TATE & LYLE INGREDIENTS AMERICAS, INC. 2200 E. ELDORADO STREET DECATUR, IL 32521-1578,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
	§	
Taxpayer,	§	DOCKET NO. CORP. 07-162
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Tate & Lyle Ingredients Americas, Inc. ("Taxpayer") for corporate income tax for the fiscal year ending March 2005. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on July 12, 2007. Paul Frankel, Bruce Ely, and Jimmy Long represented the Taxpayer. Assistant Counsel J.R. Gaines and David Avery represented the Department.

ISSUE

The Taxpayer realized a gain of approximately $345 million in 2005 from the sale of its one-third stock interest in the Amylum Group, a European company based in Belgium. The ultimate issue is whether that income can be apportioned to and taxed by Alabama. Two sub-issues are involved:

(1) Is Alabama prohibited from taxing the income by the Commerce Clause and/or the Due Process Clause of the U.S. Const. art. I, § 8, cl. 3 and U.S. Const. amend. XIV, § 1, respectively.

(2) If Alabama is not constitutionally barred from taxing the income, is the income apportionable "business income," as that term is defined for Alabama purposes at Code of Ala. 1975, §40-27-1.1.

FACTS

The Taxpayer is a Delaware corporation headquartered in Illinois. It manufactures, markets, and sells cereal sweeteners and other products to food manufacturers and industrial companies. It primarily sells to customers in North America, and its manufacturing and other facilities are located in North America. The Taxpayer uses corn to manufacture its products.

In 1960, the Taxpayer, then known as A.E. Staley Manufacturing Company, purchased a one-third stock interest in Amylum, a European manufacturer of cereal sweeteners. Amylum sells to customers in Europe, and its manufacturing and other facilities are located in Europe. It uses wheat to manufacture its products. Amylum was previously 100 percent owned by the Callebaut family.

In 1976, Tate & Lyle, PLC, a holding company based in London, England, purchased a one-third stock interest in Amylum. That purchase resulted in the Taxpayer, Tate & Lyle, and the Callebaut family each independently owning a one-third interest in Amylum. The Callebaut family continued to manage the business as before.

In 1988, Tate & Lyle purchased a controlling interest in the Taxpayer. Tate & Lyle's policy is to allow its subsidiaries to operate independently through their own management teams. Accordingly, the Taxpayer's existing management continued operating the business as before.

In 2000, Tate & Lyle purchased the Callebaut family's remaining one-third interest in Amylum.

In 2005, the Taxpayer sold its one-third interest in Amylum to Tate & Lyle at fair

market value, which resulted in the $345 million gain in issue. The sale was negotiated and closed outside of Alabama.

The Taxpayer included the gain in the denominator of its apportionment sales factor on its Alabama income tax return for the fiscal year ending March 2005. It also, however, excluded the gain from its apportionable Alabama income tax base.

The Department audited the return and determined that the gain should be apportioned to Alabama because (1) the Taxpayer had included the gain in its sales factor denominator, and (2) the Taxpayer and Amylum are owned by the same holding company and are in the same general line of business, i.e., they both sell cereal sweeteners. It consequently treated the gain as apportionable business income, and assessed the Taxpayer accordingly.

The Taxpayer sold its products to various customers in Alabama during the year in issue. It had a sales person and a technical service person that worked in Alabama during the year. It also maintained a small inventory of products in Alabama during the year, but had no remaining inventory at the end of the year.

As indicated, the Taxpayer uses corn to manufacture its products and sells to customers in North America, whereas Amylum uses wheat and sells to customers in Europe. Amylum has never made sales or otherwise done business in Alabama. The companies have no common directors. They separately purchase their own raw materials, and have no shared facilities, employees, or officers. They also have separate accounting, payroll, legal, and tax departments, and different customer and technical service employees. They have separate management teams, and independently manufacture,

price, market, and sell their respective products. They sell to some of the same customers, but the sales are in different geographical locations, for separately negotiated prices, and with different terms and conditions.

The Taxpayer purchased some finished products from Amylum at fair market value during the subject year, which it resold to customers in North America. Those sales represented less than one percent of the Taxpayer's total sales. Likewise, Amylum purchased a small amount of finished goods from the Taxpayer at fair market value, which it resold to customers in Europe. There was otherwise no sales or sharing of raw materials between the two companies.

The Taxpayer's executive vice-president/general counsel testified that there were sometimes meetings and general discussions among the upper level managers of the Tate & Lyle Group and its various subsidiaries. He explained that "at times, we'll have meetings among the different parts of the group, where we know what the other parts are doing. They're still run independently. . . ." R. 45, 46. He described the communications as "a sharing of information, what goes on. You know. Some people talk about what – what goes on. But it's not a sharing of responsibility or a sharing of decision-making." R. 47.

The Tate & Lyle Group also maintained global purchasing agreements with vendors for equipment, supplies, etc. Those global agreements allowed the group members to purchase the items at a reduced cost. However, the separate purchasing departments in the various subsidiaries independently ordered and paid for the items as needed. The global agreements also did not cover the primary raw materials used by the Taxpayer and Amylum, i.e., corn and wheat, respectively.

ANALYSIS

Issue (1). Is Alabama constitutionally barred from taxing the gain?

The United States Supreme Court has held that a taxpayer must have some substantial connection or nexus with a State before the State can constitutionally subject the taxpayer to the State's taxing jurisdiction. See generally, *Quill Corp. v. North Dakota*, 112 S. Ct. 1904 (1992). The Taxpayer in this case does not dispute that it has nexus with and is subject to Alabama's taxing jurisdiction.

The Supreme Court has also held that even if a taxpayer has nexus with a State, as in this case, the State may only tax that part of the taxpayer's income earned outside of the State that is related to the taxpayer's business activities in the State. "[I]n the case of tax on an activity, there must be a connection to the activity itself, rather than a connection only to the actor the state seeks to tax." *Allied-Signal, Inc. as successor-in-interest to The Bendix Corporation v. Director, Div. of Taxation*, 112 S. Ct. 2251 (1992), quoting *Quill*, 112 S. Ct. at 1909.

The threshold issue in this case is whether the Taxpayer's gain from the sale of the Amylum stock was sufficiently connected to the Taxpayer's business activities in Alabama. If so, the State may constitutionally tax a fairly apportioned part of the gain. The above issue turns on whether (1) the Taxpayer and Amylum were part of a unitary business being conducted in Alabama, or (2) the Amylum stock, while owned by the Taxpayer, was operationally related to the Taxpayer's business being conducted in Alabama.

Since the late 1800's, the U.S. Supreme Court has held that a State may tax income earned outside of its borders, but only if the income is earned as part of a unitary business

being conducted by the income recipient in the State. See generally, *Allied-Signal*, 112 S. Ct. at 2258, and cases cited therein. That is the unitary-business principle.

The Administrative Law Division summarized the unitary-business principle in *Danov Corporation v. State of Alabama*, CORP. 97-283 (Admin. Law Div. 12/22/2000).

> The "linchpin of apportionability in the field of state income taxation is the unitary-business principle." *Mobil Oil Corp. v. Comm. of Taxes of Vermont*, 100 S. Ct. 1223, 1232 (1980). The unitary-business principle requires that for a state to tax the out-of-state income of a nondomiciliary corporation, the interstate activity from which the income was derived must have some minimal connection with the corporation's activities in the taxing state. "However, a state may not tax a nondomiciliary corporation's income if it is derived from unrelated business activity that constitutes a discrete business enterprise." *Allied-Signal, Inc. v. Director, Division of Taxation*, 112 S. Ct. 2251, 2253 (1992), citing *Exxon Corp. v. Dept. of Revenue of Wis.*, 100 S. Ct. 2109, 2120 (1980). There must be "a 'minimal connection' between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the interstate values of the enterprise." *Mobil Oil Corp. v. Comm. of Taxes of Vermont*, 100 S. Ct. at 1231, citing *Moorman Mfg. Co. v. Bair*, 98 S. Ct. 2340, 2344 (1978). "If, however, the income is not connected with the corporation's trade or business in (the taxing state), it is not apportionable and is instead allocated to the corporation's domicile." *Hercules Inc. v. C.I.R.*, 575 N.W.2d 111, 115 (Minn. 1998).

Danov at 4 – 5.

The Supreme Court reaffirmed the validity of the unitary-business principle in six cases decided from 1980 through 1992. *Allied Signal*, *supra*; *Container Corp. of America v. Franchise Tax Board*, 103 S. Ct. 2933 (1983); *F. W. Woolworth v. Taxation and Rev. Dept. of State of N.M.*, 102 S. Ct. 3128 (1982); *ASARCO, Inc. v. Idaho State Tax Comm.*, 102 S. Ct. 3103 (1982); *Exxon Corp. v. Department of Rev. of Wisconsin*, 100 S. Ct. 2109 (1980); *Mobil Oil Corp. v. Comm. of Taxes of Vermont*, 100 S. Ct. 1223 (1980).

The above cited cases illustrate the interrelationship required to establish a unitary business. Those cases are discussed below.

In *Mobil*, the issue was whether Vermont could constitutionally tax dividends received by Mobil from its subsidiaries located outside of the United States. Mobil sold its finished petroleum products in Vermont, but had no oil and gas production facilities or refineries in the State. It was largely undisputed that the foreign subsidiaries were part of Mobil's integrated petroleum business.

In deciding the case, the Court stated that "what (Mobil) must show, in order to establish that its dividend income is not subject to an apportioned tax in Vermont, is that the income was earned in the course of activities unrelated to the sale of petroleum products in that State." *Mobil*, 100 S. Ct. at 1232. The Court also identified functional integration, centralization of management, and economies of scale as "factors of profitability" that must be considered in determining if a unitary relationship is present. *Mobil*, 100 S. Ct. at 1232. Applying the above factors, the Court had no problem finding that Mobil's foreign subsidiaries that refined the finished products that Mobil sold in Vermont were a part of Mobil's unitary business being conducted in Vermont, and consequently, that the dividends from those subsidiaries could be apportioned to and taxed by Vermont.

The Court decided *Exxon* just months after *Mobil*. The issue in *Exxon* was whether Exxon's marketing division, which conducted business in Wisconsin, was unitary with its exploration and production and refining divisions, which did not operate in Wisconsin. Exxon did not actively contest that its divisions all contributed to its overall business operations. Rather, it argued that its internal accounting system could separately identify

its Wisconsin-sourced income, and that taxing that part of its income earned outside of Wisconsin violated the Due Process Clause.

The Court stated that the burden was on Exxon to "prove that 'the income was earned in the course of activities unrelated to the sale of petroleum products in (Wisconsin).'" To carry its burden, Exxon was required to prove that the income was from an "'unrelated business activity' which constitutes a 'discrete business enterprise.'" *Exxon*, 100 S. Ct. at 2120, quoting *Mobil*, 100 S. Ct. at 1232. The Court found that Exxon failed to carry that burden. It held that Exxon's use of separate accounting to identify its Wisconsin-sourced income was inappropriate, and that Exxon's various divisions constituted "a highly integrated business which benefits from an umbrella of centralized management and controlled interaction." *Exxon*, 100 S. Ct. at 2120. It thus affirmed the Wisconsin Supreme Court's finding that Exxon's divisions constituted a unitary business, and that apportionment was appropriate.

The Court next decided *ASARCO* and *Woolworth* on the same day in 1982.

In *ASARCO*, Idaho sought to tax dividend and interest income received by ASARCO from various of its foreign subsidiaries, and also the gain from the sale of the stock of a foreign subsidiary. ASARCO mined and refined various non-ferrous metals. It operated a silver mine in Idaho. The foreign subsidiaries in issue were also involved in the mining business.

The Court observed that "as a general principle, a state may not tax value earned outside its borders." *ASARCO*, 102 S. Ct. at 3108. The Court noted that in *Mobil*, it had affirmed Vermont's tax on Mobil's dividends received from its foreign subsidiaries. It added,

however, that in doing so, it did "not mean to suggest that *all* dividend income received by corporations operating in interstate commerce is necessarily taxable in each State where that corporation does business. Where the business activities of the dividend payor have *nothing to do* with the activities of the recipient in the taxing State, *due process considerations might well preclude apportionability, because there would be no underlying unitary business*." *ASARCO*, 102 S. Ct. at 3310, quoting *Mobil*, 100 S. Ct. at 1234 (emphasis in original).

The Court then analyzed the connections between ASARCO and its various subsidiaries. It found that the closest question involved Southern Peru, a South American company that smelted copper. ASARCO owned 51.5 percent of the company, and annually purchased 35 percent of the company's output at fair market value. ASARCO provided Southern Peru with some services outside of Peru, for which it received fair market value. Although ASARCO's majority ownership enabled it to control Southern Peru, it entered into a management agreement whereby it could not name a majority of the company's directors. The Court also noted that a lower court had found that ASARCO did not control the company, and that the company operated independently of ASARCO. Finally, Southern Peru made its own major decisions, without approval from ASARCO. Based on those facts, the Court found that "ASARCO's Idaho silver mining and Southern Peru's autonomous business are insufficiently connected to permit the two companies to be classified as a unitary business." *ASARCO*, 102 S. Ct. at 3112.[1]

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[1] Concerning the other four subsidiaries in issue, ASARCO owned 52.7 percent of one, 49 percent of another, and 34 percent of the other two. Although ASARCO held a majority interest in one of the companies, it had never controlled or managed the company.

(continued)

The Court contrasted its holding in *ASARCO* with its holdings in *Mobil* and *Exxon* by explaining that "the State prevailed (in *Mobil* and *Exxon*) because it was clear that the corporations operated unitary businesses with a continuous flow and interchange of common products. ASARCO has proved that these essential factors are wholly absent in this case." *ASARCO*, 102 S. Ct. at 3115. And pertinent to this case, the Court also found that its holding applied equally to the capital gain from ASARCO's sale of stock as it did to the dividend income received by the company. "One must look principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability." *ASARCO*, 102 S. Ct. at 3116, quoting *Mobil*, 100 S. Ct. at 1233.

In *Woolworth*, the issue was whether New Mexico could tax dividends received by Woolworth from its foreign subsidiaries. Woolworth owned and operated retail chain stores in the United States. Its foreign subsidiaries operated the same type chain stores in the various countries in which they did business. Woolworth owned 100 percent of three of the subsidiaries in issue, and a majority interest in the other.

Citing *Mobil*, the Court reiterated that determining whether a subsidiary was unitary turned on whether there was "functional integration, centralization of management, and economies of scale" between the companies. *Woolworth*, 102 S. Ct. at 3135, quoting *Mobil*, 100 S. Ct. at 1232.

The Court found that there was little functional integration because "no phase of any subsidiary's business was integrated with the parent's." *Woolworth*, 103 S. Ct. at 3135.

ASARCO had various dealings with the subsidiaries, but the Court found that the relationships fell "far short of bringing any of them within (ASARCO's) unitary business." *ASARCO*, 102 S. Ct. at 3112.

Each subsidiary controlled its own merchandise, store site selection, and advertising. Each had its own accounting and financial staffs and outside counsel, and there was no centralized purchasing, manufacturing, or warehousing of merchandise. The subsidiaries also obtained their own financing from outside sources.

The Court also determined that there was little if any centralized management or economies of scale. The subsidiaries had separate management teams and training programs, and there was no common personnel. Importantly, each subsidiary determined the size and location of their retail stores and the items sold. Woolworth elected all or a majority of the subsidiaries' directors, but the Court gave that fact little weight, holding "that the potential to operate a company as part of a unitary business is not dispositive," if the facts otherwise fail to show a unitary relationship. *ASARCO*, 102 S. Ct. at 3134.

The Court noted that there were some links between Woolworth and the subsidiaries. Woolworth had one or more common directors with some of the subsidiaries, and there were frequent communications between the upper level managers of the subsidiaries and Woolworth. Woolworth approved all major financial decisions of the subsidiaries, and its financial statements included the subsidiaries. The Court nonetheless concluded that the subsidiaries were not unitary with Woolworth because "[e]ach of the subsidiaries at issue operated a 'discrete business enterprise,' (cite omitted), with a notable absence of any 'umbrella of centralized management and controlled interaction.'" *Woolworth*, 102 S. Ct. at 3139.

In *Container*, decided in 1983, the issue was whether Container was unitary with various of its overseas subsidiaries.

Container owned between 66.7 and 100 percent of the stock of 20 foreign subsidiaries. All of the subsidiaries, except one holding company, were in the same business as Container, i.e., they manufactured custom-ordered paperboard packaging. Container sold some materials to the subsidiaries, but, as in this case, those sales represented less than one percent of the subsidiaries' total purchases. The subsidiaries were self-managed, and largely hired their own personnel. Container had officers that oversaw the subsidiaries and established general standards of professionalism, profitability, and ethical practices. Container employees also handled major problems and long-term decisions concerning the subsidiaries. A number of individuals on Container's board were also on the boards of the subsidiaries, although they were not involved in management decisions. Approximately 50 percent of the subsidiaries' long-term debt was held or guaranteed by Container. Container employees advised and consulted with the subsidiaries concerning manufacturing techniques, engineering, design, and various other business decisions. Container also occasionally sold equipment to the subsidiaries or purchased equipment as agent for the subsidiaries.

The California Court of Appeals had found that Container and its subsidiaries were unitary. The Supreme Court stated that its task was to determine if that finding "was within the realm of permissible judgment." *Container*, 103 S. Ct. at 2946. The Court found that it was, and affirmed.

> The State Court of Appeal relied on a large number of factors in reaching its judgment that appellant and its foreign subsidiaries constituted a unitary business. These included appellant's assistance to its subsidiaries in obtaining used and new equipment and in filling personnel needs that could not be met locally, the substantial role played by appellant in loaning funds to the subsidiaries and guaranteeing loans provided by others, the

> "considerable interplay between appellant and its foreign subsidiaries in the area of corporate expansion," 117 Cal. App. 3d, at 997, 173 Cal. Rptr., at 127, the "substantial" technical assistance provided by appellant to the subsidiaries, *id.*, at 998 – 999, 173 Cal. Rptr., at 128, and the supervisory role played by appellant's officers in providing general guidance to the subsidiaries. In each of these respects, this case differs from *ASARCO* and *F. W. Woolworth*, and clearly comes closer than those cases did to presenting a "functionally integrated enterprise," *Mobil, supra*, at 440, which the State is entitled to tax as a single entity. We need not decide whether any one of these factors would be sufficient as a constitutional matter to prove the existence of a unitary business. Taken in combination, at least, they clearly demonstrate that the state court reached a conclusion "within the realm of permissible judgment."
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> The second noteworthy factor is the managerial role played by appellant in its subsidiaries' affairs. We made clear in *F. W. Woolworth Co.* that a unitary business finding could not be based merely on "the type of occasional oversight - - with respect to capital structure, major debt, and dividends - - that any parent gives to an investment in a subsidiary . . . ." 485 U.S., at 369. As *Exxon* illustrates, however, mere decentralization of day-to-day management responsibility and accountability cannot defeat a unitary business finding. 447 U.S., at 224. The difference lies in whether the management role that the parent does play is grounded in its own operational expertise and its overall operational strategy. In this case, the business "guidelines" established by appellant for its subsidiaries, the "consensus" process by which appellant's management was involved in the subsidiaries' business decisions, and the sometimes uncompensated technical assistance provided by appellant, all point to precisely the sort of operational role we found lacking in *F. W. Woolworth*.

Container, 103 S. Ct. at 2947, 2948.

The latest Supreme Court case on the issue is *Allied-Signal*. At issue in *Allied-Signal* was whether New Jersey could constitutionally tax a gain realized by the Bendix Corporation from the sale of its 20.6 percent interest in ASARCO. The parties stipulated that Bendix and ASARCO were unrelated business enterprises. New Jersey nonetheless argued that "all income of a corporation doing business in a State is, by virtue of common ownership, part of the corporation's unitary business and apportionable." *Allied-Signal*, 112

S. Ct. at 2261. Some amici curiae also argued that a State should be allowed to tax any income that qualifies as "business income," as the term is defined by the Uniform Division of Income for Tax Purposes Act ("UDITPA").

The Court rejected the above arguments and reaffirmed the validity of the unitary-business principle. Because the parties had stipulated that Bendix and ASARCO were unrelated business enterprises, there was no question that they were not unitary.

The Court also articulated that a unitary relationship is not required for foreign investment income to be apportioned to and taxed by a State. Rather, such income may also be apportioned if the asset giving rise to the income served an operational function relating to the recipient's in-state business. "We agree that the payee and the payor need not be engaged in the same unitary business as a prerequisite to apportionment in all cases. *Container Corp.* says as much. What is required is that the capital transaction serve an operational rather than an investment function." *Allied-Signal*, 112 S. Ct. at 2263.

Justice O'Conner, in her dissent in *Allied-Signal*, also stated that the Court's suggestion in *ASARCO* and *Woolworth* that a unitary relationship was required was a "doctrinal foot fault." [2] She agreed with the majority that "taxation of investment income

[2] As discussed *infra* at 9, the Court had stated in *ASARCO* that "due process considerations might well preclude apportionability, because there would be no underlying unitary business." *ASARCO*, 102 S. Ct. at 3110.

received from a nondomiciliary taxpayer's investment in another corporation requires only that the investment income be sufficiently related to the taxpayer's in-state business, not that the taxpayer's business and the corporation in which it invests be unitary." *Allied-Signal*, 112 S. Ct. at 2265.

The Court found that Bendix's ownership of the ASARCO stock did not serve an operational function, but was instead only an investment, and thus, the gain was not apportionable to New Jersey. The Court noted that the fact that "an intangible asset (the ASARCO stock) was acquired pursuant to a long-term strategy of acquisitions and dispositions does not convert an otherwise passive investment into an integral operational one . . . . The fact that a transaction was undertaken for a business purpose does not change its character." *Allied-Signal*, 112 S. Ct. at 2263, 2264. The Court also held that how Bendix intended to use the gain "reveals little about whether ASARCO was run as part of Bendix's unitary business." *Allied-Signal*, 112 S. Ct. at 2264.

Turning to this case, the Department makes various assertions in its post-hearing brief in support of its claim that the Taxpayer and Amylum were unitary and/or operationally related. First, it claims that Tate & Lyle's purchase of the Amylum stock in 2005 was a "strategic" investment that "had an operational or functional benefit for the Taxpayer and/or the Parent . . . ." Dept. Br. at 3. It next claims that "Amylum was a functional or operational 'investment' in the continuation of the Taxpayer's and the parent's business rather than a passive investment of idle funds." *Id.* at 3.

The Department later argues that "here Amylum served an operational purpose by being the operational European division of the Parent allowing the Taxpayer and the Parent

access into a market otherwise closed under the sugar regime of the EU Commission." *Id.* at 6. The Department further asserts that "the purpose of the investment in and divesture to the Parent of Taxpayer's ownership of Amylum appears to (be) more akin to business development and the sharing of resources of the Parent's existing business related resources than it was a divesture of a passive investment . . . Through the divesture by the Taxpayer, the Taxpayer and Amylum are even more clearly unitary under the Parent." *Id.* at 8. Finally, the Department argues that "there was and is a competitive advantage for the Taxpayer and the Parent in owning Amylum allowing it (presumably, the Taxpayer and Tate & Lyle) worldwide exposure and economies of scale by allowing it to combine functions and for the invaluable business information such ownership carries with it." *Id.* at 9.

The above assertions, which are speculative and unsupported by the evidence, all have a common theme that is the crux of the Department's case. That is, because the Taxpayer and Amylum are in the same general line of business, and because they have a common parent, Tate & Lyle, their business operations must be unitary. I disagree.

First, concerning the fact that the Taxpayer and Amylum both sell cereal sweeteners, the Supreme Court opined in *Container* that there may be "an administrative presumption that corporations engaged in the same line of business are unitary." *Container*, 103 S. Ct. at 2947. But that is only one factor to consider, and the presumption of a unitary relationship is rebuttable. Rather, the determining question is still whether there is a flow of value between the corporations as evidenced by functional integration, centralization of management, and economies of scale. Professor Walter Hellerstein confirms the above in his leading treatise on state and local taxation:

> Whether the businesses differ in the nature of their products, lines, and services should be irrelevant in deciding whether unitary apportionment is appropriate. Such an inquiry is not directed to the fundamental question presented in deciding whether a unitary business exists, that is, the extent of interdependence, integration, and interrelation of their basic operations, or, at a minimum, whether there is a "flow of value" between the different operations.

J. Hellerstein & W. Hellerstein, *State Taxation* ¶8.09(6)(a) (3d ed. 2001).

As discussed in detail below, there was no functional integration, centralized management, or economies of scale between the Taxpayer and Amylum. The fact that they are in the same general line of business is thus irrelevant.[3]

It is also irrelevant that the Taxpayer and Amylum were owned by a common parent. Tate & Lyle is a non-operating holding company. It had the potential to manage and control its subsidiaries, but as stated in *ASARCO*, "the potential to operate a company as part of a unitary business is not dispositive." *ASARCO*, 102 S. Ct. at 3134. Rather, actual control is required for a unitary relationship to exist, and actual control by Tate & Lyle was not present in this case. Tate & Lyle had no common directors with either the Taxpayer or Amylum, and was not involved in the management of either entity. Tate & Lyle personnel did occasionally meet and generally discuss business with officers of it subsidiaries, including the Taxpayer and Amylum, but such communications were less substantial than the communications between Woolworth and its subsidiaries, which the Supreme Court found were "the type of occasional oversight . . . that any parent gives an investment in a

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[3] In *Perelman v. State of Alabama*, INC. 01-592 (Admin. Law Div. 4/17/2002), the issue was whether three divisions of the same company, all of which sold different types of dental equipment, were unitary. The Administrative Law Division held that "the fact that the three divisions all sold dental products is irrelevant . . . What is relevant is whether the underlying operations were interrelated." *Perelman* at 12.

subsidiary." *Woolworth*, 102 S. Ct. at 3139.

In any case, the relevant inquiry concerns the relationship, or lack thereof, between the Taxpayer and Amylum, the parties involved in the transaction in issue. Applying the three factors of functional integration, centralization of management, and economies of scale, it is clear that the Taxpayer and Amylum were not involved in a unitary business.

There was no functional integration between the two entities. The Taxpayer and Amylum independently manufactured, marketed, and sold their products to customers on different continents. They had separate manufacturing facilities, and also separate accounting, payroll, legal, purchasing, and tax departments. The day-to-day operations of the entities were unrelated.

There also was no centralized management. The Taxpayer and Amylum had their own independent management teams, and were in no way involved in the management of the other. The companies also had no common directors. As indicated, there were general discussions between upper level managers in the group, but there was no sharing of decision-making between the subsidiaries.

Finally, there were no economies of scale resulting from the Taxpayer's ownership of its one-third interest in Amylum. The Taxpayer and Amylum did purchase supplies, equipment, etc. pursuant to global purchasing agreements entered into by the Tate & Lyle Group, but as subsidiaries of Tate & Lyle that would have been true even if the Taxpayer had never owned the Amylum stock. The purchase of items pursuant to the Group's global purchasing agreements only shows that the Taxpayer and Amylum had a common parent, not that they had a unitary relationship.

The Department cites the Supreme Court's decision in *Container* in support of its position. As discussed, the Court found that Container and its foreign subsidiaries were unitary. The Department argues that the facts in *Container* are similar to the facts in this case because in both cases, local management teams largely managed the subsidiaries and there was little if any exchange of employees. The Supreme Court nonetheless concluded, according to the Department, "that this was a functionally integrated enterprise because the parent assisted 'in obtaining used and new equipment and in filling personnel needs that could not be met locally' *Container*, at 179. Thus suggesting that the group of controlled corporations enjoyed economies of scale." Dept. Br. at 8.

The Department's reliance on *Container* is misplaced because it fails to identify many of the important facts in *Container* that led the Court to affirm the existence of a unitary relationship. Container had officers that oversaw the subsidiaries and established general standards of professionalism, profitability, and ethical practices. Those officers also handled major problems and long-term decisions concerning the subsidiaries. Container loaned substantial funds to and guaranteed loans for the subsidiaries. The Court concluded that the lower court had properly relied on the above facts in finding a unitary relationship. It also found that another "noteworthy factor is the managerial role played by (Container) in its subsidiaries' affairs. . . . In this case, the business 'guidelines' established by (Container) for its subsidiaries, the 'consensus' process by which (Container's) management was involved in the subsidiaries' business decisions, and the sometimes uncompensated technical assistance provided by (Container), all point to precisely the sort of operational role we found lacking in *F. W. Woolworth*." *Container*, 103 S. Ct. at 2948.

None of the above facts relied on by the Court to find a unitary relationship in *Container* are present in this case. The Taxpayer's independent management team had nothing to do with operating Amylum, and vice versa. There were no common directors, no sharing of raw materials or employees, and no interaction between the two companies, except the relatively small amount of finished goods purchased from each other at arm's-length. The companies were independent business enterprises, and there was no flow of value between the companies as required for the entities to be unitary.

The Supreme Court case most factually similar to this case is *Allied-Signal*, which also involved the apportionability of the gain from the sale of stock. The parties in *Allie-Signal* stipulated the following facts:

> There was no common management, officers, or employees of Bendix and Asarco. There was no use by Bendix of Asarco's corporate plant, offices or facilities and no use by Asarco of Bendix's corporate plant, offices or facilities. There was no rent or lease of any property by Bendix from Asarco and no rent or lease of any property by Asarco from Bendix. Bendix and Asarco were each responsible for providing their own legal services, contracting services, tax services, finance services and insurance. Bendix and Asarco had separate personnel and hiring policies . . . and separate pension and employee benefit plans. Bendix did not lend monies to Asarco and Asarco did not lend monies to Bendix. There were no joint borrowings by Bendix and Asarco. Bendix did not guaranty any of Asarco's debt and Asarco did not guaranty any of Bendix's debt. Asarco had no representative on Bendix's Board of Directors. Bendix did not pledge its Asarco stock. As far as can be determined there were no sales of product by Asarco itself to Bendix or by Bendix to Asarco. There were certain sales of product in the ordinary course of business by Asarco subsidiaries to Bendix but these sales were minute compared to Asarco's total sales . . . . These open market sales were at arms length prices and did not come about due to the Bendix investment in Asarco. There were no transfers of employees between Bendix and Asarco.

Allied-Signal, 112 S. Ct. at 2256, 2257.

The above facts are almost identical to the facts in this case. The only difference is

that the Taxpayer and Amylum sold some products directly to each other at arm's-length, whereas ASARCO's subsidiaries sold some products to Bendix at arm's-length. That subtle difference is, however, irrelevant. And unlike in this case, where there were no common directors, Bendix had two directors on ASARCO's board. It was nonetheless a foregone conclusion in *Allied-Signal* that Bendix and ASARCO were not unitary. Likewise, in this case, it is clear that the Taxpayer and Amylum were separate and unrelated businesses that were not unitary.[4]

Although the Taxpayer and Amylum were not unitary, the stock gain can still be apportioned to Alabama if the Taxpayer's ownership of the stock served an operational function relating to its business conducted in Alabama.

In *Allied-Signal*, the Court explained that the issue of whether an intangible serves an operational function "focuses on the objective characteristics of the asset's use and its relation to the taxpayer and its activities within the taxing State." *Allied-Signal*, 112 S. Ct. at 2262. It then gave two examples.

First, "a State may include within the apportionable income of a nondomicilary corporation the interest earned on short-term deposits in a bank located in another state if that income forms part of the working capital of the corporation's unitary business." *Allied-Signal*, 112 S. Ct. at 2263. The Court found in *Allied-Signal* that the sale by Bendix of the

[4] The above conclusion is also supported by the holdings in *ASARCO* and *Woolworth*. As discussed, there were various connections between the parent and the subsidiaries in those cases, but the Court found that the relationships were not sufficient to be unitary. In this case, there was virtually no connection between the Taxpayer and Amylum, other than being subsidiaries of a common parent. Also, the Supreme Court has never found a unitary relationship where a corporation owned less than 50 percent of another corporation, as in this case.

ASARCO stock which it had held for over two years was not "a short-term investment of working capital analogous to a bank account or certificate of deposit." *Allied-Signal*, 112 S. Ct. at 2264. Likewise, the Taxpayer's gain on its investment in the Amylum stock held for 45 years clearly does not constitute operationally-related income under the above criteria.

The Court also referred to footnote 19 in *Container*, which cited *Corn Products* as an example of the type of income that serves an operational versus an investment function. Professor Hellerstein explains the *Corn Products* doctrine as follows:

> The *Corn Products* case spawned the *Corn Products* doctrine under which gain or loss from the sale of intangible assets - frequently stock in other corporations - was held to be ordinary gain or loss because the asset was "bought and kept not for investment purposes, but only as an incident to the conduct of the taxpayer's business." Under the *Corn Products* doctrine, courts have found that ordinary income or loss rather than capital gain or loss resulted from (1) a geological exploration company's sale of stock and securities of corporations acquired to gain access to their personnel and expertise; (2) an oil products wholesaler's sale of a noncontrolling interest in stock of an oil refinery purchased to secure a source of supply of petroleum products; (3) a restaurant operator's sale of stock of a corporation acquired to gain access to a restaurant business; (4) a newspaper's sale of a noncontrolling interest in the stock of a paper manufacturer to secure a source of supply of newsprint; (5) a newspaper's sale of contract rights to purchase newsprint at favorable prices; (6) and a manufacturer's sale of the stock of a supplier acquired to secure the taxpayer's flow of a vital source of inventory.
>
> By analogy, dividends received on stocks falling within the *Corn Products* doctrine may be regarded as business income that is apportionable under UDITPA. Indeed, as already observed here, the MTC regulations support this view by characterizing dividends from stock acquired to secure a source of supply as business income. Moreover, the U.S. Supreme Court referred to *Corn Products* in drawing a distinction between capital transactions that serve an 'operational function' and thus give rise to constitutionally apportionable income, and transactions that serve an "investment function" and thus give rise to income that is not constitutionally apportionable. The cases also support this view. (cites omitted)

State Taxation ¶9.10(1)(c).[5]

The *Corn Products* doctrine does not apply in this case because there is no evidence that the Taxpayer purchased the Amylum stock in 1960 for purposes related to its business in Alabama. Purchasing the Amylum stock was an investment, and owning the stock did not serve an operational function or otherwise assist the Taxpayer in operating its business in Alabama or elsewhere. Unlike the taxpayer in *Corn Products*, the Taxpayer did not use Amylum as a source of supply because the companies used different raw materials, i.e., corn versus wheat, and there were no sales or exchanges of raw materials between the companies.

Although not raised by the Department in its brief, it could also be argued that how the Taxpayer used or intended to use the proceeds from the stock sale could be relevant in determining if the gain is apportionable.

The Taxpayer's executive vice president/general counsel testified that the Taxpayer used the gain in issue to expand its business. R. 79, 80. The Supreme Court suggested in *Allied-Signal* that income to be used in the future operation of a taxpayer's business may be apportionable. "Hence, in *ASARCO*, although we rejected the dissent's factual

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[5] In *Vulcan Materials Co. v. State of Alabama*, CORP. 98-157 (Admin. Law Div. O.P.O. 12/12/1999), the Administrative Law Division applied the *Corn Products* doctrine in holding that income from the sale of stock served an operational function because the income recipient was required to buy the stock to obtain the insurance needed to operate its chemical business, and also to operate in a foreign country. See, *Vulcan Materials* at 9, 10.

contention that the stock investments there constituted 'interim uses of idle funds accumulated for the future operation of [the taxpayer's] . . . business [operation],' we did not dispute the suggestion that had that been so the income would have been apportionable." *Allied-Signal*, 112 S. Ct. at 2263.

The above dicta is, however, contrary to the Court's subsequent finding in *Allied-Signal* that how Bendix may have used the income from the ASARCO stock was irrelevant. "Even if we were to assume Martin Marietta, once acquired (with funds from the ASARCO stock sale), would have been operated as part of Bendix's unitary business, that (how the income is later used) reveals little about whether ASARCO was run as part of Bendix's unitary business." *Allied-Signal*, 112 S. Ct. at 2264. That statement correctly emphasizes that the operationally-related test focuses on whether the asset that resulted in the income was used in a taxpayer's business before the income was realized, not how the income, once realized, may later be used.

Professor Hellerstein has also criticized what he characterized as "[t]he Court's gratuitous remark" in *Allied-Signal* concerning the relevance of how income may later be used by the recipient. He states that "the mere possibility that assets might be used in the business in the future does not justify treating them as used in the business now." *State Taxation*, §8.08(2)(e) at 8-99 – 8-100. Consequently, the fact that the Taxpayer later used the gain in issue to expand its business is irrelevant.[6] What is relevant is whether the

[6] In a separate but related context, the Administrative Law Division held in *Kimberly-Clark Corporation v. State of Alabama*, CORP. 01-983 & 01-995 (Admin. Law Div. 3/11/2003), that how income is later used by the recipient is irrelevant in determining whether the income is apportionable business income or allocable nonbusiness income.

(continued)

Amylum stock, while owned by the Taxpayer, had been operationally related to the Taxpayer's business in Alabama. As discussed, it was not.

The Taxpayer's expert witness, Professor Rick Pomp, testified in substance that the evidence did not show that the Taxpayer and Amylum were either unitary or operationally related. "And I did not hear anything in the testimony, I did not see anything in my due diligence, that would suggest that we have such interdependencies as to view the two entities as if they were a single business, . . . that based on what I heard, we have two discrete business enterprises. The sale of the stock has nothing to do with Alabama. I don't see a sufficient connection between the gain on the sale of the stock and anything going on in Alabama that would justify Alabama taxing the gain." R. 120, 129.

The Department asserts that however persuasive Professor Pomp may be, his testimony should be disregarded as inadmissible legal conclusions that are not binding on the Administrative Law Division. That may be the case, but Professor Pomp's conclusions correctly apply the constitutional principles enunciated by the Supreme Court to the facts in this case.

> I respectfully disagree that how income is later used is relevant in determining whether it is business or nonbusiness income under the transactional test. Rather, the issue turns on the nature of the transaction, i.e., was the transaction in the regular course of the taxpayer's business. How the income is later used cannot change the nature of the transaction that gave rise to the income. For example, a multistate retailer derives business income from the sale of its merchandise. It is irrelevant that the retailer later uses the income to buy more merchandise, or to buy undeveloped property as a speculative investment, or distributes it as a dividend to its shareholders. In all cases, the income would still be business income from the retailer's regular course of business.

Kimberly-Clark at 11.

By submitting substantial evidence that the Taxpayer and Amylum operated separate, discrete businesses, and that the Amylum stock, while owned by the Taxpayer, was not operationally related to the Taxpayer's business being conducted in Alabama, the Taxpayer has carried its burden of proving that "the income was earned in the course of activities unrelated" to the Taxpayer's business in Alabama. *Exxon*, 100 S. Ct. at 2120, quoting *Mobil*, 100 S. Ct. at 1232. The Department is thus constitutionally barred from taxing the gain.

The issue of whether the stock gain was business or nonbusiness income is pretermitted by the above holding. As pointed out by the Department in its brief, however, a case is currently pending before the U.S. Supreme Court that involves the constitutional issues discussed above. See, *MeadWestvaco Corp. v. Illinois Dep't of Revenue*, 861 N.E.2d 1131 (Ill. App. 2007), *cert*. granted 9/25/2007. It is improbable that the Court will change its position, as expressed in *Allied-Signal* and prior cases, concerning when two corporations or divisions of a single corporation are unitary, or when a foreign investment is operationally related to a taxpayer's in-state activities. And even if the Court tweaks its constitutional analysis of the above issues in *MeadWestvaco*, it is even more improbable that any revised analysis would allow Alabama to tax the income in issue in this case.[7] But

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[7] In *MeadWestvaco*, Mead realized a gain in 1994 from its sale of Lexis/Nexis, which it had owned and treated as a division or separate subsidiary since 1968. Mead had contributed capital to Lexis/Nexis, manipulated Lexis/Nexis's business organization for its own tax benefit, and controlled Lexis/Nexis's excess cash. It also had to some extent overseen major decisions at Lexis/Nexis, and otherwise had a hand in managing the company. The Illinois court held that Mead's ownership of Lexis/Nexis served an operational function, and consequently, that Illinois could constitutionally tax the gain as apportionable business income.
It has been argued that the facts in *MeadWestvaco* fall somewhere between *Container*,
(continued)

if it did, the statutory business versus nonbusiness income issue would become dispositive. Consequently, that issue is addressed below.

Issue (2). Is the stock gain business or nonbusiness income?

Before 2001, Alabama law defined "business income" using the original definition of the term in UDITPA. That definition, found at Code of Ala. 1975, §40-27-1, Art. IV, 1.(a), reads as follows:

> "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

In *Ex parte Uniroyal Tire Co.*, 779 So.2d 227 (Ala. 2000), the issue was whether the above definition contained both a transactional test ("income arising from transactions and activity in the regular course of the taxpayer's trade or business. . ."), and a functional test (". . . and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations."). The Alabama Supreme Court, citing the rule of

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where the Court found a unitary relationship, and *Allied-Signal*, where the entities were not unitary or operationally related. See, J. Carr & C. Griffith, *Will the Supreme Court Change the Operational Function Test?*, State Tax Notes, January 7, 2008, at 49. The Court could hold that the facts are more akin to *Container*, and thus affirm the Illinois court, although I agree with the authors of the above article that it is unlikely that the Court granted certiorari only to affirm the lower court. In any case, even if the Court allows Illinois to tax the gain in *MeadWestvaco*, which is improbable, that holding would not change the result in this case. Unlike the circumstances in *MeadWestvaco*, where there were some facts suggesting an operational relationship between Mead and Lexis/Nexis, there are none between the Taxpayer and Amylum in this case.

construction that a taxing statute must be construed against the taxing authority, held that the definition contains only a transactional test. Applying that test, the Court determined that Uniroyal's one-time sale of a partnership interest was not done as part of its regular trade or business, and thus produced nonbusiness income.[8]

The Alabama Legislature responded to the *Uniroyal* decision by amending the definition of "business income." See, Acts of Ala. 2001-1113. The amended definition, found at Code of Ala. 1975, §40-27-1.1, reads as follows:

> Notwithstanding any other provision of law to the contrary and specifically Section 40-27-1, for purposes of Article IV of the Multistate Tax Compact, the term "business income" means income arising from transactions or activity in the course of the taxpayer's trade or business; or income from tangible or intangible property if the acquisition, management, or disposition of the property constitute integral parts of the taxpayer's trade or business operations; or gain or loss resulting from the sale, exchange, or other disposition of real property or of tangible or intangible personal property, if the property while owned by the taxpayer was operationally related to the taxpayer's trade or business carried on in Alabama or operationally related to sources within Alabama, or the property was operationally related to sources outside this state and to the taxpayer's trade or business carried on in Alabama; or gain or loss resulting from the sale, exchange, or other disposition of stock in another corporation if the activities of the other corporation were operationally related to the taxpayer's trade or business carried on in Alabama while the stock was owned by the taxpayer. A taxpayer may have more than one trade or business in determining whether income is business income.

[8] The Court's use of the above cited rule of construction in reaching its decision is unfortunate. Either the taxpayer or the State may benefit from the Court's interpretation. Uniroyal benefited in the actual case because it was domiciled outside of Alabama, and the nonbusiness income was thus allocated 100 percent outside of Alabama. If, however, Uniroyal (or any similarly situated taxpayer) had been domiciled in Alabama, then all of the gain would have been allocated 100 percent to Alabama, a result that clearly would not have been "most favorable for the taxpayer." *Uniroyal*, 779 So.2d at 231.

The 2001 amendment retained the transactional test, and, by substituting “or” for “and includes,” also added a separate functional test. The amendment further added a third “operationally-related” test, which itself has two subparts. The first subpart is – “or gain or loss resulting from the sale, exchange, or other disposition of real property or of tangible or intangible personal property, if the property while owned by the taxpayer was operationally related to the taxpayer’s trade or business carried on in Alabama or operationally related to sources within Alabama, or the property was operationally related to sources outside this state and to the taxpayer’s trade or business carried on in Alabama;. . . .” The second subpart is – “. . . or gain or loss resulting from the sale, exchange, or other disposition of stock in another corporation if the activities of the other corporation were operationally related to the taxpayer’s trade or business carried on in Alabama while the stock was owned by the taxpayer.”

Factors to be considered in determining if the transactional test is satisfied are “the nature of the particular transaction giving rise to the income” and “the frequency and regularity of similar transactions.” *Uniroyal*, 779 So.2d at 230. Applying those factors, the Taxpayer’s sale of its Amylum stock that it had held for 45 years was an infrequent transaction not in the Taxpayer’s regular course of business. The income from the sale clearly was not business income under the transactional test.

The gain also did not constitute business income under the functional test because the Taxpayer did not acquire, manage, or dispose of the Amylum stock as an integral part of its regular business of selling cereal sweeteners. As discussed, the Taxpayer and Amylum operated totally separate and independent businesses. The Taxpayer’s purchase,

ownership, and/or sale of the Amylum stock had nothing to do with the Taxpayer's business in Alabama or elsewhere. For similar cases on point, see *Blessing/White, Inc. v. Zehnder*, 329 Ill. App. 3d 714, N.E.2d 332, *appeal denied*, 201 Ill. 2d 560, 786 N.E.2d 10 (2002); *Lenox, Inc. v. Tolson*, 353 N.C. 659, 548 S.E.2d 513 (2001); *Laurel Pipe Line Co. v. Pennsylvania*, 537 Pa. 205, 642 A.2d 472 (1994); and *McVean & Barlow, Inc. v. New Mexico Bureau of Revenue*, 88 N.M. 521, 543 P.2d 489 Ct. App., *cert denied*, 89 N.M. 6, 546 P.2d 71 (1975).

The operationally-related test added by the 2001 amendment is a statutory adoption of the constitutional "operational-function" test discussed by the U.S. Supreme Court in *Allied-Signal*. The statutory test requires, as does the constitutional test, that the activities of the corporation from which the taxpayer derived a stock gain must have been "operationally related to the taxpayer's trade or business carried on in Alabama while the stock was owned by the taxpayer." Section 40-27-1.1. As discussed, *infra* at 24 – 26, it is irrelevant how the gain is used after it is realized by the taxpayer.

For the reasons discussed above, the Taxpayer's ownership of the Amylum stock was not operationally related to the Taxpayer's business in Alabama for purposes of determining if the subsequent gain on the sale of the stock was business or nonbusiness income. Because the stock gain was not business income under the transactional, functional, or operationally related tests set out in §40-27-1.1, the income was nonbusiness income, and thus not apportionable to Alabama.

The Department should recalculate the Taxpayer's Alabama liability for the subject year by (1) removing the gain on the Amylum stock from apportionable business income,

and (2) also removing the gain from the sales factor.[9] It should notify the Administrative Law Division of the adjusted amount due. A Final Order will then be entered.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered January 15, 2008.

BILL THOMPSON
Chief Administrative Law Judge

bt:dr
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Melody Moncrief

[9] The Taxpayer conceded in its notice of appeal, at the administrative hearing, and in its post-hearing brief, that it had erroneously included the gain in its sales apportionment factor. I agree.