

STATE OF ALABAMA
DEPARTMENT OF REVENUE,

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

v.

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DOCKET NOS. INC. 94-285
INC. 94-286
INC. 94-287

SENECA GP, INC.
Post Office Box 2563
Birmingham, Alabama 35202,

Taxpayer.

FINAL ORDER

The Revenue Department denied refunds of income tax requested by Seneca GP, Inc. ("Taxpayer") for the years 1988 and 1989. The Department also assessed the Taxpayer for additional income tax for 1990. The Taxpayer appealed to the Administrative Law Division, and a hearing was conducted on December 8, 1994. Roy Crawford and Hal West, Jr. represented the Taxpayer. Assistant Counsel Mark Griffin represented the Department.

The ultimate issue in this case is whether the Taxpayer is liable for Alabama income tax during the years in issue. The specific issues are as follows:

- (1) Was the Taxpayer "doing business" in Alabama during the subject years, and thereby subject to Alabama income tax pursuant to Code of Ala. 1975, §40-18-31;
- (2) If the Taxpayer was subject to Alabama income tax, should certain interest income earned by the Taxpayer during the subject years be classified as "business" or "non-business" income. "Business" income must be apportioned among the various states in which a corporation does business, whereas "non-business" income is allocated in full directly to the corporation's state of commercial domicile. See generally, Department Reg. 810-3-31-.02.

The facts are undisputed.

The Taxpayer was incorporated in Delaware on January 21, 1987 for the sole purpose of serving as a general partner in two Delaware limited partnerships. The limited partners in the partnerships operated a petroleum products transporting business in the Eastern United States. The limited partners did not operate in Alabama.

The Taxpayer's sole business purpose was to serve as a general partner in the partnerships and maintain a sufficient equity to satisfy the net worth requirements imposed under the Internal Revenue Code by Revenue Procedure 72-13, 1972-1C.B.735 (1972).

To satisfy those net worth requirements, the Taxpayer's sole shareholder, Sonat, Inc., contributed to the Taxpayer \$100,000.00 in cash and a demand promissory note dated April 14, 1987 and payable by Sonat to the Taxpayer in the amount of \$4,871,875.00. The interest income earned by the Taxpayer on that demand note is the basis for the income tax in issue.

The Taxpayer has never qualified to do business in Alabama, but is qualified to do business in those states in which the partnerships conduct business, Delaware, Florida, Maine, Maryland, New Jersey, Pennsylvania, Rhode Island, and Virginia.

The Taxpayer did not employ any employees, own any real property, or have any gross sales in Alabama during the years in issue. The Taxpayer's officers and directors were employees of Sonat in Alabama. However, they served in their capacity as officers and directors of the Taxpayer without compensation. The Taxpayer also maintained its books and a bank account in Alabama, and also held the above referenced promissory note in Alabama.

The Taxpayer filed Alabama income tax returns in 1988 and 1989. On the 1988 return, the Taxpayer treated the interest income from the promissory note as "business" income, and apportioned the income 100% to Alabama. On the 1989 return, the Taxpayer treated the interest income as "non-business" income, and allocated it 100% directly to Alabama. The Taxpayer paid the tax due as reported on both returns.

The Taxpayer later determined that it was not subject to Alabama income tax. The Taxpayer accordingly filed petitions for refund on July 8, 1992 for the years 1988 and 1989 in the amounts of \$21,850.00 and \$32,186.00, respectively.

The Taxpayer also filed a 1990 Alabama return showing no tax due. The 1990 return claimed a refund of \$33,000.00 in estimated tax paid in 1990. The Department processed and issued the 1990 refund to the Taxpayer.

The Department failed to act on the 1988 and 1989 refund petitions within six months as required by Code of Ala. 1975, §40-2A-7(c)(3). Consequently, the refunds were deemed denied after the six month period expired on January 8, 1993. The Department also entered a final assessment against the Taxpayer for additional 1990 tax due. The Taxpayer appealed both the denial of the refunds and the final assessment to the Administrative Law Division.

Issue 1 - Is the Taxpayer subject to Alabama income tax?

Code of Ala. 1975, §40-18-31 levies an income tax on foreign corporations "doing business in this state". The tax is measured by "the entire net income . . . (of the foreign corporation) . . . from property situated within this state and from business done and transacted within in this state."

Code of Ala. 1975, §40-18-2(3) also levies an income tax on "every corporation doing business in Alabama or deriving income from sources within Alabama, including income from property located in Alabama;".

The Taxpayer is correct that no Alabama cases have defined the term "doing business" for purposes of the income tax levied on corporations at §40-18-31. However, for franchise tax purposes, a corporation is "doing business" in Alabama if it is conducting some business activities or functions in Alabama for which the corporation was created. State v. City Stores Company, 171 So.2d 121 (1965); State v. Anniston Rolling Mills, 27 So 921 (1900). As stated by the Alabama Supreme Court in State v. Anniston Rolling Mills, supra, at page 922, for purposes of determining if a corporation is "doing business" in Alabama "the real test is, is the corporation engaged in the transaction of business, or any part of the business, for which it was organized or created?"

The Taxpayer in this case was created for the sole business purpose of acquiring and holding the demand note from Sonat, which allows the limited partnerships to comply with the net worth requirements of the Internal Revenue Code. It was engaged in that business activity in Alabama, and thus was "doing business" in Alabama within the context of §40-18-31.

The Taxpayer states on page 11 of its brief that, "Taxpayer was not engaging, and has not engaged, in any activities in Alabama which furthered its corporate purpose of serving as a general partner of the Partnerships". However, as stated, the Taxpayer's sole business purpose was to serve as general partner and hold the demand note, which it did in Alabama. The Taxpayer concedes on page 13 of its brief that "the Note clearly arose

out of and was created as a result of Taxpayer's business activity".

Issue 2 - Should the interest income from the demand note be classified as "business" income or "non-business" income?

The Department claims that the interest income from the note was "non-business", and must be allocated in full to Alabama, the Taxpayer's state of commercial domicile. The Taxpayer counters that the interest income was "business" income, and thus apportionable to Alabama and the various other states in which the partnerships did business.

Alabama's allocation and apportionment rules are set out in Department Reg. 810-3-31-.02. "Business" income is defined at Department Reg. 810-3-31-.02(1)(a) as follows:

". . . income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations."

Department Reg. 810-3-31-.02(1)(a)4(iii) provides as follows:

"Interest - Interest income is business income if the intangible with respect to which the interest was received arises out of or was created by a business activity of the taxpayer and in those situations where the purpose for acquiring the intangible is directly related to the business activity of the taxpayer."

Department Reg. 810-3-31-.02(1)(a)3 further provides:

"For purposes of administration of this regulation, the income of the taxpayer is business income unless clearly classifiable as nonbusiness income under this regulation."

If the Taxpayer's sole business function and purpose was holding the demand note from Sonat, and thereby satisfying the net worth requirements of Rev. Proc. 72-13, then acquiring and holding the note was directly related to and constituted an integral part of the Taxpayer's business. The interest income derived from the note thus clearly

constituted "business" income as defined by the above Department regulations. If the Taxpayer is "doing business" in Alabama by holding the note in Alabama, it follows that the income derived from the note must also be treated as "business" income.

The Department concedes that the Taxpayer did not have any sales, property, or payroll in Alabama during the subject years. Consequently, while the Taxpayer was "doing business" in Alabama and thus subject to Alabama tax, the Taxpayer also had a zero apportionment factor and thus is not liable for Alabama income tax in those years.

The issue of whether the Taxpayer was "commercially domiciled" in Alabama during the subject years is pretermitted by the above holding.

The above considered, the Department is directed to grant the refunds claimed by the Taxpayer for 1988 and 1989. The 1990 final assessment in issue is also dismissed.

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

Entered June 20, 1995.

BILL THOMPSON
Chief Administrative Law Judge