PILLIOD FURNITURE, INC. 1284 N. Telegraph Road Monroe, MI 48162-5138,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. B.P. 03-791
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Pilliod Furniture, Inc. ("Taxpayer") for 2000 Alabama shares tax. 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 February 10, 2004. Peter Stathopoulos represented the Taxpayer. Assistant Counsel Ron Bowden represented the Department.

The Taxpayer was acquired by LADD Furniture, Inc. via a stock purchase in 1994. Pursuant to Generally Accepted Accounting Principles ("GAAP"), the goodwill associated with the purchase was pushed down to the Taxpayer's books for financial reporting purposes. The goodwill was being amortized on the Taxpayer's books over a 40 year period pursuant to Accounting Principles Board ("APB") Opinion No. 17. APB 17 was superseded by Financial Accounting Standards Board ("FASB") Pronouncement 142, effective June 2001.

On its 2000 Alabama business privilege and shares tax return, the Taxpayer excluded the goodwill from its shares tax base pursuant to Code of Ala. 1975, §40-14A-33(b)(4). For the 2000 tax year, that statute allowed a deduction from the shares tax base for the "unamortized balance of any amount that the taxpayer properly elected pursuant to pronouncements of the Financial Accounting Standards Board or any successor authority,

to amortize over a period of years rather than immediately charging that amount to earnings."

The Department audited the 2000 return and added back the goodwill to the Taxpayer's shares tax base, which resulted in the final assessment in issue. The Taxpayer appealed.

The first issue is whether the goodwill could be subtracted from the Taxpayer's shares tax base pursuant to §40-14A-33(b)(4). As indicated, that statute, as it read on January 1, 2000, the date on which the 2000 Alabama shares tax must be calculated, provided for a deduction for any amount that the taxpayer amortized over a period of years pursuant to a pronouncement of FASB.[1] The goodwill in issue was on the Taxpayer's financial statements pursuant to APB Opinion 17. The issue thus turns on whether an APB Opinion constitutes a pronouncement of FASB within the purview of §40-14A-33(b)(4).

This issue was addressed in *Rheem Manufacturing v. State of Alabama*, B.P. 03-1086 (Admin. Law Div. 6/14/05). The issue in *Rheem* was whether amounts included on Rheem's financial statements pursuant to APB 16 could be subtracted from its shares tax base pursuant to §40-14A-33(b)(4). The Administrative Law Division held that APB 16 was not a pronouncement of FASB, and consequently that the deduction did not apply. The Final Order in *Rheem* reads in pertinent part as follows:

> This issue turns on whether Opinion 16 issued by the APB constituted a pronouncement of FASB. If not, the Department correctly refused to allow Rheem to subtract the $85,122,900 from its shares tax base.
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> The APB issued Opinion 16 in the late 1960's. At the time, the APB was the

[1] Section 40-14A-33(b)(4) was amended by Act 2000-705 in 2000. The amendment substituted "Pronouncement 106" for "pronouncements." However, the amendment became effective May 23, 2000, and thus is not relevant in this case.

> recognized governing authority concerning generally accepted accounting principles ("GAAP"). FASB was established in 1973 and succeeded the APB as the governing authority on accounting standards. FASB subsequently issued several pronouncements that amended or related to APB Opinion 16. FASB issued Pronouncement 141 in 2001, which superseded APB Opinion 16.
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> Dr. Wayne Aldeman, a distinguished professor of Accounting at Auburn University, testified that in his opinion, APB Opinion 16 was a pronouncement of FASB. With due respect to the Professor, I must disagree.
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> Opinion 16 was issued by the APB before FASB was ever established. Consequently, APB Opinion 16 when originally issued was not a pronouncement of FASB. The APB Opinions remained in effect after FASB superseded the APB in 1973, with FASB taking editorial control over the Opinions. Dr. Alderman stated in his Report, Taxpayer Ex. 17, that "[t]he FASB, the AICPA, the accounting profession, and the Securities and Exchange Commission all view APBs and ARBs as in force and authoritative." Dr. Alderman further stated that "the FASB, the AICPA, and the SEC clearly have endorsed and enforced (APBs). . ." The fact remains, however, that while APB Opinion 16 remained in force and effect as an accounting guideline under the auspices of FASB, it was never a pronouncement of FASB, as required for the §40-14A-33(b)(4) deduction to apply.
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> FASB pronouncements are issued by FASB's seven member board. After due deliberations, the board votes on all proposed pronouncements. A majority of four votes is required to adopt a pronouncement. It is undisputed that FASB's seven member board never voted to adopt or enact APB Opinion 16 as a formal pronouncement. The plain language of §40-14A-33(b)(4) required that a taxpayer must have made an election pursuant to a pronouncement of FASB or a successor authority. An Opinion of a predecessor authority, the APB, was not mentioned. Strictly construing the plain language of the deduction against Rheem, as required by Alabama law, Rheem is not entitled to the deduction in this case.

Rheem at 6 – 7.

Applying the rationale of *Rheem*, the Taxpayer is not entitled to subtract the goodwill in issue pursuant to §40-14A-33(b)(4) because the goodwill was not on its financial statements pursuant to a pronouncement of FASB.

The Taxpayer also argues that substance over form should govern. It thus contends

that the goodwill should not be included in its shares tax base because in substance the goodwill did not increase its net worth or capital. The Taxpayer cites *Mueller v. State of Alabama*, F. 95-364 (Admin. Law Div. 2/20/97), in support of its position.

In *Mueller*, the Administrative Law Division held that goodwill pushed down to Mueller's financial statements should not be included in Mueller's taxable capital base for franchise tax purposes because in substance Mueller's capital was not increased. The Administrative Law Division relied on *Mueller* in a subsequent franchise tax case, *Rheem Manufacturing v. State of Alabama*, F. 00-132A, F. 00-174A, and F. 00-175A (Admin. Law Div. Opinion and Preliminary Order 3/1/05), which was decided after the parties had filed briefs in this case. In the *Rheem* franchise tax case, the Administrative Law Division again held that pushed down goodwill should not be included in a corporation's capital base for franchise tax purposes.

The rationale of *Mueller* and the *Rheem* franchise tax case does not apply in this case because for business privilege and shares tax purposes, the tax base is determined by how the taxpayer reports items on its financial statements. In the *Rheem* business privilege and share tax case, Rheem argued that the goodwill pushed down to its books should not be included in its business privilege and shares tax base, citing *Mueller* and the prior *Rheem* franchise tax case. The Administrative Law Division rejected that argument, as follows:

> Rheem argues that . . . , its net worth and taxable shares base should not have increased as a result of the goodwill pushed-down to its books because, in substance, its business and its assets were exactly the same after the acquisition as before. Rheem cites as support the Administrative Law Division's decision in a franchise tax case, *Rheem Manufacturing Co. v. State of Alabama*, F. 00-132A, F. 00-174A, and F. 00-175A (Admin. Law Div. Opinion and Preliminary Order 3/1/05).

In the *Rheem* franchise tax case, the Administrative Law Division held that the goodwill pushed down to Rheem as a result of the Paloma acquisition of PACE should not be included in Rheem's capital base for franchise tax purposes because in substance Rheem did not receive additional capital from the transaction. That holding was based on the fact that for franchise tax purposes, Alabama law required a foreign corporation's capital to be determined in accordance with GAAP. GAAP did not require that the goodwill resulting from the Paloma/PACE transaction must be pushed down to Rheem. Further, "for accounting purposes, the substance of a transaction, rather than its form, should govern. AICPA Professional Standards §411.06." *Rheem Manufacturing*, at 9.

The holding in the *Rheem* franchise tax case does not apply in this case. As indicated, a foreign corporation's capital base for franchise tax purposes was governed by GAAP. For business privilege and shares tax purposes, however, Code of Ala. 1975, §40-14A-2(a) requires that a "taxpayer's net worth shall be determined for purposes of the (business privilege and shares) taxes levied by this chapter in accordance with the accounting principles used in preparing the taxpayer's financial statements . . ." The push-down accounting principle was employed to pushdown the goodwill in issue onto Rheem's financial statements. Consequently, because Rheem elected to push-down the goodwill to its books, §40-14A-2(a) requires that its tax base for business privilege and shares tax purposes must include that goodwill.

In the *Rheem* franchise tax case, the Department argued that Opinion 20 of the Accounting Principles Board required Rheem to use push-down accounting for franchise tax purposes because it had used push-down accounting in preparing its financial statements. The Administrative Law Division rejected that argument based on the difference between preparing financial statements and complying with the statutory requirements for determining capital for franchise tax purposes.

> The Department also argues that under Opinion No. 20 ("Accounting Changes") of the Accounting Principles Board ("APB 20"), Rheem must use push-down accounting in determining its §40-14-41(b) capital because Rheem uses push-down accounting in preparing its financial statements. The Department is correct that APB 20 does apply to the preparation of *financial statements* used for *financial reporting* purposes. APB 20, ¶3. However, application of APB 20 would be inappropriate in determining a taxpayer's §40-14-41(b) capital because (1) it ignores the distinction between preparing financial statements for financial reporting purposes and complying with the statutory requirements for determining

capital,. . .

Rheem Manufacturing, at 11, 12.

> As indicated, however, for business privilege and shares tax purposes there is no distinction between a taxpayer's financial statements and its tax base. Section 40-14A-2(a) specifies that the tax base shall be determined by the accounting principles used by a taxpayer in compiling its financial statements. A taxpayer's tax base for business privilege and shares tax purposes is thus controlled by how it reports items on its financial statements. Consequently, the goodwill pushed down to Rheem's financial statements must be included in its statutory tax base for business privilege and shares tax purposes.

Rheem at 7 – 9.

The Taxpayer argues that the operating rules in §40-14A-2(a) apply only in determining a taxpayer's "net worth," and thus apply only to the business privilege tax because only that tax is measured by "net worth," see, §40-14A-22(a); whereas the shares tax is measured by "the taxable shares base," see, §40-14A-31(a). The Taxpayer asserts:

> For purposes of the privilege tax, net worth must be determined "in accordance with the accounting principles used in preparing the taxpayer's financial statements reported to its owners . . ." Ala. Code § 40-14A-2(a). However, for shares tax purposes, <u>there was no similar operating rule for determining the taxpayer's "initial taxable shares tax base</u>." Accordingly, it was unclear whether the shares tax base must be determined using GAAP or another accounting methodology.

Taxpayer's Brief at 4 – 5.

Section §40-14A-2(a) does specifically refer only to "net worth." However, the statute further provides that the operating rules specified therein apply "for purposes of the taxes levied by this chapter . . ." Both the business privilege tax and the shares tax are levied in Chapter 14A of Title 40, Code 1975. Consequently, the Legislature clearly intended for the operating rules in §40-14A-2(a) to apply to both the business privilege tax and the shares tax. A taxpayer's taxable shares base thus must be determined in

accordance with the accounting principles used in preparing its financial statements.

Also, "net worth," as defined at §40-14A-23 for business privilege tax purposes, and "taxable shares base," as defined at §40-14A-33 for shares tax purposes, contain essentially the same items. Both include a corporation's capital stock, any additional paid-in capital, but without reduction for treasury stock, and retained earnings, but not less than zero. Recorded goodwill is thus included in both net worth and the taxable shares base as additional paid-in capital. The business privilege tax and shares tax do contain different deductions and exclusions from the tax base, but that is irrelevant for purposes of determining what should be initially included in the base.

Applying the rationale of the *Rheem* business privilege and shares tax case, the goodwill in issue must be included in the Taxpayer's tax base for shares tax purposes because the Taxpayer included the goodwill on its financial statements pursuant to applicable accounting principles.

The final assessment was entered on August 11, 2003. The Taxpayer timely appealed, and the case was heard on February 10, 2004. Unfortunately, due to an administrative oversight by the Administrative Law Judge, the case was not decided in due course. Consequently, the case has been submitted to the Department's Taxpayer Advocate for purposes of abating the interest that has accrued due to the undue delay in deciding the case, see, Code of Ala. 1975, §40-2A-4(b)(1)c. A Final Order will be entered after the Taxpayer Advocate responds.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala.

1975, §40-2A-9(g).

Entered July 19, 2005.

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BILL THOMPSON
Chief Administrative Law Judge