STATE OF ALABAMA DEPARTMENT OF REVENUE,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE
	§	ADMINISTRATIVE LAW DIVISION
vs.	§	
AMERICAN FRUCTOSE DECATUR, INC. State Docks Road, Route 1, Box 8 Decatur, AL 35601,	§	DOCKET NO. F. 94-125
Taxpayer.	§	

FINAL ORDER

The Revenue Department assessed franchise tax against American Fructose Decatur, Inc. ("Taxpayer") for the years 1988 through 1992. The Taxpayer appealed to the Administrative Law Division and a hearing was conducted on May 4, 1994. Bruce Ely and Allyson L. Edwards represented the Taxpayer. Assistant counsel Dan Schmaeling represented the Department.

The issue in this case is whether amounts invested by the Taxpayer in two wholly-owned subsidiary corporations, AMPCO Holding Corporation ("AMPCO") and Amp International Exporting, Inc. ("AMP International"), can be deducted from the Taxpayer's capital base for Alabama franchise tax purposes pursuant to Department Reg. 810-2-3-.03. That regulation allows an exclusion or deduction from capital for "the actual investment of the owning corporation in an operating subsidiary corporation doing business exclusively outside Alabama." The specific issues to be decided are as follows:

(1) Did AMPCO and AMP International constitute "operating subsidiary corporations which are regularly engaged in normal and recognized business activities and not merely dormant or holding corporations" so as to qualify for the exclusion under subparagraph (e) of Reg. 810-2-3-.03; and (2) Even if the investments in the

two subsidiary corporations can be excluded under Reg. 810-2-3-.03, should the regulation itself be rejected because it is not supported by Alabama law.

The facts are undisputed.

The Taxpayer (presently known as American Maize-Products Decatur, Inc.) was incorporated in Maryland and operates a corn wet milling business in Alabama. Both AMPCO and AMP International were wholly-owned subsidiary corporations of the Taxpayer during the years in issue.

AMPCO was initially a New York corporation, but changed domiciles to Texas in 1991. AMPCO does not do business in and is not qualified to do business in Alabama. AMPCO manages and invests the excess cash generated by the Taxpayer and various related entities. Specifically, AMPCO makes intercompany loans, handles excess intercompany cash, and evaluates and trades various investment vehicles such as commercial paper and certificates of deposit.

AMP International was organized under the laws of Barbados in 1991 and also does not do business in and is not qualified to do business in Alabama. AMP International is an electing foreign sales corporation ("FSC") that acted as commission agent for the Taxpayer and related entities and engaged in export sales during the subject period.

The Taxpayer's investment in AMPCO during the subject years consisted of excess cash transferred by the Taxpayer to AMPCO for investment purposes, plus earnings from the investments. The

Taxpayer's investment in AMP International was a much smaller amount, and consisted of the Taxpayer's initial investment, plus earnings.

The Taxpayer deducted the amounts invested in both subsidiary corporations from capital on its Alabama foreign franchise tax returns for the subject years. The Department audited the Taxpayer, denied the deductions, and based thereon entered the final assessment in issue.

Issue (1) - Did the Taxpayer's investments in AMPCO and AMP International qualify for the exclusion from capital allowed by Reg. 810-2-3-.03.

Reg. 810-2-3-.03 reads in pertinent part as follows:

> 810-2-3-.03 Exclusion of Investment In Subsidiaries. The investments held by foreign corporations in operating subsidiaries not commercial domiciled in Alabama are not includable in the franchise tax base. Therefore, there shall be allowed as an exclusion the actual investment of the owning corporation in an operating subsidiary corporation doing business exclusively outside Alabama. The following tests must be met in order to qualify the investment in a subsidiary as an exclusion:
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> (e) To qualify as a exclusion, the investment must be in an operating subsidiary corporation which is regularly engaged in normal and recognized business activities and not merely a dormant or holding corporation.
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> * * *

The Department argues that the investments in the two subsidiaries failed to qualify under subparagraph (e) of Reg.

810-2-3-.03 because AMPCO and AMP International were holding companies and not operating subsidiary corporations during the subject years. I disagree.

The Department claims that AMPCO and AMP International were not operating subsidiaries because they did not have operating income. (R.24). However, the regulation does not mention operating income, nor does it otherwise define "operating subsidiary corporation". In any case, even if operating income is accepted as a guideline, both subsidiaries generated operating income from their business activities during the assessment period.

"Operating income" is defined by the Department (and Black's Law Dictionary) as "income derived from the operations of business in contrast to operations from investments. " (R. 24). AMPCO and AMP International were both actively engaged in business activities during the subject years. AMPCO was actively engaged in the business of investing, and AMP International was actively engaged in the export business. Income derived from those business activities clearly constituted operating income.

AMPCO and AMP International also were not dormant or holding companies during the subject years. The Department concedes that the subsidiaries were not dormant corporations. (R. 23). "Holding company" is defined in substance as a corporation that owns stock in and supervises management of

other corporations. (R.27, 28). There is no evidence that either subsidiary owned stock in or controlled any other corporation during the assessment period. Clearly, neither AMPCO nor AMP International were holding companies under the above definition.

Based on the above, AMPCO and AMP International were operating subsidiaries and not holding companies during the subject period. Accordingly, the Taxpayer's investments in the two subsidiaries qualify for the exclusion from capital allowed by Reg. 810-2-3-.03.

Issue (2) - Should Reg. 810-2-3-.03 be followed?

The Department claims in the alternative that even if the investments can be excluded from capital under Reg. 810-2-3-.03, the regulation itself is not supported by statute and should not be followed.

Reg. 810-2-3-.03 was promulgated by the Department sometime prior to 1971. The Department attempted to repeal the regulation in late 1993. However, numerous foreign corporations objected. The Department finally discontinued its repeal efforts because a financial impact study had not been performed as required by Code of Ala. 1975, §41-22-23. The regulation is thus still in effect, and the Department has not reinstituted repeal procedures.

The exclusion allowed by Reg. 810-2-3-.03 is not authorized by any specific Alabama franchise tax statute. Nonetheless, the Taxpayer argues that the regulation must be

followed because it has stood unchanged by the Department and the Alabama Legislature for over 20 years, citing Hamm v. Proctor, 198 So.2d 782; State v. Tri-State Pharmaceutical, 371 So.2d 910. The Taxpayer also argues that reenactment of a statute without change signals the Legislature's approval on any existing administrative interpretation of the statute, citing State v. Mobile Gas Service Corporation, 621 So.2d 1333.

However, general rules of statutory construction should be applied only if the statute that the regulation seeks to interpret is ambiguous. If the statute is not ambiguous, or, as in this case, there is no statute on which the Department's regulation is based, then rules of statutory construction should not be applied. "If, however, the statutory language is plain and unambiguous, its meaning obvious, our review has ended, for in such a case we do not apply rules of construction". Robertson v. City of Montgomery, 485 So.2d 695, at page 696, citing State v. Dawson, 889 So.2d 103. See also, EEOC v. Sears & Roebuck Company, 857 F.Supp. 1223.

There is no statutory basis for Reg. 810-2-3-.03. Consequently, the proper rule to be applied is that a regulation cannot subvert or enlarge upon statutory policy. Jefferson County Board of Education v. Alabama Board of Cosmetology, 380 So.2d 913. A regulation must be laid aside if it is erroneous and a different construction is required by the statute. Ex parte City of Florence, 417 So.2d 191. That

rule obviously also applies if there is no statutory basis for a regulation. Just as a Department regulation cannot limit a statutory deduction or expand the scope of a levy, the Department also cannot by regulation grant a deduction or exclusion from tax not otherwise allowed by statute. Orca Bay Seafood v. Northwest Truck Sales, Inc., 32 F.3rd 433. (Transportation Department regulation exempting large trucks from statutory odometer disclosure rules rejected because not authorized by statute).

Finally, this case involves a claimed deduction from tax. A deduction or exclusion from tax must be construed against the taxpayer and for the Department, and should be allowed only when clearly authorized by statute. Ex Parte Kimberly - Clark Corp., 503 So.2d 304. The exclusion allowed by Reg. 810-2-3-.03 is clearly not allowed by statute and is rejected.

In State v. Arch of Alabama, Inc., Docket No. F90-173, decided by the Administrative Law Division on July 22, 1994, the issue was whether intercompany receivables could be deducted from capital for franchise tax purposes. The Department as an informal policy had allowed all foreign corporations, including Arch, to net or deduct intercompany receivables against intercompany payables. Arch argued that it should also be allowed to deduct intercompany receivables in excess of payables. Arch's argument was rejected. In addition, the Department's informal netting policy was also

rejected because it was not authorized by statute[1]. The same logic applies in this case. As stated in the Arch opinion, at page 3:

> An administrative agency cannot usurp legislative authority, nor by regulation or policy subvert or enlarge upon statutory policy. Ex parte Jones Manufacturing Company, Inc., 589 So.2d 208; Jefferson County Board of Education v. Alabama Board of Cosmetology, 387 So.2d 913; Iglesias v. U. S.,848 F.2d 362. As stated, there is no statutory authority for deducting or excluding intercompany receivables from capital. Accordingly, the Department's unauthorized policy of allowing foreign corporations to net intercompany receivables against intercompany payables is rejected. If netting cannot be allowed, obviously intercompany receivables in excess of intercompany payables also cannot be deducted.

The Taxpayer also argues that because neither subsidiary has nexus with Alabama, not allowing the exclusions would in effect be taxing the subsidiary corporations in violation of the Commerce Clause of the U.S. Constitution and the Due Process Clause of the U.S. and Alabama Constitutions. The Taxpayer contends that "any attempt to tax an investment in the subsidiary

[1]Arch is presently pending on appeal in Montgomery County Circuit Court.

which does not do business in Alabama is contrary to the nexus requirement", and thus should be rejected. Taxpayer's pre-hearing brief at page 12.

I agree that a taxpayer must have nexus with Alabama to be subject to Alabama taxation. I also agree that the two subsidiaries in issue do not have nexus with Alabama. However, the premise on which the Taxpayer's argument is based is false. That is, not allowing the Taxpayer to exclude from capital its investments in the two foreign subsidiaries does not either directly or indirectly constitute a tax on the foreign subsidiaries.

The Department is not attempting to tax or include the investments per se as an item of capital employed in Alabama. To the contrary, what the Taxpayer is attempting to do is reduce its established capital base by deducting from capital the amounts invested in the two subsidiaries. Clearly under Alabama law it cannot. The Taxpayer cannot elect to transfer excess cash to a foreign subsidiary for investment purposes and then deduct or remove the amount transferred from capital on the theory that either the amount transferred or the foreign subsidiary itself has no nexus with Alabama.

The Taxpayer cites State v. Anniston Sportswear, Inc., 151 So.2d 778, and State v. Reynolds Metal Co., 196 So.2d 408, in support of its case. Taxpayer's post-

hearing brief at p.14. The issue in those cases was whether an intangible account receivable should be included as a specific item of "capital employed" in Alabama.

Under Alabama law at the time, an intangible asset constituted capital in Alabama only if the corporation was domiciled in Alabama or the intangible asset was used as an integral part of the corporation's business in Alabama. See, Anniston Sportswear, supra, at p. 782. The Alabama Supreme Court correctly ruled in both cases that the account receivables were not capital employed in Alabama because they were not used as an integral part of the corporation's business in Alabama.[2]

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[2] "Capital" was not defined by statute for franchise purposes prior to 1961. Rather, case law defined "capital" as a corporation's tangible assets located and employed in Alabama, plus

intangible assets as set out above. That definition was applicable in the Anniston Sportswear and Reynolds Metal cases. "Capital" was first defined by statute by Act No. 912 in 1961, effective January 1, 1964. That definition is presently set out at §40-14-41(b).

This case can be distinguished from the above cases. As discussed above, the issue in this case is not whether the amounts invested in the subsidiaries should be included in the Taxpayer's capital base as a specific item of capital employed in Alabama. Rather, the issue here is whether the investments can be deducted from the Taxpayer's already established capital base. The Department is not taxing the amounts invested, it is merely disallowing the amounts as a deduction. There is a subtle but important distinction.

There is no question that foreign corporations can and do utilize subsidiaries to their advantage to reduce their Alabama franchise liability. Taxpayer's post-hearing brief at p. 16, citing White v. Reynolds Metals Co., Inc., 558 So.2d 373, 389 (footnote 10). However, the advantage must be gained in accordance with Alabama law. Clearly in the case the exclusion allowed by Reg. 810-2-3-.03 is not authorized by Alabama law or otherwise mandated by constitutional principles.

Notwithstanding the above, the Department should nonetheless be required to follow Reg. 810-2-3-.03 and allow the exclusions for the period in issue.

An administrative agency must adhere to its own rules and regulations. Reuters Limited v. FCC, 781 F.2d 946; Romeiro deSilva v. Smith, 773 F.2d 1021. In addition, presumably all other foreign corporations

subject to Alabama franchise tax were allowed to exclude from capital their investments in foreign subsidiary corporations as allowed by Reg. 810-2-3-.03 during the subject period. Consequently, the Taxpayer would be denied equal protection if it was not also allowed the benefit of Reg. 810-2-3-.03 during the same period.

A similar result was reached in the above cited Arch case. Although the Department's informal netting policy was declared invalid, Arch was nonetheless allowed to net intercompany receivables against payables during the subject period because all other foreign corporations had been allowed to do so for the same period. The Department was directed to discard its erroneous netting policy prospectively only so as to treat all foreign corporations equally. See, Arch, at page 8. The same logic applies in this case.

The above considered, the final assessment in issue is dismissed. The Department should, however, instigate procedures in accordance with the Alabama Administrative Procedures Act for the repeal of erroneous Reg. 810-2-3-.03.

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

Entered on December 14, 1994.

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BILL THOMPSON
Chief Administrative Law Judge