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Sweet Alabama Victory: Sibling Manufacturers of Cereal Sweeteners Held Not to Be Engaged in a Unitary Business

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Editor's Note: Our friend Bruce Ely of the Bradley Arant firm served as local counsel in this case. At press time, it was still unclear whether the Alabama Department of Revenue may appeal this great taxpayer victory.

A recent Alabama ruling holds that the taxpayer overcame the administrative presumption of unity, even though the affiliated entities were in the same line of business and shared a common parent, where there was no meaningful flow of value between the affiliates.[1] In *Tate & Lyle*, Chief Administrative Law Judge ("ALJ") Bill Thompson ruled that Alabama could not tax the $345 million gain recognized by Tate & Lyle Ingredients Americas, Inc. (the "Taxpayer") on the sale of its European subsidiary and sister company, Amylum Group ("Amylum").[2]

The Taxpayer owned a one-third (1/3) interest in Amylum. The other two-thirds (2/3) interest was held by a common parent, Tate & Lyle, PLC ("Parent"). In 2005, the Taxpayer sold its equity interest in Amylum to the Parent. In its 2005 Alabama corporate income tax return, the Taxpayer included the gain in its sales factor denominator but excluded the gain from its Alabama income tax base. The Taxpayer considered Amylum an investment and reasoned that the resulting gain should be allocated out of the state and not be subject to apportionment. The Alabama Department of Revenue ("Department") argued that the $345 million gain must be apportionable to Alabama because the Taxpayer and Amylum were (1) owned by a common parent and (2) engaged in the same general line of business.

Similar Lines of Business Do Not Equate to a Unitary Business

The Department alleged that Amylum was more than a mere investment to the Taxpayer. The Department argued that the Taxpayer and Amylum were part of a unitary business because they operated in the same general line of business: the manufacture

[1] *Tate & Lyle Ingredients Americas v. State of Alabama*, No. 07-162 (AL Dep't of Rev. Admin. Law Div. January 15, 2008).

[2] *Id.*

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of cereal sweeteners (*i.e.*, that the only discernable difference in the business models of the two companies was that the Taxpayer marketed and sold corn-based sweeteners to companies in the U.S., whereas Amylum marketed and sold wheat-based sweeteners to companies in Europe).

While there is an administrative presumption in Alabama and other jurisdictions that commonly owned companies are unitary if they engage in the same line of business, this presumption is rebuttable. As the Supreme Court of the United States established in Container Corp., there must be a flow of value before there can be a constitutionally acceptable unitary finding.[3] Merely being in the same line of business as a subsidiary or sibling corporation by itself does not meet this test.

The Taxpayer rebutted the unitary presumption by persuading the ALJ that there was no flow of value between the Taxpayer and Amylum from the factors of profitability as provided by the United Supreme Court in Mobil Oil: (1) functional integration, (2) centralized management, and (3) economies of scale.[4]

In *Tate & Lyle*, there was no functional integration between the Taxpayer and Amylum. The day-to-day operations of the two companies were totally unrelated. Each company independently manufactured, marketed, and sold its products to customers on different continents. Each company had its own manufacturing facilities and separate administrative departments such as accounting, payroll, and legal. There was no sharing of raw materials or employees. Also, the companies purchased only a small amount of finished product from each other, and when they did so–it was at arm's-length prices.

There was no centralization of management between the companies. They had independent management teams that made all operating decisions and "were in no way involved with the management of the other." The companies also had no common directors on their respective boards.

There were also no meaningful economies of scale. While both companies did purchase supplies pursuant to a global purchasing agreement arranged by their common parent, the ALJ ruled that this alone was not sufficient evidence to prove a unitary relationship. Rather, the ALJ found the agreement to be merely evidence that the two companies shared a common parent. As a result, the Taxpayer met its burden and rebutted the presumption that it and Amylum must be unitary because they were in the same general line of business.

A Unitary Finding Requires Actual Control By the Parent Corporation

The Department also alleged that the Taxpayer and Amylum were necessarily unitary because they shared a common parent. Of course, the Supreme Court in *F.W. Woolworth Co.* took a contrary position when it held that wholly owned subsidiaries are

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[3] *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 178-79 (1983).

[4] *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425 (1980).

not unitary with a parent if the parent does not exercise control over the subsidiaries.[5] The Supreme Court distinguished the corporate stewardship found in *Woolworth* from the active control exhibited in a unitary business by holding that "[e]xcept for the type of occasional oversight—with respect to capital structure, major debt, and dividends—that any parent gives to an investment in a subsidiary, there is little or no integration of the business activities or centralization of the management of these five corporations."[6]

Citing *ASARCO Inc.*, the ALJ recognized the actual control requirement and found that evidence of actual control was lacking.[7] The Parent did not share common directors with either the Taxpayer or Amylum. More importantly, the Parent did not involve itself in the management of either company. There was some occasional discussion of business between the Parent and the subsidiaries, but there was nothing that exceeded the permissible bounds of stewardship established in *Woolworth*. Therefore, the common ownership of the Taxpayer and Amylum was insufficient to merit a unitary finding.

Long-Term Investments Do Not Serve an Operational Function

The Taxpayer's long-term investment in Amylum did not serve an operational function. The operational function test was announced by the Supreme Court in *Allied-Signal*.[8] This test focuses on "the objective characteristics of the asset's use and its relation to the taxpayer and its activities within the taxing State."[9] In particular, it allows states to apportion income earned outside of their borders—provided the income-producing asset performs an operational function in an in-state business.

In *Allied-Signal*, the Court gave two examples of income meeting the operational function test: (1) out-of-state bank accounts used to hold short-term working capital and (2) hedging transactions.[10] The ALJ in *Tate & Lyle* found that the Taxpayer's interest in Amylum did not resemble either example. The Taxpayer's interest in Amylum was not similar to a short-term deposit of capital because the interest had been held for 45 years. In addition, no evidence was presented that suggested the purchase of Amylum constituted a hedging transaction. As a result, the purchase of Amylum stock by Taxpayer was an investment that served no operational function in Taxpayer's business anywhere.

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[5] *F.W. Woolworth Co. v. Taxation and Revenue Dep't*, 458 U.S. 354, 362 (1982).

[6] *Id.* at 369.

[7] *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982).

[8] *Allied-Signal, Inc. v. Dir., Div. of Tax'n*, 504 U.S. 768, 785 (1992).

[9] *Id.*

[10] *Id.* at 788.

Use of Proceeds is Not a Relevant Inquiry

In dicta, the ALJ addressed testimony by the Taxpayer's general counsel that proceeds from the sale of Amylum were going to be used to expand the Taxpayer's business. Relying on *Allied-Signal*, the ALJ recognized that future use of proceeds from the sale cannot change the characterization of the Taxpayer's interest in Amylum. The ALJ ruled 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." Because the Taxpayer purchased and held the Amylum stock as an investment, the resulting gain could not be apportioned, irrespective of how the proceeds were later spent. As a result, it was held that the income earned from the stock sale was not apportionable to Alabama.

Conclusion

In *Tate & Lyle*, the ALJ reached a result firmly grounded in and supported by United States Supreme Court precedent. The Commerce Clause does not require commonly owned companies to engage in distinct lines of business in order to be held not unitary. The *Tate & Lyle* decision properly recognizes that the "flow of value" is the proper measure when making a unitary business determination.

The United States Supreme Court is currently revisiting the unitary business concept in *MeadWestvaco Corp. v. Illinois Dep't of Revenue*.[11] While it is unclear how *MeadWestvaco* will reshape unitary business jurisprudence, *Tate & Lyle* provides a sound interpretation of its current state.■

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[11] *MeadWestvaco Corp. v. Illinois Dep't of Revenue*, 861 N.E.2d 1131 (Ill. App. 2007), *cert. granted*, 128 S.Ct. 29 (U.S.Ill. Sept. 25, 2007).