

HOHENBERG BROTHERS COMPANY '
P.O. Box 5626
Minneapolis, MN 66440,

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

Taxpayer,

DOCKET NOS. CORP. 96-197
CORP. 97-357

v.

STATE OF ALABAMA
DEPARTMENT OF REVENUE.

FINAL ORDER

The Revenue Department assessed 1991 and 1992 corporate income tax against Hohenberg Brothers Company, Inc. (ATaxpayer@). The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, ' 40-2A-7(b)(5)a. The appeal was docketed as CORP. 96-197. The Department later assessed the Taxpayer for 1991 through 1994 corporate tax, which incorporated the 1991 and 1992 final assessments. The Taxpayer again appealed. That appeal was docketed as CORP. 97-357. A hearing was conducted on April 9, 1998. Larry Neer represented the Taxpayer. Assistant Counsel Mark Griffin represented the Department.

Issue

The IRS required the Taxpayer to recognize deemed dividend distributions from a Domestic International Sales Corporation (ADISC@) as income in 1991 and 1994. The issue in this case is whether the Taxpayer should also be required to recognize the deemed distributions as income for Alabama purposes in those years.

Facts

The Taxpayer formed a DISC, Hohenberg Brothers International (HBI), in the early 1970's. As a DISC, HBI charged the Taxpayer a percentage commission on its qualified export sales. A portion of HBI's income was tax-deferred for federal purposes. DISCs were abolished by the Federal Tax Reform Act of 1984. That Act also allowed a DISC to distribute tax-free to its parent corporation all previously tax-deferred accumulated dividends.

HBI distributed its accumulated dividends of \$16,113, 553 to the Taxpayer during the fiscal year ending (fye) May 31, 1985. As indicated, that distribution was tax-free for federal purposes. HBI was liquidated in April 1986.

Alabama never adopted the federal DISC provisions. Consequently, for Alabama purposes, all DISC income was taxable to the parent in the year earned. See, Dept. Reg. 810-3-34.01.

The Taxpayer failed to report the dividend distribution from HBI on its fye May 31, 1985 Alabama return. The Department audited the Taxpayer and included the dividend distribution as income in that year. The Department failed, however, to assess the tax before the statute of limitation expired for the year. The Taxpayer thus did not pay Alabama tax on the dividend distribution.

The IRS audited HBI for fye May 31, 1978 through fye May 31, 1980. Pursuant to 26 U.S.C. '992(c), the IRS required the Taxpayer to recognize a deemed distribution from HBI of \$4,651,359 in fye May 31, 1991, and \$10,796,955 in fye May

31,1994.

The Department tracked the federal audit, and included the deemed distributions as income for Alabama purposes in both years. The Taxpayer appealed the resulting final assessments.

Analysis

The dividend distribution constituted income to the Taxpayer when received in 1985, and thus was taxable in that year. See, Code of Ala. 1975, ' 40-18-14(1), which reads in part - AThe amount of all such items (of income) shall be included in the gross income for the taxable year in which received by the taxpayer...@ See also, Dept. Reg. 810-3-14-.01, which reads in part - A...income is to be reported for the year in which received@. Income taxable in 1985 cannot also be taxed in 1991 and 1994.

The IRS required the Taxpayer to recognize the deemed distributions in 1991 and 1994 pursuant to a specific federal statute, 26 U.S.C. ' 992(c). As indicated, that federal statute was not adopted by Alabama, and thus cannot be relied on by the Department.

The Department concedes that the actual dividend distribution should have been taxed in 1985. It argues, however, that because the dividends were not taxed in 1985, they can now be taxed in 1991 and 1994, citing Reg. 810-3-34.01.

I disagree.

Reg. 810-3-34.01 reads in pertinent part:

AFor shareholders of a DISC prior to and including December 31, 1984, gross income of the shareholder for the tax year which includes December 31, 1984, also includes the amount of income deferred into the DISC, which has not been taxed either as deemed dividends or as actual distributions.@

The above regulation acknowledges that because Alabama never adopted

the federal DISC tax-deferral provisions, a parent corporation must recognize DISC income in the year received, i.e. no tax deferral. The regulation does not authorize the Department to tax DISC distributions at any time, which would be the result if the Department's argument was accepted. Even if it did, the regulation would be contrary to the ' 40-18-14(1) requirement that income must be taxed in the year earned or received. The regulation also specifically applies only to tax years prior to and including December 31, 1984.@

The final assessments in issue are dismissed.

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

Entered May 27, 1998.

BILL THOMPSON
Chief Administrative Law Judge

BT:ks

cc: Mark Griffin, Esq.
Laurence M. Neer
Chris Sherlock