

GENERAL AMERICAN
TRANSPORTATION CORP.
500 W. Monroe Street
Chicago, IL 60661-3620,

Taxpayer,

v.

STATE OF ALABAMA
DEPARTMENT OF REVENUE.

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

DOCKET NO. CORP. 02-384

FINAL ORDER

The Revenue Department assessed General American Transportation Corporation (“Taxpayer”) for Alabama income tax for 1997, 1998, and 1999. 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 16, 2003. CPA Frank O’Connell represented the Taxpayer. Assistant Counsel Jeff Patterson represented the Department.

ISSUE

The issue in this case is whether the Taxpayer correctly computed the numerator of its apportionment sales factor on its Alabama returns in the subject years.

FACTS

The Taxpayer leases railcars to customers in Alabama and throughout the United States. As a multistate corporation, the Taxpayer allocates and apportions its income to Alabama pursuant to the Multistate Tax Compact (“MTC”), Code of Ala. 1975, §40-27-1, et seq. The MTC requires that a corporation’s business income must be apportioned among the various states in which it operates in accordance with a three-factor formula of sales (gross receipts), payroll, and property. Code of Ala. 1975, §40-27-1, Art. IV, ¶9. This case

involves the sales factor.¹

Code of Ala. 1975, §40-27-1, Art. IV, ¶15 provides that the numerator of the sales factor shall be the taxpayer's total sales or receipts in Alabama. The denominator is the taxpayer's total sales or receipts everywhere. Dept. Reg. 810-27-1-4-.17(e)(2)(B) concerns the sales factor numerator for corporations that lease tangible personal property, and reads in pertinent part as follows:

If the property is within and without this state during the rental, lease or licensing period, gross receipts attributable to this state shall be measured by the ratio which the time the property was physically present or was used in this state bears to the total time or use of the property everywhere during that period.

During the years in issue, the Taxpayer computed its Alabama sales factor numerator based on the billing addresses of its Alabama customers. That is, the Taxpayer included in the numerator the receipts from its customers with an Alabama billing address. The sales factors reported by the Taxpayer on its 1997, 1998, and 1999 Alabama returns were 0.5801, 1.2231, and 1.2625, respectively.

The Department audited the Taxpayer and recomputed the sales factor numerators based on the miles traveled by the Taxpayer's railcars in Alabama versus miles traveled everywhere.² The mileage information used by the Department was obtained from the

¹ The term "sales factor" was adopted in the 1950's because the three-factor formula originally applied primarily to companies that manufactured and sold tangible personal property. The factor could now be more accurately described as the receipts or gross receipts factor. See generally, J. Hellerstein & W. Hellerstein, *State Taxation* (3d ed. 2001) at ¶9.18.

² The Department also made other adjustments that are not contested.

Taxpayer, and is not disputed. The sales factors for 1997, 1998, and 1999 as recomputed by the Department were 3.7005, 3.7093, and 3.8151, respectively.

The Taxpayer argues that using its customers' billing addresses to compute the sales factor numerator more accurately identifies its Alabama receipts than does the mileage ratio used by the Department. In support of that claim, the Taxpayer offered a time study it prepared in November 1994 pursuant to an audit by another southeastern state. It also argues that the mileage ratio should not be used for its sales factor because the ratio is already used in computing a component of its property factor. Finally, the Taxpayer claims that it has consistently used the customer billing addresses in computing its sales factor numerator, and that the Department did not contest its use of that method in prior audits.

The Department contends that a customer's billing address has nothing to do with where the railcars are used, i.e. where the lease receipts were derived. It also argues that the mileage ratio more closely conforms to Reg. 810-27-1-4-.17(e)(2)(B).

ANALYSIS

The function of the three-factor formula is to accurately identify and tax that part of a multistate corporation's income attributable to the state. *Container Corp. of America v. Franchise Tax Board*, 103 S.Ct. 2933 (1983). Toward that end, the "factor or factors used in the apportionment formula must accurately reflect a reasonable sense of how income is generated." *Container*, 103 S.Ct. at 2943.

Reg. 810-27-1-4.17(e)(2)(B) provides that the numerator of the sales factor, i.e. "gross receipts attributable to the state," shall be determined by multiplying total receipts by the ratio of the time the property was physically present or used in Alabama over the time

the property was present or used everywhere. Concerning movable property, attributing rental receipts to a state based on the percentage of time the rental property was present or used in the state is a reasonable method for determining what portion of the rental receipts were derived from the lessor's activities in the state.

The Taxpayer's primary argument against the Department's miles traveled ratio is that Alabama is a "bridge" state as opposed to a "destination" state. Railcars more often travel through a bridge state without stopping, whereas they stop to load and unload in a destination state. Consequently, a railcar that traveled equal distances in a destination state and a bridge state may be physically present longer in the destination state than in the bridge state.

I agree that the Department's miles traveled ratio may not exactly reflect the time the Taxpayer's railcars were physically present or used in Alabama. However, it does provide a reasonable approximation, and certainly the miles traveled ratio more accurately identifies the Taxpayer's receipts from business done in Alabama than the method used by the Taxpayer. There is no evidence a customer's billing address has any relationship to where the railcars are used. Theoretically, an Alabama customer may lease railcars from the Taxpayer that in fact never enter Alabama.

To strictly comply with the regulation, the sales factor numerator should be based on the time the railcars were used in Alabama over the time the railcars were used everywhere. But there is no evidence establishing those times. The 1994 time study offered by the Taxpayer is insufficient to establish the percentage of time the railcars were in Alabama during the subject years. First, the validity of the time study was not established. Second, different periods were involved.

It is also irrelevant that the Department for whatever reason never questioned the Taxpayer's method for computing its sales factor numerator in prior audits. Nor is it relevant that the miles traveled ratio was used to compute a component of the Taxpayer's property factor. Where the railcars were used or present is relevant to both factors.

A Department regulation will be affirmed unless it is contrary to the statute to which it relates or is unreasonable. *Adair v. Alabama Real Estate Comm'n*, 303 So.2d 119 (Ala.Civ.App. 1974). Reg. 810-27-1-4-.17(e)(2)(B) is neither contrary to nor inconsistent with the MTC sales factor provision, nor is it unreasonable. The Department's miles traveled ratio provides a reasonable approximation of the time the Taxpayer's railcars were in Alabama, and is affirmed. Further, the burden was on the Taxpayer to prove that the *prima facie* correct final assessment is incorrect. Code of Ala. 1975, §40-2A-7(b)(5)c. It failed to carry that burden.

The final assessment is affirmed. Judgment is entered against the Taxpayer for \$145,821. Additional interest is also due from the date of entry of the final assessment, April 18, 2002.

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

Entered April 4, 2003.

BILL THOMPSON
Chief Administrative Law Judge