

MCI TELECOMMUNICATIONS CORP., INC. §  
1133 19th Street, NW  
Washington, DC 20036, §

STATE OF ALABAMA  
DEPARTMENT OF REVENUE  
ADMINISTRATIVE LAW DIVISION

Taxpayer, §

DOCKET NO. F. 95-301

v. §

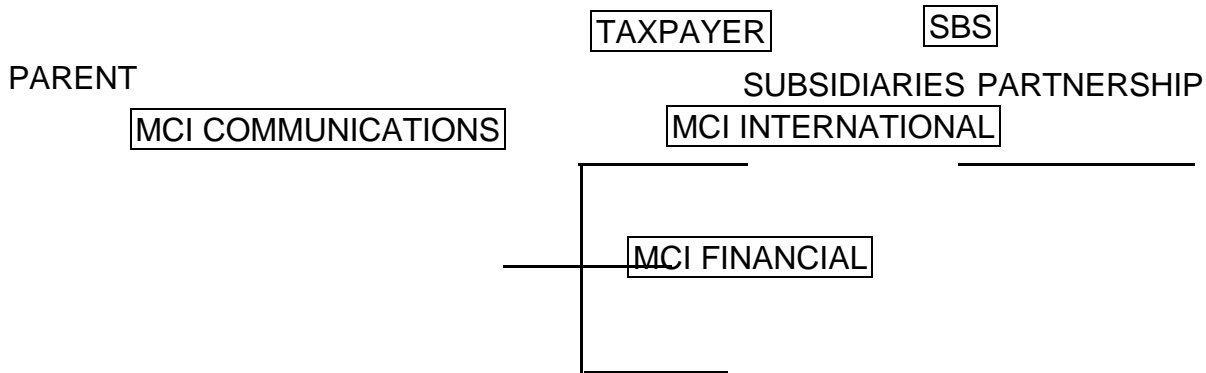
STATE OF ALABAMA §  
DEPARTMENT OF REVENUE.

### FINAL ORDER

The Revenue Department assessed franchise tax against MCI Telecommunications Corporation, Inc. ("Taxpayer") for the years 1989 through 1992. The Taxpayer appealed to the Administrative Law Division, and a hearing was conducted on October 10, 1995. Daniel Piekarczyk represented the Taxpayer. Assistant Counsel Dan Schmaeling represented the Department.

The issue in this case is whether certain intercompany payables and demand notes should be included as "capital" for franchise tax purposes pursuant to Code of Ala. 1975, §40-14-41(b)(3). That section defines capital to include all indebtedness of a corporation maturing and payable in more than one year ("long-term" debt). The Taxpayer also argues that if the accounts and notes are included as capital, the penalty assessed by the Department should be waived for reasonable cause. Finally, the Taxpayer claims that the Alabama foreign franchise tax is unconstitutional, and that all amounts previously paid by the Taxpayer should be refunded.

The Taxpayer is a foreign corporation for Alabama franchise tax purposes, and is qualified to do business in Alabama. The Taxpayer's parent is MCI Communications Corporation. The Taxpayer has numerous sister corporations, two of which are MCI Financial Management, Inc. ("MCI Financial") and MCI International, Inc. ("MCI International"). The Taxpayer is also part-owner of a partnership, Satellite Business Systems ("SBS"). The relationship of the relevant parties is illustrated below:



The Department reviewed the Taxpayer's franchise tax returns and financial statements for the subject years and included as capital certain demand notes representing debt owed by the Taxpayer to MCI Financial. The notes are for a sum certain, are at a specified rate of interest, and are payable on demand.

The Department also included as capital certain intercompany accounts payable representing debt owed by the Taxpayer to both SBS and MCI International.

SBS is in the satellite communications business and, as stated, is partially owned by the Taxpayer. The Taxpayer, by agreement, performed SBS's billing and collection services during the subject period. The intercompany account in issue represents the amounts collected by the Taxpayer on behalf of and payable to SBS. The account is an open account payable on demand.

The Taxpayer provides international telephone service to its customers. As a result, the Taxpayer is required to pay foreign telecommunications companies for completing its international calls. MCI International, by agreement, pays the foreign companies on behalf of the Taxpayer. MCI International then bills the Taxpayer monthly, which results in the intercompany account payable in issue.

"Capital" is defined for foreign franchise tax purposes at Code of Ala. 1975, §40-14-41(b). Subsection (b)(3) includes as capital certain long-term debt as follows - "The amount of bonds, notes, debentures, or other evidences of indebtedness maturing or payable more than one year after the first day of the franchise tax year."

The Department argues that the demand notes from the Taxpayer payable to MCI Financial are long-term debt under subsection (b)(3) because the Taxpayer did not have sufficient assets on hand to pay the notes on demand. I disagree.

The above issue was decided in State v. Magnolia Methane, Inc., Admin. Law Docket No. F. 94-178, decided June 27, 1994, aff'd Montgomery County Circuit Court, September 15, 1995.<sup>1</sup> In Magnolia Methane, the taxpayer had an open-end demand note payable to its corporate grandparent. As in this case, the Department argued that the note should be deemed long-term because the taxpayer did not have sufficient assets available to pay the note on demand. The Department's position was rejected, as follows:

This is a statutory construction case. The plain language of §40-14-41(b)(3) is that a debt is long-term and thus must be included as capital only if it matures and is payable more than one year after the first day of the franchise tax year. A demand note by its own terms is payable immediately upon demand, not in more than one year. A demand note thus is not a long-term indebtedness, but rather is in substance identical to the open-account advances at issue in Norandal (Norandal USA, Inc. v. State, Dept. of Revenue, 545 So.2d 792 (Ala.Civ.App. 1989)), which were treated as short-term debt. The fact that the Taxpayer did not have sufficient assets to pay the note immediately does not convert the demand note to long-term debt, nor does the fact that the Taxpayer characterized the note as "non-current" for internal accounting purposes.

---

<sup>1</sup>Magnolia Methane was appealed by the Department to the Court of Civil Appeals on October 24, 1995.

Magnolia Methane, at page 3.

Likewise, the demand notes payable to MCI International also must be treated as short-term because, by their terms, they are payable in less than one year. See also, Budget Rent A Car System, Inc. v. State, Admin. Law Docket F. 94-418, decided October 2, 1995, in which indebtedness maturing and payable in more than one year pursuant to the language of the debt instrument was held to be long-term, and thus includable as capital under subsection (b)(3), even though the debt was in fact paid in less than one year.

The demand notes also must be treated as short-term debt under generally accepted accounting principles ("GAAP"). By Act 95-564, the Alabama Legislature amended §40-14-41(b) to provide that capital as defined in that section shall be "determined in accordance with generally accepted accounting principles appropriate in the particular case, as promulgated by the Financial Accounting Standards Board or a similar or successor agency or board, . . . ."

FASB 78 (Taxpayer Exhibit 2), issued December 1983, amended Accounting Research Board ("ARB") 43 to read as follows:

The current liability classification is also intended to include obligations that, by their terms, are due on demand or will be due on demand within one year (or operating cycle, if longer) from the balance sheet date, even though liquidation may not be expected within that period.

The demand notes between the Taxpayer and MCI Financial clearly are short-term

liabilities under FASB 78.<sup>2</sup>

Again relying on GAAP, the intercompany accounts payable to MCI International and SBS also must be treated as short-term debt. ARB 43 (Taxpayer Exhibit 3) reads as follows:

The term *current liabilities* is used principally to designate obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of other current liabilities. As a balance-sheet category, the classification is intended to include obligations for items which have entered into the operating cycle, such as payables incurred in the acquisition of materials and supplies to be used in the production of goods or in providing services to be offered for sale; collections received in advance of the delivery of goods or performance of service; and debts which arise from operations directly related to the operating cycle, such as accruals for wages, salaries, commissioner, rentals, royalties, and income and other taxes.

The accounts payable to both MCI International and SBS arose in the ordinary course of the Taxpayer's regular business operations. MCI International, by agreement, pays foreign telecommunications companies on behalf of the Taxpayer, and in turn bills the Taxpayer monthly, resulting in the subject intercompany payables. The Taxpayer also provides routine billing and collection services for SBS, which results in the intercompany payables to SBS. As indicated in ARB 43, debt arising from operations in the regular operating cycle constitutes a current liability.

The above considered, the waiver of penalty issue is moot. The Administrative Law Division also does not have jurisdiction or authority to decide the constitutional issues

---

<sup>2</sup>FASB 78 was also cited in support of the holding in Magnolia Methane, at page 4.

raised by the Taxpayer. Beaird v. City of Hokes Bluff, 595 So.2d 903 (1992); Curtis v. Taylor, 648 F.2d 946 (1980).

Because the demand notes and the intercompany payables do not constitute capital under §40-14-41(b), the final assessment in issue is 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 11, 1996.

\_\_\_\_\_  
BILL THOMPSON  
Chief Administrative Law Judge