



This Week in State Tax (TWIST)

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Minnesota: Gain from Sale of Goodwill was Apportionable Business Income

The Minnesota Supreme Court recently reviewed a dispute between the Commissioner of the Department of Revenue and a taxpayer over whether gain from the sale of goodwill was apportionable business income or nonbusiness income that was allocated. The taxpayer was an S corporation that did business in Minnesota and Wisconsin and was owned in part by a Minnesota nonresident. Following the sale of the S-corporation to another business, the taxpayer and its nonresident partial owner filed Minnesota tax returns characterizing the gain on the sale of goodwill as income that was not subject to apportionment. This approach was taken after consultation with advisors and was supported by a 2006 Minnesota Tax Court decision, *Nadler*. The tax court in *Nadler* determined that income generated by the sale of goodwill constituted “nonbusiness income” that was subject to allocation. However, unbeknownst to the taxpayer and its advisors, the Department of Revenue did not acquiesce to the *Nadler* decision and did not publicly share this position until it issued a notice in 2017. Upon audit, the Department treated the taxpayer’s gain as apportionable. The matter eventually went to the tax court where the Commissioner prevailed. This appeal followed.

The first issue before the court was whether the Department was required to adhere to the *Nadler* decision with respect to the taxpayer’s audit and assessment. The court noted that it was “troubled by the Commissioner’s conduct that this case has brought to light.” Specifically, the Department had declined to appeal the *Nadler* decision, but had internally decided—without notice to the public—not to follow it. Nevertheless, the court noted that as the state’s highest court, it was not bound by a tax court decision and therefore did not need to decide whether the Commissioner was bound by *Nadler* to decide the appeal. The court next turned to the substantive issue, which was one of statutory construction. The taxpayer argued that the gain on the sale of its goodwill was allocated under Minn. Stat. § 290.17, subd. 2(c). The Commissioner, however, asserted that the taxpayer’s income was subject to apportionment because it was business income derived from a unitary asset, which was apportioned under another subdivision of Minn. Stat. § 290.17. After reviewing the statutes, the court determined the language of the statute was ambiguous and therefore it was appropriate to look to legislative history to determine the legislature’s intent. After doing so, the court concluded that the Commissioner’s interpretation of the statute was more reasonable. The legislative history reflected the intent to overrule a decision setting forth a functional test and put in place a purely constitutional distinction between business and nonbusiness income. The income at issue, which was derived from a unitary asset, did not constitute nonbusiness income and was therefore subject to apportionment. Two justices dissented on the basis that the Commissioner should be bound by a decision that it did not appeal unless it provided public notice of its disagreement with such decision. Please contact Caroline Balfour with questions on *Cities Management, Inc. v. Commissioner of Revenue*.

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