

HOHENBERG BROTHERS
CORPORATION
P.O. Box 5626
Minneapolis, MN 55440-5625,

Taxpayer,

v.

STATE OF ALABAMA
DEPARTMENT OF REVENUE.

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

DOCKET NO. CORP. 98-405

FINAL ORDER

The Revenue Department assessed Hohenberg Brothers Corporation (ATaxpayer@) for corporate income tax for the fiscal years ending May 31, 1978 through May 31, 1984. 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 7, 1999. Larry Neer represented the Taxpayer. Assistant Counsel Mark Griffin represented the Department.

The IRS audited the Taxpayer for the fiscal years ending May 31, 1978 through May 31, 1984. The Revenue Department received a copy of the federal audit in May 1998. The Department used the federal audit to assess the tax in issue pursuant to Code of Ala. 1975, ' 40-2A-7(b)(2)g.1. That statute allows the Department one year to assess a taxpayer for additional Alabama tax resulting from federal audit changes. The issue is whether the federal audit resulted in additional Alabama income tax owed by the Taxpayer during the subject years.

The Taxpayer formed a domestic international sales corporation (ADISC@),

Hohenberg Brothers International (HBI), in the early 1970's. A portion of HBI's accumulated dividend income was tax-deferred for federal purposes.

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

Alabama never adopted the federal DISC provisions. Consequently, for Alabama purposes all DISC distributions were taxable to the parent in the year received. Dept. Reg. 810-3-34.01.

The Taxpayer failed to report the dividend distribution from HBI on its fiscal year ending May 31, 1985 Alabama return. The Department audited the Taxpayer and included the distribution as income in that year. The Department failed, however, to assess the tax due before the statute of limitations expired for the year. The Taxpayer thus failed to pay Alabama income tax on the distribution.

The IRS audited the Taxpayer's parent corporation, Cargill, Inc., and all related subsidiaries, including the Taxpayer and HBI, for the fiscal years ending May 31, 1978 through May 31, 1984. The IRS determined that HBI had insufficient qualified export assets as required by federal law during the subject years. To correct the problem and requalify HBI as a DISC, federal law required the Taxpayer to recognize deemed distributions from HBI of \$4,651,359 in the fiscal year ending May 31, 1991, and \$10,796,955 in the fiscal year ending May 31, 1994. See, 26 U.S.C.

'992(c). The deemed distributions were computed based on HBI's accumulated dividends during 1978 through 1984, plus interest from those years.

The Department included the deemed distributions as income for Alabama purposes in 1991 and 1994, and assessed the Taxpayer for additional Alabama tax due in those years. The Taxpayer appealed to the Administrative Law Division.

The Administrative Law Division dismissed the 1991 and 1994 final assessments because the deemed distributions did not constitute income for Alabama purposes. Hohenberg Brothers Company v. State of Alabama, Corp. Inc. 96-197 and Corp. Inc. 97-357 (Admin. Law Div. 05/27/98). Rather, the Department should have taxed the actual dividend distribution by HBI to the Taxpayer in 1985. As indicated, the Department attempted to tax the distribution in 1985, but failed to do so before the statute of limitations expired.

The Taxpayer provided the Department with a copy of the federal audit in May 1998. The audit included two closing agreements in which the Taxpayer agreed to recognize the deemed distributions for federal purposes in 1991 and 1994.

The Department reviewed the closing agreements and determined that the IRS had in substance increased the Taxpayer's income during 1978 through 1984 by the amount of the deemed distributions. The Department accordingly increased the Taxpayer's 1978 through 1984 Alabama income, and entered the final assessment in issue pursuant to '40-2A-7(b)(2)g.1. The Taxpayer again

appealed to the Administrative Law Division.

Section 40-2A-7(b)(2)g.1. reads in pertinent part:

g.1. When the Internal Revenue Service changes the amount of federal income tax or federal estate tax in any manner and the change results in an increase in additional income tax or estate tax owed under this title, the department may, at any time within one year after the department is notified or otherwise learns that the change has become final, enter a preliminary assessment for additional tax due...Any tax assessed within the additional one year period allowed shall be limited to those items changed on the federal income tax return or federal estate tax return that affect the income tax liability or the estate tax liability imposed by this title.

The Department contends that although the IRS required the Taxpayer to recognize the deemed distributions in 1991 and 1994, the actual income adjustments related to 1978 through 1984. The Department thus contends it is authorized by ' 40-2A-7(b)(2)g.1 to make corresponding changes to the Taxpayer's 1978 through 1984 Alabama income. I disagree.

The IRS did not increase the Taxpayer's income or change the amount of federal tax owed by the Taxpayer for 1978 through 1984. The federal changes, which do not apply for Alabama purposes, were made to the Taxpayer's 1991 and 1994 liabilities. The IRS was required by federal law to compute the amount of the deemed distributions based on HBI's accumulated DISC income in 1978 through 1984, but again, no changes were made to the Taxpayer's income or federal liabilities in those years.

In any case, it is irrelevant when the Taxpayer was required to recognize the

DISC dividends as income for federal purposes because Alabama never adopted the federal DISC provisions. For Alabama purposes, the dividend distribution from HBI to the

Taxpayer could only have been taxed in 1985, the year received by the Taxpayer.

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 18, 1999.

BILL THOMPSON
Chief Administrative Law Judge

BT:ks

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