PACCAR, INC. P.O. BOX 1518 BELLEVUE, WA 98009,	§ §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. CORP. 04-715
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department denied refunds of 1998, 1999, and 2000 corporate income tax requested by Paccar, Inc. ("Paccar"). Paccar appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(c)(5)a. A hearing was conducted on July 6, 2005. Sean Lay represented Paccar at the hearing. Michael Locascio filed Paccar's brief. Assistant Counsel Keith Maddox represented the Department at the hearing. Assistant Counsel J.R. Gaines filed the Department's brief.

ISSUE

Multistate corporations are required to apportion their business income to Alabama using a three factor formula of property, payroll, and sales. This case involves the sales factor.

Paccar sold trucks during the years in issue that were ultimately delivered to customers in Alabama. However, physical possession and title passed to the customers outside of Alabama. The issue is whether the sales should be included as Alabama sales in the numerator of Paccar's Alabama sales factors. That issue turns on whether a sale is in Alabama for sales factor purposes if (1) the property is physically delivered and title passes in Alabama, as argued by Paccar, or (2) the ultimate destination of the property is Alabama, regardless of where the initial delivery occurs, as argued by the Department.

FACTS

The relevant facts are undisputed.

Paccar manufactures and sells light, medium, and heavy-duty trucks and truck parts to various independent dealers throughout the United States. The dealers resell the trucks and parts to their customers. Paccar manufactures the trucks and parts at facilities in Texas, Ohio, Tennessee, and Washington.

Paccar sold truck and truck parts to dealers located in Alabama during the subject years. Paccar shipped the parts directly to the Alabama dealers via common carrier.

Concerning the trucks sold to the Alabama dealers, Paccar contracted for a third-party carrier, Active Transport Company, to pick up the trucks at one of Paccar's manufacturing facilities outside of Alabama. The contract specified that the risk of loss, title, and control over the trucks passed to Active, on behalf of the Alabama dealer/purchaser, at the Paccar facility. Active would thereafter deliver the truck to the dealer/purchaser in Alabama.

Paccar included the subject sales as Alabama sales in the numerator of its sales factor on its 1998, 1999, and 2000 Alabama returns. It later filed amended returns and excluded the subject sales from the sales factor numerators. The reduced sales factors resulted in claimed refunds of $65,073, $143,196, and $47,601 in 1998, 1999, and 2000, respectively.[1] The Department denied the refunds based on its position that the sales in

[1] Paccar subsequently filed a second set of amended returns for the subject years on which it reported minor federal audit adjustments. The federal adjustments resulted in a small amount of tax due in each year, which Paccar paid instead of offsetting its previously claimed refunds. The refunds claimed on the first amended returns are thus still in issue.

issue were properly included as Alabama sales in the sales factor numerators.

ANALYSIS

Paccar concedes that the parts it sold to the independent dealers in Alabama were Alabama sales, and thus includable in its Alabama sales factor numerator, because Paccar delivered the parts into and title passed in Alabama. It argues, however, that the trucks sold to the Alabama dealers should not be included in the sales factor numerator because the trucks were delivered and title passed to the dealers outside of Alabama.

Multistate corporations doing business in Alabama are required to allocate and apportion their income to Alabama pursuant to the Multistate Tax Compact ("MTC"), Code of Ala. 1975, §40-27-1, et seq. The MTC is based on the Uniform Division of Income for Tax Purposes Act ("UDITPA"), which was approved by the National Conference of Commissioners on Uniform State Laws in 1957. The purpose of the MTC/UDITPA was to provide a uniform system whereby a multistate corporation can fairly attribute its income to the various states in which it does business. See generally, *Ex parte Uniroyal Tire Co.*, 779 So.2d 227, 230 (Ala. 2000). Income not derived from a corporation's business activities, i.e., nonbusiness income, is allocated to a single state, generally the corporation's state of domicile, with some exceptions. Income attributable to a corporation's business activities, i.e., business income, is apportioned among the states in which it operates pursuant to an equal-weighted three factor formula of property, payroll, and sales or gross receipts.

The U.S. Supreme Court has recognized that the three factor formula "has gained wide approval precisely because payroll, property, and sales appear in combination to reflect a very large share of the activities by which value is generated." *Container Corporation of America v. Franchise Tax Board*, 103 S.Ct. 2933, 2949 (1983). The property and payroll factors give weight to the contribution of the states in which the corporation's offices, factories, and employees are located. See generally, J. Hellerstein & W. Hellerstein, *State Taxation* (3d ed. 2001) at ¶8.06[1]. Conversely, the sales factor recognizes and gives weight to the states in which the goods are marketed and consumed, i.e., the source of the income being taxed. "The sales factor, by contrast, attributes income to states in which goods are consumed and serves as a counterbalance to the property and payroll factors which tend to attribute income to states in which goods are produced." *State Taxation* at ¶8.06[2].

The MTC sales factor, adopted by Alabama at Code of Ala. 1975, §40-27-1, Art. IV, 15, is as follows:

> The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.

The MTC further specifies that "[s]ales of tangible personal property are in this state if: (a) The property is delivered or shipped to a purchaser, other than the United States government, within this state regardless of the f.o.b. point or other conditions of the sale; . . ." Code of Ala. 1975, §40-27-1, Art. IV, 16.(a). Reg. 810-27-1-4-.16(a)(3) elaborates that property "is delivered or shipped to a purchaser within this state if the shipment terminates in this state, . . ."

This is a case of first impression in Alabama. Paccar argues that a sale occurs in Alabama for sales factor purposes only if the goods are initially delivered by the seller to the purchaser or the purchaser's agent in Alabama, i.e., the "place-of-delivery" rule. The alternative argument is that a sale is in Alabama for sales factor purposes if the ultimate destination of the property is Alabama, regardless of where the seller delivers the goods or title passes, i.e., the "ultimate destination" rule.

Professor Hellerstein states in his treatise that as a matter of statutory construction, the issue could reasonably be decided either way. *State Taxation* at ¶9.18(1)(a). If Reg. 810-27-1-4-.16(a) is interpreted so that "within this state" modifies "delivered or shipped," the place of delivery rule would apply. If "within this state" is construed to modify "purchaser," the ultimate destination rule would apply.

A cardinal rule of statutory construction is that if a statute is vague and susceptible to two meanings, it must be construed in accordance with the intent and purpose of the legislature. *John Deere Co. v. Gamble*, 523 So.2d 95 (Ala. 1988). The purpose of the three factor formula is to "reflect a reasonable sense of how income is generated." *Container Corp.*, 103 S.Ct. at 2942. As discussed, the sales factor is included to counterbalance the property and payroll factors by recognizing the contribution of the "consumer" states in the production of income. That purpose is satisfied if sales are attributed to the state to which the property is finally delivered and consumed, i.e., the state from which the income is derived. Consequently, a sale is in Alabama for sales factor purposes if the goods are ultimately delivered to a purchaser in Alabama, regardless of where the seller initially delivered the goods or title transfers.

Paccar cites a recent Indiana Tax Court decision, *Miller Brewing Co. v. Indiana Dept. of State Revenue* (Case No. 49T10-011-TA-82), in support of its case. In a characteristically well-written opinion, Judge Fisher found in the above case that goods (beer) picked up by the purchaser's agent outside of Indiana and then brought into Indiana were not Indiana sales for sales factor purposes. In so holding, Judge Fisher focused on an Indiana regulation which specified that sales are not in Indiana "if the purchaser picks up the goods at an out-of-state location and brings them back into Indiana in his own conveyance." Ind. Admin. Code tit. 45, r. 3.1-1-53 (1996). By promulgating the above regulation, Indiana has in effect adopted the "place of delivery" rule discussed above. Applying the regulation, Judge Fisher held that because the purchasers, through their common carrier agents, picked up the beer outside of Indiana, the sales were not Indiana sales for sales factor purposes.[2]

The holding in *Miller Brewing* can be distinguished because Alabama has no regulation akin to the Indiana regulation relied on by Judge Fisher. The majority of courts in other states that have addressed the issue have also held that the ultimate destination of the goods must control.

In *McDonnell Douglas Corp. v. Franchise Tax Board*, 26 Cal. App. 4th 1789, 33 Cal. Rptr. 2d 129 (1994), the issue was whether the sale of airplanes delivered to customers in California but destined for out-of-state locations were California sales for MTC sales factor purposes. The Franchise Tax Board argued that the sales should be included in the California sales factor numerator because the airplanes were delivered to the customers in California. The court disagreed, holding that the sales should be attributed to the states in which the airplanes were ultimately delivered. The court cited numerous cases from other states in support of its position:

> (McDonnell Douglas), on the other hand, provides us with numerous opinions

[2] Paccar indicates that the Tax Court's decision in *Miller Brewing* is currently being appealed. See, Paccar's post-hearing letter brief at 7.

from various jurisdictions, which reach precisely the opposite result; i.e., that delivery to a purchaser in California is not considered a sale within California if the goods are ultimately destined for use in another state.

In *Department of Revenue v. Parker Banana Co.* (Fla. 1980) 391 So. 2d 762, language from a Florida statute virtually identical to (the MTC sales factor provision) was construed in determining the taxability of sales of bananas which were picked up in Florida by out-of-state purchasers. By referring to legislative intent, the Florida Court of Appeal held that the language “within this state” referred to the state of the purchaser and not the state of delivery. (391 So. 2d at p. 763.)

In *Pabst Brewing Co. v. Wis. Dept. of Revenue* (1986) 130 Wis.2d 291 [387 N.W.2d 121], the Wisconsin Court of Appeals addressed the identical issue with reference to a statute identical to (the MTC sales factor provision), and concluded that legislative intent mandated the conclusion that “within this state” refers to the location of the purchaser and not the place of delivery. (387 N.W.2d at p. 123.)

In *Olympia Brewing Co. v. Com’r of Revenue* (Minn. 1982) 326 N.W.2d 642, the same issue was addressed by the Supreme Court of Minnesota with reference to a virtually identical Minnesota statute. That court also held that the taxability of sales picked up by out-of-state purchasers was not determined by the place of delivery. The court indicated that a destination rule would provide a substantial incentive to in-state export firms. It also found that any increased burden in record keeping resulting from the application of a destination rule was not a sufficient basis to overcome the stated purpose of the statute, that is, to recognize the contribution of the consumer’s or purchaser’s state. (Id. at pp. 647 – 648.)

In *Lone Star Steel Co. v. Dolan* (Colo. 1983) 668 P.2d 916, a statute identical to (the MTC sales factor provision) was interpreted with respect to pipe which was manufactured and delivered in Texas, but then wrapped in Colorado and shipped to a purchaser outside Colorado. The Supreme Court of Colorado held there was no Colorado sale for income tax purposes. In so holding, the court relied on the reasoning of a law review article, which explained that, ‘Manufacturing states probably would prefer a system attributing sales to the place from which goods are shipped in every case. However, the national conference (that adopted UDITPA) was of the opinion that such a system would merely duplicate the property and payroll factors which emphasize the activity of the manufacturing state, so that there would tend to be a duplication by such a sales factor. Moreover, it is believed that the contribution of the consumer states toward the production of the income should be recognized by attributing the sales to those states. . . .’ Pierce, *the Uniform Division of Income for State Tax Purposes*, 35 Taxes 747, 780

> (1957)." (668 P.2d at p. 920.)
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> In *Dupps Co. v. Lindley* (1980) 62 Ohio St.2d 305 [405 N.E.2d 716], the taxing statute at issue did not contain the same language as (the MTC sales factor provision), but it was nevertheless held by the Supreme Court of Ohio that the test for considering a sale within the state is where the goods were "ultimately received." (405 N.E.2d at p. 718.)
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> In *Texaco, Inc. v. Groppo* (1990) 215 Conn. 134 [574 A.2d 1293], the Supreme Court of Connecticut held, in deciding the taxability of petroleum products delivered out of state, that "the uniform holding of courts in other states interpreting essentially identical language has been that the destination of goods, and not their delivery point is dispositive. [Citations.]" (Id. at p. 1297.)
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> In *Strickland v. Patcraft Mills, Inc.* (1983) 251 Ga. 43 [302 S.E.2d 544], the destination rule was also applied by the Supreme Court of Georgia in determining the taxability of carpet picked up at the seller's Georgia office but taken out-of-state for resale. (Id. at p. 545.)

McDonnell Douglas, 26 Cal. App. 4th at 1794 – 1795.

The court In *McDonnell Douglas*, while recognizing the administrative problems inherent in the destination rule, also found that the rule was consistent with the purpose of UDITPA.

> UDITPA has been interpreted to provide that "sales of tangible personal property should be apportioned to the state or country of destination, provided the taxpayer is subject to tax in such state or country. If the taxpayer is not subject to tax in the state or country of destination, the sales are apportioned to the state or country from which shipped." (Keesling & Warner, *California's Uniform Division of Income for Tax Purposes Act* (1968) 15 UCLA L.Rev. 665, 671.) In UDITPA, "the drafters . . . made a deliberate policy decision to recognize the contribution of the 'consumer' states to the production of income by allocating sales to those states that produce the buyer." (Reich, *Dock Sales - - The New State Income Tax Battleground* (1982) 1 J. St. Taxation 42, 43.)
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> Moreover, as the Minnesota Supreme Court noted, "administrative ease, while a legitimate concern, does not justify an interpretation of a statute which is inconsistent with its purpose (here, to recognize the contribution of the consumer's or purchaser's state). [Citation.]" (*Olympia Brewing Co. v. Com'r of Revenue*, *supra*, 326 N.W.2d at p. 648.)

> For these reasons, we find the trial court correctly applied the "destination" rule rather than the "place of delivery" rule in computing the amount of California sales made by (McDonnell Douglas).

McDonnell Douglas, 26 Cal. App. 4th at 1796.[3]

In this case, the third-party carrier picked up the trucks at the Paccar facilities outside of Alabama on behalf of the Alabama dealers. Title passed to the dealers at that time. However, the trucks were ultimately delivered to the dealers' locations in Alabama. Consequently, the sales were Alabama sales that must be included in Paccar's sales factor numerators in the subject years.[4]

Paccar's petitions for refund are denied.

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

Entered January 11, 2006.

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BILL THOMPSON
Chief Administrative Law Judge

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[3] For a subsequent case affirming the holding in *McDonnell Douglas*, see *Revenue Cabinet v. Rohm and Haas Kentucky, Inc.*, 929 S.W.2d 741 (Ct. of Appeals 1996) (Goods sold by a Kentucky subsidiary to its out-of-state parent that were picked up by the parent in Kentucky and transported outside of Kentucky were held not to be Kentucky sales pursuant to the "ultimate destination" rule).

[4] In so holding, I also note that the "ultimate destination" rule is not inherently pro-Department or pro-taxpayer. The Department won in this case based on the rule, but the taxpayers won in *McDonnell Douglas*, *Rohm and Haas Kentucky*, and most of the other cases cited herein because the final destination of the property in issue was outside of the taxing state. And while the place of delivery rule may be easier to administer, see, *State Taxation* at ¶9.18(1)(a), I agree with the court's finding in *McDonnell Douglas* that administrative ease "does not justify an interpretation of a statute which is inconsistent with its purpose. . . ." *McDonnell Douglas*, 26 Cal. App. 4th at 1796, citing *Olympia Brewing*, 326 N.W.2d at 648.