DRAVO CORPORATION Post Office Box 2068 Mobile, AL 36652,	§ §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. CORP. 96-418
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department denied a refund of 1990 corporate income tax requested by Dravo Corporation ("Taxpayer"). The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(c)(5)a. A hearing was conducted on January 11, 2002 in Mobile, Alabama. The Taxpayer's representative was notified of the hearing, but failed to appear. Assistant Counsel Duncan Crow represented the Department.

ISSUE

The issue in this case is whether the Taxpayer was authorized or entitled to file a combined Alabama corporate income tax return in 1990.[1]

FACTS

The Taxpayer conducted business in Alabama and was liable for Alabama income tax in 1990. It initially filed a separate entity Alabama return for that year. It later filed an amended 1990 combined return with 12 of its subsidiary corporations. The amended

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[1]On a combined return, the income of an in-state taxpayer subject to Alabama tax is computed by applying the apportionment factors of a unitary group of corporations to the taxable net income of the unitary group. For an excellent discussion of the unitary business principle, see, J. Hellerstein & W. Hellerstein, *State Taxation*, ¶8.07[1] et seq (3d ed. 2001).

return requested a refund of $198,164. The Department rejected the combined return, and consequently denied the refund. The Taxpayer appealed.

ANALYSIS

Code of Ala. 1975, §40-18-39 requires that every corporation subject to Alabama income tax must file a return with the Department. The Department has long interpreted that statute to require that each corporation must file a separate return. This is confirmed by Dept. Reg. 810-3-39-.01(5), which provides that "each and every corporation shall make a separate return."

Section 40-18-39 was substantially amended in 1998 by Act 98-502. That Act for the first time allowed corporations to elect to file consolidated Alabama returns under certain circumstances. The Act also added §40-18-39(i), which states that "[n]othing in this section shall be construed as allowing or requiring the filing of a combined income tax return under the unitary business concept." Section 40-18-39 was again amended in 2001 by Act 2001-1089, but that Act did not change the anti-combined reporting language of subsection (i).

Combined returns clearly are not allowed under §40-18-39(i). However, that statute was enacted in 1998, after the year in issue. But as indicated, even before §40-18-39(i), the Department interpreted §40-18-39 as requiring separate returns. The long standing interpretation of a statute by the Department must be given great weight. *Pilgram v. Gregory*, 594 So.2d 114 (Ala.Civ.App. 1991).

The Taxpayer argues that the Multistate Tax Compact ("MTC"), Code of Ala. 1975, §40-27-1, et seq., authorizes corporations to file combined unitary returns.[2] That statute requires generally that a multi-state corporation doing business in

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[2]The MTC was adopted in Alabama, effective in 1977. *State, Dept. of Revenue v. MGH Mgt. Inc.*, 627 So.2d 408 (Ala.Civ.App. 1993). In substance, the MTC adopted the allocation and apportionment rules set out in the Uniform Division of Income for Tax Purposes Act ("UDITPA").

Alabama must allocate and apportion its income to Alabama using a three-factor formula. Section 40-27-1, Art. IV, Para. 18, provides that if the standard apportionment and allocation provisions do not fairly represent a taxpayer's business activity in Alabama, "the taxpayer may petition for or the tax administrator may require" an alternative method, including separate accounting, the exclusion or inclusion of different factors, or the "employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income."

The issue of whether UDITPA's §18 relief provision allows a corporation to use, or authorizes a state to require, combined reporting has never been addressed by Alabama's courts. See, *Ex parte Sonat, Inc.*, 752 So.2d 1211, 1218 n.2 (Ala. 1999). The issue has, however, been addressed in numerous other states, with different results. For example, the Kansas and Kentucky Supreme Courts have held that UDITPA authorizes the use of combined returns. On the other hand, the Tennessee, Maine, and the Missouri courts have rejected the idea that UDITPA authorizes combined reporting.[3]

The §18 relief provision does not specifically authorize combined reporting, and nowhere in UDITPA is combined reporting mentioned. I agree with the following excerpt from the Hellerstein treatise that §18 of UDITPA, by itself, does not authorize or allow the use of combined reporting:

> While we strongly believe that combined reporting as applied to multicorporate unitary enterprises is eminently sound from a tax policy standpoint, there is something to be said for the views of the

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[3]See, *GTE & Subsidiaries v. Rev. Cabinet*, 889 S.W.2d 788 (Ky. 1994); *American Tel. & Tel. Co. v. Huddleston*, 880 S.W.2d 682 (1994); *Sears Roebuck & Co. v. State Tax Assessor*, 561 A.2d 172 (Me. 1989); *Williams Cos. v. Dir. of Revenue*, 799 S.W.2d 602 (Mo. 1990); and *Pioneer Container Corp. v. Beshears*, 684 P.2d 396 (1984). For a detailed analysis of the issue and other cases on point, see, J. Hellerstein & W. Hellerstein, *infra* n. 2, ¶8.11[2][a] and ¶9.20.

> Tennessee and Maine courts that the equitable adjustment provision typified by Section 18 of UDITPA does not vest the tax administrator with the power to apportion income on a combined basis. Combined reporting was known and had been used in California and other states long before the enactment of UDITPA. Its use was based on broad statutory provisions, other than the equitable adjustment provisions, that in some states explicitly prescribed the use of combined apportionment. Moreover, Section 18 by its terms authorizes the tax administrator to prescribe separate accounting, but not combined reporting, which strongly suggest that requiring combined reporting was not intended to be included in the omnibus provisions authorizing the tax administrator to require "the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income."

J. Hellerstein & W. Hellerstein, *infra* n. 2, ¶8.11[2][a].

Even if combined reporting was an available alternative method under §18 of UDITPA, before an alternative method can be used, the taxpayer must first show that the method applied by the state does not fairly reflect the taxpayer's business activities in the state. *American Tel. & Tel.*, 880 S.W.2d at 691. The Taxpayer in this case has offered no evidence that the taxable income reported on its original 1990 return does not accurately reflect its business conducted in Alabama in that year. Consequently, the combined return filed by the Taxpayer was properly rejected by the Department.[4]

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[4]The Alabama Legislature recently added Code of Ala. 1975, §40-2A-17 to Alabama's tax code. See, Act 2001-1088. That statute provides that when dealing with commonly owned or controlled corporations, the commissioner of revenue may "distribute, apportion, or allocate gross income, deductions, credits, or allowances, if the commissioner determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of Alabama income taxes or to clearly reflect the income of any such (corporation)." Section 40-2A-17(a). The commissioner "shall exercise such authority in a manner consistent with . . . 26 U.S.C. §482 and rulings and regulations issued thereunder." Section 40-2A-17(f).

It is problematic whether the above language authorizes the commissioner to force combination, especially given the language in §40-18-39(i). However, §40-2A-17 was enacted after §40-18-39(i), and §40-18-39(i) specifies only that "[n]othing in this section (§40-18-39) shall be construed as allowing or requiring

The 1990 corporate income tax refund requested by the Taxpayer is denied.

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

Entered February 5, 2002.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Duncan R. Crow, Esq.
John Dahlke
Chris Sherlock

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combined returns." It thus could be argued that §40-18-39(i) has no bearing on whether the Department may require combination under §40-2A-17. But if §40-2A-17 does authorize the Department to combine related corporations, that authority is limited to situations where the taxpayer is attempting to evade Alabama tax, or the taxpayer's return as filed does not clearly reflect income attributable to Alabama. See generally, *American Tel. & Tel.*, 880 S.W.2d at 688.