COCA-COLA ENTERPRISES, INC. P.O. BOX 723040 ATLANTA, GA 31139-0040,	§	STATE Of ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. CORP. 09-641
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER ON REHEARING

This case involves a partially denied refund of 2007 corporate income tax requested by the above Taxpayer. The issue is whether the Taxpayer's Alabama affiliated group can deduct on its 2007 Alabama consolidated return various net operating losses ("NOLs") incurred by the Taxpayer before 2007.

An Opinion and Preliminary Order was entered on August 15, 2012 holding that the NOLs incurred by the Taxpayer before 1999 were subject to the SRLY rule limitation at Code of Ala. 1975, §40-18-39(h), and thus could not be claimed on the group's 2007 consolidated return, but that the NOLs incurred in 1999 and later years could be deducted.

> To summarize, §40-18-39 must be construed as allowing Alabama affiliated group members to share NOL carryovers on an Alabama consolidated return, but only if the §40-18-39(h) limitation does not apply. The subsection (h) limitation applies if an NOL was incurred by a group member in a year before the member became a member of the Alabama affiliated group. Because an Alabama affiliated group did not exist before 1999, all NOLs incurred before 1999 are subject to the subsection (h) limitation. If, however, the loss was incurred in 1999 or later, and the corporation that incurred the loss was a group member in the loss year, the subsection (h) limitation does not apply, even if the Alabama affiliated group did not file an Alabama consolidated return in the loss year.
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> The Taxpayer incurred the NOLs in issue in 1992 through 2002 and 2004. The §40-18-39(h) limitation applies to the 1992 through 1998 NOLs. Those losses thus cannot be used on the group's 2007 Alabama consolidated return because the Taxpayer had negative taxable income in that year.

> The Taxpayer's 1999 through 2002 and 2004 NOLs can be allowed as group NOLs on the 2007 consolidated return because the Taxpayer was a member of the Alabama affiliated group in those loss years. Again, it is irrelevant that the Taxpayer's Alabama affiliated group did not file Alabama consolidated returns before 2007.

Opinion and Preliminary Order at 17 – 18.

The Department recomputed the refund due the Taxpayer pursuant to the Opinion and Preliminary Order, and a Final Order was entered on October 15, 2012 showing a refund due of $378,584.38.

The Taxpayer timely applied for a rehearing because it believed that the Department had miscalculated the amount of the refund.

The Department subsequently also applied for a rehearing. It argued that by statute an Alabama affiliated group cannot exist before the group files its first Alabama consolidated return, and that because the Taxpayer's group did not file its first Alabama consolidated return until 2007, all of the Taxpayer's pre-2007 NOLs are subject to the SRLY limitation and cannot be claimed on the 2007 return.

In support of its position, the Department first cites the rule of statutory construction that a deduction statute must be strictly construed against the taxpayer and for the taxing authority. The case does involve the NOL deduction allowed corporations at Code of Ala. 1975, §40-18-35.1, but the NOL deduction statute itself is not in issue. Rather, the issue is whether the SRLY rule at §40-18-39(h) applies to limit the Taxpayer's NOL deduction. The above rule of construction should not apply to a statute that limits or disallows an otherwise allowable deduction, which is more in the nature of a taxing statute that should be construed for the taxpayer and against the taxing authority. *Alabama Farm Bureau Mutual*

Cas. Ins. Co. v. City of Hartselle, 460 So.2d 1219 (Ala. 1984).

In any case, the issue on rehearing does not involve the interpretation of a deduction statute. Rather, the issue is whether an Alabama affiliated group can exist before the group files its first Alabama consolidated return. The applicable rule of construction in deciding that issue is that the intent of the Legislature, as expressed in the language used in the statute, must control. *Gholston v. State*, 620 So.2d 719 (Ala. 1993). As discussed below, the Alabama Legislature clearly intended for the federal consolidated return provisions to apply in Alabama, and under federal law, an affiliated group of corporations can exist before the group elects to file a federal consolidated return. The language used in §40-18-39 also confirms that an Alabama affiliated group can elect to file, or not file, an Alabama consolidated return, which further shows that an Alabama affiliated group can, and indeed must, exist before it files its first Alabama consolidated return.

The Department's position is based on one specific subparagraph in Code of Ala. 1975, §40-18-39(b)(1). That subparagraph reads in pertinent part as follows:

> (b) As used in this chapter, unless the context requires otherwise:
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> (1) "Alabama affiliated group" means a group of corporations, each member of which is subject to tax under Section 40-18-31 and Public Law 86-272 (15 U.S.C. §§ 381-384), which are members of an affiliated group as defined in 26 U.S.C. § 1504 and which affiliated group files a federal consolidated corporate income tax return, each member of which:
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> a. Has the same taxable year;
>
> b. Is a member of the group for the entire taxable year or was a member of the group for a portion of the taxable year if the member was subject to Section 40-18-31 during the entire portion of the taxable year during which it was not a member of the federal consolidated group;
>
> c. Apportions Alabama taxable income or loss separately for each corporation;

> d. Allocates taxable income or loss separately for each corporation in accordance with Section 40-27-1, Article IV;
>
> e. Computes apportionable income or loss utilizing separate apportionment factors for each corporation in accordance with Section 40-27-1, Article IV; and
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> f. Combines and reports taxable income or loss computed in accordance with paragraphs c through e of this subsection on a single return for the Alabama affiliated group;
>
> and which includes all members of the affiliated group included on the federal consolidated income tax return that are eligible under this section to be included in the Alabama affiliated group; but shall not include corporations subject to the insurance premium license tax imposed by Section 27-4A-1 et seq. or the financial institution excise tax imposed by Section 40-16-1 et seq.

The Department argues that §40-18-39 (b)(1)f. makes the filing of an Alabama consolidated return a prerequisite to the existence of an Alabama affiliated group. I disagree.

By itself, §40-18-39(b)(1)f. can arguably be construed as supporting the Department's position. But various other provisions in §40-18-39, when read together, show that the actual filing of an Alabama consolidated return is not a prerequisite to the existence of an Alabama affiliated group.

The consolidated return statute, §40-18-39, allows an Alabama affiliated group the option of electing to file an Alabama consolidated return. This is reflected in the enabling legislation, Acts of Ala. 1998-502, which provided "for *an election* to file annual Alabama consolidated corporate income tax returns, in conformity with federal income tax rules." (emphasis added). Code of Ala. 1975, §40-18-39(b)(2) also defines an "Alabama consolidated return" as "an Alabama corporation income tax return filed by or on behalf of the member of an Alabama affiliated group. . ., pursuant to *an election* made under

subsection (c) below." (emphasis added). Code of Ala. 1975, §39-18-39(c)(1) specifies that "[a]n Alabama affiliated group filing or required to file a federal income tax return *may elect* to file an Alabama consolidated return for the same year." (emphasis added). Code of Ala. 1975, §40-18-39(c)(8) further provides for an annual fee of from $5,000 to $25,000 for any "Alabama affiliated group that has made an Alabama consolidated return *election* under this subsection. . . ." (emphasis added). The above Alabama provisions allowing an Alabama affiliated group the option of electing to file an Alabama consolidated return also conforms to federal law at 26 U.S.C. §1501, which provides that "[a]n affiliated group of corporations shall . . . have the privilege of making a consolidated return . . . in lieu of separate returns."

If an Alabama affiliated group can elect to file a consolidated return, it necessarily follows that the group can elect not to file a consolidated return, as the Taxpayer's Alabama affiliated group did from 1999 through 2006. A nonexistent entity cannot elect to file or not file an Alabama consolidated return, or take any other action. Consequently, an Alabama affiliated group must already exist to be able to elect to file or not file an Alabama consolidated return in a given year. The Taxpayer is thus correct that "the actual filing of a consolidated return cannot be a 'prerequisite' to qualifying as an Alabama affiliated group." Taxpayer's Response to Department's Application for Rehearing at 2.

The purpose for the SRLY rule limitation is to prevent an affiliated group of corporations from purchasing another corporation that has amassed large NOLs in prior years, and then using those NOLs to offset the income of the other group members in subsequent years. That is, the SRLY rules prevent an affiliated group from "buying" tax

losses by limiting an acquired corporation's pre-acquisition NOLs to only offset the current year and future income of the acquired corporation. The SRLY rules do not apply, however, to NOLs incurred by a corporation that filed separate returns in the loss years but was also a member of the same affiliated group during the loss years, as in this case. Taxpayer's Response, at 2, 3, is directly on point.

> The history of Alabama's consolidate return statute is inapposite to the Department's position. By enacting Acts of Ala. 1998-502, the Legislature provided "for an election to file annual Alabama consolidated corporate income tax returns, in conformity with federal income tax rules." Specifically, the Legislature incorporated the federal separate return limitation year ("SRLY") rule to limit the ability of a consolidated group to share net operating losses ("NOLs") among its members in certain circumstances. Ala. Code § 40-18-39(h). However, the Alabama and federal SRLY rules do not apply to NOLs incurred by corporations that filed separate returns but were members of the same affiliated group during the loss year. Treas. Reg. § 1.1502-1(f)(2)(ii) (providing the SRLY rule does not apply in "[a] separate return year of any corporation which was a member of the group for each day of such year"); Ala. Admin. Code r. 810-3-35.1-.03(2)(a)(3)(ii), effective for all tax periods prior to November 19, 2010 (same). By adopting the federal SRLY rule, the Legislature clearly recognized that corporations could be members of the same Alabama affiliated group before the group elected to file its first consolidated return (and when such an election is finally made, that the separate company NOLs could be deducted by the group). This is consistent with both the 1998 and 2001 definitions of an Alabama affiliated group, neither of which requires an election to file a consolidated return in order to qualify as an Alabama affiliated group, and the Legislature's intent in adopting the federal consolidate filing regime.

In this case, the Taxpayer and its subsidiaries, Roddy Coca-Cola Bottling Company, Inc. and Vending Holding Company, were members of the Taxpayer's Alabama affiliated group from 1999 forward. Allowing the affiliated group to deduct the NOLs incurred by the Taxpayer since 1999 is clearly authorized under Alabama law, and does not allow the Taxpayer "to circumvent taxation," as argued by the Department. Department's Application for Rehearing at 7.

In its Response, the Taxpayer indicated that the Department has recalculated the 2007 refund due to be $414,248.19, plus statutory interest. Judgment is entered accordingly. The October 15, 2012 Final Order is voided.

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

Entered February 14, 2012.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
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