SMACKO OPERATING, LLC P.O. Box 649 Brewton, AL 36427,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. MISC. 02-787
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

An Opinion and Preliminary Order was entered in this case on May 23, 2003 holding that the Taxpayer could not use the "cost recovery method" for expensing its processing costs under the workback method. The Order also held that if the Taxpayer could establish by "verifiable data" that some of the previously expensed items were in fact capital expenditures, it should be allowed to capitalize and depreciate those items.

The Department had refused to allow the Taxpayer to capitalize the expenditures because the Taxpayer had expensed the items for federal income tax purposes, and had not subsequently capitalized the items on an amended income tax return, ad valorem filings, or other financial documents as specified in Dept. Reg. 810-8-6-.01(6)(a)2. The Administrative Law Division held that the various documents listed in the regulation were not an exclusive list, and that any verifiable information establishing that the items were capital in nature would be sufficient.

The May 23 Order directed the parties to meet for the purpose of allowing the Taxpayer to provide information to the Department showing that the expenditures were capital in nature. The parties have notified the Administrative Law Division that they met on July 1, 2003. At the meeting, the Taxpayer's representative again presented the Department with joint billing interests and supporting invoices. The representative argued

that the expenditures were capital improvements at the Taxpayer's two processing facilities in Alabama. He also pointed out that the unusually large amounts spent in various months showed that the amounts included extraordinary capital expenditures.

The Department responded to the July 1 meeting by reasserting its position that the expenses cannot be capitalized because the Taxpayer failed to prove by adequate records that the expenses were capital in nature. The Department contends that the Taxpayer must consistently report capital and expense items, and that because the Taxpayer expensed the items in issue on its federal tax returns, it must also expense the items for Alabama severance tax purposes.

I agree that as a general rule a taxpayer should consistently report expenditures as either capital or expense items. But more importantly, the expenditures should be correctly reported. Consequently, if the costs in issue were capital in nature, the Taxpayer should be allowed to capitalize and depreciate the costs, regardless of how it reported the items for federal income tax purposes. If the costs were capital, the Taxpayer should not have expensed the items for federal income tax purposes.[1] It is that incorrect reporting for income tax purposes that should be corrected, not the disallowance of an otherwise depreciable expense for severance tax purposes.

This issue turns on whether there is sufficient evidence to determine that the costs in issue were capital expenditures. As discussed in the May 23 Opinion and Preliminary

[1] This assumes, of course, that the Internal Revenue Code does not include a provision that allowed the Taxpayer to currently expense certain capital expenditures. In that case, the Taxpayer certainly should be allowed to expense the costs for federal income tax purposes, and also capitalize and depreciate the items for Alabama severance tax purposes.

Order, the documents set out in Reg. 810-8-6-.01(6)(a)2. are not an exclusive list. Any evidence reasonably establishing that the expenditures were capital would be sufficient. In that regard, if a Department examiner, after reviewing all surrounding facts and circumstances, can reasonably determine in his or her judgment that the costs were capital in nature, they should be treated as capital expenditures.

Unfortunately for the Taxpayer, the Department determined that insufficient information was presented establishing that the costs were capital. There also is not sufficient evidence before the Administrative Law Division from which that determination can be made. Consequently, the Department's refusal to capitalize and depreciate the expenses must be affirmed.

The final assessment is affirmed. Judgment is entered against the Taxpayer for $25,003.66. Additional interest is also due from the date of entry of the final assessment, September 11, 2002.

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

Entered August 14, 2003.

[2] If the Taxpayer appeals, it may submit additional evidence to the circuit court establishing that the expenditures in issue were for capital improvements.