

NAVISTAR FINANCIAL CORPORATION §
455 North City Front Plaza Drive §
Chicago, IL 60611, §

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

Taxpayer, §

vs.

STATE OF ALABAMA §
DEPARTMENT OF REVENUE. §

DOCKET NO. INC. 93-249

FINAL ORDER

The Revenue Department assessed financial institution excise tax against Navistar Financial Corporation, Inc. ("Taxpayer") for the years 1989 and 1990. The Taxpayer appealed to the Administrative Law Division and the matter was submitted on a joint stipulation of facts. Ron G. Robbins represented the Taxpayer. Assistant counsel Mark Griffin represented the Department.

The issue in this case is whether the Taxpayer correctly apportioned its net income to Alabama for financial institution excise tax purposes during the years in question.

The Department argues that the Taxpayer must use the equally weighed three-factor apportionment formula of property, payroll and sales. The Taxpayer agrees that the three factors of property, payroll and sales should be used, but that the sales (gross receipts) factor should be computed using Department Income Tax Reg. 810-3-31-.02(5)(c)9(xii)(VII)IV. That regulation provides in substance that gross receipts in the three-factor formula shall be computed based on the ratio which the total property and payroll

factors in Alabama bear to the total property and payroll factors everywhere.

The facts are undisputed.

The Taxpayer is a wholly-owned subsidiary of Navistar International Transportation Corp. ("parent"). Both corporations are Delaware corporations headquartered in Illinois. The parent manufactures trucks and mid-range diesel engines and sells those products throughout the United States, including Alabama. The Taxpayer's principal business activity is the financing of wholesale and retail sales of the products manufactured and sold by the parent.

The Department audited the Taxpayer for 1983 - 1985 and directed the Taxpayer to apportion its income to Alabama for financial institution excise tax purposes using the three-factor formula of property, payroll and sales as set out in Department Income Tax Reg. 810-3-31-.02(5). The Taxpayer complied. However, the Taxpayer subsequently discovered the above-mentioned Reg. 810-3-31-.02(5)(c)9(xii)(VII)IV, and accordingly apportioned income to Alabama for the years in issue using that regulation. As stated, the above regulation allows a taxpayer to compute the gross receipts factor in the three factor apportionment formula based on the ratio that the property and payroll factors in Alabama bear to the property and payroll factors everywhere.

The Department rejected the Taxpayer's use of the above regulation and recomputed the Taxpayer's liability using the

standard three-factor formula. The Taxpayer appealed the resulting final assessment to the Administrative Law Division.

The Alabama financial institution excise tax is levied on the net income of a financial institution for the privilege of engaging in business as a financial institution in Alabama. Code of Ala. 1975, §40-16-4. "Net income" is defined at Code of Ala. 1975, §40-16-1(2) as gross income less the deductions set out therein. Unfortunately, neither the financial institution excise tax statutes (Title 40, Chapter 16), nor the Department's regulations relating thereto dictate how a financial institution operating in Alabama should apportion or compute its percentage of income earned in Alabama.

Rather, the Department as a matter of general policy requires all financial institutions to apportion net income to Alabama using the standard three-factor formula of property, payroll and sales. Those three factors are commonly used by most states for apportionment of income, franchise and other taxes because taken together they most accurately reflect the business activities by which value or income is generated. See generally, Container Corporation of America v. Franchise Tax Board, 103 S.Ct. 2933; Moorman Manufacturing Company v. Bair, 98 S.Ct. 2348.

I agree with the Taxpayer that the Department should have regulations that clearly instruct all financial institutions how to apportion income to Alabama, or otherwise how they should compute their Alabama financial institution excise tax liability. However,

the fact that the Department does not have adequate regulations does not authorize the Taxpayer in this case or any other financial institution to select an apportionment formula that does not fairly and accurately apportion net income to Alabama.

An apportionment formula must fairly and accurately reflect a taxpayer's activities in a given state. The standard three factor formula is used by the Department for financial institution excise tax purposes because it most accurately reflects the business activities of financial institutions by which value or income is generated. The Taxpayer in this case has failed to establish or even argue that use of Income Tax Reg. 810-3-31-.02(5)(c)9(XII)(VII)IV would more accurately apportion net income to Alabama than the standard three factor formula. To the contrary, the above regulation would disproportionately emphasize the property and payroll factors and thus reduce the relative importance of what should be the most heavily weighted factor for financial institutions, the gross receipts factor. In short, use of the above regulation does not accurately apportion the Taxpayer's net income to Alabama, and accordingly is rejected.

The Taxpayer also has not been denied due process because the Taxpayer had actual prior knowledge that the Department required all financial institutions to use the three factor formula. The Taxpayer had in fact used that formula for the years prior to the years in dispute in this case.

The final assessments in issue are affirmed, and judgment is entered against the Taxpayer for 1989 financial institution excise tax in the amount of \$22,863.48, and 1990 financial institution excise tax of \$17,422.52.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered on September 30, 1994.

BILL THOMPSON
Chief Administrative Law Judge