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Gain From Sale Held Not Apportionable Income

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Recently, in *Tate & Lyle Ingredients Americas, Inc.,*[1] Alabama's Chief Administrative Law Judge Thompson held that a taxpayer's gain from its sale of its one-third interest in a foreign corporation to its parent, which owned the other two-thirds of the foreign corporation, was not apportionable "business income" under the Alabama statute, and that Alabama is constitutionally barred from taxing the income "earned in the course of activities unrelated to the Taxpayer's business in Alabama."

The Department, citing *Container,*[2] relied on "an administrative presumption that corporations engaged in the same line of business are unitary" and the fact that the taxpayer and the foreign company, Amylum Group ("Amylum"), were owned by the same parent holding company. Judge Thompson, however, rejected the Department's presumptions and view of *Container* and, based upon a complete analysis of the facts, determined that not only were the taxpayer and Amylum not unitary, but also the Amylum stock did not serve an operational function under *Allied-Signal.*[3]

The facts relied on by Judge Thompson were as follows. In 1960, the taxpayer, Tate & Lyle Ingredients Americas, Inc., formerly known as A.E. Staley Manufacturing Co., an Illinois-based manufacturer of cereal sweeteners and starch products used by food manufacturing and industrial companies, acquired a one-third interest in Amylum, a family-run Belgium manufacturer of cereal sweeteners. The taxpayer produced its products from corn and served the North American market, while Amylum produced its products from wheat and served the European market.

In 1988, the taxpayer was acquired by Tate & Lyle PLC ("Tate & Lyle"), a U.K. holding company that owned numerous industrial ingredients manufacturing businesses, including a one-third interest in Amylum. In 2000, Tate & Lyle acquired the remaining one-third interest in Amylum that had been in private hands, and in 2005, Tate & Lyle purchased the taxpayer's one-third interest in Amylum at a price determined by an independent appraiser. On its 2005 Alabama return, the taxpayer excluded the gain from its apportionable business income on the basis that it was nonapportionable, nonbusiness, investment income.

The facts supporting the determination that Amylum was not part of the taxpayer's unitary business operations were substantial. For the five years prior to the sale, no officer or director of the taxpayer served as an officer or director of Amylum, and no Amylum officer or director served as an officer or director of the taxpayer. Judge Thompson found that actual control of Amylum by the taxpayer did not exist because "[t]he Taxpayer and Amylum had their own independent management teams, and were in no way involved in the management of the other"; therefore, "the fact that they are in the same general line of business is . . . irrelevant."

Further, Amylum did not conduct business in Alabama or the United States, and the taxpayer conducted no business in Europe. Each company independently manufactured, marketed and sold its products on different continents. There were no shared facilities and each company provided its own administrative and corporate services. Each company purchased its own raw materials, and the only intercompany sales were the arm's-length purchases by each company of finished product for resale, representing 1% of sales. In the absence of functional integration, centralized management, and economies of scale, the Judge concluded, "[t]he companies were independent business enterprises, and there was no flow of value between the companies as required for the

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entities to be unitary."

Judge Thompson found the Supreme Court's decision in *Allied-Signal* to be factually similar to this case. In both cases, there was a small amount of intercompany sales of products at arm's length, and whereas Bendix had two directors on ASARCO's board, there were no common directors in this case. Reaching the same conclusion as the Supreme Court in *Allied-Signal*, Judge Thompson held that "it is clear that the Taxpayer and Amylum were separate and unrelated businesses that were not unitary."

Judge Thompson also rejected as "speculative and unsupported by the evidence" the Department's assertion that, even if Amylum was not unitary with the taxpayer, Amylum's stock served an "operational purpose," by allowing access into an otherwise closed European market.

Judge Thompson discussed the two examples given in *Allied-Signal* where income from the sale of an intangible asset is apportionable because it serves an "operational function." In *Allied-Signal*, the Court provided two examples of "operational assets," short-term deposits of working capital and hedging transactions, such as those identified in *Corn Products Refining Co. v. Commissioner*.[4] In *Corn Products*, the Court found that corn futures purchased were "vitally important to the company's business,"[5] strongly suggesting that an inextricable relationship between the investment and the fundamental operations of the taxpayer must be present before an "operational relationship" can be found to exist. Judge Thompson correctly discerned that the taxpayer's gain on its investment in the Amylum stock held for 45 years clearly was not a short-term investment, and that the Amylum stock was neither purchased nor used for purposes related to the taxpayer's business in Alabama. Based on his determinations that no unitary relationship existed between the taxpayer and Amylum and that the Amylum stock did not serve an operational purpose, Judge Thompson concluded that "[t]he Department is thus constitutionally barred from taxing the gain."

Judge Thompson also determined that the gain was not "business income" under any of the three alternative tests in the Alabama statute[6] – the "transactional test," the "functional test," or the "operationally related test." The gain did not satisfy the "transactional test" because the sale of Amylum stock — held for 45 years — was an infrequent transaction, not in the taxpayer's regular course of business. The gain also did not constitute business income under the "functional" test because the stock was not acquired, managed or disposed of as an integral part of the taxpayer's regular business.

The Alabama legislature added the "operational-function" test to codify the U.S. Supreme Court–created alternative basis for finding apportionable income in the absence of a unitary relationship. As discussed earlier, the U.S. Supreme Court's *Allied-Signal* "operational-function test" was not satisfied with respect to taxpayer's investment in the Amylum stock. Therefore, the income was nonbusiness income and not apportionable to Alabama under Alabama's statutory test.

Prior to issuing his Opinion, Judge Thompson issued a preliminary order denying the Department's Motion to hold this case in abeyance pending a decision by the U.S. Supreme Court in *Mead*.[7] Judge Thompson rejected the Department's argument that the Supreme Court's decision in *Mead* could "affect the holding and/or constitutional and/or factual analysis of any decision regarding this appeal," stating that "the constitutional issue in dispute has been decided by the U.S. Supreme Court in numerous cases," and that *Mead* "is also not controlling on the separate issue of whether [the taxpayer's] income . . . is apportionable 'business income' under Alabama's definition of the terms."

Footnotes:

[1] *Tate & Lyle Ingredients Americas, Inc. v. Alabama Dep't of Revenue*, No. CORP. 07-162 (Ala. Admin. Law Div. Jan. 15, 2008). Paul Frankel and Michael Pearl, with Bruce Ely and James Long, represented the taxpayer in this case.

[2] *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159 (1983).

[3] *Allied-Signal, Inc. v. Director, Div. of Taxation,* 504 U.S. 768 (1992).

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[4] 350 U.S. 46 (1955).

[5] *Id*. at 50.

[6] Ala. Code § 40-27-1.1.

[7] *Mead Corp. v. Department of Revenue*, 861 N.E.2d 1131 (Ill. App. Ct. 1st Dist.), *appeal denied*, 862 N.E.2d 235 (Ill.), *vacated and remanded sub nom. by MeadWestvaco Corp. v. Illinois Dep't of Revenue,* No. 06-1413, 2008 U.S. LEXIS 3473 (Apr. 15, 2008). Morrison & Foerster LLP represents Mead, now known as MeadWestvaco, in that case.

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