

STATE OF ALABAMA,
DEPARTMENT OF REVENUE,

vs.

AUTOMOTIVE RENTALS, INC.
P.O. Box 1153
Pennsauken, NJ 08109

Taxpayer.

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

DOCKET NO. F. 89-173

FINAL ORDER

The Revenue Department assessed franchise tax against Automotive Rentals, Inc. (Taxpayer) for the years 1984 through 1987. The Taxpayer appealed and two hearings were conducted by the Administrative Law Division. Charles Clark represented the Taxpayer at both hearings. Assistant counsel Dan Schmaeling represented the Department.

The issue in dispute is whether the Department correctly calculated the Taxpayer's capital employed in Alabama for franchise tax purposes during the years in question. That issue turns on which formula and factors from Schedules C and D of the Alabama return should be used in apportioning the Taxpayer's capital to Alabama.

The Taxpayer was incorporated in New Jersey and operated in Alabama and throughout the United States during the period in issue. The Taxpayer is in the business of automobile sales, automobile leasing, the remanufacture and sale of automobile parts, and fleet management services.

The Taxpayer filed Alabama franchise tax returns during the years in question under category 6 on Schedule D of the return as a corporation primarily engaged in services. Category 6 requires

the use of the income, salary and property factors (3, 6 and 7) from Schedule C.

The Department audited the Taxpayer, rejected the Taxpayer's use of category 6, and instead recomputed the Taxpayer's liability under category 7 on Schedule D as a corporation primarily engaged in leasing. The Department treated the Taxpayer as a leasing corporation because the Taxpayer's primary activity in Alabama is leasing, and the Department's position during the years in issue was that a corporation must select its Schedule D category based on its primary business activity in Alabama. Category 7 requires use of the income and property factors (3 and 7) only. In other words, the Department eliminated the payroll factor from the Taxpayer's apportionment formula and recomputed the Taxpayer's liability accordingly.

The Department also contends that the payroll factor should not be used in any case because the Taxpayer had no payroll in Alabama during the subject years. The Department argues that use of a zero payroll factor would not accurately reflect the actual amount of capital employed by the Taxpayer in Alabama.

The Taxpayer responds that it should use all three factors of income, payroll and property, and that omitting the payroll factor unfairly increases capital apportioned to Alabama. The Taxpayer argues in the alternative that if the two-factor leasing formula is used, then the Department should apply the formula only to that part of the Taxpayer's overall capital associated with its leasing operation.

Apportionment formulas are widely accepted for corporate income or franchise tax purposes. Container Corporation of America v. Franchise Tax Board, 103 S. Ct. 2933; Moorman Manufacturing Company v. Bair, 98 S. Ct. 2448. No particular apportionment formula is required, Goldberg v. Sweet, 109 S. Ct. 582, and a formula will be upheld if it fairly apportions a corporation's business activities to the taxing state. Moorman, supra.

Alabama's apportionment method set out on Schedules C and D is reasonable and if properly applied fairly reflects the actual capital employed by a corporation in Alabama. Alabama's use of different formulas on Schedule D is more precise than use of a single, uniform formula because corporations engaged in different business activities normally employ capital differently. For example, the activities of a category 3 sales corporation are best reflected by use of the three factors of payroll, property and sales, whereas the activities of a category 5 transportation company are best reflected by the factors of income, total mileage and payroll.

However, in deciding which Schedule D formula to apply, the Department must consider the corporation's primary activity everywhere, not its primary activity in Alabama only. Because the apportionment factors are applied to a corporation's total capital employed everywhere, the Schedule D category that determines which

factors are used must also be selected based on the corporation's primary activity everywhere.¹

The Department adopted Reg. 810-2-3-.13 in early 1993 which now requires a corporation to use its primary activity overall in choosing its Schedule D category. That method most accurately apportions capital to Alabama, and thus should also be used in this case.

¹Apportioning capital using a corporation's primary activity in Alabama as opposed to overall also probably violates the internal consistency requirement of the Commerce Clause of the United States Constitution. To be internally consistent, "a tax must be structured so that if every state were to impose an identical tax, no multiple taxation would result". Goldberg v. Sweet, supra, at 589; see also Container, supra at 2242. An apportionment formula based on a corporation's primary activity in a particular state would most likely result in multiple taxation.

Schedule 1 attached hereto was compiled by the Taxpayer and shows that the Taxpayer's primary activity overall during the years in question was sales. Automobile sales and parts and engine sales together comprised a greater percentage of the Taxpayer's business activity in all years than did leasing. Consequently, the Taxpayer should have reported under category 3 on Schedule D as a corporation primarily engaged in sales.

The Taxpayer's representative testified that the category 3 factors of sales, salary and inventory involve the same numbers as the factors of gross income (sales), salary and tangible property (inventory) actually used on the Taxpayer's returns. R. at p. 24. Consequently, assuming the Taxpayer's representative is correct, and also that Schedule 1 correctly reflects the Taxpayer's business activities during the period in question, the Taxpayer's returns should be accepted as filed.

The Department's argument that including a zero payroll factor in the apportionment formula unfairly decreases capital employed in Alabama is also rejected. The Department promulgated the formulas used on Schedule D, and if a Schedule D formula requires the use of three factors, all three factors must be used. There is no authority or logical reason why a zero factor should be eliminated, and to do so would improperly increase a corporation's capital apportioned to Alabama. The same conclusion was reached in a prior Administrative Law Division decision, Department v. Aristech Chemical Corporation, Docket No. F.92-350, decided November 16, 1993.

The above considered, the assessment in issue is dismissed.
This Final Order may be appealed to circuit court within 30 days
pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered on January 5, 1994.

BILL THOMPSON
Chief Administrative Law Judge