JONES WALKER
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TAX & ESTATES

August 2011 Vol. 44 tax@joneswalker.com

GAIN ON SALE OF LOUISIANA REFINERY CONSTITUTES APPORTIONABLE INCOME

In *BP Products North America, Inc. v. Bridges*, No. 2010 CA 1860 (La. App. 1 Cir. 8/10/11), the Louisiana First Circuit Court of Appeal affirmed a trial court decision holding that gain recognized by the taxpayer on the sale of a refinery in Louisiana constituted apportionable income for Louisiana corporation income tax purposes. The Louisiana Department of Revenue (the "Department") argued that the gain constituted allocable income that was allocated entirely to Louisiana. While the applicability of the decision has been altered by subsequent amendments to the relevant statutes,[1] the decision remains an important one in several respects.

BP Products North America, Inc. (the "Taxpayer") was involved in the exploration and production of oil and gas, transportation of oil and gas products through pipelines, refining crude oil into various consumer products, manufacturing of chemicals, development of alternative energy sources, and marketing of its various products through retail sales outlets. The Taxpayer was a member of an affiliated group of entities (the "BP Group") and operated as part of that group's overall exploration, production, and refining business. One of the properties owned by the Taxpayer was a refinery in Louisiana.

As part of the BP Group's annual strategic planning efforts, all refineries owned by the BP Group were evaluated to determine which of them best fit the group's overall global strategic goals and strategies. Based on the annual evaluations, decisions concerning acquisitions and divestitures were made and implemented. Over the years the BP Group had bought and sold several refineries as part of its overall business. As a result of the 1998 annual evaluation and strategic decision to reduce the BP Group's exposure in the refining business, the Taxpayer sold the Louisiana refinery in 2000 and recognized a gain on the sale. After the sale of the refinery, the Taxpayer continued its refining business at other locations and expended them to meet market needs. The proceeds from the sale were invested in other aspects of the BP Group's overall business and were not distributed to shareholders.

On its 2000 Louisiana corporation income tax return, the Taxpayer reported the gain on the sale of the Louisiana refinery as apportionable income, which was apportioned within and outside Louisiana in accordance with the applicable statutory apportionment formula. The Taxpayer essentially took the position that the sale of the Louisiana refinery was made in the regular course of its business, and, therefore, was properly characterized as apportionable income. On audit, the Department determined that the gain on the sale of the refinery should be treated as allocable income and allocated it

[1] For taxable years beginning prior to January 1, 2006, profits or losses from sales or exchanges of property not made in the regular course of business were treated as allocable income and specifically allocated to one state. The Louisiana corporation income tax statutes were amended in 2005, applicable to periods beginning after December 31, 2005, to treat any gain from the sale of property, whether made in the regular course of business or not, as apportionable income. *See* Acts 2005, No. 401. Despite this statutory shift, the determination of whether or not a sale is in the regular course of business remains relevant for certain taxpayers for purposes of applying the statutory apportionment provisions. *See, e.g.,* La. R.S. 47:287.95(F) and La. Admin. Code, Title 61, § I.1134(D).

entirely to Louisiana. The Department asserted that the Taxpayer's regular business was exploration, production, refining, and marketing of oil and gas and related petroleum products. The Department claimed that the Taxpayer was not in the business of buying and selling refineries. The Department partially relied on its own regulation, Louisiana Administrative Code, Title 61, § I.1134(D)(2) ("Reg. 1134"), as it applied during the 2000 taxable period which provided that sales of "property acquired for use in the production of income" are not considered sales made in the regular course of business.[2] The Department also relied on its "stated policy," which apparently is unwritten, of treating as allocable income all income from sales of any property that was used to produce the products that are sold in the regular course of a taxpayer's business.

The Taxpayer paid the additional tax under protest and filed a refund suit challenging the Department's classification of the gain as allocable income. The parties filed cross-motions for partial summary judgment. The Taxpayer presented substantial evidence that the sale of the Louisiana refinery was indeed made in the regular course of business and that the gain should be treated as apportionable income. The Department did not contest the considerable facts presented by the Taxpayer. Instead, the Department relied exclusively on Reg. 1134 and its unwritten "stated policy." The district court granted the Taxpayer's motion and denied the Department's motion, concluding that the sale of the Louisiana refinery was made in the regular course of the Taxpayer's business and the gain was apportionable income. The Department appealed to the Louisiana First Circuit Court of Appeal.

For Louisiana corporation income tax purposes, all items of taxable gross income must be segregated into two classes – allocable income and apportionable income. La.R.S. 47:28.92(A). Specifically enumerated items of allocable income are listed in La. R.S. 47:287.92(B). All items of income that are not specifically listed as allocable income are treated as apportionable income. La. R.S. 47:287.95(C). Items of allocable income are specifically allocated to the state where the income is earned or derived. La. R.S. 47:287.93. Apportionable income is apportioned within and outside Louisiana based on the applicable statutory apportionment formula. La. R.S. 47:287.93 and 47:287.94.

For the tax year at issue, 2000, allocable income included "profits or losses from sales or exchanges of property … not made in the regular course of business." La.R.S. 47:287.92(B)(2).[3] Further, La.R.S. 47:287.93(A)(3), as it applied during the 2000 taxable period, provided in pertinent part that "profits or losses from sales or exchanges not made in the regular course of business … shall be allocated to the state where such property is located at the time of the sale."[4] Louisiana Administrative Code, Title 61, § I:1130.A.3 ("Reg. 1130") provides the following guidance for the meaning of "regular course of business":

[2] This regulation is now embodied in La. Admin. Code, Title 61, § I.1134(D)(3).

[3] La. R.S. 47:287.92(B)(2) was amended by Acts 2005, No. 401, effective for taxable periods beginning after December 31, 2005, to remove profits and losses from sales or exchange of property not made in the regular course of business from the definition of allocable income. As a result, such profits and losses now are treated as apportionable income.

[4] This provision was deleted by Acts 2005, No. 401, effective for taxable periods beginning after December 31, 2005.

> Whether a sale or exchange is a sale not made in the regular course of business is a factual determination required to be made with respect to each property sold which would take into consideration such factors as the frequency of sales of similar properties and the relationship of the particular sale to other business transacted by the taxpayer.

The Louisiana First Circuit Court of Appeal first addressed the Department's reliance on Reg. 1134 which states unequivocally that the sale of any property that is acquired for use in the production of income is considered a sale not made in the regular course of business, regardless of the facts surrounding such sale. The court correctly noted that such regulation, as applied by the Department, ignores the language of the La.R.S. 47:287.92(B)(2) and 47:287.93, both of which state that only the profits from sales not made in the regular course of business are to be taxed as allocable income. In order to determine whether a sale is not made in the regular course of business, it is necessary to examine all of the factual circumstances surrounding the sale taking into consideration the factors described in Reg. 1130. The court noted that the Department failed to make any inquiry into the factors described in Reg. 1130, and simply relied on Reg. 1134. The court admonished the Department's position as follows:

> Used in this way, the Department creates a definition in Regulation 1134 that undermines the **statutory** mandate to consider the regular course of business in determining whether or not a sale results in allocable income. Also, the Department thereby ignores Regulation 1130, which requires that a factual determination be made. An administrative construction cannot be given effect where it is contrary to or inconsistent with the legislative intent of the applicable statute. Therefore, we believe the Department's reliance on Regulation 1134 is misplaced, and it failed to consider the relevant factors when it reclassified the gains from the Alliance refinery sale as allocable income.

2010-1860, p. 6 (citations omitted).

The court then recited the significant evidence presented by the Taxpayer showing that the sale of the refinery was part of a global business strategy. The court concluded that it was clear from the evidence that the sale of the refinery was a type of business transaction that was a regular practice of the Taxpayer and part of the overall global strategy of the refinery segment of the BP Group. In addition, the court noted that the sale was directly related to its overall business since it was designed to streamline the refining operations so that those operations better served the current needs of all segments of the business and met the BP Group's strategic goals. The court concluded that the sale of the refinery was made in the regular course of the Taxpayer's business and that the income was properly treated as apportionable income.

Although treatment of the gain at issue in the case as apportionable income is now statutorily mandated by the amendments enacted by Acts 2005, No. 401, the case is important for several reasons. *First*, the court flatly rejected the Department's reliance on its unwritten, "stated policy" that gain on the sale of an asset that was used by a taxpayer in a business could never constitute a sale in the regular course of business. *Second*, the court also rejected the Department's reliance on Reg. 1134, which was inconsistent with the applicable statutes and Reg. 1130. *Third*, as noted above in footnote 1, the determination of whether or not a sale is in the regular course of business remains relevant for certain

taxpayers for purposes of applying statutory apportionment provisions. *Finally*, the case demonstrates the importance of analyzing transactions "on the front end" to determine the likely tax aspects. In this case, the BP Group designed, documented, and implemented annual strategic plans, which often included sales of major assets, such as the Louisiana refinery. The Taxpayer was able to present evidence supporting the Taxpayer's reporting position that the sale of the Louisiana refinery was indeed made in the regular course of the Taxpayer's business.

--For additional information, please contact a member of the Jones Walker Tax & Estates Practice Group.

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August 2011 Vol. 44 tax@joneswalker.com

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