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| DOW-UNITED TECHNOLOGIES COMPOSITE PRODUCTS, INC.<br>15 Sterling Drive<br>Wallingford, Connecticut 06492-1843, | § | STATE OF ALABAMA<br>DEPARTMENT OF REVENUE<br>ADMINISTRATIVE LAW DIVISION |
| Taxpayer, | § | DOCKET NO. F. 95-174 |
| v. | § | |
| STATE OF ALABAMA<br>DEPARTMENT OF REVENUE. | § | |

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed franchise and admission tax against Dow-United Technologies Composite Products, Inc. ("Taxpayer") for the years 1989 through 1992. The Taxpayer appealed to the Administrative Law Division, and a hearing was conducted on September 26, 1995. Bruce Ely and Mike Velezis represented the Taxpayer. Assistant Counsel Dan Schmaeling represented the Department.

The issues in this case are:

(1) On what date is a newly qualified foreign corporation's franchise tax liability fixed for the first year that the corporation begins doing business in Alabama;

(2) Concerning the admission tax, when does the $500.00 maximum cap set out in Code of Ala. 1975, §40-14-1 apply. Specifically, is a corporation entitled to the $500.00 cap, even if it fails to file the required resolution of its board of directors concurrent with the information required to be filed by Code of Ala. 1975, §40-14-2;

(3) Should the penalties in issue be waived.

The facts are undisputed.

The Taxpayer was incorporated in Delaware on November 13, 1989. The Taxpayer is owned equally by Dow Chemical Company and The United Technologies Corporation. United Technologies was doing business in Alabama in 1989 through Sikorsky Aircraft in Tallassee, Alabama, and consequently reported and paid 1989 Alabama franchise tax of approximately $91,000.00.

On November 22, 1989, the Taxpayer filed its initial admission tax and franchise tax return and other related forms with the Alabama Secretary of State, as necessary to be qualified to do business in Alabama. The Secretary of State issued a certificate of authority to the Taxpayer on December 7, 1989, thus qualifying it to do business in Alabama on that date. The Taxpayer had capital stock of $1,000.00, but no other capital on that date.

On December 8, 1989, United Technologies contributed the assets and liabilities of Sikorsky, and Dow Chemical contributed some cash, to the Taxpayer.

The Taxpayer failed to pay its initial franchise tax liability with its return because of a case pending in the Alabama Supreme Court challenging the constitutionality of the Alabama franchise tax. See, White v. Reynolds Metals Co., 558 So.2d 373 (Ala. 1989), cert. denied, 496 U.S. 912, 110 S.Ct. 2602 (1990). The Supreme Court upheld the franchise tax in Reynolds, and the Department thereafter notified the Taxpayer that its 1989 liability was due.

The Taxpayer paid the minimum franchise tax based on its $1,000.00 capital on December 7, 1989, plus penalty and interest ($12.50 minimum tax for one-half year, plus $4.00 penalty and interest).

The Department audited the Taxpayer and assessed additional 1989 franchise tax based on the capital acquired from Sikorsky on December 8, 1989. The Taxpayer had also paid its admission tax based on the $500.00 cap provided at §40-14-1. The Department disallowed the cap and assessed the Taxpayer for additional admission tax because the Taxpayer had failed to timely file with the Department a resolution of its board of directors as required by §40-14-1. The Department also assessed late payment and late filing penalties against the Taxpayer.

The Department now concedes that the late filing penalty was incorrectly assessed, and also that the interest assessed is excessive and should be reduced. On the other hand, the Taxpayer concedes that except for the late payment penalties, the Department's adjustments for 1990 through 1992 are correct. The only disputed items are the Taxpayer's franchise tax and admission tax liability for 1989, and the late payment penalty for all years.

Issue I - On what date did the Taxpayer's initial franchise tax liability for 1989 become fixed?

The Taxpayer argues that its 1989 liability was fixed on the date it qualified with the Secretary of State, December 7, 1989,

citing International Paper Co. v. Curry, 9 So.2d 8 (1942). It is undisputed that the Taxpayer had capital of only $1,000.00 on that date. The Department contends that the liability of a newly qualified corporation can only be fixed on the date the corporation starts doing business and has capital employed in Alabama, regardless of its qualification date. The Department thus argues that because the Taxpayer was not doing business in Alabama and did not have substantial capital employed in Alabama until December 8, 1989, when it acquired the capital of Sikorsky, the Taxpayer's 1989 franchise tax liability should be computed on its capital employed in Alabama on that date.

The Department's argument is not unreasonable. A foreign corporation is subject to Alabama franchise tax only if it is doing business in Alabama. Code of Ala. 1975, §40-14-41. Consequently, if a foreign corporation qualifies to do business in Alabama on one date, but does not actually begin doing business (or have nexus with) Alabama until a later date, the corporation would not be liable for Alabama franchise tax on the qualification date. Logically, a foreign corporation's franchise tax liability should not be computed or based on capital employed in Alabama on a date prior to when the corporation actually became liable for Alabama tax. I can find nothing specific in the franchise tax statutes, Title 40, Chapter 14, or in §232 of the Alabama Constitution supporting the Taxpayer's position to the contrary.

However, the Taxpayer's argument is directly supported by the Alabama Supreme Court's holding in International Paper. The Supreme Court expressly held in International Paper that the fixed date of liability for a newly qualified corporation is the date of qualification.

> Such capital employed is that amount employed at the time fixed for liability to accrue; which (a) as to a previously qualified corporation is January 1st, and (b) as to a newly qualified corporation is that date of qualification. General Acts of Alabama of 1935, § 324, p. 390, Code 1940, Tit. 51, § 354; State v. National Cash Credit Association, 224 Ala. 629, 141 So. 541; State v. Anglo-Chilean Nitrate Corporation, 225 Ala. 141, 142 So.87.

International Paper, at page 11.

> It follows from our authorities that the law date of liability of the newly qualified corporations is the date of qualification under the Alabama laws. The status on such date determines the liability of franchise for such year in which the corporation qualified to do business in this state.

International Paper, at page 13.

> This provision of the Legislature has definitely required the collection of a franchise tax, but has provided that such tax shall be based on the status of the corporation at the time it qualified. If at such time it had no capital employed in the State, it was due no tax. The mere fact that in filing its statement for entrance fee purposes it showed an intent to employ capital at a future date *cannot authorize the levy of a tax on any other basis than that fixed by the Constitution*, to wit, capital employed on the date of qualification.[1]

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[1]As illustrated, the Supreme Court flatly states in International Paper that the date of qualification is "fixed by the Constitution" as the liability date for a newly qualified corporation. But again, I have carefully reviewed §232 of the Constitution, and the statutes cited in the decision, and I can find nothing, except the International Paper opinion itself,

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> By the same token, the department of revenue has no right to assess franchise taxes against a foreign corporation on the theory that at some date subsequent to qualification, such corporation will employ capital in the state; nor does the tax department have a right to hold the return until such time as the corporation actually employs capital and makes assessment for franchise tax thereafter.

International Paper, at page 14.

International Paper was decided in 1942. However, it has not been overturned or modified by the Alabama Supreme Court, and thus remains good law.

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stating that the fixed date of liability must be the date of qualification.

I do, however, question whether the Supreme Court even considered the question here, that is - Is the fixed liability date always the date of qualification, even if the corporation is not doing business in and thus is not liable for Alabama franchise tax on that date. Rather, it appears that the Supreme Court presumed, without question, that if a foreign corporation qualifies to do business in Alabama, it is also in fact doing business in Alabama on that date.[2] But while §40-14-41(a) provides that a corporation qualified in Alabama is prima facie presumed to be doing business in Alabama, the presumption is rebuttable. State v. City Stores Co., 171 So.2d 121 (1965). I doubt that the Taxpayer's representative in this case would concede that if a foreign corporation with substantial capital qualified in Alabama in one year, but did not actually begin doing business in or have nexus

[2]The Taxpayer points out that the Administrative Law Division has also accepted the qualification date as the fixed liability date for a newly qualified corporation, citing State v. Capital Credit Corp., Admin. Law Docket F. 93-294, decided January 5, 1994. However, Capital Credit, like International Paper, also did not involve the issue here, and it was assumed that the taxpayer in that case was also doing business in Alabama on its qualification date.

with Alabama until the next year, it would still be subject to Alabama franchise tax on the date of qualification.

There is a dispute as to whether the Taxpayer was doing business in Alabama on its qualification date, December 7, 1989. The Taxpayer offered some evidence that it was (R. 29-33), while the Department argues that the Taxpayer began doing business only when it obtained the assets and capital of Sikorsky on December 8.

However, that question is moot given the plain language of International Paper. Until the Supreme Court readdresses the issue, International Paper requires that the qualification date must be recognized as the fixed liability date in all cases, including this appeal. The Taxpayer's capital employed in Alabama for 1989 franchise tax purposes was its capital on its qualification date of December 7, 1989, or $1,000.00. Additional 1989 franchise tax was thus improperly assessed.

The Taxpayer also argues in the alternative that even if the Sikorsky capital acquired on December 8 is included in its capital base, a credit should be allowed for the 1989 franchise tax previously paid by United Technologies on that capital. I agree. A franchise tax should be paid but once on the same capital employed in Alabama. See, International Paper, supra; Showell Farms, Inc. v. State, Admin. Law Docket F. 94-387 and F. 94-406, decided May 25, 1995. Thus, because United Technologies already paid tax on the Sikorsky capital, another tax against the Taxpayer on the same capital would not be due.

Issue II - The applicability of the $500.00 admission tax cap.

It is undisputed that unlike the franchise tax, a foreign corporation's admission tax liability is based on its capital on the qualification date, and also any additional capital acquired during the year. International Paper, supra, at page 11.

The admission tax is levied at §40-14-1 and includes a $500.00 cap, as follows:

> . . . provided, that the maximum amount of such qualification fee or admission tax shall not exceed $500 for each foreign corporation which files in the office of the Department of Revenue the instrument required by Section 40-14-2, together with certified copies of resolutions by its board of directors (1) locating within this state its principal administrative office, its principal distribution or manufacturing plant, or its principal place of business, and which corporation thereafter actually locates such office, plant or place of business within this state within one year from the date of such filing, or (2) authorizing it to become the successor or assignee of all or a substantial portion of the taxable property within this state of any foreign or domestic corporation theretofore qualified or admitted to engage in or transact business in this state, and which corporation thereafter actually becomes such successor or assignee within one year from the date of such filing.

The Taxpayer filed its initial franchise return in November 1989, and at the same time also filed the instrument specified in §40-14-2. However, the Taxpayer admittedly did not file the required resolution from its board of directors authorizing it to become a successor to Sikorsky in Alabama until September 1995. The Department argues that because the resolution was not timely filed along with the initial return, the Taxpayer failed to comply

with §40-14-1, and the $500.00 cap does not apply.

The Taxpayer responds that the actual filing of the board resolution is a ministerial act only, and should not prevent the cap from applying. The Taxpayer argues that the Department was put on actual notice that the Taxpayer would succeed Sikorsky in Alabama when it filed its initial tax return.

I agree with the Department. Reading §§40-14-1 and 40-14-2 together, it is clear that the $500.00 cap applies only if the required board resolution is timely filed together with the instrument required to be filed under §40-14-2, which is due at the time the admission tax return and payment are due.

The $500.00 cap applies if the corporation "files in the office of the Department of Revenue the instrument required by Section 40-14-2, <u>together with</u> certified copies of resolutions by its board of directors. . . ." The instrument specified in §40-14-2 must be filed "at the time of paying such tax. . . ." Consequently, the board resolution must also be filed along with the instrument at the time of paying the tax.

Section 40-14-1 also requires that the foreign corporation must "thereafter" actually locate in the State, or "thereafter" become a successor "within one year from the date of such filing." That language further indicates that the resolution must be filed when the admission tax return is filed and the tax paid. The Taxpayer failed to do so in this case. Consequently, the $500.00

cap does not apply, and additional admission tax was properly assessed based on the after-acquired capital of Sikorsky.

The Taxpayer argues in the alternative that if the cap does not apply, it should be allowed a credit against its admission tax for the 1989 franchise tax paid by United Technologies on the Sikorsky capital. I disagree.

The admission tax is a privilege tax paid for the privilege of doing business in Alabama. The tax is measured by capital employed in Alabama during a corporation's initial year of operation in Alabama. The admission and franchise taxes are separate taxes. Both are due, without credit, from every newly qualified foreign corporation doing business in Alabama.

United Technologies properly paid 1989 franchise tax on the Sikorsky capital on its liability date, January 1, 1989. The Taxpayer likewise is liable for admission tax based on its capital on December 7, 1989, plus all after-acquired capital during the year, including the Sikorsky capital acquired on December 8, 1989. A credit against the admission tax cannot be allowed for franchise tax also paid on the subject capital.

Issue III - Should the penalties be waived?

The Department also assessed late filing and late payment penalties relating to both the admission tax and the franchise tax. The Department concedes that the late filing penalty was incorrectly assessed. The late payment penalty relating to franchise tax is moot because, as discussed above, no additional

1989 franchise tax is due. The only penalty remaining in issue is the late payment penalty concerning the admission tax.

Code of Ala. 1975, §40-2A-11(h), as amended by Act 95-607, authorizes the Department, the Administrative Law Division, and the circuit and appellate courts to waive a penalty for reasonable cause. Reasonable cause is defined to include those instances where the taxpayer has acted in good faith. See generally, Compaq Computer Corp. v. State, Admin. Law Docket F. 95-435, decided February 12, 1996.

The Taxpayer timely filed its admission tax return and paid the tax in accordance with the $500.00 cap provided at §40-14-1. Although the cap does not apply for the reasons stated above, the Taxpayer in good faith believed the cap applied because it intended to and did become successor to the Sikorsky Division of United Technologies in Alabama within one year. Consequently, because the Taxpayer acted in good faith, the 10% late payment admission tax penalty should be waived.[3]

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[3]The Franchise Tax Division had previously agreed to waive all penalties in a letter to the Taxpayer dated August 3, 1994. However, the penalties were included in the final assessment because the assessment officer's instructions at the time were to add all penalties to a final assessment, regardless of reasonable cause.

The failure to timely pay penalty also would not have been applicable under §40-2A-11(b), as amended by Act 95-607, effective July 31, 1995. Under subparagraph (b), as amended, the failure to pay penalty is applicable only if a taxpayer fails to pay the amount due as reported on a return. That is, after July 31, 1995 the failure to pay penalty is not applicable to additional tax assessed pursuant to an audit, as was the tax in issue. However,

However, the 5% negligence penalty levied at §40-2A-11(c) should be applied. The negligence penalty applies if any underpayment is caused by negligence or any careless disregard for the rules.

Section 40-14-41 clearly specifies that the $500.00 cap can be allowed only if the board resolution is timely filed along with the admission tax return and the documents required under §40-14-2. The Taxpayer reasonably should have known that the required board resolution must be filed along with the initial return. The Taxpayer's failure to do so, although in good faith, constitutes negligence or a careless disregard for the plain requirements of the statute. The 5% negligence penalty is thus applicable concerning the admission tax liability.

The Department is directed to recompute the Taxpayer's liability in accordance with this Opinion and Preliminary Order. A Final Order will then be entered. This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed by either party to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

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Act 95-607 does not apply in this case because the tax and penalties were assessed prior to the effective date of Act 95-607.

Entered March 12, 1996.

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BILL THOMPSON
Chief Administrative Law Judge