

STATE OF ALABAMA
DEPARTMENT OF REVENUE,

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

§

v.

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DOCKET NO. INC. 86-257

JONES MANUFACTURING CO., INC. §
P. O. Box 6696
Birmingham, AL 35210, §

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Taxpayer. §

§

ORDER

Jones Manufacturing Company, Inc. ("Taxpayer") filed a petition for refund of corporate income tax for its short tax year ending July 12, 1984. The Department disallowed the refund and the Taxpayer appealed to the Administrative Law Division. A hearing was conducted in the matter on November 24, 1987. CPA Grant McDonald was present and represented the Taxpayer. Assistant counsel Mark Griffin appeared for the Department. Based on the evidence presented at the hearing, the Administrative Law Judge entered a recommended order on January 19, 1988, which was forwarded along with the Administrative Law Division record in the case to the Commissioner of Revenue for entry of a final order. After review of the record and the recommended order, the following findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

The facts are undisputed.

The Taxpayer's stock was purchased by another corporation in 1984. The transaction was treated as a sale of assets under 26

U.S.C. §338. That section is incorporated into Alabama law by Code of Ala. 1975, §40-18-8(1). Also, no gain on the transaction was recognized by the Taxpayer on its federal income tax return, as allowed by 26 U.S.C. §337, except that certain depreciation was recaptured and reported as ordinary income, as required by 26 U.S.C. §1245.

The non-recognition provisions of §337 are incorporated into Alabama law by Code of Ala. 1975, §40-18-8(j). Consequently, no gain was recognized by the Taxpayer on its Alabama income tax return. The Taxpayer also failed to recapture depreciation on its Alabama return.¹ The Department objected, arguing that the Taxpayer must recapture depreciation on its Alabama return in the same manner as under federal law.

The Taxpayer subsequently filed an amended return which included the depreciation recapture as income, in order that the Department could issue a partial uncontested refund due the Taxpayer. The subject refund petition relative to the depreciation recapture was filed simultaneously with the amended return.

¹The Alabama corporate income tax is computed using federal gross income as a starting point. Thus, technically the Taxpayer subtracted or backed out on its Alabama return the amount of recaptured depreciation included as gross income on its federal return.

The determinative issue is whether depreciation must be recaptured in Alabama, notwithstanding the applicability of the non-recognition provisions of §337.

CONCLUSIONS OF LAW

During the tax year in question, §337 provided in substance that no gain or loss shall be recognized on the sale or exchange of property within 12 months after adoption of a plan of complete liquidation.² As noted, §337 is made a part of Alabama law by §40-18-8(j).

Taking advantage of §337, no gain or loss was recognized by the Taxpayer on either its federal or Alabama return filed for the period in question. However, 26 U.S.C. §§1245 and 1250 both require that depreciation must be recaptured as ordinary income upon the sale or other disposition of the subject asset. Those sections apply "notwithstanding any other provision of this subtitle". [See §1245(d) and §1250(i).] Consequently, for federal

²Section 337 was enacted to eliminate the disparity in tax treatment resulting from Commissioner v. Court Holding Company, 324 U.S. 331, 65 S.Ct. 707, U.S. v. Cumberland Public Service Commission, 338 U.S. 451, 70 S.Ct. 280, and numerous related cases. For a short history see Benedict Oil Company v. U.S., 582 F.2d 544, and Central Tablet Manufacturing Company v. U.S., 94 S.Ct. 2516. Section 337 was substantially amended by the Tax Reform Act of 1986.

purposes, the Taxpayer was required to recapture depreciation as ordinary income, notwithstanding the non-recognition provisions of §337, see Brigham v. U.S., 539 F.2d 1312; F. Clayton, 52 T.C. 911, Dec. 29,726. The question in dispute is whether the Taxpayer must also recapture depreciation on its Alabama return.

Code of Ala. 1975, §40-18-35(6) provides for corporations "[A] reasonable allowance for the exhaustion, wear and tear of property used in a trade or business. . . ." No statutory guidelines are provided as to the amount or method by which the deduction should be computed. However, Code of Ala. 1975, §40-18-57 provides that the Department shall promulgate such reasonable rules and regulations as necessary for ascertaining gains and income within the State.

Department Reg. 810-3-15-.05 governs depreciation for both corporations and individuals and provides in substance at subsections (8) and (9) that depreciation shall be computed "in the same manner and subject to the same limitations as provided for federal income tax returns". Further subsection (10) of the regulation provides that federal law shall also be followed relating to the recapture of depreciation.

In summary, the Legislature has provided in general terms for a reasonable allowance for depreciation, and has provided the Department with authority to establish guidelines by which the deduction should be computed. The Department responded by adopting

federal statutory guidelines, included those federal statutes relating to recapture.

The Taxpayer argues that the regulation is legislative in character and exceeds the Department's rule-making authority in that it "is out of harmony with, or alters, extends or limits the statute being administered", citing Hamm v. State ex rel Martin, 33 So.2d 358.

However, the regulation is merely an adoption of reasonable regulatory guidelines for computing a reasonable allowance for depreciation. Without the regulation, neither the Department nor taxpayers would have guidance in claiming and computing depreciation. The fact that the guidelines were adopted from various federal statutes does not make the regulation legislative in character.

The Department's use of federal guidelines in computing depreciation is long-standing and well-established. Certainly, the Legislature would have taken corrective action if the Department's use of federal authority was unreasonable or unfair. To the contrary, §40-18-35 has been recodified on several occasions without change. The reenactment or recodification of a statute without change indicates the Legislature's approval of the method by which the statute has been interpreted and administered. Kruse v. Hampton, 394 F.Supp. 764, affirmed 513 F.2d 1231; Moody v. Ingram, 361 So.2d 513.

Simply stated, federal law at §§1245 and 1250 provides that depreciation claimed in prior years must be recaptured and reported as ordinary income upon the sale or other disposition of the asset.

The recapture rules apply notwithstanding the non-recognition provisions of §337. As noted, subsection (10) of Reg. 810-3-15-.05 provides that federal recapture rules shall apply in Alabama. Consequently, depreciation must be recaptured for Alabama income tax purposes in the same manner and to the same extent as under federal law.

The above considered, the recaptured depreciation was correctly reported by the Taxpayer on its amended return, and the refund petition is due to be denied.

This order constitutes a final order in this action for purposes of review under Code of Ala. 1975, §41-22-20.

Done this 28th day of January, 1988.