

QMS, INC. § STATE OF ALABAMA
Post Office Box 81250 DEPARTMENT OF REVENUE
Mobile, Alabama 36689-1250, § ADMINISTRATIVE LAW DIVISION
Taxpayer, § DOCKET NO. F. 96-170
v. §
STATE OF ALABAMA §
DEPARTMENT OF REVENUE.

FINAL ORDER

The Revenue Department assessed franchise tax against QMS, Inc. for 1994. QMS appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on June 18, 1996. Gregory Jones, Arnie Nelson, and Ed Langley represented QMS. Assistant Counsel Dan Schmaeling represented the Department.

"Capital" is defined for Alabama franchise tax purposes to include bonds, notes, and other evidences of indebtedness "maturing and payable (in) more than one year," i.e. long-term debt. Code of Ala. 1975, §40-14-41(b)(3). Capital does not include demand notes and other short-term debt.¹ State v. Magnolia Methane, F. 94-178 (Admin. Law Div. 6/27/94); MCI Telecommunications Corporation, Inc. v. State, F. 95-301 (Admin. Law Div. 1/11/96).

The issue in this case is whether long-term debt initially due and payable by QMS in more than one year is converted to short-term debt for franchise tax purposes because the lenders acquired the

¹An exception is short-term debt between certain related parties. See, Code of Ala. 1975, §40-14-41(b)(4). However, that section is not relevant in this case.

authority to call the debt on demand.

QMS obtained loans from a banking group, and also from Connecticut General Life Insurance Company ("CIGNA") before the subject year. The loans were initially due and payable in more than one year.

The loan agreements contained covenants which, if breached and not waived, would constitute a default. If QMS defaulted, the lenders had the option of calling the loans on demand.

QMS breached the loan covenants during the year in issue. The lenders issued waivers of noncompliance, but only on a quarterly basis several weeks after the beginning of each quarter.

QMS booked the debt as long-term on its financial statements, but failed to include the loans as capital on its 1994 Alabama franchise tax return. The Department audited QMS, included the loans in QMS' capital base as long-term debt, and assessed the additional franchise tax in issue. QMS appealed to the Administrative Law Division.

Code of Ala. 1975, §40-14-41(b), as amended by Act 95-564, requires that the capital of a foreign corporation shall be "determined in accordance with Generally Accepted Accounting Principals ("GAAP") appropriate in the particular case, as promulgated by the Financial Accounting Standards Board"

QMS argues that the callable loans in question must be classified as short-term debt under Financial Accounting Standards

Board Publication 78 ("FASB No. 78"). FASB No. 78 is entitled *Classification of Obligations That Are Callable by the Creditor* and reads in pertinent part as follows:

The current liability classification . . . is also intended to include long-term obligations that are or will be callable by the creditor either because the debtor's violation of a provision of the debt agreement at the balance sheet date makes the obligation callable or because the violation, if not cured within a specified grace period, will make the obligation callable. Accordingly, such callable obligations shall be classified as current liabilities

However, FASB No. 78 also provides that short-term obligations that are expected to be refinanced on a long-term basis, including those callable obligations discussed in FASB No. 78, shall be classified in accordance with FASB No. 6, *Classification of Short-Term Obligations Expected to Be Refinanced*. FASB No. 6 provides that short-term obligations are excluded from current liabilities if the debtor intends to refinance the obligation on a long-term basis and has the ability to do so.

QMS concedes that it intended to and actually refinanced the debt in issue. "Taxpayer had, in fact, such an intent (to refinance) and ability and did subsequently refinance the bank group debt and considerably reduced the CIGNA debt." QMS Memorandum of Law, at page 2. QMS also complied with FASB No. 6 by treating the debt as long-term on its financial statements. Consequently, the loans must be classified as long-term debt under GAAP for franchise tax purposes.

QMS argues that as between the statutory definition of "capital" and GAAP, the statute must control, citing Department of Revenue v. Arch of Alabama, Inc., F. 90-173 (Admin. Law Div. 7/22/94). However, Arch of Alabama was decided prior to Act 95-564, which now requires GAAP to be followed in determining capital under §40-14-41(b).

The final assessment is affirmed. Judgment is entered against QMS for 1994 franchise tax in the amount of \$94,026.76, plus applicable interest.

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

Entered September 17, 1996.

BILL THOMPSON
Chief Administrative Law Judge