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LOUISIANA AND TENNESSEE COURTS RULE ON STATE LAW APPORTIONMENT OF GAINS FROM BUSINESS DISPOSITIONS AND REORGANIZATION

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Recent Louisiana and Tennessee cases reflect a presumption of that income or loss from sales or restructuring of business assets is generally treated as apportionable business income or loss. The most recent Louisiana case addressing the treatment of an IRC § 338(h)(10) election furthers the trend of state to conform to the federal tax treatment, which helps to reduce unexpected results for multistate taxpayers.

Louisiana – Gain From Sale of Business Assets

The Louisiana Court of Appeal, in *BP Products North America, Inc. v. Bridges*, No. 2010 CA 1860, 2011 WL 3792833 (La. Ct. App. Aug. 10, 2011), addressed whether gain from the taxpayer's sale of a refinery was apportionable or allocable. The taxpayer is engaged in the business of refining crude oil. As part of an annual examination of all its refineries, it made the decision to sell its Belle Chasse, Louisiana, facility. The sale took place during the 2000 tax year, and the taxpayer reported the gain on the sale as apportionable income on its Louisiana corporate income tax return. The Louisiana Department of Revenue (the "Department") audited the taxpayer in 2004 and determined that the gain from the sale should have been classified as allocable income, with all of the associated state income taxes paid to Louisiana.

At issue was whether the gain was allocable on the basis of the Department's assertions that: 1) the taxpayer was not engaged in the business of buying and selling refineries for profit; 2) the refinery was used to produce the products the taxpayer sells in the regular course of its business; and 3) the divestiture constituted the one-time sale of an entire business operation.

The district court granted summary judgment in favor of the taxpayer, and the Louisiana First Circuit Court of Appeal affirmed. Both courts found that the sale of the refinery was made in the regular course of the taxpayer's business and that the gain from the sale was thus apportionable despite the fact that the refinery was used for the production of the taxpayer's products. The court based its decision upon the following facts: 1) the sale was not of fixed assets only; instead, it was the sale of an operating business, including the inventory, people, training, records, and equipment necessary to run the business; 2) the taxpayer remained in the refining business after the sale and retained other refineries that it owned; and 3) the sale of a refinery was not a one-time event for the taxpayer.

Louisiana – State Treatment of an IRC § 338(h)(10) Election

In *ConAgra Foods, Inc. v. Bridges*, 48 So.3d 1249 (La. Ct. App. 2010), the Louisiana Court of Appeal addressed the state treatment of a federal § 338(h)(10) election. The taxpayer, ConAgra Foods, Inc., was the parent company of three wholly owned subsidiaries that operated in Louisiana. It entered into an agreement with two unrelated third parties under which ConAgra sold the stock of the wholly owned subsidiaries to the unrelated parties. For federal income tax purposes, the sellers and the purchasers made a joint election under IRC § 338(h)(10) to treat the stock sale as a deemed-asset sale.

Pursuant to an IRC § 338(h)(10) election, the following steps occur:

- First, the selling corporation receives consideration from the purchaser for the stock of the selling corporation’s subsidiary.

- Second, the subsidiary’s assets are deemed to have been transferred to a newly created corporation.

- Third, ownership in the new corporation is deemed to be transferred to the purchaser.

- Fourth, the original subsidiary entity is treated as retaining all of its tax attributes, including net operating losses (“NOLs”) but no longer owns the assets that were transferred to the new corporation.

- Finally, the original subsidiary is liquidated into the parent company (the seller) pursuant to IRC § 332, and the NOLs transfer to the parent company.

The Louisiana Department of Revenue (the “Department”) did not dispute that ConAgra was the owner of the NOLs for federal income tax purposes but asserted that it was not the owner for Louisiana state income tax purposes. The trial court granted summary judgment in favor of the taxpayer, and the Department appealed. At issue was whether an election under IRC § 338(h)(10) operates to transfer NOLs to the selling corporation under Louisiana law.

On appeal, the court upheld the grant of summary judgment. It first noted the Department’s stipulation that ConAgra was the owner of the NOLs for federal income tax purposes. Next, the court compared IRC § 381, which supports ConAgra’s ownership of the NOLs at the federal level, with the state NOL carry-over provision, LA. REV. STAT. ANN. § 47:287:86. The court found the provisions to be “nearly identical” and, accordingly, found that ConAgra was entitled to the NOL carry-forwards for state income tax purposes.

Tennessee – Capital Gain Resulting From Reorganization Stock Sale

The Tennessee Supreme Court in *Blue Bell Creameries, LP v. Roberts*, 333 S.W.3d 59 (Tenn. 2011), addressed the taxability of capital gains resulting from the acquisition and sale of stock in the course of a corporate reorganization. The taxpayer is a Delaware limited partnership with its principal place of business in Texas. It produces, sells, and distributes ice cream products in various states, including Tennessee. The taxpayer was formed as a limited partnership so that the operations of its predecessor organization, a corporate entity, would be subject to pass-through treatment for income tax purposes. Soon after the taxpayer's formation, all of the assets and liabilities of the predecessor corporation were transferred to the taxpayer.

In addition, BBC USA, Inc., the parent company of both the taxpayer and the predecessor corporation, decided to reorganize as an S corporation. Because an S corporation can have no more than 75 shareholders, BBC USA could allow only 75 shareholders to retain an interest in the S corporation. The shareholders who could not retain an interest in BBC USA were permitted to exchange their BBC USA shares for equivalent limited partnership interests in the taxpayer. BBC then redeemed the shares of its stock contributed to the taxpayer in exchange for $142,506,000. The taxpayer reported capital gains of $119,909,317 on its 2001 federal income tax return and classified the capital gains on its Tennessee excise tax return as nonbusiness earnings, not subject to excise tax. The Tennessee Department of Revenue classified the capital gains as business earnings subject to tax, and the Supreme Court of Tennessee agreed.

The court found that the taxpayer's gain from the one-time purchase and sale constituted business earnings under a functional test and was therefore subject to tax. The interest sold was integral to the taxpayer's generation of income. The transaction served an operational, rather than investment, function and was thus unitary with the taxpayer's ice cream business as well as with the business of its parent company.

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