

STATE OF ALABAMA
DEPARTMENT OF REVENUE,

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

v.

§

DOCKET NO. INC. 87-106

MCGOWAN BROADCASTING, INC.
P.O. Box 1259
Ozark, AL 36361,

§
§

Taxpayer.

§

ORDER

The Department entered a preliminary assessment of income tax against McGowan Broadcasting, Inc. ("Taxpayer") for the calendar year 1985. The Taxpayer appealed to the Administrative Law Division and a hearing was conducted on December 1, 1987. The Taxpayer was represented by CPA Marcus J. Wolf. Assistant counsel Mark Griffin appeared on behalf of the Department. Based on the evidence submitted by the parties, the following findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

The relevant facts are undisputed.

The Taxpayer filed an Alabama and a federal Subchapter S corporation information return for the calendar year 1985. The federal return included a gain of \$145,449.00 from a corporate liquidation under 26 U.S.C. §337. The gain resulted from the recapture of depreciation as required by 26 U.S.C. §1245. The recaptured depreciation was not reported on the Taxpayer's Alabama return, which showed a net loss of \$43,942.00.

The Department denied the Taxpayer Subchapter S status because

a non-resident shareholder failed to timely file a consent report as required by Code of Ala. 1975, §40-18-160. The Taxpayer agrees that the shareholder report was not timely filed and thus that Subchapter S status should not be allowed.

The Department also adjusted the Taxpayer's taxable income to include the depreciation recapture of \$145,449.00 as taxable gain.

The preliminary assessment in issue is based on the resulting net income of \$101,469.00.

The determinative issue, as stated by the Taxpayer, is as follows:

Whether gain in a corporate liquidation that meets the requirements of Internal Revenue Code §337 is taxable to the extent of depreciation recapture as provided under federal statutes and guidelines, for Alabama income tax purposes.

CONCLUSIONS OF LAW

During the subject year, 26 U.S.C. § 337 provided 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.¹

¹Section 337 was enacted to eliminate the uncertainty which resulted from Commissioner v. Court Holding Company, 324 U.S. 331, 65 S.Ct. 707; U.S. 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

Section 337 was incorporated into Alabama law by Code of Ala. 1975, §40-18-8(j).

However, 26 U.S.C. §1245 requires that depreciation must be recaptured and reported as ordinary income upon the sale or other disposition of the subject asset. Section 1245(d) further provides that the recapture rules apply "notwithstanding any other provision of this subtitle". Accordingly, the Taxpayer was required to recapture depreciation as ordinary income on its 1985 federal return. The issue is whether depreciation must also be recaptured in Alabama, notwithstanding the non-recognition provisions of §337.

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

by the Tax Reform Act of 1986.

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 specifically 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 authorized the Department to establish guidelines by which the deduction should be computed. Accordingly, the Department adopted federal statutory guidelines, including those federal statutes relating to recapture.

The Department's use of federal guidelines in computing depreciation is long-standing and well-established. Certainly, the Legislature would have enacted its own statutory guidelines if the Department's use of federal authority was deemed unreasonable or improper. 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 by the Department. Kruse v. Hampton, 394 F.Supp. 764, affirmed 513 F.2d 1231.

Simply stated, federal law provides that certain depreciation 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 Revenue Department is hereby directed to make the assessment final as entered, with interest as required by statute.

Done this 25th day of February, 1988.

BILL THOMPSON
Chief Administrative Law Judge