



## **WELCOME TO THE JONES WALKER STATE AND LOCAL TAX BLOG**

Welcome! If you are reading this, you likely have an interest in state and local taxation (“SALT”). As part of our ongoing efforts to inform clients, colleagues, associates and friends in as timely a manner as possible about current events involving the SALT world, we, the Jones Walker SALT Team, decided to start a blog. In deciding on the format for the blog, and as New Orleanians, we, based upon our own experience and practice in the SALT arena, decided that we would not only discuss and explore the world of SALT, but would also include features and discussions related to the world of food and all that it involves, including our own recent experiences with food. Other than the obvious relationship of SALT (or salt) and food, food has, at least for me, served as a great source of creative inspiration for handling SALT issues. As the head of our SALT Team, Bill Backstrom, likes to say everything is better with a little salt.

While one might think that a blog that combines SALT with food is kitschy, and at some level it may be, as I commented above, food has provided me with many practical analogies for handling SALT cases. In fact, in a very specific case involving Louisiana state and local sales taxes, food provided the analogy that I believe explained the issue to the Louisiana Supreme Court better than any technical expert could have.

The case involved the manufacture of white paper like each of us use daily. In manufacturing the paper, my client, International Paper Company, Inc. (“IP”) purchased three raw materials that were specifically chosen for use in the bleaching process. While a discussion of the technical aspects of the papermaking process would not likely encourage you to continue reading (unless you are Dwight Schrute), I will provide a bit of context. As I learned while handling the case, raw wood is composed of three types of fiber: cellulose, hemicellulose and lignin. Lignin is the glue that holds the other fibers together. During the initial conversion of the raw timber into pulp, much of the lignin is dissolved and removed. However, a certain percentage of the lignin intentionally remains in the wood pulp and it is the lignin that gives pulp its brown color, (i.e. a typical paper bag one gets at the grocery store). In the bleaching portion of the process, the three raw materials at issue are introduced into the process. These materials interact with the lignin at the atomic level and as a result 1) the lignin becomes water soluble and thus is easier to remove from the pulp, and 2) the remaining lignin molecules are oxidized so that they reflect all visible light and thereby give the pulp a white color.

Under Louisiana law, materials purchased for further processing are excluded from sales and use taxes at the state and local level. *See* La. R.S. 47:301(10)(c)(ii). Louisiana courts have interpreted that statute and the Louisiana Department of Revenue’s Regulation to impose a three-part test for determining whether a particular item qualifies as a material purchased for further processing. Those three criteria are: 1) the raw material must become a recognizable and identifiable component of the end-product; 2) the raw material must be of benefit to the end-product; and 3) the raw material must be purchased for the purpose of inclusion in the end-product.

The Department argued that the three materials at issue did not qualify under the test because the taxpayer allegedly purchased the materials for the “primary” purpose removing the lignin and not to oxidize it and become part of the finished product. The testimony from expert witnesses and the actual engineer in charge of the process testified that the raw materials at issue were purchased to serve the two purposes described above; i.e. remove lignin and oxidize the remaining lignin. The testimony was undisputed that, as papermakers sell paper by weight, the more lignin that remained in the end-product resulted in higher revenues.

The matter was tried to the Louisiana Board of Tax Appeals (“BTA”) who ruled in favor of the taxpayer. That decision was affirmed by the district court. However, the Department appealed that ruling to the Court of Appeal, Second Circuit. That Court concluded that the appropriate standard did include a “primary” purpose test, as argued by the Department, and that each specific material had one “primary” purpose and that purpose would be the determining factor in whether the material met the test to be a material purchased for further processing. Based on that conclusion, the Court of Appeal reversed the decisions of the BTA and the district court. The Louisiana Supreme Court granted writs and agreed to review the lower court decisions.

At this point, although you as a SALT professional likely find issues like these interesting, you are wondering how these further processing issues are related to food and how food can serve as an inspiration for the case. The answer is simple: Bananas Foster.

As I prepared for oral argument before the Louisiana Supreme Court, I tried to think of an analogy that would clearly illustrate to the Justices why our arguments regarding the application of the further processing exclusion were correct. While I believe we had written our position very clearly and succinctly in the briefs, and knew that as an exclusion that the provision should be construed in the taxpayer’s favor, I was also aware that the case involved technical facts and involved technical legal concepts. In the outline of my oral presentation, I left a blank for that perfect analogy that, as of the morning of the argument, had escaped me.

For those of you who have never been to the Louisiana Supreme Court, it is housed in a building dating to 1910 (recently renovated) at 400 Royal Street in the French Quarter in New Orleans. As I and my partner Andre Burvant, walked down Royal Street from Canal Street to the Courthouse, I continued to go through my planned argument in my mind. For those of you who have been to the Louisiana Supreme Court, or stumbled down Royal Street at some point in your visits to the City, you may also be aware that the building across the street from the Louisiana Supreme Court on Royal Street houses Brennan’s Restaurant.

As we walked closer to the well-known pink exterior of the restaurant, I saw an image in the window of a waiter making a familiar and renowned New Orleans dessert: Bananas Foster. As I walked up the steps of the Courthouse, I recalled a recent birthday celebration for my brother where Bananas Foster was made at tableside. One of the key ingredients in Bananas Foster is dark rum that is added to brown sugar, butter, and the bananas, of course, and is “flamed” as part of the process of combining the ingredients and cooking the bananas. While the flavor of the rum remains in the sauce, as the waiter explained to my pregnant sister at the dinner, the alcohol is

burned off. As I replayed this fun family evening in my mind, and as I passed through security at the Supreme Court Building, as I gathered my briefcase, I realized that I had found my analogy.

During oral argument, in the place I had left in my outline, and after I described the facts of the process as discussed above, I used the analogy of making Bananas Foster as the reason why the raw materials at issue were excluded from sales tax. As I pointed out, no one disputed that when the restaurant purchased the rum, it was purchased, with respect to Bananas Foster, for more than one purpose. The rum provides flavor to the sauce even though the alcohol is burned off. As a majority of the Justices rocked back in their chairs smiled and shook their heads in a sign of acknowledgement of their understanding, it was clear that most of them understood my case and understood the arguments we had made. In fact, when the attorney for the Department began his argument to the Court, one of the first questions asked by the Justices was for his thoughts on my analogy of the process at issue with the making of Bananas Foster. His response was simply that he was not familiar with the dish.

About eight weeks later, the Louisiana Supreme Court issued its decision reversing the Court of Appeal and reinstating the decision of the BTA that the taxpayer was entitled to a refund of taxes paid on the materials at issue. *See International Paper Company, Inc. v. Bridges*, 2007-1151 (La. 1/16/08), 972 So. 2d, 1121. The Court also articulated what is now the standard for every case involving materials purchased for further processing as follows:

- 1) The raw materials, or any of their component parts, must become recognizable and identifiable components of the end-products; 2) the raw materials, or their components, must be beneficial to the end-products; and 3) the raw materials, or their component parts, are material for further processing and as such are purchased with the purpose of inclusion in the end-products.

The decision clarified the law regarding materials purchased for further processing and has given taxpayers clarity regarding this important issue.

As you can see, the Jones Walker SALT Team believes that the relationship between food and the practice of state and local tax are closely intertwined for many reasons. Bill, Andre and I occasionally walk into the French Quarter seeking inspiration. Based on our own experiences and our love of food and SALT, we intend to post about important and relevant developments in state and local tax and also share our thoughts and experiences about food and all that goes with it (i.e. wine and cocktails). We hope that you will enjoy the blog and encourage you to participate and share your own experiences, not only in the SALT realm, but also with food.