SPEEDRING, INC. 7777 Fay Avenue, Suite 120 La Jolla, California 92037-4388,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NOS. F. 95-237 F. 95-288
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed franchise tax against Speedring, Inc. ("Taxpayer") for the years 1989 through 1992, and also for the years 1993 and 1994. The Taxpayer appealed, and the cases were consolidated and heard together on October 10, 1995. Jim Sizemore and John Barran represented the Taxpayer. Assistant Counsel Dan Schmaeling represented the Department.

This case involves the following issues:

(1) Is the Department bound by a settlement agreement entered into by the Department and the Taxpayer on July 7, 1993 concerning the Taxpayer's 1989 through 1992 liability;

(2) Should the Taxpayer be required to include an intercompany account payable to its parent, Precision Aerotech, Inc. ("Precision Aerotech" or "Precision"), in its capital base. Precision Aerotech had acquired the Taxpayer with borrowed funds. The intercompany account payable in issue was created when that debt was "pushed down" by Precision onto the Taxpayer's financial statements; and

(3) Various miscellaneous items disputed by the Taxpayer.

The Taxpayer is located in Alabama and was acquired by

Precision Aerotech in 1988. Precision Aerotech does not do business in Alabama, and consequently is not subject to Alabama franchise tax.

Precision Aerotech purchased the Taxpayer with funds borrowed from a third-party lender. In recording the acquisition, Precision used "push-down" accounting to push down or transfer the debt onto the Taxpayer's financial statements as an intercompany payable to Precision.

The Taxpayer filed Alabama franchise tax returns for 1989, 1990, and 1991 in October 1990. The Taxpayer concedes that the returns were substantially incorrect.

The Department audited the Taxpayer in 1992 for franchise tax for the years 1989 through 1992. In the audit, the Department treated the intercompany account payable that had been pushed down to the Taxpayer's financial statements as capital pursuant to Code of Ala. 1975, §40-14-41(b)(4). A preliminary assessment was entered for the years 1989 through 1992 on February 12, 1993.

The Taxpayer filed a petition for review with the Franchise Tax Division, and an informal conference was conducted on July 7, 1993. Representatives of the Department and the Taxpayer agreed at that meeting that the intercompany payable pushed down to the Taxpayer would be deleted from the Taxpayer's capital base. As a result, the Department agreed that the Taxpayer's adjusted liability for the subject years was $206,000.00. The Taxpayer paid

the agreed amount due, plus interest, in early 1994, and the Department's audit file was closed. The penalty initially assessed by the Department was also waived.

The Department reopened the file in early 1995, and a final assessment was entered for the balance of the preliminary assessment due, plus interest and penalty. The Department also conducted a desk audit of the Taxpayer's 1993 and 1994 returns. The Department again included the intercompany payable as capital, and accordingly entered a final assessment for those years. The Taxpayer timely appealed both final assessments to the Administrative Law Division.

Issue I - The Settlement Agreement.

The Taxpayer strenuously argues that the July 7, 1993 settlement agreement is binding, and that the Department should be prohibited from assessing additional tax, interest, or penalty for the years 1989 through 1992. As stated, the parties agreed at that meeting that the intercompany payable pushed down to the Taxpayer's financial statements would be eliminated, and that the Taxpayer would pay the adjusted amount due in two installments. The Taxpayer paid in full, and the audit file was closed.

The Department's position, presumably, is that the Department cannot be estopped from assessing and collecting tax that is properly owed. However, the cases in support of that position involve either erroneous advice given by the Department, see, State

v. Norman Tie & Lumber Company, 393 So.2d 1022 (1981), or a prior erroneous interpretation of a statute by the Department, see, State v. Maddox Tractor & Equipment Company, 69 So.2d 426 (1953); Boswell v. Abex, 317 So.2d 317 (1975).

This case can be distinguished. In this case, the Department and the Taxpayer entered into an arm's-length settlement of the disputed tax liability. There is authority that such a settlement is as binding as a contract, and cannot be altered by either party absent fraud, mistake, or accident. Nero v. Chastang, 358 So.2d 740 (1978); Cia Anon Venezolana De Navegacion v. Frank L. Harris, 374 F.2d 33 (1967).

> The law in Alabama is clear in that agreements made in settlement of litigation are as binding on parties thereto as any other contract. See *Brocato v. Brocato*, Ala. 332 So.2d 722 (1976). A settlement agreement once entered into cannot be repudiated by either party and will be summarily enforced. See *Cia Anon Venezolana De Navegacion v. Harris*, 374 F.2d. 33 (5th Cir. 1967).
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> When parties who are *sui juris* make a final settlement between themselves, such settlement is as binding on them in many respects as a decree of the court. However, such settlement may be opened for fraud, accident, or mistake. See *Burks v. Parker*, 192 Ala. 250, 68 So.271 (1915).
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> In the present case, appellant has not raised any issue concerning fraud, accident, or mistake. Therefore, the settlement agreement is binding upon the appellant and cannot be repudiated.

Nero v. Chastang, supra, at page 743.

There is a valid public policy reason why the Department should not be estopped from assessing tax because of erroneous

advice or a prior erroneous interpretation of a statute by a Department employee. On the other hand, a taxpayer should be able to rely on an arm's-length settlement agreement entered into in good faith with the Department. There is no proof that the July 7, 1993 settlement was entered into through fraud, accident, or mistake.

However, the above issue need not be decided because, as explained below, even if the agreement is not binding, the intercompany payable in issue still should not be included in the Taxpayer's capital base.

Issue II - The Intercompany Account Payable.

Code of Ala. 1975, §40-14-41(b)(4) includes as capital "the amount of bonds, notes, debentures, or other evidences of indebtedness which are payable at the time to . . . another corporation owning more than 50% of the outstanding capital stock of the taxpayer . . . ."

The intercompany payable in issue was included on the Taxpayer's financial statements as a result of "push-down" accounting.[1] However, in substance, there was no underlying indebtedness owed by the Taxpayer to Precision. There were no

[1]"Push-down" accounting is not required under GAAP, but may be used at the option of the taxpayer. Frankly, I do not understand the rationale or benefits of "push-down" accounting, or why it is used.

"bonds, notes, debentures, or other evidences of indebtedness" as necessary for the accounting entry to be included as capital pursuant to subparagraph (b)(4). See, West Point Pepperell, Inc. v. State Dept. of Revenue, 624 So.2d 579, 581 (Ala.Civ.App. 1992).

The Department generally relies on a foreign corporation's financial statements to determine the corporation's capital base. However, if an entry on a financial statement does not in substance constitute capital as defined at §40-14-41(b), then the item should not be included in the corporation's capital base. As stated in Weavexx Corp. v. State, Admin. Law Docket F. 94-300, decided January 16, 1996:

> 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.

Weavexx, at page 3.

The Department argues that even if the debt is not pushed down as an intercompany payable, the Taxpayer's capital would still have increased as a result of the acquisition. See, testimony of Rick Umstead, Franchise Tax Hearing Officer, at pages 15 and 22 of transcript.

On the other hand, an independent CPA called by the Taxpayer testified that "push down" accounting is not required by GAAP, and that the Taxpayer could have made no changes on its financial

statements as a result of the acquisition. In other words, the Taxpayer's capital should not have changed due to the acquisition. See, testimony of Rory Gordon at pages 64 and 99-103 of transcript. The arguments are obviously conflicting. However, there is no independent testimony or other evidence verifying the Department's position. Given that "push-down" accounting is not required by GAAP, and that there was no underlying note or other evidence of indebtedness between the Taxpayer and Precision, I must hold that the intercompany account payable did not constitute "capital" under §40-14-41(b)(4), and thus should not be included in the Taxpayer's capital base. The Department also has not established that the 1988 acquisition would have otherwise increased the Taxpayer's capital base.

Issue III - The Miscellaneous Items

The Department accepted the allocation formula used by the Taxpayer on its returns. The Taxpayer now contends that the formula was improper, and has offered new apportionment data which it contends more accurately reflects its capital employed in Alabama. See, Issue III in Taxpayer's brief.

The Taxpayer also claims that some debt included by the Department in the Taxpayer's capital base as long-term debt was in fact short-term debt, and thus should be deleted from capital. See, Issue IV in Taxpayer's brief.

Finally, the Taxpayer argues that the Department used the

wrong balance sheet in computing its 1990 liability. According to the Taxpayer, using the correct data would decrease its 1990 liability by $15,000.00. See, Issue V in Taxpayer's brief.

The Department is directed to respond and set out its position concerning the above issues. The Department should contact the Taxpayer if necessary for explanatory or additional information. An Amended Opinion and Preliminary Order or a Final Order will then be entered, or other action will be taken, as appropriate.

This Opinion and Preliminary Order is not an appealable order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered April 26, 1996.

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BILL THOMPSON
Chief Administrative Law Judge