AT&T CORPORATION ROOM 4A235 ONE AT&T WAY BEDMINSTER, NJ 07921-7206,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. CORP. 05-403
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed AT&T Corporation for 1999 and 2000 corporate income tax.[1] AT&T appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on October 12, 2005. Chris Grissom and Matt Houser represented AT&T. Assistant Counsel Jeff Patterson and Glen Powers represented the Department.

ISSUES

This case involves two issues:

(1) AT&T filed consolidated Alabama income tax returns for 1999 and 2000. The first issue is whether one of AT&T's subsidiary corporations, Global Card Holdings, Inc. ("GCH"), was a part of AT&T's Alabama affiliated group in those years, and thus required to be included on the consolidated returns. That issue turns on whether GCH was subject to the Alabama financial institution excise tax ("FIET") levied at Code of Ala. 1975, §40-16-1, et seq. Financial institutions subject to the FIET are specifically excluded from an "Alabama affiliated group," as defined at Code of Ala. 1975, §40-18-39(b)(1), and thus not required to be included on an Alabama consolidated return.

[1] A joint stipulation of facts filed by the parties indicated that the final assessment was for 1999, 2000, and 2001. However, while the Department audit and the preliminary assessment entered by the Department included 2001, the final assessment involves only

(2) AT&T acquired Tele-Communications, Inc. ("TCI") and various TCI subsidiaries in March 1999. The TCI subsidiaries had incurred net operating losses ("NOLs") in prior years. The second issue is whether AT&T's use of those NOLs on its 1999 Alabama consolidated return is limited by the federal separate return limitation year ("SRLY") rules found in 26 U.S.C. §1502, and related regulations, or by the NOL limitation found in 26 U.S.C. §382, and related regulations. Federal §§1502 and 382 have both been adopted by Alabama, see Code of Ala. 1975, §§40-18-39(h) and 40-18-35.1(6), respectively.

If the SRLY rules apply, as argued by the Department, then AT&T can use the NOLs only to offset the separately stated income of the TCI subsidiaries in 1999. As explained below, the SRLY rules do not apply if application of those rules results in an overlap with the §382 limitation. If an overlap occurred in this case, and §382 applies instead of the SRLY rules, as argued by AT&T, the issue becomes how the §382 limitation should be computed for Alabama purposes.

FACTS

Global Card Holdings, Inc.

AT&T has one hundred-plus subsidiaries worldwide. Before 1997, AT&T's internal treasury division arranged and supervised the intercompany financing agreements between the various subsidiaries. The treasury division would identify a subsidiary with excess cash and arrange for that subsidiary to make a loan to another subsidiary that needed cash. According to AT&T's director of cash operations and banking, AT&T's pre-1997 method of financing its subsidiaries resulted in a "spaghetti ball of intercompany loans." (R. 33,34.)

1999 and 2000.

GCH was formed as an AT&T subsidiary in 1997 to manage the debt of another AT&T subsidiary. AT&T sold the other subsidiary, and GCH thereafter effectively served as the central internal lender for AT&T and its subsidiaries.

AT&T's treasury division continued to forecast and analyze the future cash needs of the various AT&T subsidiaries. If a subsidiary needed cash, the treasury division would identify the need, and GCH would make the loan as directed. All loans were properly documented, and were at a fair market rate based on comparable rates in the country or area in which the borrower was located. If a borrower failed to make a scheduled loan payment, the interest due was capitalized and added to the loan balance.

GCH had one full time employee and two non-payroll employees that were based at its office in Colorado during the years in issue. The two non-payroll employees helped manage the loan portfolio and maintain the corporation's books. GCH had no employees or property in Alabama in the subject years.

AT&T's treasury division reviewed GCH's financial status on a regular basis. If GCH needed money to make a loan, AT&T transferred the required cash to GCH. If GCH had excess cash on hand, it either invested the cash in short-term instruments or paid the excess cash to AT&T as dividends.

GCH derived approximately 95 percent of its income during the subject years from interest on the loans to the subsidiaries. None of the loans were executed in or made to a subsidiary in Alabama. GCH did not make loans other than to AT&T and its subsidiaries. The subsidiaries were also prohibited from borrowing money from outside sources, although AT&T occasionally did so. GCH was not a chartered bank or otherwise licensed or regulated by any federal or state banking agency.

GCH was a member of AT&T's federal consolidated group in 1999 and 2000. AT&T did not, however, include GCH in its Alabama affiliated group on its 1999 and 2000 Alabama consolidated returns. GCH also did not file separate Alabama income tax returns or Alabama financial institution excise tax returns in those years.

Tele-Communications, Inc.

AT&T acquired TCI and its various subsidiaries in March 1999. TCI's subsidiaries carried forward approximately $17.9 million in Alabama NOLs when they were acquired by AT&T. AT&T computed the §382 limitation concerning the NOLs. The limitation exceeded the total NOL amount. Consequently, AT&T deducted the NOLs in full on its 1999 Alabama consolidated return.

The Department's Adjustments.

The Department reviewed AT&T's 1999 and 2000 consolidated returns and made two disputed adjustments. First, the Department included GCH in AT&T's Alabama affiliated group, and thereby added approximately $942.9 million and $2.084 billion to the consolidated group's 1999 and 2000 federal consolidated income, respectively.[2] Second, the Department applied the federal SRLY limitation instead of the §382 limitation to the TCI group NOLs. It thereby allowed AT&T to deduct the NOLs only to offset the separately stated income of the group, i.e., $2,289,911, as reported on the 1999 consolidated return.

ANALYSIS

Issue (1). Was GCH required to be included on AT&T's consolidated Alabama returns?

[2] The Department also included five other AT&T subsidiaries that AT&T had excluded from its Alabama affiliated group. AT&T does not dispute those inclusions.

AT&T and members of its Alabama affiliated group elected to file Alabama consolidated returns in 1999 and 2000. In those years, an "Alabama affiliated group," as defined at §40-18-39(b)(1), included all members of the federal consolidated group; provided, the group "shall not include corporations subject to . . . the financial institution excise tax imposed by Section 40-16-1 et seq." This issue thus turns on whether GCH was subject to the Alabama FIET in the subject years.

Concerning 1999, Code of Ala. 1975, §40-16-4(a) levied the FIET on "[e]very such financial institution . . . for the privilege of engaging in this state in the business of banking and of conducting a financial institution, as in this chapter defined, and of conducting a business employing moneyed capital coming into competition with the business of national banks. . . ."

Concerning 2000, §40-16-4(a)(1), as amended by Act 99-665, levied the FIET on "[e]very such financial institution engaging in any of the following businesses:

(i) Banking;

(ii) Conducting the business of a financial institution as defined in this chapter;

(iii) Conducting a credit card business through the issuance of credit cards to Alabama residents or businesses; or

(iv) Conducting a business employing moneyed capital coming into competition with the business of national banks."

Concerning both 1999 and 2000, Code of Ala. 1975, §40-16-1(1) defined "financial institution" for Alabama FIET purposes to include any person, corporation, or other entity "doing business in this state as (an) . . . industrial or other loan company . . ., and any other institution or person employing moneyed capital coming into competition with the business

of national banks. . . ."

AT&T argues that GCH was a financial institution subject to the FIET in 1999 and 2000, and thus properly excluded from AT&T's Alabama consolidated returns in those years, because GCH was a loan company and/or an institution that employed moneyed capital that competed with national banks. AT&T's Post-Hearing Brief at 9 – 15.

The Department disputes that GCH was a loan company or that it competed with national banks. Rather, the Department argues that GCH was only "the conduit for AT&T's internal financing needs." Department's Reply Brief at 3.

GCH was in a general sense a loan company because it loaned money to AT&T and AT&T's other subsidiaries. However, a "loan" for FIET purposes is defined as "[a]ny extension of credit resulting from direct negotiations between the taxpayer and its customer . . ." Dept. Reg. 810-9-1-.05(3)(i). It is questionable that GCH and the various AT&T subsidiaries negotiated the loans because while the loans were at market rate, GCH was required to make the loans and the subsidiaries could only borrow from GCH. Consequently, the transactions were not negotiated at arm's-length.

It is also problematic whether GCH was competing with national banks. As discussed, the AT&T subsidiaries were required to borrow from GCH and were prohibited from borrowing from a national or other bank. GCH thus never actively competed with national banks when it made the loans to the subsidiaries.

AT&T borrowed from outside sources, but that does not establish that GCH was competing with national banks for AT&T's business. AT&T's treasury division in effect controlled GCH because it instructed GCH when to make the loans. GCH may have loaned money the same as national banks, but it was not competing with national banks

when it made the required loans as directed by AT&T.

In any case, even if GCH was a loan company and/or competing with national banks, to be a "financial institution" pursuant to §40-16-1(1), GCH must have been "doing business in this state." "Doing business" is not defined for FIET purposes. The Alabama Supreme Court has held, however, that a corporation is doing business in Alabama if it is "engaged (in Alabama) in the transaction of business, or any part of the business, for which it was created." *State v. Anniston Rolling Mills*, 27 So. 921, 922 (1900). See also, *State v. City Stores Co.*, 171 So.2d 121 (1965); *Dial Bank v. State of Alabama*, Inc. 95-289 (Admin. Law Div. 8/10/98); *State of Alabama v. Seneca GP, Inc.*, Inc. 94-285 (Admin. Law Div. 6/20/95).

GCH was in the business of making loans to AT&T and its subsidiaries. GCH had no employees or property in Alabama, and none of its loans were negotiated or executed in Alabama. GCH also did not make loans to any AT&T subsidiaries or to AT&T in Alabama. Because GCH did not make loans in Alabama, it was not doing business in Alabama, and thus was not a "financial institution" as defined at §40-16-1(1). Because it was not a financial institution for FIET purposes, it was not subject to the Alabama FIET, and thus not excludable from AT&T's Alabama affiliated group pursuant to §40-18-39(b)(1). The Department thus correctly included GCH on AT&T's Alabama consolidated returns in 1999 and 2000.

AT&T argues that a financial institution may be subject to Alabama's FIET even if it is not doing business in Alabama. AT&T asserts that the phrase "doing business in this state," as used in the definition of "financial institution" at §40-16-1(1), applies to some, but not all, of the entities listed in the definition.

> According to the State's statutory scheme, a financial institution may be subject to the FIET even if it does not have business activities in Alabama. The statutory definition of financial institution does not require all financial institutions to be doing business in Alabama; the requirement of doing business in this state only applies to corporations doing business as a "national banking association, bank, banking association, trust company, industrial or other loan company or building and loan association." Ala. Code §40-16-1(1). There is no statutory requirement of doing business in Alabama for corporations like GCH that "employ moneyed capital coming into competition with national banks."

AT&T's Reply Brief at 1, 2.

I disagree. All terms and phrases in a statute must be construed *in pari materia*, with the goal that the intent of the legislature in enacting the statute must be determined. *McDonald's Corp. v. DeVenney*, 415 So.2d 1075 (Ala. 1982). The purpose of the Alabama FIET is to levy an excise tax on financial institutions doing business in Alabama. The Alabama Legislature did not intend to levy the FIET on national banks, banking associations, loan companies, etc. only if they are doing business in Alabama, but on all entities employing moneyed capital and competing with national banks, regardless of where those entities are located or doing business. Clearly, the phrase "doing business in this state," as used in §40-16-1(1), applies to all types of entities listed in the statute, including those employing moneyed capital and competing with national banks.

AT&T further asserts that the FIET levy statute, §40-16-4(a)(1), as amended by Act 99-665, confirms that an entity is not required to be doing business in Alabama to be subject to the FIET. I again disagree.

As discussed, for 1999 and prior years, §40-16-4(a) levied the Alabama FIET on every financial institution "engaging in this state in the business of banking and of conducting a financial institution, . . ., and of conducting a business employing moneyed

capital coming into competition with the business of national banks . . .” The above statute clearly required the financial institution to have been “engaging in this state” in one of the several types of activities specified in the statute. AT&T does not dispute that §40-16-4(a), as it read in 1999, required a financial institution to be engaged in business in Alabama to be subject to the FIET.

AT&T argues, however, that when the Legislature amended §40-16-4(a) by Act 99-665, effective for 2000 and subsequent years, it effectively deleted the requirement that a financial institution must be doing business in Alabama to be subject to the FIET. Section 40-16-4(a)(1), as amended, levies the FIET on financial institutions engaged in any one of four delineated activities. AT&T argues that only one of the activities, i.e., the issuance of credit cards to Alabama customers, requires that the activity must be carried on in Alabama. See, §40-16-4(a)(1)(iii). “There is no such requirement on the other three activities, and when the legislature amended section 40-16-4 in 1999 to insert the provision concerning credit card business in Alabama, it elected not to require that the other three activities be carried on in Alabama.” AT&T’s Reply Brief at 2.

AT&T is correct that of the four activities listed in §§40-16-4(a)(1)(i) – (iv), only one, subparagraph (iii) relating to credit cards, mentions that the activity must be in Alabama. However, the introductory phrase of §40-16-4(a)(1) refers to “such financial institution,” which is a financial institution as defined at §40-16-1(1). As discussed, to be a financial institution as defined at §40-16-1(1), the entity must be “doing business in this state.” Consequently, to be “such financial institution” subject to the levy at §40-16-4(a)(1), as amended, the entity must be doing business in Alabama. It is irrelevant that in identifying the four types of activities a financial institution must be engaged in to be subject to the

FIET, subparagraphs (i), (ii), and (iv) of §40-16-4(a)(1), as amended, do not specify that the activity must be conducted in Alabama. That requirement is inherent in the §40-16-1(1) definition of "financial institution."

Finally, AT&T contends that "section 40-16-3(a) requires '[e]very financial institution' to file FIET returns. Again, there is no requirement that the financial institution be doing business in Alabama. Thus under Alabama's statutes these out-of-state financial institutions are 'subject to' Alabama FIET." AT&T's Reply Brief at 2.

In making the above argument, AT&T ignores the fact that §40-16-3(a) requires "[e]very financial institution, *as in this chapter defined*," to file an Alabama FIET return. To repeat, to be a financial institution for FIET purposes, the entity must be doing business in Alabama. Consequently, only financial institutions doing business in Alabama are required to file Alabama FIET returns. Also, if AT&T's position is accepted, every financial institution in the country (or the world) would be subject to the Alabama FIET and required to file an Alabama FIET return, regardless of where they are located or doing business. Certainly, that is not the case.

AT&T elected to file Alabama consolidated returns in 1999 and 2000. Reg. 810-3-39-.01(4) provides that if an affiliated group elects to file an Alabama consolidated return, "each and every member of the Alabama affiliated group has voluntarily agreed to nexus with the State of Alabama for income tax purposes."

AT&T argues that if the above regulation gave GCH nexus with Alabama for income tax purposes, then GCH also had Alabama nexus for FIET purposes because the FIET is an income tax. "Thus, if Rule 810-3-39-.01(4) requires that GCH have nexus with Alabama for income tax purposes, then GCH has nexus with Alabama for FIET purposes as well,

because the FIET is an income tax. See, *Burton Manufacturing Co. v. State*, 469 So.2d 620 (Ala. Civ. App. 1985)." AT&T then asserts that "as soon as GCH is attributed with nexus for FIET purposes, it becomes 'subject to' FIET under any definition of 'subject to.' When it becomes subject to FIET, then it is no longer part of the Alabama affiliated group." AT&T's Reply Brief at 3. I disagree.

First, Reg. 810-3-39-.01(4) only gives members of an Alabama affiliated group nexus for income tax purposes, which is the sole purpose for which an Alabama consolidated income tax return is filed. It does not also give an entity nexus for FIET purposes. The Alabama FIET is "an excise tax," not an income tax. See, §40-16-4(a)(1). That fact is not changed because the Alabama Court of Civil Appeals construed a Florida privilege tax as an income tax for purposes of the credit allowed at Code of Ala. 1975, §40-18-21 for income tax paid to another state. See, *Burton Manufacturing Co. v. State of Alabama*, 469 So.2d 620 (Ala. Civ. App. 1985).

In any case, even if a taxpayer has nexus with a state, the taxpayer still may not be subject to a specific tax levied by the state. Nexus is a constitutional concept that requires generally that a taxpayer must have sufficient minimum contacts with a state before the taxpayer becomes subject to the state's taxing jurisdiction. See generally, *Allied-Signal, Inc. v. Director, Division of Taxation*, 112 S.Ct. 2251 (1992); J. Hellerstein & W. Hellerstein, *State Taxation* (3d ed. 2001) at ¶6.01, et seq. A taxpayer without the necessary physical or other contacts with a state sufficient to establish nexus may nonetheless voluntarily consent to be subject to the state's taxing jurisdiction for purposes of a specific tax, as GCH did in this case concerning the Alabama income tax. But consenting to nexus with a state for purposes of a specific tax does not establish that the taxpayer automatically becomes

subject to all taxes levied by the state. Consequently, even if GCH was attributed nexus with Alabama for FIET purposes (which it was not), GCH still would not have been a financial institution, as defined for FIET purposes at §40-16-1(1), because it still would not have been doing business in Alabama.[3] Consequently, it still would not have been subject to Alabama's FIET.

AT&T argues that Alabama subjects financial institutions and non-financial institution corporations to different taxes, i.e., the FIET and the corporate income tax, respectively, and that all financial institutions, including GCH, are exempt from the Alabama income tax pursuant to Code of Ala. 1975, §40-18-32(a)(9).

AT&T is correct to a point. Financial institutions are subject to the FIET and exempt from Alabama income tax, but only those financial institutions as defined at §40-16-1(1). GCH was not a financial institution as defined at §40-16-1(1) because it was not doing business in Alabama. Consequently, it was not subject to the FIET, and thus not exempt from Alabama income tax.

Finally, AT&T argues that including GCH in its Alabama consolidated group, and thereby subjecting GCH to Alabama income tax, would unconstitutionally discriminate against out-of-state financial institutions. "The Department would, however, subject out-of-

[3] In *State v. Prattville Manufacturing, Inc.*, F. 93-183 (Admin. Law Div. 10/27/93), the Administrative Law Division incorrectly equated having nexus with Alabama with doing business in Alabama. *Prattville Mfg.* at 5. The concepts are different, however, as the Administrative Law Division recognized in *Dial Bank v. State of Alabama*, Inc. 95-289 (Admin. Law Div. O.P.O. 8/10/98), holding that "nexus is a constitutional-based concept involving whether a state has (jurisdiction) to tax a taxpayer," whereas "doing business in Alabama is a practical question of whether a taxpayer is engaged in a primary business activity in Alabama." *Dial Bank* at 13. A taxpayer may have nexus sufficient to subject it to a state's taxing jurisdiction, but still not be engaged in a primary business activity in the state, and thus not be subject to a tax levied by the state on that activity.

state financial institutions (but not in-state financial institutions) to (Alabama's) corporate income tax." According to AT&T, "such discriminatory treatment of financial institutions would also be a rather flagrant violation of the Commerce Clause of the United States Constitution." AT&T's Reply Brief at 6.

To begin, the above argument fails because GCH is not a financial institution. Alabama's taxing scheme also does not discriminate against or treat out-of-state financial institutions different from in-state entities. All financial institutions, as defined at §40-16-1(1), which includes both in-state and out-of-state entities doing business in Alabama, are equally subject to the Alabama FIET and exempt from the Alabama income tax . All other corporations, both in-state and out-of-state, that have nexus with and that are doing business in Alabama are subject to the Alabama corporate income tax. There is no discriminatory treatment or double taxation. Also, AT&T voluntarily elected to file Alabama consolidated income tax returns in the subject years, and thus consented for GCH to be subject to Alabama's taxing jurisdiction. See, Reg. 810-3-39-.01(4). A corporation that voluntarily subjects itself or its subsidiaries to Alabama income tax cannot later argue that it is being discriminated against. Subjecting GCH to Alabama income tax also does not hinder interstate commerce or otherwise violate the Commerce Clause.

Issue (2). Does the SRLY limitation or the §382 limitation apply to the NOLs incurred by the TCI group?

Sub-Issue (A). Do the SRLY rules apply?

The federal SRLY rules are found in 26 U.S.C. §1502 and Treas. Reg. §1.1502-21. Alabama has by reference adopted 26 U.S.C. §1502, see Code of Ala. 1975, §40-18-39(h), and has promulgated regulations modeled after the federal SRLY regulations, see Reg.

810-3-35.1-.03.

Simply stated, if a corporation acquires a previously unrelated corporation that has NOLs carried over from prior years, the SRLY rules, if applicable, allow the acquiring corporation to use the NOLs only to offset the income of the acquired corporation reported on the current year's consolidated return. "In summary, losses incurred . . . by a corporation which is unrelated at the time of its losses to its subsequent affiliates, before it becomes a member of an affiliated group filing a consolidated return, can only be carried forward and used on the consolidated return to the extent that the corporation that incurred the losses has current income reflected on the consolidated return." *Weyerhaeuser USA Subsidiaries v. State of Alabama*, Corp. 04-511 (Admin. Law Div. 3/11/05) at 7, quoting *Wolter Construction Co., Inc. v. C.I.R.*, 634 F.2d 1029, 1032 – 1033 (6th Cir. 1980).

The federal and Alabama SRLY regulations also specify that the SRLY rules do not apply if application of those rules results in an overlap with 26 U.S.C. §382. See, 26 C.F.R. §1.1502-21(c) and Reg. 810-3-35.1-.03(3), which provides that the SRLY limitation "does not apply to net operating loss carryovers when the application of (the SRLY limitation) results in an overlap with the application of 26 U.S.C. §382."

Section 382 governs the amount of an NOL that can be carried over in certain corporate acquisitions, and is "exceptionally mystifying, even by IRC standards." *Colonial BancGroup v. State of Alabama*, Corp. 99-515 (Admin. Law Div. 1/5/01) at 6. Alabama has adopted §382 pursuant to Code of Ala. 1975, §40-18-35.1(6), which provides that "in the case of a new loss corporation within the meaning of 26 U.S.C. §382, . . ., only the net operating losses as are allowable in accordance with (§382) shall be allowed as a deduction under this section."

An overlap with §382 occurs with respect to an NOL "if a corporation becomes a member of a consolidated group (the SRLY event) within six months of the change date of an ownership change giving rise to a §382 limitation with respect to that carryover (the §382 event)." Reg. 810-3-35.1-.03(3)(a); see also, 26 C.F.R. §1.1502-21(g)(2)(ii). The SRLY event occurred in this case when AT&T acquired TCI and its subsidiaries on March 9, 1999. The change of ownership giving rise to the §382 event also occurred on that date. An overlap thus occurred, in which case the §382 limitation applies, not the SRLY limitation.

Sub-Issue (B). How should the §382 limitation be computed for Alabama purposes?

If a corporation acquires another corporation that has pre-acquisition NOLs, §382 generally limits the corporation's use of the NOLs for federal purposes to an amount determined by multiplying the value of the equity of the corporation prior to the acquisition by the federal long-term tax-exempt rate. See, 26 U.S.C. §382(b)(1).

AT&T computed the federal §382 limitation relating to the NOLs in issue by treating TCI and its subsidiaries as a single subgroup. The Department first argues that if §382 applies, the limitation should be computed individually concerning each TCI subsidiary. I disagree.

Treas. Reg. §1.1502-91(a)(1) specifies that "the section 382 limitation (is) determined with respect to those attributes for the group (or loss group) on a single entity basis and not for its members separately." The Department concedes that the above language "seems to support" AT&T's position. Department's Reply to Preliminary Order at 2. The Department then argues, however, that the above language is inapplicable because the phrase "those attributes for the group" does not apply in this case. That is, the

Department contends that because Alabama did not allow consolidated returns before 1999, there was no TCI consolidated group before 1999. Consequently, according to the Department, the above language in Treas. Reg. §1.1502-91(a)(1) cannot apply to TCI and its subsidiaries as a group.

The Department's position is incorrect because the TCI group was a "loss subgroup" in 1999 for federal purposes. See, Treas. Reg. §1-1502-91(d)(1). Consequently, it should also be treated as a group for Alabama purposes because Alabama has adopted the federal statutes and regulations relating to both the SRLY rules and §382. AT&T thus correctly determined the federal §382 limitation on a group basis. See, Treas. Reg. §1.1502-91(a)(1).

The Department also argues that if the §382 limitation applies, it must be apportioned to Alabama.

> TCI also states that it apportioned its NOLs to Alabama. Such an apportionment was required. However, it also is the position of the Department that the §382 limitation must be apportioned to Alabama. Otherwise, the federal application of §382 would allow for too much of the limitation to be used for only one of the multiple states in which AT&T could claim the NOLs. For example, if the §382 limitation is not apportioned to Alabama, then AT&T could use 100% of that limitation (calculated for federal purposes) to offset Alabama income and again use 100% of that limitation to offset its income in every other state in which AT&T does business. Section 40-18-1.1 does not allow such a result. Instead, that section requires the apportionment of the §382 limitation, as well. For these types of questions, it is important to remember that the federal rules, such as those relating to §382, do not contemplate apportionment, because there is no federal apportionment.

Department's Reply to AT&T's Response to Preliminary Order at 5, 6.

I agree with the Department's rationale. The §382 limitation amount computed for

federal purposes applies to limit a corporation's (unapportioned) losses available for federal purposes. However, only a part of the corporation's losses are apportioned to Alabama (assuming the corporation is multistate and operating in Alabama). Because only a portion of the corporation's NOLs are deductible for Alabama purposes, it follows in principle that only a pro rata portion of the federal §382 limitation amount should apply for Alabama purposes.

Arguably, the three-factor formula used to apportion business income to Alabama could be used to apportion the §382 limitation to Alabama.[4] Otherwise, a corporation's entire §382 limitation amount that applies for federal purposes to the corporation's total acquired NOLs would also apply in full to only that part of the NOLs attributable to Alabama.

The above rationale is supported by Code of Ala. 1975, §40-18-1.1(a), which provides that if Alabama has adopted a federal income tax statute, "the principles set forth in such specified section or sections and the computations required by such section or sections shall be applied for purposes of this chapter, but shall be applied to the amounts of gain, loss, income, basis, earnings, and profits or other items determined for purposes of this chapter and not to such items for federal income tax purposes." Section 40-18-1.1 confirms that the principle behind §382 should control, and that because only a portion of a multistate corporation's acquired NOLs are apportioned to Alabama, only an apportioned part of the federal §382 limitation amount should apply to those apportioned losses.

Paragraph (c) of §40-18-1.1 authorizes the Department to promulgate regulations

[4] The three equal-weighted factors are property, payroll, and sales. See, the Multistate Tax Compact, Code of Ala. 1975, §40-27-1, Art. IV, §9.

necessary to implement the principles set forth in the federal provisions adopted by Alabama. Some federal provisions may be easily implemented and administered for Alabama purposes without a regulation. Section 382 is not one of those provisions. While Reg. 810-3-35.1-.01(9) addresses §382, it only reiterates verbatim the language in §40-18-35.1(6). The Department has no regulation explaining how the federal §382 limitation should be applied in principle for Alabama purposes.[5] Consequently, without duly promulgated guidelines specifying how the §382 limitation should be apportioned and otherwise applied for Alabama purposes, the federal limitation amount must be allowed. Because the federal §382 limitation is greater than the TCI group NOLs in issue, AT&T must be allowed to deduct all of the NOLs on its 1999 consolidated return.

The Department is directed to recompute AT&T's liabilities for the subject years as indicated herein. A Final Order will then be entered.

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).

[5] The regulation should specify if the MTC three-factor formula or some other factors should be used to apportion the limitation to Alabama. The regulation should also explain whether the limitation should be apportioned using the factors in the year or years the losses were incurred or the year the carryover is being claimed. The regulation may address other issues as necessary to fairly implement the §382 principles for Alabama purposes. Such a regulation is clearly necessary, and if reasonable and not contrary to statute, would be affirmed. *Ex parte White*, 477 So.2d 422 (Ala. 1985), on remand 477 So.2d 425.

Entered June 30, 2006.

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BILL THOMPSON
Chief Administrative Law Judge