

**IN THE
SUPREME COURT OF MISSOURI**

SC87811

ABB C-E NUCLEAR POWER INC.,

Respondent,

v.

DIRECTOR OF REVENUE,

Appellant.

**From the Administrative Hearing Commission of Missouri
The Honorable Karen A. Winn, Commissioner**

**SUBSTITUTE REPLY BRIEF
OF APPELLANT DIRECTOR OF REVENUE**

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ARGUMENT

A. The "business."

In arguing that the Director looks the wrong place to determine the nature of the taxpayer's business, ABB Nuclear focuses solely on the Director's discussion of the business of ABB Nuclear's parent or of the ABB family of companies. ABB Nuclear does not attack the Director's characterization of that business, except to deny that the record is as sparse as the Director suggests. Tellingly, though, ABB cites nothing specific as support for that denial. In fact, unable to cite anything, ABB cites everything; the record it created consists almost entirely of "the Affidavit of Julietta Guarino . . . and the extensive exhibits attached thereto" that ABB cites. Resp. Br. at 24 & n. 6. But if there is something in that affidavit and the accompanying exhibits that gives any substantial information about the true scope of ABB's business - and, most pertinent, the role of buying and selling companies in that business - ABB Nuclear apparently is unable or unwilling to identify it. And as discussed in the Appellant's brief, the Director has reviewed the record and determined that it simply is not there.

In ABB Nuclear's view, of course, the absence of evidence about the business of the parent or the family of companies is irrelevant: because ABB set up a subsidiary, assigned to that subsidiary certain assets and businesses, all that matters is what that subsidiary, ABB Nuclear, does. That argument leads

inexorably to a conclusion that ABB Nuclear ignores: that the AHC was required to determine just what ABB Nuclear's business was. Thus, even more telling than the absence from ABB Nuclear's brief of reference to specific evidence of ABB's business is the absence of even discussion of ABB Nuclear's business. Even in its Statement of Facts, ABB gives the business of ABB Nuclear a single paragraph, consisting of two sentences: the first a conclusory, non-exclusive sentence about the business ("ABB C-E Nuclear was engaged in the nuclear business in the United States." Resp. Br. at 13), without citation to any source; the second identifying the location of ABB Nuclear facilities, citing a single conclusory paragraph from someone who didn't even work at ABB Nuclear (*id.*, citing Guarino affidavit ¶ 18).

Apparently unable to cite anything in the record that would give at least a hint as to what the parameters of "the nuclear business" were (or even whether it was ABB Nuclear's only business), ABB Nuclear simply objects to the Director's conclusion that ABB Nuclear operated as a division of ABB. Resp. Br. at 24-25. But even then, ABB Nuclear is unable to provide any record support for its implied conclusion that ABB Nuclear operated independent of ABB in any meaningful sense.

ABB closes its discussion of the record with an odd reference to "the substantial discovery in this case by the Director." Resp. Br. at 25. The Director might well disagree that the discovery she undertook was "extensive." But the disagreement would not be material here. After all, the AHC was

required to rule based on the record, not on discovery. And it was ABB Nuclear's burden, not the Director's, to be sure that the record contained sufficient information about ABB Nuclear to support its claim. Evidence that can support nothing more than the non-exclusive finding that ABB Nuclear was "engaged in the nuclear business" (AHC ¶ 3) is simply not enough.

B. "Business income."

ABB Nuclear does not contest the key statutory construction point made by the Director in light of the decision of the Court of Appeals, Western District to transfer: that § 32.200 Art. IV § 1(1) should be construed to contain two alternative tests for determining whether something is "business income." Thus the question before the Court is whether the sale of ABB Nuclear's assets produced income within either one of those tests. In that regard, a few of ABB's specific points merit a brief response.

1. The transactional test.

In its Statement of Facts, ABB (this time, with support from the record) states that a large portion of the value obtained by the purchaser of ABB Nuclear was "from the sale of goodwill." Resp. Br. at 17. Goodwill is earned, of course, from the operation of a business. Thus the Oregon Tax Court held that "[u]nder the transactional test, the sale of goodwill by definition is business income." *Sandoz Agro, Inc. v. Department of Revenue*, 2000 WL 292930 (Ore. 2000).

In ABB's view, however, all that matters is that the income, from goodwill or not, is produced by liquidation. In that view,

the dispositive point is that “ABB C-E Nuclear was not in the business of selling all of its assets and then liquidating and distributing all of its sales proceeds to its parent corporation .” Resp. Br. at 31. (Of course, the record does not expressly support that statement - hence it is followed not by citation to the record, but to a series of cases decided in other states. See *id.*) The Director cannot reasonably argue, of course, to the contrary; it makes no logical sense that any company would be in the business of liquidating itself. But as the Director argued in her opening brief, that is not the right way to define a “business.” See App. Br. at 33-38. Again, the Court should reject ABB’s request that it create a “liquidation exception.”

2. The functional test.

ABB’s functional test argument focuses on the words “acquisition, management, and disposition of the property.” § 32.200, Art. IV § 1(1). Apparently in ABB’s view, the proper application of the functional test requires the Court to look at each piece of property, and conclude whether it was acquired, managed, and disposed of in the regular course of the taxpayer’s business. Resp. Br. at 34. That is an irrational reading of the statute. It would exclude from the definition of “business income” any income that is produced from the “management” of property - unless and until the company disposes of that property. ABB provides no justification, in either logic or precedent, for such a reading. The logical reading is that the functional test covers income that is derived from property that

is acquired in the regular course of business, property that is managed in the regular course of business, and property that is disposed of in the course of the taxpayer's business. And here, there is no real argument - much less an argument based on anything in the record - that the assets of ABB Nuclear were at the very least acquired and managed in the course of "the nuclear business."

The sole Missouri case that ABB cites in its functional test argument, *James v. International Telephone & Telegraph Corp.*, 654 S.W. 2d 865 (Mo. banc 1983), is not to the contrary. Indeed, it stands for a very different conclusion: that the functional test does not cover revenue derived from the disposition of property for a truly extraordinary reason - such as a disposition in response to regulatory or legal requirements, rather than to grow its own business. In *James*, the disposition was a divestiture required in a consent decree in "an antitrust suit against ITT brought by the United States Department of Justice." *Id.* at 866. It was not the result of a business decision to refocus a company's power supply services efforts.

That was not true, of course, in the Illinois case that ABB principally cites, *American States Insurance Co. v. Hamer*, 816 N.E. 2d 659 (Ill. App. Ct. 2004). But there the sale "result[ed] in a cash distribution to shareholder," not the reinvestment of the proceeds in other aspects of a company's business. *Id.* at 661. There is simply no logical reason to exclude from "business income" the proceeds of the sale of property used in one aspect

of a business so that those proceeds can be used elsewhere, simply because that particular sale encompasses all (or the last of) a subsidiary's property.

C. "Deemed" sale of assets.

ABB Nuclear includes a curious discussion, in its part IV, of how the transaction would be treated in the absence of the "deemed sale of assets" election. ABB makes no argument for such treatment, merely offering it as an alternative. It is an alternative that the Court should decline to accept - not just because ABB provides neither a reason to accept it, but because such treatment is correct under Missouri law.

The General Assembly has chosen to have Missouri income tax laws draw from federal income tax laws. Missouri imposes a tax on a corporation's "Missouri taxable income." § 143.071. That income is calculated as the "Missouri adjusted gross income" with certain adjustments. § 143.111. And "Missouri adjusted gross income" is defined as "federal gross income subject to [certain] modifications." § 143.121.1. The Director and the AHC agreed that once a taxpayer chooses an election that modifies its "federal gross income," it is bound by that election when filing in Missouri - a conclusion that is consistent with the philosophy enacted in § 143.091: "Any term used [in the Missouri income tax law] shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required by provisions of [the Missouri law.]"

In that respect, Missouri law is the same as the law in Massachusetts, applied in *General Mills, Inc. v. Commissioner of Revenue*, 795 N.E.2d 552 (Mass. 2003). There the Massachusetts Supreme Court rejected the rule on which ABB's "treat as a stock sale" argument would be based. Missouri, like Massachusetts, includes in gross income all income not excluded. *Id.* at 566. And in Missouri, like Massachusetts, "[t]here is no statute that denies recognition of an election under § 338(h)(10) or otherwise excludes income resulting from such an election." *Id.* The Massachusetts Court explains, for Talbots (a subsidiary like ABB Nuclear) and General Mills (a parent like ABB), the practical effect of the election:

Had Talbots actually sold its assets, there can be no doubt that the gain would have been taxable in Massachusetts. The "fiction" created by [Internal Revenue Code] § 338(h)(10) simply allowed the parties to change the means by which the gain was realized and by whom. It permitted General Mills and Talbots to elect which of them would report that gain on its portion of their consolidated Federal return. . . . There was nothing "fictional" about the effect of the election for Federal tax purposes.

Id. at 567.

Here, too, there is "nothing 'fictional'" about the federal tax treatment of the sale of ABB Nuclear. ABB and its subsidiary voluntarily chose a method of taxation that affected both their federal and their state tax liability. There is simply no need

to consider what the effect might have been if they had made a different choice.

CONCLUSION

For the reasons stated above and in the Director's opening brief, the Court should reverse the decision of the Administrative Hearing Commission and affirm the decision of the Director of Revenue.

Respectfully submitted,

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CERTIFICATION OF COMPLIANCE

The undersigned hereby certifies that the foregoing brief complies with the limitations contained in Rule No. 84.06(b), and that the brief contains 1,935 words.

The undersigned further certifies that the labeled disk simultaneously filed with the hard copies of the brief has been scanned for viruses and is virus-free.

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