

WEAVEXX CORPORATION §
Post Office Box 471
Wake Forest, North Carolina 27588, §

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

Taxpayer, § DOCKET NO. F. 94-300

v. §

STATE OF ALABAMA §
DEPARTMENT OF REVENUE.

FINAL ORDER

The Revenue Department assessed franchise tax against Weavexx Corporation ("Taxpayer") for the years 1988 through 1993. The Taxpayer appealed to the Administrative Law Division, and hearings were conducted on January 3, 1995 and April 19, 1995. Tom J. Mahoney, Jr. represented the Taxpayer at the April 19, 1995 hearing. Assistant Counsel Dan Schmaeling represented the Department at both hearings.

This case involves two issues:

(1) Does debt designated as "loans from stockholders" on the Taxpayer's financial statements constitute debt owed to a related corporation so as to be included as "capital" under Code of Ala. 1975, §40-14-41(b)(4); and

(2) Does certain other debt designated as "other liabilities" on the financial statements constitute long-term debt, which should also be included as capital under §40-14-41(b)(3).

The Department audited the Taxpayer's franchise tax returns and financial statements during the subject years and included as capital the aforementioned accounts labeled "loans from stockholders" and "other liabilities". The final assessment in

issue is based on those adjustments.

The Department argues that the "loans from stockholders" account represents intercompany payables to a related corporation, which constitutes capital under Code of Ala. 1975, §40-14-41(b)(4).

The Department also claims that the "other liabilities" accounts represent long-term debt, which should also be included as capital under §40-14-41(b)(3).

The Taxpayer concedes that the "loans from stockholders" account as set out on its financial statements does appear to qualify as capital under Alabama law.¹ However, the Taxpayer argues that the account in fact represents intracompany transactions between operating divisions of the same corporation, not debt between different corporations. William White, Tax Manager for the Taxpayer, testified at the April 19 hearing that "They are fictitious book accounts that only reflect activity within itself, within the legal entity named, in those days, Hyuck Corporation (predecessor of Taxpayer). They were simply accounts within itself." (R. 15).

White also contends that the "other liabilities" accounts are cash concentration accounts between various related corporations.

There are no notes or other evidences of indebtedness relating to the accounts, and no interest is paid on the accounts. White

¹". . . The Taxpayer admits that (loans from stockholders) account might, on its face, be includable in the franchise tax base; . . ." Taxpayer's memorandum brief, at page 3.

explained the accounts as follows - "In essence, the principle purpose of the accounts is simply to account for the cash transactions of the company. They are not long term accounts from my point of view. They are true open accounts between related companies or unrelated companies, and they have no long-term nature. They are fully demand accounts." (R. 19).

As stated, the Department argues that the accounts should be included as capital based on how the accounts were handled on the Taxpayer's financial statements. However, the Department also concedes that if the accounts in fact are not capital as defined at §40-14-41(b), then the true nature of the accounts should control, not the financial statements.²

The Department necessarily must rely on a foreign corporation's financial statements in determining capital employed in Alabama. However, if the true nature of an account or other item on a financial statement is established as something other than capital, as that term is defined at §40-14-41(b), then the true nature of the account must govern.

The Taxpayer has presented uncontroverted evidence explaining that the accounts in issue do not constitute capital as defined at §40-14-41(b). The "loans to stockholders" account is an intracompany account, not debt between related corporations. The

²The Department conceded at the April 19 hearing that "If they can explain sufficiently to the Court and to the Department's representative that they (accounts) are indeed something else (other than as indicated on the financial statements), we cannot in good conscience argue otherwise." (R. 10).

"other liabilities" accounts are short-term open accounts, not long-term debt. Consequently, the accounts should not be included in the Taxpayer's capital base for the subject years. The final assessment in issue is accordingly dismissed.

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

Entered January 16, 1996.

BILL THOMPSON
Chief Administrative Law Judge