SIMCALA, INC. P.O. BOX 68 MOUNT MEIGS, AL 36057-0068,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. W. 06-178
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed Simcala, Inc. ("Taxpayer") for 2003 withholding 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 August 30, 2006. Roy Goldfinger represented the Taxpayer. Assistant Counsel J.R. Gaines represented the Department.

ISSUE

The Alabama Legislature enacted Act No. 93-851, i.e., the "Mercedes Act," in 1993. Code of Ala. 1975, §41-10-44.1 et seq. The Act granted economic incentives for industry to locate in Alabama. Specifically, the Act allows a qualifying corporation to (1) claim a direct tax credit against its Alabama income tax liability, and (2) withhold and retain job development fees from the wages of new employees hired at a qualifying project, see Code of Ala. 1975, §§41-10-44.8(a)(1) and (a)(2), respectively. This case involves the job development fees.

Section 41-10-44.8(a)(2) allows an approved company to withhold job development fees up to 5 percent of the gross wages paid to new employees at a qualifying project. The company is in substance allowed to retain the Alabama income tax withheld from its employees' wages that would otherwise be remitted to the State. Provided, however, the fees shall only be allowed "to the extent that debt service payments under the financing

agreement(s) exceed the income tax credit" otherwise allowed by the Act. Section 41-10-44.8(a)(2). The issue in this case is what constitutes "debt service payments under the financing agreement(s). . ."

The Department contends that debt service is limited to the principal and interest paid pursuant to a financing agreement between a qualifying company and the Alabama State Industrial Development Authority ("Authority"). The Taxpayer argues that debt service is not only the principal and interest paid pursuant to a financing agreement, but also any related fees paid by the qualifying company to keep the bonds current and marketable, including in this case fees (1) for a letter of credit, (2) to a remarketing agent, and (3) to a bond rating agency (Moody's).

FACTS

In February 1995, the Authority issued $6 million in industrial revenue bonds pursuant to the Act. The Authority loaned the bond proceeds to the Taxpayer pursuant to a January 1, 1995 Loan Agreement. The Taxpayer used the loan proceeds to pay for a qualifying project pursuant to the Act.

The Taxpayer paid interest of $75,484.89 on the bonds in 2003.[1] It also paid a $54,491.68 fee for a letter of credit, a $15,000 fee to a remarketing agent, and a $10,000 fee to Moody's, all relating to the subject bonds. The above fees were incurred to keep the bonds current and marketable. The Taxpayer treated the interest and fees (totaling $154,976.57) as debt service for purposes of computing the job development fees to which it was entitled under the Act.

[1] The Taxpayer is not required to pay principal until the bonds finally mature.

The Department audited the Taxpayer and determined that the Taxpayer had overstated the amount of debt service it had paid in 2003. Specifically, the Department determined that the fees paid for the letter of credit, to the remarketing agent, and to Moody's did not constitute debt service within the purview of §41-10-44.8(a)(2). It consequently assessed the Taxpayer for the excess job development fees withheld by the Taxpayer in the year, plus a 10 percent penalty and interest.

ANALYSIS

As indicated, the Act allows job development fees "only to the extent that debt service payments under the financing agreement(s) exceed the income tax credit" otherwise allowed by the Act. Section 41-10-44.8(a)(2).

"Financing agreement" is defined at §41-10-44.2(2), as "[a]ny loan, agreement, financing agreement . . . or other type of agreement entered into by the authority and an approved company. . . ." The Department argues that the only agreement entered into by the Authority and the Taxpayer, i.e., the approved company, in this case was the January 1, 1995 Loan Agreement. It contends that the only debt service or other amount paid pursuant to that financing agreement in 2003 was the $75,484.89 in interest paid by the Taxpayer on the bonds. It thus asserts that the job development fees available to the Taxpayer in 2003 were limited to that amount, less the tax credit otherwise allowed by the Act. The Department cites the Loan Agreement in support of its position, which defines "Debt Service" at page four as "the principal, interest and any premium due on the bonds for that period or payable at that time."

The Taxpayer argues that the phrase "debt service payments under the financing agreement(s). . .", as used in §41-10-44.8(a)(2), must be broadly construed to include the annual fees it paid for the letter of credit, to the remarketing agent, and to Moody's. That is, "'debt service payments under financing agreement(s)' properly include all payments (1) necessary to keep the Bonds current and not in default, (2) made under all documents entered into in connection with the Bonds." (emphasis in original) Taxpayer's Brief at 7.

The Taxpayer points out that the limitation on the tax credit at §41-10-44.8(a)(1) is "debt service on the project obligations," whereas the limitation on the job development fees at §41-10-44.8(a)(2) is "debt service payments under the financing agreement(s)." The Taxpayer contends that by using different language in the two clauses, the Legislature must have intended that "debt service," as used in §41-10-44.8(a)(2), should be broadly construed to encompass more than only the principal and interest on the project bonds.

The Taxpayer's arguments are eloquent but unpersuasive. The Taxpayer asserts that §41-10-44.8(a)(2) should be broadly construed to effectuate the Legislature's intent. The overriding rule of statutory construction, however, is that the plain language of a statute must be followed. "The fundamental rule of statutory construction is to ascertain and give effect to the intent of the legislature in enacting the statute. Words used in a statute must be given their natural, plain, ordinary, and commonly understood meaning, and where plain language is used a court is bound to interpret that language to mean exactly what it says." *IMED Corp. v. Systems Engineering Associates Corp.*, 602 So.2d 344 (Ala. 1992).

"Debt service" is not defined in the Act. The term is, however, defined as follows in

Black's Law Dictionary, 7th ed, (1999) at 412 – "The funds needed to meet a long-term debt's annual interest expenses, principal payments and sinking-fund contributions." That definition supports the Department's claim that debt service includes only the interest paid on the bonds in issue. Importantly, as discussed, the January 1, 1995 Loan Agreement between the Taxpayer and the Authority also defines "Debt Service" as "the principal, interest, and other premium due on the Bonds. . . " The fees in issue are not debt service pursuant to that definition.

The Taxpayer contends that "debt service" should not be limited by the above definitions. Rather, it asserts that the term should be given its commonly understood meaning in the municipal bond industry, which includes principal, interest, and all related fees. The Taxpayer offered the testimony of an industry representative, who explained that a letter of credit, a remarketing agreement, and a bond service rating are all necessary to keep bonds current and marketable. The witness further testified that when an entity seeks to raise funds by issuing bonds, the entity necessarily considers all costs, including the interest to be paid "plus the credit enhancement cost, plus the remarketing cost, plus other annual fees. I mean, so any time a client is borrowing money, they want to know what their all-in cost is. And so there are various components that add into the equation." T. at 52.

It is understandable, as testified to by the above witness, that a borrower would consider debt service and also all related costs before approving a bond issuance. It does not follow, however, that all costs relating to the bonds should be considered as part of debt service. Given the definition of the term in *Black's Law Dictionary*, and also in the January 1, 1995 Loan Agreement, "debt service" must be construed to include only the interest paid

by the Taxpayer on the bonds. The related fees may be a necessary cost, but they are not part of debt service within the purview of the statute.

Even if "debt service" is construed to include the fees, §41-10-44.8(a)(2) further requires that the debt service must be paid pursuant to a financing agreement. As indicated, "financing agreement" is defined at §41-10-44.2(2) as an agreement between the Authority and an approved company, the Taxpayer in this case. The only agreement between those parties was the January 1, 1995 Loan Agreement. The fees in issue were not paid pursuant to that agreement. Consequently, they cannot be considered as debt service for purposes of the job development fee limitation at §41-10-44.8(a)(2).

The Taxpayer contends that its interpretation of "debt service" is supported by a Revenue Department Legal Division memorandum issued in January 1996. The memorandum addressed whether prepaid principal payments constituted debt service under the Mercedes Act. The author concluded that prepaid principal was a part of debt service. In so concluding, the author determined that the definition of "debt service" found in the financing agreement between the parties must control – ". . . it appears to me that the definition that would be found in the financing agreement of the obligation would be the place that the definition (of) debt service would be made." See, January 2, 1996 Memorandum, Dept. Ex. 2 at 2. That conclusion supports the finding in this case that the definition of "Debt Service" in the January 1, 1995 Loan Agreement must control.

The Taxpayer does not directly dispute the conclusion in the memorandum that the definition in the financing agreement should control, although it argues in its Reply Brief at

1, that the term "debt service," as defined in the January 1, 1995 Loan Agreement, was not intended "as an interpretation of the concept of 'debt service,' but as mere nominalism." [2] The Taxpayer instead focuses on the memorandum's subsequent reference to the definition of "Debt Service" in Act 95-373, which established the Alabama Incentives Financing Authority. That definition, found at Code of Ala. 1975, §41-10-541(a)(7), includes principal, interest, and various related fees. The memorandum states – "For all practical purposes, this definition (in §41-10-541(a)(7)) appears to indicate that this would be the definition assigned to 'debt service' had the legislature addressed the issue in" the Mercedes Act. Citing that statement, the Taxpayer concludes that the definition in §41-10-541(a)(7) should apply in this case because the Department has adopted the statement as "its formal policy in interpreting the (Mercedes) Act." Taxpayer's Brief at 8. I disagree.

The statement in the 1996 memorandum is not the Department's formal policy on the issue. It is merely speculative dicta. There is also nothing in the definition of "debt service" at §41-10-541(a)(7) that "appears to indicate" that the Legislature would have used the definition had it included a definition of the term in the Mercedes Act. To the contrary, the fact that the Legislature included various fees as part of "debt service" in §41-10-541(a)(7), but did not define the term in the Mercedes Act to include such fees, shows an intent that such fees not be included in the term.

The Department did announce its formal position on the issue in a December 22, 2005 memorandum, Dept. Ex. 1. That memorandum reads in part:

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[2] The definition of "debt service" in the financing agreement referred to in the 1996 memorandum was identical to the definition in the January 1, 1995 Loan Agreement between the Taxpayer and the Authority. The Taxpayer's representative in this case drafted both agreements.

> Under Section 41-10-44.2(2), "financing agreement" is defined as "Any loan, agreement, financing agreement, credit agreement, security agreement, mortgage, guaranty agreement or other type of agreement entered into by the authority and an approved company in connection with the financing of a project by the authority." The loan agreement is the "financing agreement" used by the State Industrial Development Authority (SIDA) between the approved company, the local industrial development board, and SIDA, in which SIDA defined "debt service." Debt service was defined in the loan agreements as principal, interest and any premium payable on the bonds. Based on this definition, the Department recognizes only scheduled principal payments, interest and any additional payments applied to the principal of the bonds, as "debt service" payments under the "financing agreement" for purposes of the tax incentives provided under Section 41-10-44.1 et al.

The December 2005 memorandum addressed the broad issue of what constitutes "debt service" under the Mercedes Act (unlike the 1995 memorandum, which only addressed the specific issue of whether prepaid principal constituted debt service), and concluded that the term includes only principal and interest. That interpretation of the statute by the Department "should be given great weight and deference." *Patterson v. Emerald Mt. Expressway Bridge, LLC*, 856 So.2d 826, 833 (Ala. Civ. App. 2002), citing *Yelverton's, Inc. v. Jefferson County*, 742 So.2d 1216 (Ala. Civ. App. 1997).

Finally, the Taxpayer cites §41-10-44.1, which provides that the Act "shall be liberally construed in conformity with the intentions of the Legislature expressed above." As discussed, however, the actual language used by the Legislature in the Act must control. Reading the provisions of the Act together, the Legislature clearly specified that job development fees are limited to the debt service, i.e., principal and interest, paid pursuant to a financing agreement, which, as defined, includes only an agreement between the Authority and a qualifying company. The only debt service (or other amount) paid pursuant to the financing agreement in this case was the interest paid by the Taxpayer on the bonds.

The job development fees available to the Taxpayer in the subject year were thus limited to that amount, less the tax credit otherwise allowed by the Act.

The Taxpayer is correct that under the circumstances, the penalties assessed by the Department should be waived for cause. Code of Ala. 1975, §40-2A-11(h). Interest is required by statute, Code of Ala. 1975, §40-1-44, and cannot be waived or abated absent undue delay by the Department. Code of Ala. 1975, §40-2A-4(b)(1)c. There was no undue delay by the Department in this case.

The final assessment, less the penalties, is affirmed. Judgment is entered against the Taxpayer for tax and interest of $81,894.62. Additional interest is also due from the date the final assessment was entered, December 28, 2005.

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

Entered February 7, 2007.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Cleophus Gaines, Jr., Esq.
Roy S. Goldfinger, Esq.
Neal Hearn