ The Court of Appeals’ decision thus appears to be crafted to allow the State to recover a great deal more money because the court simultaneously held that the subsidiaries lacked substance apart from

173. David Sawyer, *Did Maryland’s Addback Statute Get Gored?*, 72 STATE TAX NOTES 191, 192 (2014).

174. Alexander & Friedman, *supra* note 172, at 98 (observing that “Maryland’s high court said that ‘the Tax Court identified the correct legal standard’” of real economic substance and, “[i]mportantly, the court ruled that the lower court’s application of the unitary business principle was wrong, writing that ‘the unitary business principle cannot be used to establish nexus’”).

175. *Id.*

176. W.L. Gore & Assocs. v. Comptroller of the Treasury, No. 07-IN-OO-0084, 2010 Md. Tax LEXIS 3, at *1 (Md. T.C. Nov. 9, 2010), *aff’d sub nom.* Comptroller of the Treasury v. Gore Enter. Holdings, Inc., 209 Md. App. 524, 60 A.3d 107 (2013), *aff’d*, 437 Md. 492, 87 A.3d 1263 (2014).

177. Spotlight on Maryland Taxes, *Compliance Programs FAQs*, COMPTROLLER OF MARYLAND, http://taxes.marylandtaxes.com/Resource_Library/Taxpayer_Assistance/Frequently_Asked_Questions/Tax_Compliance_and_Enforcement_FAQs/Compliance_Programs_FAQs.shtml (last visited Mar. 26, 2015).

178. *Gore*, 437 Md. at 500, 87 A.3d at 1267.

179. *Id.* at 501, 87 A.3d at 1268.

180. *Id.* (explaining that the Comptroller assessed \$193,178 against W.L. Gore and \$26,436,315 and \$2,608,895 against GEH and FVI, respectively).

Gore¹⁸¹ yet found them independent enough to be taxed separately from their parent company.¹⁸²

Logically, the Maryland Court of Appeals' finding of a lack of real economic substance would imbue the subsidiaries with an identity that is inseparable from its parent company and thus taxation would be limited to W.L. Gore alone. The court's decision, however, seems to skirt around this logical conclusion, much to the detriment of a clear and generally applicable nexus standard.¹⁸³

B. As Corporations Continue to Move Their Business Out of the State, the Gore Court's Unwillingness to Establish a Bright-Line Test for Taxation Extenuates Maryland's Hostile Economic Atmosphere

The State of Maryland's high taxes and strict regulations have resulted in a number of Fortune 500 companies leaving the State to pursue more "friendly" conditions in Virginia.¹⁸⁴ Maryland's lack of a "bright-line rule" for taxing out-of-state subsidiaries deprives large corporations of notice as to what types of transactions will be subject to taxation.¹⁸⁵ The apprehension of doing business in Maryland is real, as large corporations and many Fortune 500 companies have been driven out of the State, costing Maryland revenue and many of its residents jobs.¹⁸⁶

Both former-Lieutenant Governor Anthony Brown and Governor Larry Hogan addressed the issue of Maryland's economic climate throughout their respective gubernatorial campaigns.¹⁸⁷ While Brown claimed that the

181. *Id.* at 517–18, 87 A.3d at 1277 ("GEH and FVI lacked substance apart from Gore, and consequently satisfied the constitutional requirements for taxation in Maryland.").

182. *Id.* at 530, 87 A.3d at 1285 ("Consequently, GEH's tax liability was calculated by multiplying royalties paid by W.L. Gore times the W.L. Gore apportionment formula. For FVI, the tax is calculated by multiplying interest paid by W. L. Gore times the W.L. Gore apportionment formula." (quoting *W.L. Gore & Assocs. v. Comptroller of the Treasury*, No. 07-IN-OO-0084, 2010 Md. Tax LEXIS 3, at *12 (Md. T.C. Nov. 9, 2010), *aff'd sub nom.* *Comptroller of the Treasury v. Gore Enter. Holdings, Inc.*, 209 Md. App. 524, 60 A.3d 107 (2013), *aff'd*, 437 Md. 492, 87 A.3d 1263 (2014))).

183. Alexander & Friedman, *supra* note 172, at 99 ("While the unitary business principle may permit Maryland to tax an apportioned share of Gore's income from its unitary business, including income attributable to GEH and FVI, it does not presumptively validate the application of Gore's apportionment factor to apportion the income of GEH and FVI.").

184. *Maryland Loses Its Fourth Fortune 500 Company in as Many Years*, URBAN MID-ATLANTIC (Aug. 21, 2012), <http://urbanmidatlantic.blogspot.com/2012/08/maryland-loses-its-fourth-fortune-500.html>.

185. David Sawyer, *Maryland High Court Upholds Ruling in Gore*, TAX ANALYSTS (March 25, 2014), <http://www.taxanalysts.com>.

186. Elizabeth G. Olsen, *McCormick, Granddaddy of American Spices, May Leave Its Baltimore Home*, FORTUNE (July 7, 2014), <http://fortune.com/2014/07/07/mccormick-baltimore>.

187. John Wagner, *Candidates' Frustrations on Display in Final Md. Gubernatorial Debate*, WASH. POST (Oct. 18, 2014), http://www.washingtonpost.com/local/md-politics/candidates-frustrations-on-display-in-final-md-gubernatorial-debate/2014/10/18/31a7154a-5613-11e4-ba4b-f6333e2c0453_story.html.

“top strategic goal in his administration would be ‘to have the most competitive business climate in the nation,’” Hogan mocked his opponent, calling the damage to Maryland’s economy “self-inflicted wounds” caused by the O’Malley-Brown administration’s onerous regulatory environment and steep taxes.¹⁸⁸ Hogan, who campaigned largely on a tax-driven platform,¹⁸⁹ achieved a surprising win over former-Lieutenant Governor Brown.¹⁹⁰ Governor Hogan credited his victory to “Marylanders [holding] our leaders accountable for eight years of failed economic policy.”¹⁹¹ Governor Hogan’s defeat of heir-apparent Anthony Brown proved that issues of taxation are public concerns, and not restricted to the courtroom or the boardroom. The court’s decision in *Gore* added to the “eight years of failed economic policy”¹⁹² that drove voters to rally behind Governor Hogan’s campaign and his ultimate victory.

V. CONCLUSION

In *Gore Enterprise Holdings, Inc. v. Comptroller of the Treasury*, the Maryland Court of Appeals concluded that the State may constitutionally tax an out-of-state subsidiary of an in-state parent company if the out-of-state entity lacks real economic substance.¹⁹³ The court’s analysis incorrectly relied on the overly fact-specific real economic substance test instead of adopting a uniform bright-line test.¹⁹⁴ Although the Court of Appeals arrived at the correct result, the *Gore* court should have given more weight to the unitary business principle rather than relying on an incorrect application of the real economic substance test.¹⁹⁵ The *Gore* court expended a great deal of effort differentiating the unitary business principle and the real economic substance test, but ultimately conflated the two analyses.¹⁹⁶ Rather than create a meaningful distinction between the two tests, the Court of Appeals further muddled the criteria for state taxation of an out-of-state subsidiary.¹⁹⁷ It is critical that Larry Hogan, the winner of the Maryland gubernatorial race, remedy Maryland’s disparaged reputation as a hostile

188. *Id.*

189. *Id.*

190. Ian Shapira, *For Supporters of Governor-Elect Larry Hogan, Tuesday Night was Time to Party*, WASH. POST (Nov. 5, 2014), http://www.washingtonpost.com/local/md-politics/for-supporters-of-governor-elect-larry-hogan-tuesday-night-was-time-to-party/2014/11/05/5407421a-64b7-11e4-bb14-4cfea1e742d5_story.html.

191. *Id.*

192. *Id.*

193. *Gore Enter. Holdings, Inc. v. Comptroller of the Treasury*, 437 Md. 492, 533, 87 A.3d 1263, 1287 (2014).

194. *See supra* Part IV.A.

195. *See supra* Part IV.A.

196. *See supra* Part IV.A.

197. *See supra* Part IV.A.

2015] *Gore Enterprise Holdings, Inc. v. Comptroller of the Treasury* 1055

business environment.¹⁹⁸ To keep revenue, jobs, and economic progress within the State, Maryland must improve its corporate relationships by abandoning the real economic substance test in favor of an assessment that provides the proper notice to multi-state corporations.¹⁹⁹

198. *See supra* Part IV.B.

199. *See supra* Parts IV.A–B.