ALABAMA TAX TRIBUNAL

HUHTAMAKI, INC.,	§	
Taxpayer,	§	DOCKET NOS. BIT. 19-890-JP
v.	§	BIT. 19-1091-JP
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

These consolidated cases involve final assessments of business income tax for tax years 2009, 2010, and 2013, and a denial of the Taxpayer's request for a business income tax refund for 2015. The cases came before the Tax Tribunal for trial on January 23, 2023. The Taxpayer was represented by Bruce Ely and Jimmy Long. The Revenue Department was represented by David Avery and Andrew Gidiere. Sara Janssen and Tommi Etholen testified for the Taxpayer. Tameka Finklea and Matt Tidwell testified for the Revenue Department. Amanda Herman also was present for the Taxpayer. The parties addressed a post-trial evidentiary issue and later submitted briefs.

Facts

At trial, the parties submitted the following Joint Stipulation of Selected Facts to the Tax Tribunal:

1. Huhtamaki Company Manufacturing, Inc. filed a final year Alabama business income tax return for tax year 2009. The return reported federal taxable income reported on a separate entity basis as the starting point for the calculation of taxes in Alabama of $15,231,951.00 and an Alabama apportionment factor of 20.1385%

2. Huhtamaki Company Manufacturing, Inc. merged into Huhtamaki, Inc. as of December 31, 2009. Huhtamaki, Inc. filed business income tax returns in Alabama prior to tax year 2010 but those returns are not at issue in this appeal.

3. The Taxpayer, Huhtamaki, Inc., is a "C" corporation commercially domiciled in Kansas and a wholly-owned subsidiary of Huhtamaki Americas, Inc. ("Americas"), which is also commercially domiciled in Kansas as a holding company and the U.S. parent of the Taxpayer's consolidated group for federal income tax purposes.

4. Huhtamaki Oyj (the "Parent"), commercially domiciled in Finland, is a Related Member and indirect parent company of Americas and the Taxpayer. For purposes of these stipulations, Related Member shall have the same meaning as that term is defined in Ala. Code §40-18-1(29)

5. This appeal is a consolidated appeal from the Department's Final Assessments of corporate income tax, interest, and penalties for the 2009, 2010 and 2013 calendar years and an appeal from the Department's denial of the Taxpayer's corporate income tax refund claim for the 2015 calendar year (collectively, the "Audit Period")….

6. The Taxpayer timely appealed to this Tribunal each of the Final Assessments at issue as well as the Department's denial of the Taxpayer's refund claim.

7. During the period January 1, 2009 through December 31, 2009, Huhtamaki Company Manufacturing, Inc. had deducted in the calculation of federal taxable income on a separate entity basis as disclosed on Schedule AB to the 2009 return a deduction for royalties to its Related Member, Parent in the amount of $10,107,700.00. Also reported on the Schedule AB was a deduction for interest to its Related Member, Huhtahung Asset Management in the amount of $6,277,818.00. The Taxpayer did not initially indicate on the Schedule AB a taxing jurisdiction where that second transaction was taxed. The Taxpayer subsequently indicated during the desk audit that this interest payment was actually taxed to the Related Member in Switzerland and Hungary. The Taxpayer has further explained that Huhtahung Asset Management is a translated or trade name of Huhtahung, Kft (the "Hungary Affiliate").

8. In a desk audit of the 2009 return, the Department determined that the Huhtamaki Company Manufacturing, Inc. deduction for royalties

to Parent was actually taxed to the Parent in Finland and thereby exempt from inclusion as an adjustment to federal taxable income under Ala. Code §40-18-35(b)(1). For purposes of these stipulations, Ala. Code §40-18-35(b) is referred to herein as the "Add-Back Statute". The exception from inclusion under the Add-Back Statute set forth by Ala. Code §40-18-35(b)(1) and the regulations relating thereto is referred to herein as the "Subject to Tax Exception".

9. The taxpayer Huhtamaki Company Manufacturing, Inc. in the desk audit asserted that the interest in 2009 was paid indirectly to Huhtahung Vagyonkezelo Korlatolt Felelossegu Tarsaug, Baar Branch (the "Swiss Branch") but was directly paid to Americas. The Swiss Branch is not a separate legal entity but is a division of the Hungary Affiliate.

10. During the period January 1, 2009 through December 31, 2009, Americas filed a federal consolidated income tax return where the interest received from the Taxpayer was offset or eliminated in the federal consolidated return which included the Taxpayer. Americas also filed state tax returns in states requiring combined reporting in a return that included the Taxpayer. In those combined state returns the interest received by Americas from the Taxpayer was offset or eliminated in the combined returns. In the 2010 Kansas combined return filed by Americas, Americas reported a zero apportionment for itself.

11. During the period January 1, 2010 through December 31, 2010, the Taxpayer reported its federal taxable income determined on a separate entity basis on its Alabama return to be $33,936,249.00 and on Schedule AB reported that its determination of federal taxable income had included deductions taken for intangible or interest expenses with three Related Members. It reported interest deductions taken in the amounts of $3,042,450.00 and $7,325,093.00 to Huhtalux S.a.r.l. (the "Luxembourg Affiliate"), and the Hungary Affiliate.

12. The Taxpayer asserts, and is not contested by the Department, that the deduction to the Swiss Branch is for the period of January 1, 2010 to September 14, 2010, and the deduction to the Luxembourg Affiliate is for the period of September 15, 2010 to December 31, 2010. It also reported a royalty deduction to Parent for 2010 in the amount of $9,305,000.00. In the Department's desk audit of the Taxpayer's return, the royalty deduction to Parent was found to meet

the Subject to Tax Exception, but the Department did not find the two other deductions to meet exceptions to the Add-Back Statute.

13. In the desk audit, the Taxpayer asserted that the 2010 interest payments were made indirectly to the Luxembourg Affiliate or Swiss Branch but were directly made to Americas.

14. During the period January 1, 2009 through September 14, 2010, the Taxpayer asserted during the desk audit that Americas deducted on its consolidated federal income tax return interest paid to its foreign related member, the Swiss Branch, in an amount that was in excess of the interest deducted by the Taxpayer on its Alabama income tax returns.

15. The Department was provided a full copy of the Americas federal consolidated return for 2009, 2010 and 2015.

16. The Department agrees that Americas deducted more interest to Related Members that were not in the U.S. consolidated group than the Related Member interest deductions reported by the Taxpayer for 2009.

17. During the period January 1, 2013 through December 31, 2013, the Taxpayer reported federal taxable income determined on a separate entity basis to Alabama of $2,672,714.00 and reported that its calculation of federal taxable income included an intangible and interest expense deductions to two Related Members. It reported that an interest deduction was taken for $28,771,826.00 for the Luxembourg Affiliate and a royalty and interest payment to Parent in the combined amount of $1,713,417.00. In the Department's desk audit of the 2013 return, the Department found that the deductions for royalty and interest paid to the Parent on the Alabama return met the Subject-to-Tax Exception.

18. During the period January 1, 2013 through December 31, 2013, the Taxpayer asserts that it made the interest payment to Americas directly, and indirectly to the Luxembourg Affiliate. The federal consolidated income tax return where the interest received from the Taxpayer was offset or eliminated in the federal consolidated returns which included the Taxpayer was not provided to the Department, but the Department does not contest this conclusion.

19. During the period January 1, 2015 through December 31, 2015, Americas filed a consolidated federal income tax return where the

interest received from the Taxpayer was offset or eliminated in the federal consolidated return which included the Taxpayer.

20. During the period January 1, 2015 through December 31, 2015, the Taxpayer reported federal taxable income determined on a separate entity basis to Alabama of $47,532,805.00 and reported that its calculation of federal taxable income included intangible deductions to two Related Members. It reported that an interest deduction was taken for $31,205,345.00 for the Luxembourg Affiliate and a royalty payment to Parent in the amount of $20,924,000.00. In the Department's desk audit of the 2015 return, the Department found that the Taxpayer had failed to prove the exclusion to the Add-Back Statute claimed for the royalty deduction to the Parent or the interest deduction taken for the Luxembourg Affiliate on the Alabama return. [1]

21. At all relevant times during the Audit Period, the Parent, the Hungary Affiliate, the Swiss Branch and the Luxembourg Affiliate (collectively, the "Foreign Affiliates") were each in countries that were subject to income tax treaties with the United States.

22. The Department in its audit of tax year 2010 determined that the intangible royalty payment to the Parent was exempted from inclusion under the Add-Back Statute based on documentation provided by the Taxpayer.

23. The parties have resolved their differences involving the calculation of the sales and property apportionment factors for the calendar year 2010. The Taxpayer agrees that its Alabama property factor should be increased from 11.2901% to 14.8596% as adjusted by the Department. The Taxpayer agrees that the amount of gross receipts that should be included in the Alabama numerator is $6,897,377, and thus the Taxpayer's Alabama sales factor for that year should be adjusted from 0.7949% to 0.9836%.

24. The Taxpayer on appeal asserts that it deducted interest paid to Americas in the following amounts for Alabama corporate income tax purposes during the Audit Period:

[1] Although not reflected in the joint stipulation, the Taxpayer stated that the Revenue Department agreed that the subject-to-tax exception applied to the payment of royalties in 2015.

Year	Amount
2009	$6,277,818
2010	$7,325,093
2010	$3,042,450
2013	$28,771,826
2015	$31,205,345

25. The deductions detailed in the above paragraph were each "otherwise deductible interest expense and costs … directly or indirectly paid, accrued, or incurred to, or in connection directly or indirectly with one or more direct or indirect transactions, with one or more related members" and were thereby subject to the application of the Add-Back Statute.

26. The Taxpayer asserts that the examiner previously agreed to use calendar year 2010 as the test period and to use the "subject to tax" findings under Ala. Code § 40-18-35(b)(1) and "conduit" findings under Ala. Code § 40-18-35(b)(4), if any, for the test period for each of the tax years then involved in the Audit Period. The Department has not agreed to a similar test period for this appeal and for trial before the Alabama Tax Tribunal. However, counsel for the Department have agreed to allow the Taxpayer to produce the documents for 2009 and 2010 and that those results will be used for 2013 and 2015 except as stipulated otherwise above.

27. The Parent, the Swiss Branch, the Hungary Affiliate and the Luxembourg Affiliate filed income tax returns in their respective jurisdictions of Finland, Switzerland, Hungary and Luxembourg during the Audit Period.

28. The Taxpayer provided the Department with copies of all or portions of the Finland, Hungary, Switzerland and Luxembourg income tax returns of the Foreign Affiliates for portions of the Audit Period.

29. The Parent reported external interest paid to various lenders in the amount of 23,163,023.32 (EUR) on its Finnish 2010 tax return.

30. Exhibit D-5 (attached) is a public report of general circulation by the European Commission to Luxembourg dated July 3, 2019 regarding

possible state aid in favor of Huhtamaki by tax rulings issued by Luxembourg and is admissible in this proceeding.

31. Exhibit D-6 (attached) is a Press Release issued on the same day as Exhibit D-5 acknowledging the European Commission's investigation of certain Huhtamaki tax rulings from Luxembourg and is admissible in this proceeding.

Discussion

Considering the stipulations and subsequent statements by the parties, the dispositive issue is whether certain interest payments that the Taxpayer made directly to Huhtamaki Americas, Inc. ("Americas"), and which were then paid by Americas to foreign affiliates, were "attributed to" those foreign jurisdictions, pursuant to § 40-18-35(b)(1), Ala. Code 1975.[2] That section states the following:

> For purposes of computing its taxable income, a corporation shall add back otherwise deductible interest expenses and costs and intangible expenses and costs directly or indirectly paid, accrued, or incurred to, or in connection directly or indirectly with one or more direct or indirect transactions, with one or more related members, except to the extent the corporation shows, upon request by the commissioner, that the corresponding item of income was in the same taxable year: … b. subject to a tax based on or measured by the related member's net income by a foreign nation which has in force an income tax treaty with the United States, if the recipient was a 'resident' (as defined in the income tax treaty) of the foreign nation. For purposes of this section, subject to a tax based on or measured by the related member's net income means that the receipt of the payment by the recipient related member is reported and included in income for purposes of a tax on net income, and not offset or eliminated in a combined or consolidated return which includes the payor. Any portion of an item of income that is not attributed to the taxing jurisdiction, as determined by that jurisdiction's allocation and apportionment methodology or other sourcing methodology, is not included in income for purposes of a tax on net income and, therefore, shall not be considered subject to a tax. That portion of an item of income which is attributed to a taxing jurisdiction

[2] The Taxpayer also argues that the interest payments fall within the "conduit exception" set out in Ala. Code 1975 § 40-18-35(b)(4). Because, as explained *infra*, the Taxpayer's interest payments fall within the "subject-to-tax exception," a discussion of the conduit exception is unnecessary.

> having a tax on net income shall be considered subject to a tax even if no actual taxes are paid on such item of income in the taxing jurisdiction by reason of deductions or otherwise.

(emphasis added).

The following payments are at issue: (1) for 2009, interest payments made by the Taxpayer directly to Americas and then to the Hungary Affiliate, with a portion of those interest payments being made to the Hungary Affiliate's Swiss Branch; (2) for 2010, interest payments made by the Taxpayer directly to Americas and then to the Hungary Affiliate, and interest payments made by the Taxpayer directly to Americas and then to the Luxembourg Affiliate; and (3) for 2013 and 2015, interest payments made by the Taxpayer directly to Americas and then to the Luxembourg Affiliate.

For 2009 and 2010, the Taxpayer asserts that the interest income was reported and included in income on the Hungary income tax returns filed by the Hungary Affiliate and on the Switzerland income tax return filed by the Hungary Affiliate on behalf of its Swiss Branch. The Taxpayer also admits that the Hungary Affiliate was allowed to deduct an amount equal to approximately 95% of the interest income it received from its Swiss Branch.

For 2010, 2013, and 2015, the Taxpayer contends that the interest income was reported and included in income on the Luxembourg income tax return filed by the Luxembourg Affiliate. (As noted in the stipulations, the Revenue Department agreed to allow the Taxpayer to produce documents for 2009 and 2010, and to use the results from the review of those documents for 2013 and 2015 except as stipulated otherwise.)

The Taxpayer admitted that the Luxembourg Affiliate was allowed to deduct notional interest and interest payments in calculating its net income.

Concerning § 40-18-35(b)(1), there is no dispute that the entities involved are related members. Otherwise, there would be no add-back adjustment. Moreover, the parties have stipulated that each of the entities to which interest was paid -- the Hungary Affiliate and the Luxembourg Affiliate (collectively, "the foreign affiliates") -- was in a country that had in force an income tax treaty with the United States.

The evidence presented at trial and the stipulations of the parties concerning the Luxembourg Affiliate show that, in 2010, 2013, and 2015, the Taxpayer paid interest expenses directly to Americas, which then were paid to the Luxembourg Affiliate. And the Luxembourg Affiliate was a "resident" of Luxembourg, pursuant to an income tax treaty in effect with the United States. Further, the Luxembourg Affiliate's receipt of the interest payments was "reported and included in income [in Luxembourg] for purposes of a tax on net income, and [was] not offset or eliminated in a combined or consolidated return which includes the payor." § 40-18-35(b)(1). Pursuant to the 2008 amendment to § 40-18-35(b)(1), the fact that the Luxembourg Affiliate was allowed to deduct notional interest and interest payments in calculating its net income does not defeat the Taxpayer's entitlement to the subject-to-tax exception. *See Pfizer v. State of Alabama Department of Revenue*, Docket No. BIT. 18-236-JP (Ala. Tax Tribunal 2022).

The evidence and stipulations concerning the Hungary Affiliate show that, in 2009 and 2010, the Taxpayer paid interest expenses directly to Americas, which then

were paid to the Hungary Affiliate, including its Swiss Branch. The Hungary Affiliate was a "resident" of Hungary pursuant to an income treaty in effect with the United States. And the Hungary Affiliate's receipt of the interest payments was "reported and included in income for purposes of a tax on net income [in Hungary], and [was] not offset or eliminated in a combined or consolidated return which includes the payor." § 40-18-35(b)(1). As with the Luxembourg Affiliate, the fact that the Hungary Affiliate was allowed to deduct 95% of the interest payments in calculating its net income does not defeat the Taxpayer's entitlement to the subject-to-tax exception.[3]

Thus, the Taxpayer met the subject-to-tax exception to the add-back statute with respect to both the indirect interest payments to the Luxembourg Affiliate and the Hungary Affiliate.

As the Taxpayer points out, the Revenue Department's own regulation describes a situation in which a corporation makes a direct payment to a second, related corporation, which then makes a direct payment to a third, related corporation.[4] The regulation classifies the payment from the initial corporation to

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[3] Although the Taxpayer presented evidence that the interest payments to the Hungary Affiliate's Swiss Branch also were subject to tax in Switzerland, the Taxpayer did not present evidence that the Hungry Affiliate was a "resident" of Switzerland pursuant to the treaty that was in effect between that country and the United States. However, the Taxpayer apparently takes the position that it is entitled to a full subject-to-tax exception relative to the Hungary Affiliate based solely on the filing in Hungary.

[4] 810-3-35-.02(3)(d)1. provides:

"EXAMPLE. Corporations B and C are related members with respect to Corporation A. Corporation A is an Alabama taxpayer that sells products it purchases from Corporation B on a cost plus basis. Corporation B licenses intangible property from Corporation C and makes intangible expense payments to Corporation C based in part on the sales Corporation B makes to Corporation A. To the extent the intangible expenses Corporation B pays to Corporation C are reflected in the costs of the products Corporation A purchases from Corporation B, the direct intangible expenses of Corporation B are considered to be indirect intangible expenses of Corporation A. Furthermore, for purposes of Ala. Code §40-18-35(b)(3) and subsection (2)(c) of this regulation Corporation A is deemed to directly pay

the third corporation as an indirect payment. Moreover, the statute itself repeatedly uses the phrases "direct or indirect" and "directly and indirectly" in referring to payments and transactions. *See* Ala. Code 1975 § 40-18-35(b)(1) & (4). And it is noted that the Revenue Department has not amended its regulation after the 2008 amendment to § 40-18-35(b).

Concerning the subject-to-tax exception, the Revenue Department's brief cited no legal authority to dispute the Taxpayer's entitlement to the exception. Instead, the Revenue Department focused on a letter from the European Commission which seemed to preliminarily conclude that certain Luxembourg tax rulings conferred unlawful "State aid" on the Huhtamaki corporate group, specifically Huhtalux, which aid was incompatible with the Treaty on the Functioning of the European Union. The Commission's conclusion was disputed by the Taxpayer's vice president of global tax, Mr. Etholen, who stated that the treaty's particular provision related to competition within the European Union and not taxation. He also stated that "[t]he conclusions of this whole commission paper is incorrect."

In a separate portion of its brief, the Revenue Department requested the Tax Tribunal to reconsider its ruling in *Pfizer*. The Tax Tribunal declines to do so for two reasons. First, the Tax Tribunal remains of the opinion that the *Pfizer* ruling was correct based on the facts and the plain wording of the statute. Second, the *Pfizer* ruling is on appeal to the Montgomery Circuit Court. *See State of Alabama Department of Revenue v. Pfizer, Inc.*, CV.-2022-901481-00.

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an intangible expense to Corporation B and indirectly pay an intangible expense to Corporation C."

Conclusion

The Taxpayer proved its entitlement to the subject-to-tax exception to the add-back statute for all deductions at issue.

The Revenue Department is directed to recalculate the final assessments and the refund petition in accordance with this opinion and the stipulations of the parties, and to notify the Tax Tribunal of its recalculations no later than **March 29, 2024**.

Entered February 26, 2024.

/s/ *Jeff Patterson*
JEFF PATTERSON
Chief Judge
Alabama Tax Tribunal

jp:ac
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