CERRO COPPER PRODUCTS, INC. Post Office Box 66800 St. Louis, Missouri 63166,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. F. 94-443
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department denied refunds of franchise tax requested by Cerro Copper Products, Inc. ("Taxpayer") for the years 1990 through 1993. The Taxpayer appealed to the Administrative Law Division, and the case was submitted on a joint stipulation of facts. Will Sellers represented the Taxpayer. Assistant Counsel Dan Schmaeling represented the Department.

This case involves four issues:

(1) The primary issue is whether the Taxpayer had sufficient nexus with Alabama to be subject to Alabama's taxing jurisdiction under both the Due Process Clause, U.S. Const. 14th Amendment, and the Commerce Clause, U.S. Const. Art. I, §8, cl. 3;

(2) A second and related issue is whether the Taxpayer was "doing business" in Alabama and thus subject to Alabama franchise tax pursuant to Code of Ala. 1975, §40-14-41(a);

(3) If the Taxpayer was subject to Alabama's taxing jurisdiction and was "doing business" in Alabama, the next issue is whether the Taxpayer had "capital employed" in Alabama, again as required by §40-14-41(a) to be liable for Alabama franchise tax; and,

(4) If the Taxpayer is not liable for Alabama tax, the final issue is whether the Taxpayer requested refunds for the subject years within the applicable statute of limitations.

The Taxpayer is a Delaware corporation engaged in the manufacture and sale of copper tubing and other copper products. The Taxpayer's principal offices are located in Sauget, Illinois. The Taxpayer had no employees, owned no property, and maintained no manufacturing facilities in Alabama during the subject years.

The Taxpayer qualified to do business in Alabama in 1978. During the years in issue, the Taxpayer solicited sales in Alabama by direct mail, telephone, and telecopier from outside the State. All orders from Alabama customers were subject to approval by the Taxpayer in Illinois. All goods were delivered into Alabama by third-party commercial carriers. The Taxpayer's sales in Alabama and everywhere during the subject years were as follows:

Year	Total Sales	Alabama Sales	Percent
1990	$365,113,917	$10,984,043	3.01%
1991	$365,392,706	$10,717,752	2.93%
1992	$434,310,581	$12,921,870	2.98%
1993	$360,126,792	$10,452,073	2.90%

The Taxpayer's customers were billed by invoice issued from the Taxpayer's facility in Sauget, Illinois. All credit decisions were made and all accounts receivable records were maintained at Sauget.

The Taxpayer filed Alabama franchise tax returns for 1990, 1991, 1992, and 1993 on November 5, 1990, September 9, 1991,

September 14, 1992, and September 10, 1993, respectively. The Taxpayer apportioned capital to Alabama on those returns using the three factors of sales, salaries, and inventory.[1]

The Taxpayer overpaid Alabama franchise tax in March 1988 and March 1989 totaling $13,223.00. Those overpayments were subsequently applied to the Taxpayer's 1990, 1991, and 1992 liabilities. The Taxpayer paid additional franchise tax of $2,108.18 in March 1992 and $2,715.73 in March 1993.

The Taxpayer filed petitions for refund on April 5, 1994 for the years 1990 through 1993. The Taxpayer also filed a 1994 franchise tax return showing no tax due. The Taxpayer claims that it incorrectly paid franchise tax in the subject years because (1) it did not have substantial nexus with Alabama, (2) it was not "doing business" in Alabama, and (3) it did not have "capital employed" in Alabama during those years.

The Department failed to act on the petitions within six months as required by Code of Ala. 1975, §40-2A-7(c)(3). The refunds were thus deemed denied by operation of law on October 5, 1994. The Taxpayer thereafter appealed to the Administrative Law

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[1]The Department subsequently reviewed the returns and eliminated the salary and inventory factors because they were zero. Based thereon, the Department assessed additional tax against the Taxpayer in all years. However, the Department later voided the assessments after it acquiesced in the Administrative Law Division decision in State v. Aristech Chemical Corp., Admin. Law Docket F. 92-350, decided November 16, 1993. Aristech rejected the Department's policy of eliminating a zero factor from an apportionment formula.

Division.

Issue 1 - Nexus.

The Commerce Clause and the Due Process Clause both require that an out-of-state taxpayer must have nexus with a state to be subject to the state's taxing jurisdiction. The leading tax case concerning nexus is Quill Corp. v. North Dakota, 112 S.Ct. 1904 (1992). The facts in Quill are in substance almost identical to the facts in this case. Quill, an out-of-state mail order retailer, solicited sales in North Dakota by direct mail, catalogs, etc. from outside the State. Quill had no outlets or sales representatives in North Dakota. The goods sold by Quill to North Dakota customers were delivered into North Dakota by common carrier. North Dakota required Quill to collect use tax from its North Dakota customers and remit the tax to the State. Quill appealed. The North Dakota Supreme Court upheld the tax. The United States Supreme Court reversed, holding that Quill did not have sufficient nexus to be subject to North Dakota's tax.

Concerning the Due Process Clause, the Supreme Court rejected the physical presence test previously established in National Bellas Hess v. Department of Revenue of Illinois, 81 S.Ct. 1389 (1967), and held that a taxpayer has sufficient nexus with a taxing state for due process purposes if the taxpayer purposely directs its activities towards residents of the state and avails itself of the economic benefits of the state. Quill, at pages 1910, 1911. The Court then concluded that by actively soliciting and making

substantial sales in North Dakota, Quill clearly had sufficient economic activity in North Dakota to satisfy due process nexus.

Concerning the Commerce Clause, Quill reiterated the validity of the four-pronged Commerce Clause test set out in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 97 S.Ct. 1076 (1977), the first-prong of which is that the taxpayer must have "substantial nexus" with the taxing state. The Court then upheld Bellas Hess to the extent that "substantial nexus" is created for Commerce Clause purposes only if the taxpayer has some physical presence in the taxing state. Because Quill did not have a physical presence in North Dakota, the Court concluded that Quill was protected by the Commerce Clause.

Predictably, the Department argues that the Quill physical presence test applies only to sales and use tax. The Department contends that the Taxpayer in this case had nexus with and was "doing business" in Alabama for franchise tax purposes because it availed itself of Alabama's economic market by making substantial sales in Alabama, and also because it had "intangibles located in this state". (Department's brief at page 7).

First, I disagree that Quill affirmatively limited the Commerce Clause physical presence test to only sales and use taxes. Rather, the Supreme Court left open the issue by stating that "silence does not imply repudiation of the Bellas Hess (physical presence) test" concerning other taxes. Quill, at page 1914.

I agree with the following analysis that a state is prohibited

by the Commerce Clause from taxing an out-of-state taxpayer unless the taxpayer has at least some physical presence in the state:[2]

> . . . Indeed, the (Quill) Court also notes expressly that all of its prior cases upholding taxes against Commerce Clause challenges, including the modern case on which North Dakota placed reliance, involved taxpayers who did in fact have a physical presence in the taxing state.
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> Thus, although the Court in *Quill* did not expressly extend the "bright-line, physical-presence" requirement to other taxes, and leaves open the possibility of a "balancing analysis" to determine if "substantial nexus" consistent with the Commerce Clause exists in areas other than use tax collection, the Court nevertheless made it clear that the nexus required under the Commerce Clause is *more* than the minimum contacts/purposeful availment of a state's market that are sufficient to satisfy the modern Due Process Clause; and at least to this point, "substantial nexus" sufficient to satisfy the Commerce Clause has always involved some degree of physical presence with the state.

If the Taxpayer does not have sufficient nexus with Alabama for sales and use tax purposes, which it clearly does not have under Quill, then it is incongruous that the Taxpayer would have "substantial nexus" to be subject to Alabama's franchise tax. As

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[2]Constitutional Limitations on Jurisdiction to Tax and the Impact of Quill and Geoffrey, State Tax Notes, August 7, 1995, at page 423.

a practical matter, the same benefits of a bright-line, physical presence test cited in Quill, at page 1915, for sales and use tax purposes would also apply equally to other types of taxes.

Although not cited, the Department's "intangibles" argument is presumably based on the South Carolina Supreme Court's holding in Geoffrey, Inc. v. South Carolina Tax Commission, 437 S.E. 2nd 13 (S.Car. 1993), cert. denied 114 S.Ct. 550 (1993).

Geoffrey, a Delaware holding company, licensed the use of the giraffe trademark to Toys "R"Us in South Carolina. Toys "R" Us in turn paid royalties to Geoffrey based on a percentage of its sales in South Carolina. Geoffrey otherwise had no employees, assets, etc., in South Carolina.

The South Carolina Supreme Court held that Geoffrey had purposely availed itself of South Carolina's economic market sufficient to satisfy the due process requirements of Quill. The Court also ruled that "In addition to our finding that Geoffrey purposefully directed its activities toward South Carolina, we find that the 'minimum connection' required for due process also is satisfied by the presence of Geoffrey's intangible property in this State". Geoffrey, at page 16.

The South Carolina Court next concluded "that by licensing intangibles for use in this State and deriving income from their use here, Geoffrey has a 'substantial nexus' with South Carolina" for Commerce Clause purposes. Geoffrey, at page 18.

I agree that Geoffrey clearly availed itself of South Carolina's economic market sufficient to establish due process nexus under Quill. But I disagree with Geoffrey's Commerce Clause analysis concerning intangibles. Specifically, I disagree that receivables generated by a non-resident taxpayer's activities in a state are necessarily "located" in the state. I also disagree that the "use" or "presence" of intangibles in a state is, by itself and without some physical presence, sufficient to establish "substantial nexus" for Commerce Clause purposes.

First, this case can be distinguished factually from Geoffrey. The South Carolina Court relied primarily on the fact that Geoffrey licensed the use of its intangible trademark in South Carolina. Arguably, the trademark was being used by Geoffrey in South Carolina, although the actual user was the licensee, Toys "R" Us. But the Taxpayer in this case is not licensing a trademark. That factual difference alone materially distinguishes Geoffrey from this case. As discussed below, the Taxpayer also is not otherwise "using" the receivables in Alabama.

The South Carolina Court summarily concluded that because the Geoffrey trademark was being used in South Carolina, the resulting receivables also had a "presence" in South Carolina. Presumably relying on Geoffrey, the Department argues that the receivables created by the Taxpayer's sales into Alabama were also "located" in Alabama. I disagree.

The general rule is that intangibles are located for tax

purposes in the taxpayer's state of domicile. An exception is if the corporation has established a "commercial domicile" in another state, from which the corporation operates and engages in its normal business activities. Alabama Textile Products Corp. v. State, 83 So.2d 42 (1955).

A second exception is if the intangible has acquired a "business situs" in another state. A "business situs" is established if the intangible is actively used by the corporation in carrying out its business functions within the state. Anniston Sportswear Corp. v. State, 151 So.2d 778 (1963), citing United Gas Corp. v. Fontenot, 129 So.2d 776 (La. 1960).

The Taxpayer's state of incorporation is Delaware, and its commercial domicile is Illinois. The receivables also were not used by the Taxpayer in Alabama so as to have a "business situs" in Alabama. (Unlike the Geoffrey trademark, which was used in and arguably had a "business situs" in South Carolina). Consequently, the receivables were not "located" in Alabama, in which case they clearly could not give the Taxpayer a "substantial nexus" with Alabama.

Geoffrey, at page 16, cites Mobil Oil Corp. v. Comm'r of Taxes of Vermont, 100 S.Ct. 1223 (1980), for the proposition that intangibles need not be taxed at a single situs.
However, Mobil did not involve the threshold issue of whether the "presence" of an intangible in a state is by itself sufficient to give a taxpayer nexus with the state. Rather, Mobil clearly

otherwise had nexus with the taxing state, Vermont, and the only issue was whether Mobil should apportion its foreign source dividend income among Vermont and the various other states in which it conducted business. The Supreme Court held that apportionment was proper, but again, that holding is not relevant to the threshold issue of nexus.

Geoffrey, at page 18, also cites various cases in support of its Commerce Clause analysis that physical presence is not necessary for nexus. However, those cases can be factually distinguished (from both Geoffrey and this case), and importantly, they did not involve the Commerce Clause.[3]

[3]For an analysis as to why the cases cited in Geoffrey do not support the Court's holding, see Constitutional Limitations on Jurisdiction to Tax and the Impact of Quill and Geoffrey, State Tax Notes, August 7, 1995, at page 427.

Geoffrey, again at page 18, also cites J. Hellerstein and W. Hellerstein, State Taxation (2nd Edition, 1992), at Para. 6.08, for the proposition that "any corporation that regularly exploits the markets of a state should be subject to its jurisdiction to impose an income tax even though not physically present". Geoffrey, at page 18.[4] However, the author of the above statement also recognized that Quill holds otherwise. (". . . Notwithstanding the Supreme Court's decision to the contrary in the *Quill* case. . .".

[4]The critical analysis of the Quill physical presence test in State Taxation, Para. 6.08, must be attributed to Jerome Hellerstein, professor at NYU, and not his son, Walter Hellerstein, professor at the University of Georgia. Walter Hellerstein was very critical of the Geoffrey opinion in an article in the May 1994 edition of the Journal of Taxation, at page 296. The apparent disagreement between the two Hellersteins, both recognized experts in the field of state taxation, illustrates the extent of the controversy caused by the Geoffrey decision.

State Taxation, at Para. 6.08). As noted in Quill, at page 1916, Congress is free to change the Commerce Clause physical presence requirement if it so desires.

This opinion is a respectful dissent from Geoffrey. I understand and agree with the South Carolina Supreme Court's concern, and the Department's concern in this case, that an out-of-state corporation can economically exploit and profit from a state's citizens, yet cannot be required by the state to pay its fair share of tax. The Court was obviously concerned with the use of a Delaware holding company to create "nowhere" income, and thus avoid all state taxation. Geoffrey, at footnote 1. Perhaps a perceived "fairness" in the Geoffrey result contributed to the United States Supreme Court's denial of certiorari. However, the denial of certiorari does not indicate the Supreme Court's approval of Geoffrey on the merits. Daniels v. Allen, 73 S.Ct. 437 (1953), at page 439. In any case, even if the Taxpayer's receivables are treated as being "located" in Alabama, I can find no authority, other than Geoffrey, holding that the "use" or "presence" of an intangible in a state, without some physical presence, is sufficient to create "substantial nexus" under the Commerce Clause.

The Alabama Supreme Court has also ruled that a corporation engaged exclusively in interstate commerce or making interstate sales into Alabama is not subject to Alabama's franchise tax. State v. Plantation Pipe Line Co., 89 So.2d 549 (1956); State v. Transcontinental Gas Pipe Line Corp., 123 So.2d 172 (1960); State

v. West Point Wholesale Grocery Co., 223 So.2d 269 (1969).

> Solicitation of orders and subsequent delivery of the products ordered are not sufficient nexus with Alabama to subject the company to the franchise, permit, and admission taxes. Family Discount Stamp Company of Georgia, etc. v. State of Alabama, 274 Ala. 311, 148 So.2d 218.

West Point Wholesale, at page 272.

The above Alabama cases relied on Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602, 71 S.Ct. 508 (1951), which held that a state was strictly prohibited from taxing an activity in interstate commerce.

Spector was overruled in Complete Auto Transit, Inc. v. Brady, supra, in 1977. Under Complete Auto, a state can now tax an activity in interstate commerce without violating the Commerce Clause, but only if four conditions are met. The first condition is that the activity must have a "substantial nexus" with the taxing state, which, as discussed, requires at least some physical presence in the state.[5]

Finally, in Prattville Manufacturing, Inc. v. State, Docket F. 93-183, decided October 27, 1993, the Administrative Law Division held that a foreign corporation (Echlin, Inc., Prattville Manufacturing's parent) that made interstate sales into Alabama,

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[5]If West Point Wholesale was decided today, the taxpayer would arguably have nexus with and be subject to Alabama tax because the goods were delivered into Alabama in the taxpayer's vehicles, and the taxpayer otherwise had a substantial physical presence in Alabama. The same is not true in this case.

licensed its trademark in Alabama, and had employees and other activities in Alabama, was still not "doing business" in Alabama for franchise tax purposes. The opinion also affirmed that Echlin's interstate sales into Alabama alone were not sufficient to create nexus with Alabama:

> Echlin did make sales in Alabama, but the sale and delivery of goods into Alabama by an out-of-state company does not create sufficient nexus so as to subject the out-of-state company to Alabama taxation. National Bellas Hess v. Department of Revenue, 386 U.S. 753; Miller Brothers Company v. Maryland, 347 U.S. 340; Quill Corporation v. North Dakota, 112 S.Ct. 1904. Certainly if a business lacks (constitutional) nexus with Alabama it also cannot be doing business in Alabama for franchise tax purposes.

Prattville Manufacturing, at page 5.

Ironically, the Department had argued that Echlin was not "doing business" in Alabama, in which case Prattville Manufacturing would be required to include certain intercompany payables in its capital base under Code of Ala. 1975, §40-14-41(b)(4). Prattville Manufacturing cited Geoffrey in support of its argument that the licensing of Echlin's trademark in Alabama subjected Echlin to Alabama tax liability. However, Geoffrey had only recently been decided and was not discussed in the opinion.

In any case, Echlin's employees, assets, and other contacts with Alabama were probably sufficient to give Echlin nexus with Alabama. But the assets and employees were employed in Alabama only incidental to Echlin's primary business activity, and thus did not constitute "doing business" in Alabama for franchise tax

purposes. See generally, State v. Anniston Rolling Mills, 27 So. 921 (1906); Omega Minerals, Inc. v. State, 288 So.2d 145 (Ala.Civ.App. 1973). Although the concepts of nexus and "doing business" are related, a foreign corporation's presence or activities in Alabama may be sufficient to establish threshold nexus, but still may not reach the higher level of "doing business" for franchise tax purposes. That was the case in Prattville Manufacturing.

Finally, a foreign corporation that has qualified to do business in Alabama, as did the Taxpayer, is presumed to be "doing business" in Alabama. Code of Ala. 1975, §40-14-41(a). However, the presumption is rebuttable, State v. City Stores Co., 1717 So.2d 121 (1965), which is clearly the case here.

Issues 2 and 3 - "Doing Business" and "Capital Employed"

The above discussion of Issue 1 pretermits the second issue of whether the Taxpayer was "doing business" in Alabama. As discussed, if the Taxpayer does not have sufficient nexus to be subject to Alabama tax, it cannot be "doing business" in Alabama for franchise tax purposes. The third issue of whether the Taxpayer had "capital employed" in Alabama is also pretermitted by the above holding.[6]

[6]I disagree with the Taxpayer's argument that even if it was subject to Alabama franchise tax, it did not have "capital employed" in Alabama. The cases cited in the Taxpayer's brief were decided when "capital" was defined as the value of all physical assets located in Alabama, and all intangibles with a situs in

Alabama. As discussed, I agree that the receivables in issue do not have a situs in Alabama, and thus would not constitute "capital employed" in Alabama under that definition.

However, the franchise definition of "capital" was changed by Act 912 in 1961 so that "capital" now consists of the various items

(profits, indebtedness, etc.) specified in Code of Ala. 1975, §40-14-41(b).

Under current law, the location of assets and intangibles is still relevant, but only in deciding the threshold issue of whether the foreign corporation has nexus with or is doing business in Alabama. But once it is established that a foreign corporation is subject to Alabama tax, then capital employed in Alabama is computed by taking total capital everywhere, as defined at §40-14-41(b), regardless of where it is "located", and then apportioning a percentage of that total capital to Alabama. For example, if the Taxpayer in this case was liable for Alabama franchise tax, total capital everywhere would be apportioned to Alabama using the sales, salaries, and inventory factors, see footnote 1, supra. The positive sales factor would cause some capital to be apportioned as

Issue 4 - Statute of Limitations

The final issue is whether the Taxpayer timely requested refunds for the years in question.

The Taxpayer overpaid franchise tax in March 1988 and March 1989. Those overpayments were subsequently credited to pay the Taxpayer's 1990 and 1991 liabilities in full, and to partially pay the 1992 liability. The 1990 return was filed (and the credit presumably applied) on November 5, 1990. The 1991 return was filed (and the credit presumably applied) on September 9, 1991. The 1992 return was filed (and the balance of the credit presumably applied) on September 14, 1992. The 1993 return was filed on September 10, 1993. The Taxpayer filed its petition for refund relating to all years on April 5, 1994.

Code of Ala. 1975, §40-1-34 required that any petition for refund must be filed within three years from when the tax was paid. Section 40-1-34 was repealed effective October 1, 1992 in conjunction with the effective date of the Taxpayers' Bill of Rights and Uniform Revenue Procedures Act. Code of Ala. 1975, §40-2A-7(c)(2) now governs any refund claim that was open on October 1, 1992. That section provides that a refund must be requested within

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"capital employed" in Alabama.

three years from the date the return was filed or two years from payment of the tax, whichever is later.

The Taxpayer concedes that the petition for refund was not timely filed for the 1990 tax. On the other hand, the Department also concedes that the Taxpayer timely petitioned for the tax actually paid in March 1992 and March 1993. At issue then is the tax overpaid in March 1988 and March 1989 that was carried over as a credit to pay the tax due in 1991 and 1992. If that tax is treated as "paid" when remitted in 1988 and 1989, then the tax is out-of-statute and cannot be refunded. But if the tax is treated as being "paid" when the credits were applied in September 1991 and September 1992, then the petition was timely filed within three years and the refunds should be granted.

The tax overpaid in 1988 and 1989 was used to pay the 1991 and 1992 liabilities. The 1991 and 1992 tax in issue was thus "paid" when the credits were applied in September 1991 and September 1992. Consequently, those 1991 and 1992 taxes were paid within the three year statute, and should be refunded.

The 1990 refund is disallowed. The amounts credited to pay the 1991 liability and partially pay the 1992 liability, and the amounts actually remitted in 1992 and 1993, should be refunded. Interest should be paid on the amounts paid by credit in 1991 and 1992 only from the date the credit was used to pay the tax, September 9, 1991 and September 14, 1992, respectively. Interest

should run on the tax actually remitted in 1992 and 1993 from the date of payment. See generally, Code of Ala. 1975, §40-1-44(b)(1).

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

Entered December 11, 1995.

BILL THOMPSON
Chief Administrative Law Judge