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FIRST CIRCUIT DENIES REHEARING OF AUTOZONE NOTWITHSTANDING THE RECENT LOUISIANA SUPREME COURT DECISION OF KEVIN ASSOCIATES, L.L.C.

By

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On February 27, 2004, the Court of Appeal of Louisiana, First Circuit, denied the Louisiana Department of Revenue's (the "Department") request for rehearing of its decision in *Cynthia Bridges v. AutoZone Properties, Inc.*, Docket No. 2003-CA-0492, 2004 La. App. LEXIS 1 (La. App. 1 Cir., 1/05/04), *rehearing denied*, 2004 La. App. LEXIS 400 (La. App. 1 Cir., 2/27/04) notwithstanding the recent Louisiana Supreme Court decision of *Kevin Associates v. Crawford*, Docket No. 03-0211, 2004 La. Lexis 226 (La. 1/30/04).

AutoZone is a suit by the Department against AutoZone Properties, Inc. ("AutoZone Properties"), to appeal the district court's decision to sustain AutoZone Properties' peremptory exception of lack of jurisdiction for the imposition of Louisiana corporation income tax on due process grounds. AutoZone Properties' only contact with Louisiana was its ownership interest in a REIT that had substantial contacts with Louisiana. The REIT was taxed as a corporation for federal and Louisiana income tax purposes, however, REITs are not subject to tax if they distribute at least 90% (95% during the taxable periods at issue in *AutoZone*) of their taxable income as dividends.

In affirming the district court's decision sustaining AutoZone Properties' exception, the First Circuit Court of Appeals held the REIT shares "…were not acquired by [AutoZone] Properties in the course of any business conducted in Louisiana. There is no indication that any physical evidence of the share ownership or receipt of dividends has ever occurred in Louisiana. No accounting records of the dividends have been kept in Louisiana. [AutoZone] Properties plays no part in the decision-making process of Development with respect to the payment of dividends. Thus, the ownership and control of these shares remained in [AutoZone] Properties, and there has been a complete lack of localization or integration of the dividends within Louisiana, which legally is of the essence of 'business situs' for purposes of taxation." *Id., citing*, *McNamara v. George Engine Co. In*c., 519 So. 2d 217 (La. App. 5 Cir. 1988); *Gay v. Bessemer Prop.,* 32 So. 2d 59 (1947).

In its denial of the Department's application for rehearing, the First Circuit Court of Appeals stated that "… we find [*Kevin Associates*] distinguishable from the facts in the instant case, because the parent corporation in *Kevin Associates* **had a much more pervasive presence in Louisiana**." (emphasis added). The apparent position of the First Circuit Court of Appeals is that *Kevin Associates* was based on the Supreme Court's finding that the Delaware intangible holding company in question had a "pervasive presence in Louisiana" because of the presence of officers and directors in the state making decisions regarding the company. As a result, the *AutoZone* decision provides further evidence that *Kevin Associates* would not control cases of taxpayers that have properly structured their operations, such that management activities have not taken place in Louisiana and sufficient substance has been established outside of the state. If the Department wishes to tax distributions to out of state affiliates, then, as noted by the court in *AutoZone,* "the Department's remedy appears to lie with the legislature."

One certainty is that the Department is going to continue its aggressive pursuit of what it has deemed to be improper tax planning. However, so far taxpayers that have properly structured their operations have been successful in convincing the state courts that the Department's efforts are misguided.

Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues, contact:

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