

**BOARD OF APPEALS
STATE OF LOUISIANA**

**DAVIS LYNCH HOLDING CO., INC.
PETITIONER**

**VERSUS
DOCKET NO. 9586D**

**SECRETARY, LOUISIANA DEPARTMENT OF
REVENUE, STATE OF LOUISIANA
RESPONDENT**

REASONS FOR JUDGMENT

Before this Board is the Petitioner, Davis-Lynch Holding Co., Inc. (“Davis Lynch”) appealing an assessment of Louisiana income tax by the Secretary, Louisiana Department of Revenue and Taxation (the “Secretary”) for the taxable year ended December 31, 2011. This Board heard a trial on the merits on October 9, 2018. Participating in the trial were: Jason R. Brown, attorney for Davis Lynch and Miranda Y. Conner, attorney for the Secretary. After the hearing, the case was taken under advisement. For the reasons that follow, we find in favor of the taxpayer Davis Lynch.

For the taxable year 2011, Davis Lynch was a Texas Corporation that did not conduct any direct business in the State of Louisiana. However, Davis Lynch owned 100% of Davis-Lynch, L.L.C. (the “LLC”) that was authorized to (and did) business in Louisiana in 2011. The LLC was a manufacturer of cementing tools used in the oil and gas industry and had been engaged in this business in Louisiana for a number of years prior to 2011. For Federal and Louisiana income tax purposes, the LLC was a disregarded entity pursuant to Treas. Reg. §301.7701-3(a). On July 29, 2011, Davis Lynch sold 100% of its LLC interest in an arm’s length transaction to Forum

Energy Technologies, Inc., an unrelated third party purchaser. The purchase price for the LLC interest was not disclosed or otherwise introduced into evidence. Also, no party introduced the 2011 Davis Lynch federal income tax return or the purchase agreement for the LLC interest (or any related sale documents) between Davis Lynch and Forum Energy Technologies, Inc.

The Secretary conducted an income tax audit of Davis Lynch's 2011 Louisiana State Income Tax Return (CIFT-620, the "Corporate Return"), Davis Lynch, being domiciled in Texas, segregated its income as set forth in La. R.S. 47:287.92. On the Schedule P - "Computation of Louisiana Net Income" - filed with its 2011 Louisiana Corporate Return, Davis Lynch reported total gross sales of 60,863,753, total cost of goods sold of \$28,925,689, resulting in total net income of \$31,938,064. In addition, the Schedule P attached to the Louisiana Corporate Return ("Computation of Louisiana Net Income) reflected total "other income" of \$254,762,452. Statement 14 to the 2011 Louisiana Corporate Return reflected other income of \$289,717; Capital Gain Net Income of \$245,720,068; and net gain from Form 4797 (a federal form attached to the 2011 Davis Lynch Form 1120 (federal corporate income tax return) reporting sales of business property of \$8,752,667, totaling the \$254,762,452 reflected in "other income" in the Schedule P attached to the Davis Lynch Louisiana Corporate Return. Davis Lynch calculated an apportionment percentage using the three factor formula set forth in La. R.S. 47:287.95(F)(1)(a)-(c) of 1.11%, and thus allocated \$2,865,128 of the \$258,119,605 of the total net income subject to apportionment to Louisiana and paid its 2011 Louisiana income tax on that basis. Under La. R.S. 47:287.95(F)(1)(c), one of the factors in determining the apportionment percentage is the "ratio of net sales made in the regular course of business and other gross apportionable income attributable

to this state to the total net sales made in the regular course of business and other gross apportionable income of the taxpayer”. Davis Lynch did not include the “other income” of \$254,762,452 in the numerator of the ratio, but included this figure in the denominator, thus resulting in the smaller percentage of 1.11%.

On its first audit, the Department agreed with Davis Lynch’s use of the three factor analysis, but otherwise the Department adjusted the apportionment percentage substantially upward by claiming that the “taxpayer has included income that is not in the taxpayer’s regular course of business in the revenue ratio.” This adjustment resulted in a Notice of Assessment of additional tax due of \$961,621. Davis Lynch timely filed a petition with this Board in response to this Notice. The petition was assigned Docket No. 9586D.

Subsequently, the Department conducted a second audit of the 2011 Davis Lynch Louisiana Corporate return, and further increased Davis Lynch’s tax liability by \$2,381,663. The reason for the second audit was that the Secretary took the position that contrary to its prior position that Davis Lynch had properly used the three factor formula found in La. R.S. 47:289.95(F)(1), it instead should have used a single factor formula. This adjustment resulted in a second Notice of Assessment, which was also timely appealed by Davis Lynch to this Board. The petition filed in response to this second petition was assigned Docket No. 11103D. No clear basis was articulated by the Secretary for the application of a single factor formula. Prior to the trial on the merits in this matter, Davis Lynch and the Secretary resolved the second assessment and filed a Joint Motion to Dismiss the petition filed under Docket No. 11103D, and this Board signed an Order dismissing the Petition on October 23, 2018.

The issue presented is whether the gain Davis Lynch derived from the sale of

its interest in the LLC is properly included in the sales factor ratio as set forth in La. R.S. 47:298.95(F) (1) -(3).

At the relevant time, La. R.S. 47:287.95(F)(1)-(3) provided:

Manufacturing, merchandising, and other business.

(1) Except as provided in this Subsection, the Louisiana apportionment percent of any taxpayer whose net apportionable income is derived primarily from the business of transportation by pipeline or from any business not included in Subsections A through E of this Section shall be the arithmetical average of three ratios, as follows:

(a) The ratio of the value of the immovable and corporeal movable property owned by the taxpayer and located in Louisiana to the value of all immovable and corporeal movable property owned by the taxpayer and used in the production of the net apportionable income.

(b) The ratio of the amount paid by the taxpayer for salaries, wages, and other compensation for personal services rendered in this state to the total amount paid by the taxpayer for salaries, wages, and other compensation for personal services in connection with the production of net apportionable income.

(c) The ratio of net sales made in the regular course of business and other gross apportionable income attributable to this state to the total net sales made in the regular course of business and other gross apportionable income of the taxpayer.

La. R.S. 47:287.95(F)(1)(c) includes as one of the three ratios the “ratio of net sales made in the regular course of business **and other gross apportionable income** [emphasis added] attributable to this state to the total net sales made in the regular course of business and **other gross apportionable income** [emphasis added] of the taxpayer”.

Under Louisiana’s apportionment law, income is either allocable or apportionable. Under La. R.S. 47:287.92, “[a]ll items of gross income, not otherwise exempt, shall be segregated into general classes designated as allocable income and apportionable income.” Unless included in the four specific categories of income set forth in La. R.S. 47:287.92(B) (rents and royalties from immovable or corporeal

movable property, royalties or similar revenue from the use of intellectual property, income from estate, trusts and partnership, or income from construction, repair or similar services), La. R.S. 47:287.92(c) defines all other income as apportionable income. It would be inconsistent to apply a rule that defined income as apportionable, but then exclude that item of income from the sales factor calculation to determine the Louisiana apportionment percentage of that same income. Simply put, such a result is contrary to the plain reading of the then applicable statute.

The Department argues that the gain “is not gross income by definition” and therefore the gain recognized by Davis Lynch on the sale of the LLC should not be included in the denominator of the sales factor ratio as the gain “was not an item of gross apportionable income of the taxpayer.” The Department argues that a “gain” is calculated by subtracting the basis of the asset from the amount realized and thus cannot be an item of “gross” income and therefore not included in the sales factor ratio at all. However, the clear meaning of La. R.S. 47:287.95(F)(1)(c) requires that the “other gross apportionable income” be included in the ratio, and as defined by La. R.S. 47:287.92, **all** items of gross income are either “allocable” or “apportionable”. The Secretary’s interpretation would exclude entirely the income recognized by Davis Lynch on the sale of the LLC from the three factor ratio, a result clearly not contemplated by the statute. We find that the gain recognized by Davis Lynch on the sale of the LLC interest was properly included in the denominator of the sales factor ratio.

The Secretary further argues that pursuant to its Regulation 61:I.1134(D), revenue derived from sales not made in the ordinary course of business are to be excluded from the sales factor ratio. Specifically, LAC 61:I.1134(D) provides:

For the formula provided by R.S. 47:287(F), the revenue

ratio consists of the ratio of net sales made in the regular course of business and other gross apportionable income attributable to this state to the total net sales made in the regular course of business and other gross apportionable income of the taxpayer. Sales not made in the regular course of business are not included in the formula provided by R.S. 47:287.95(F).

The Secretary argues that the sale by Davis Lynch of the LLC interest was a sale not made in the ordinary course of business, and therefore under the Regulation, is not to be included in the formula provided by La. R.S. 47:287.95(F).

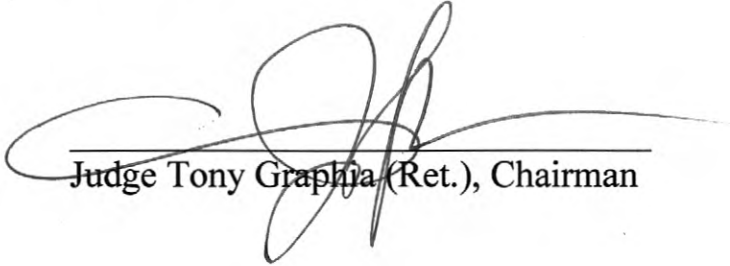
Davis Lynch argues that the above regulation substantively exceeds the scope of the relevant statute the regulation purports to interpret, and is therefore not applicable. La. R.S. 47:287.95(F)(1)(c) refers to “net sales made in the regular course of business and other gross apportionable income.” To adopt the Secretary’s interpretation would render the phrase “other gross apportionable income” meaningless. It is an accepted rule of statutory construction that it is not presumed that the legislature inserted idle, meaningless or superfluous language in a statute, or that it intended for any part or provision of a statute to be meaningless, redundant or useless. *ABL Management, Inc. v. Board of Supervisors of Southern University*, 773 So. 2d 131 (La. 2000). Likewise, it is well settled law that a tax regulation cannot exceed the taxing jurisdiction of a statute, as taxes are imposed by legislation, and not by regulation of the Secretary. *UTELCOM v. Bridges*, 77 So. 3d 39 (La. App. 1st Cir. 2011).

For the foregoing reasons, Davis Lynch’s Petition for Redetermination of Corporate Income Tax Assessment shall be granted in full, and judgment shall be

rendered against the Secretary in this matter, and the Secretary's assessments against Davis Lynch shall be vacated.

Baton Rouge, Louisiana, this 11 day of December, 2018.

For the Board:



Judge Tony Graphia (Ret.), Chairman