

MUELLER COMPANY
One Tyco Park
Exeter, New Hampshire 03833,

Taxpayer,

v.

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

DOCKET NO. F. 95-364

STATE OF ALABAMA
DEPARTMENT OF REVENUE.

FINAL ORDER

The Revenue Department assessed franchise tax against Mueller Company ("Taxpayer") for 1990 through 1994. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, § 40-2A-7(b)(5)a. A hearing was conducted on January 29, 1996. Bernard Pietrowski and Kim Jackson represented the Taxpayer. Assistant Counsel Jeff Patterson represented the Department.

Mueller Holding Company ("Mueller Holding") purchased the Taxpayer in 1986. Mueller Holding "pushed down" goodwill to the Taxpayer's books as a result of the purchase. Tyco International ("Tyco") purchased the Taxpayer in 1988. Tyco reversed the push-down by eliminating the goodwill account on the Taxpayer's books and making a corresponding treasury stock entry.

The Department audited the Taxpayer, recharacterized the treasury stock entry as capital (because the Taxpayer had no treasury stock), and based thereon assessed the additional franchise tax in issue. The issue in this case is whether that adjustment was proper.

Mueller Holding purchased the Taxpayer in 1986. At the time, the excess of the

purchase price paid by Mueller Holding over the value of the Taxpayer's tangible assets, approximately \$110 million, was pushed down as goodwill to the Taxpayer's books. "Push-down" accounting is an option under generally accepted accounting principles ("GAAP"), and allows an acquiring corporation to push down to the acquired corporation's books the debt and/or goodwill resulting from the purchase.

Tyco purchased Mueller Holding and its subsidiaries, including the Taxpayer, in 1988. Tyco's policy is not to use push-down accounting. Consequently, to conform to its policy, Tyco eliminated the goodwill account on the Taxpayer's books, and also made a corresponding treasury stock entry.¹ That entry was eliminated through consolidation at year end.

The Department determined that the Taxpayer did not have treasury stock, and accordingly added the \$110 million represented by the treasury stock account to the Taxpayer's capital base for Alabama franchise tax purposes. That resulted in the final assessment in issue. The Taxpayer appealed to the Administrative Law Division.

Alabama franchise tax is levied on capital employed in Alabama. Code of Ala. 1975, ' 40-14-41(a). "Capital" is defined at ' 40-14-41(b). That section also requires that capital must be computed in accordance with GAAP. Push-down accounting is optional under GAAP. Consequently, just as Mueller Holding elected to push down

¹My non-expert understanding is that when Mueller Holding pushed down (debited) goodwill to the Taxpayer's books in 1986, it presumably also credited the Taxpayer's contributed capital account. Consequently, when Tyco reversed the push down in 1988, the Taxpayer should have credited (eliminated) goodwill and correspondingly debited contributed capital. In other words, I do not understand why a treasury stock entry was made in the first place.

goodwill to the Taxpayer in 1986, Tyco could opt to reverse the entry. Removing goodwill from the Taxpayer's books was also consistent with Tyco's policy of not using push-down accounting.

This case illustrates the problem with using GAAP to determine a foreign corporation's capital base. That is, GAAP allows a corporation options, as with the optional use of push-down accounting. Consequently, a foreign corporation with subsidiaries operating in Alabama may elect to use push-down accounting, depending on the resulting tax consequences.

The Administrative Law Division has ruled in prior cases that substance must govern, not how a transaction is recorded on a corporation's books. Weavexx Corp. v. State, F. 94-300 (Admin. Law Div. 1/16/96); Pechiney Corp. v. State, F. 96-106 (Admin. Law Div. 1/16/97).

If Mueller Holding had not pushed down the goodwill to the Taxpayer's books in 1986, obviously the Taxpayer's books would not have included the goodwill account. In that case, Tyco would not have been required to reverse the goodwill entry in 1988.

In short, the purchase of the Taxpayer by Mueller Holding in 1986, and the purchase of Mueller Holding by Tyco in 1988, did not in substance result in additional capital to the Taxpayer. Consequently, the Taxpayer should not be required to recognize additional capital from the transactions. The final assessment 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 February 20, 1997.

BILL THOMPSON
Chief Administrative Law Judge