SUPREME COURT OF VERMONT

# TD Banknorth, N.A. v. Department of Taxes

185 Vt. 45 (2008) · No. 2007-127 · Decided September 19, 2008

## SUMMARY

The Vermont Supreme Court affirmed the assessment of bank franchise taxes, interest, and a 25% penalty against TD Banknorth for the 2000 and 2001 tax years. The Court held that reconciliation reports constituted proper returns for purposes of the applicable statute of limitations and that the assessment was timely. The Court also adopted Vermont's economic substance doctrine and upheld the disregard of holding companies that lacked a non-tax business purpose and independent economic substance.

## CASE DETAILS

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| COURT | Supreme Court of Vermont |
| WRITING FOR THE COURT | Burgess, J.; Dooley, J.; Johnson, J.; Skoglund, J. |
| JURISDICTION | Vermont |
| DECIDED | September 19, 2008 |
| DOCKET | 2007-127 |
| DISPOSITION | affirmed |
| PROCEDURAL POSTURE | Taxpayer appealed the Washington Superior Court's affirmance of the Commissioner of Taxes' assessment of bank franchise taxes, interest, and a twenty-five percent penalty for the 2000 and 2001 tax years. |
| STANDARD OF REVIEW | The court reviewed the Commissioner's determination deferentially, asking whether the agency findings had any reasonable basis on the record and presuming the determination correct, valid, and reasonable absent a clear and convincing showing to the contrary. |
| PRECEDENTIAL VALUE | published precedential opinion |
| PARTIES | TD Banknorth, N.A. v. Department of Taxes |

## TOPICS

state and local tax · tax statute of limitations · tax penalties · tax audits · statutory interpretation

## PRACTICE AREAS

state taxation administrative law corporate law appellate procedure

### QUESTIONS PRESENTED

1. Whether the Department's assessment of additional bank franchise taxes was barred by Vermont's three-year statute of limitations.
2. Whether the Commissioner properly disregarded the holding companies as separate taxable entities under Vermont's economic substance doctrine.
3. Whether the Commissioner had authority to impose a twenty-five percent penalty different from the penalty included in the Department's assessment.
4. Whether imposing the penalty violated taxpayer's due process rights.
5. Whether Vermont's penalty statute permits a penalty when the underpayment results from an erroneous tax refund rather than an initial failure to pay.

### HOLDINGS

1. The assessment was timely because the bank franchise tax reconciliation reports were proper returns that began the three-year limitations period.
2. Vermont adopts the economic substance doctrine, and the holding companies were properly disregarded because they had no non-tax business purpose and lacked independent economic substance.
3. The Commissioner had statutory authority to alter or impose a penalty during the appeal of the Department's assessment.
4. The twenty-five percent penalty did not violate taxpayer's due process rights because taxpayer had notice of the penalty issue and an opportunity to respond and present evidence.
5. The penalty statute permits a penalty when an erroneous refund results in the taxpayer's failure to pay its full tax liability.

### KEY QUOTATIONS

> *"where . . . there is a genuine multiple-party transaction with economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached, the Government should honor the allocation of rights and duties effectuated by the parties."* (¶ 22)

> *"We here adopt the economic substance doctrine in Vermont."* (¶ 26)

> *"Because the holding companies conducted virtually no independent activities, bore little or no economic risk, and never engaged in any meaningful business with third parties, they fail to qualify as independent taxable entities under the business purpose doctrine."* (¶ 32)

### FACTUAL BACKGROUND

TD Banknorth's three Vermont banks created wholly owned holding companies and transferred investment assets and economic interests in loans to them while retaining management and servicing responsibilities. The structure shifted income away from the banks, producing federal taxable losses that nearly eliminated the banks' Vermont bank franchise tax, while the holding companies paid only the statutory minimum tax. The holding companies had no independent offices, employees, tangible assets, meaningful third-party business, or substantial economic risk, and the Department concluded that they lacked economic substance and a legitimate business purpose apart from tax avoidance.

### PROCEDURAL HISTORY

TD Banknorth's Vermont banks filed bank franchise tax returns and later reconciliation reports seeking refunds based on claimed federal taxable losses. After an audit, the Department of Taxes disregarded the banks' holding companies for tax purposes and assessed additional bank franchise taxes, interest, and penalties. The Commissioner upheld the assessment but reduced the penalty from the Department's proposed one hundred percent fraud penalty to twenty-five percent. The Washington Superior Court affirmed, and the Vermont Supreme Court affirmed the superior court.

### DISPOSITION

affirmed

### CASES CITED

- State v. Trucott, 145 Vt. 274, 487 A.2d 149 (1984)
- Gregory v. Helvering, 293 U.S. 465 (1935)
- Moline Properties v. Commissioner, 319 U.S. 436 (1943)
- Frank Lyon Co. v. United States, 435 U.S. 561 (1978)
- Horn v. Commissioner, 968 F.2d 1229 (D.C. Cir. 1992)
- Rice's Toyota World, Inc. v. Commissioner, 752 F.2d 89 (4th Cir. 1985)
- Coltec Industries, Inc. v. United States, 454 F.3d 1340 (Fed. Cir. 2006), cert. denied, 127 S. Ct. 1261 (2007)
- Sochin v. Commissioner, 843 F.2d 351 (9th Cir. 1988)
- Keane v. Commissioner, 865 F.2d 1088 (9th Cir. 1989)
- James v. Commissioner, 899 F.2d 905 (10th Cir. 1990)
- ACM Partnership v. Commissioner, 157 F.3d 231? (3d Cir. 1998)
- IES Industries, Inc. v. United States, 253 F.3d 350 (8th Cir. 2001)
- Baisch v. Department of Revenue, 850 P.2d 1109 (Or. 1993)
- Sherwin-Williams Co. v. Commissioner, 778 N.E.2d 504 (Mass. 2002)
- Syms Corp. v. Commissioner, 765 N.E.2d 758 (Mass. 2002)
- Northern Indiana Public Service Co. v. Commissioner, 115 F.3d 506 (7th Cir. 1997)
- Winn-Dixie Stores, Inc. v. Commissioner, 254 F.3d 1313 (11th Cir. 2001)
- State Department of Taxes v. Tri-State Industrial Laundries, Inc., 138 Vt. 292, 415 A.2d 216 (1980)
- Town of Killington v. Department of Taxes, 2003 VT 88, 176 Vt. 70, 838 A.2d 91
- In re South Burlington-Shelburne Highway Project, 174 Vt. 604, 817 A.2d 49 (2002)

- State v. Longley, 2007 VT 101, 939 A.2d 1028
- Guiel v. Guiel, 165 Vt. 584, 682 A.2d 957 (1996) (mem.)

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