STATE OF ALABAMA, DEPARTMENT OF REVENUE,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE
	§	ADMINISTRATIVE LAW DIVISION
vs.		
	§	
MAGNOLIA METHANE CORPORATION P. O. Box 1396 Houston, TX 77251-1396,	§	DOCKET NO. F. 94-178
	§	
Taxpayer.		

FINAL ORDER

The Revenue Department assessed foreign franchise tax against Magnolia Methane Corporation ("Taxpayer") for the years 1990, 1991 and 1992. The Taxpayer appealed to the Administrative Law Division and a hearing was conducted on May 10, 1994. Thomas H. Brinkley and Daniel H. Markstein, III represented the Taxpayer. Assistant counsel Dan Schmaeling represented the Department.

The issue in this case is whether loans or advances to the Taxpayer by the Taxpayer's corporate grandparent, Transco Energy Company, Inc. ("Transco Energy"), should be included in the Taxpayer's capital base for Alabama franchise tax purposes. That issue turns on whether the advances constituted "long-term" indebtedness, which must be included as capital pursuant to Code of Ala. 1975, §40-14-41(b)(3).

The facts are undisputed.

The Taxpayer is a Delaware corporation and is wholly owned by Transco Resources, Inc. Transco Resources, Inc. is in turn wholly owned by Transco Energy.

Transco Energy advanced to the Taxpayer approximately $220,000,000.00 during the years in issue pursuant to a demand note dated August 1, 1990. The demand note provided that all advances

from Transco Energy to the Taxpayer were payable on demand by Transco Energy. As stated, the issue is whether the advances received by the Taxpayer pursuant to the demand note constituted long-term debt.

"Capital" is defined for Alabama franchise tax purposes at Code of Ala. 1975, §40-14-41(b). Subsection (b)(3) includes as capital all long-term indebtedness "maturing and payable more than one year after" the beginning of the tax year. Subsection (b)(4) also includes as capital certain short-term intercompany debt "maturing and payable at the time."

In Norandal USA, Inc. v. State, Department of Revenue, 545 So.2d 792, the Court of Civil Appeals held that short-term loans from a corporate grandparent should not be included in a corporate grandchild's capital base pursuant to §40-14-41(b)(4)(ii) because the grandparent did not directly own more than 50% of the grandchild's stock. Thus, the advances in issue should be included as capital only if they are determined to be long-term debt pursuant to §40-14-41(b)(3).

The Department argues that the advances cannot be short-term debt under subsection (b)(4), and thus must be included as long-term debt under subsection (b)(3), because they were not payable "at the time", but rather, only upon demand by Transco Energy. A balance sheet filed with the Taxpayer's franchise tax returns also shows the advances as "non-current". The Department also contends that the advances cannot be deemed short-term because the Taxpayer did not have sufficient assets available to repay the advances upon

demand. Finally, the Department argues that if the intercompany advances are not included as capital, all corporations will be able to manipulate or structure their intercompany transactions in such a way as to substantially avoid Alabama foreign franchise tax.

The Taxpayer relies primarily on generally accepted accounting principles ("GAAP") in support of its case. Specifically, the Taxpayer cites FASB 78, which provides that an obligation payable on demand must be classified as a current liability. The Taxpayer also explains that the balance sheets showing the demand note as "non-current" were unaudited financial statements prepared for internal use only and not in accordance with GAAP. The Taxpayer concedes that a demand note may constitute long-term indebtedness if the creditor has agreed not to call the note within one year. However, the Taxpayer argues that no such agreement existed in this case.

This is a statutory construction case. The plain language of §40-14-41(b)(3) is that a debt is long-term and thus must be included as capital only if it matures and is payable more than one year after the first day of the franchise tax year. A demand note by its own terms is payable immediately upon demand, not in more than one year. A demand note thus is not a long-term indebtedness, but rather is in substance identical to the open-account advances at issue in Norandal, which were treated as short-term debt. The fact that the Taxpayer did not have sufficient assets to pay the note immediately does not convert the demand note to long-term

debt, nor does the fact that the Taxpayer characterized the note as "non-current" for internal accounting purposes.

If the parties had agreed that the advances would not be called within one year, then substance over form would control and perhaps the advances would constitute long-term debt. However, Transco Energy did not agree in writing or otherwise that the advances would not be called within one year. Consequently, the demand note in issue did not constitute long-term indebtedness pursuant to §40-14-41(b)(3), and thus should not be included as capital by the Taxpayer.

The above holding is supported by the rule of statutory construction that a tax statute, other than a statutory exemption or deduction, must be construed in favor of the taxpayer and against the Department. West Point-Pepperell, Inc. v. Department of Revenue, supra; Ex parte Zewen Marine Supply, Inc., 477 So.2d 417.

GAAP also supports the above holding, specifically FASB 78. However, the statutory definition of "capital" at §40-14-41(b) and the statutory exclusions and deductions at §40-14-41(d) should control in determining a foreign corporation's capital base. GAAP should only be used as an interpretive aid if an ambiguity or uncertainty exists in those statutory definitions. No such ambiguity exists in this case. Consequently, reliance on GAAP is not necessary.

The Department argues that if the advances are excluded from capital, then foreign corporations will be allowed to structure

their intercompany transactions so as to substantially avoid Alabama franchise tax. However, all taxpayers may legally structure their business dealings so as to decrease their tax liability to the greatest extent permitted by law. West Point Pepperell v. State Department of Revenue, supra, citing Gregory v. Helvering, 293 U. S. 465, 55 S.Ct. 266. The Legislature is presumably aware of the Norandal holding that short-term loans from a corporate grandparent do not constitute capital for franchise tax purposes. The Legislature could amend the statute if it was dissatisfied with the court's interpretation. It has not done so.

The above considered, the franchise tax assessment in issue is dismissed. This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered on June 27, 1994.

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BILL THOMPSON
Chief Administrative Law Judge