STATE OF ALABAMA, DEPARTMENT OF REVENUE, vs. BETHLEHEM STEEL CORPORATION Bethlehem, Pennsylvania 18016, Taxpayer.	§ § § § §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION DOCKET NO. F. 92-151

FINAL ORDER

The Revenue Department assessed franchise tax against Bethlehem Steel Corporation (Taxpayer) for the years 1987 and 1988. The Taxpayer appealed to the Administrative Law Division and a hearing was conducted on May 21, 1992. Thomas T. Gallion, III and Robert Shattuck, Jr. represented the Taxpayer. Assistant counsel Dan Schmaeling represented the Department.

The parties agreed at the administrative hearing that the case should not be decided until an appeal involving West Point Pepperell, Inc. relating to long-term reserve accounts was finally decided. That appeal has now been decided by the Alabama Supreme Court, see, Ex parte State Department of Revenue (In re: West Point Pepperell, Inc. v. State Department of Revenue), 624 So.2d 582 (1993).

This case involves two issues: (1) What factors from Schedule C of the Alabama franchise tax return should the Taxpayer have used in reporting its 1987 and 1988 Alabama franchise tax liability; and (2) Should various long-term reserve accounts be

included as capital by the Taxpayer. The relevant facts are undisputed.

The Taxpayer is headquartered in Bethlehem, Pennsylvania and manufactures and sells iron and steel products in the United States and worldwide. The Taxpayer has no manufacturing facilities in Alabama. Rather, the Taxpayer's only business activities in Alabama are sales, servicing of customers, and storage of inventory.

The Taxpayer filed 1987 and 1988 Alabama foreign franchise tax returns under category 2 on Schedule D of the return as a corporation primarily engaged in both manufacturing and selling. Category 2 required the use of the average of factors 1 and 2, factor 6 and the average of factors 7 and 8 from Schedule C.

The Department reviewed the returns, rejected the Taxpayer's use of category 2, and recomputed the Taxpayer's liability under category 3 on Schedule D as a corporation primarily engaged in sales only. The Department argues that the Taxpayer should have filed as a sales corporation under category 2 because the Taxpayer's primary activity in Alabama was sales only during the subject years.

The Department also included as capital various long-term reserve accounts that had not been previously included as capital by the Taxpayer. The assessments in issue are based on the above adjustments.

The Alabama franchise tax is measured by the "actual amount of (a foreign corporation's) capital employed in Alabama". See, §232 of the Alabama Constitution of 1901 and Code of Ala., 1975, §40-14-41(a). The Department computes a foreign corporation's capital employed in Alabama by using the various apportionment formulas and factors on Schedules C and D of the Alabama return.

Apportionment formulas are widely accepted as the most accurate method for computing a corporation's income or franchise tax liability in a particular state. Container Corporation of American v. Franchise Tax Board, 103 S.Ct. 2933; Moorman Manufacturing Company v. Bair, 98 S.Ct. 2248. 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.

Schedules C and D on the Alabama return are reasonable, and if properly applied fairly apportion a corporation's capital to Alabama. The use of different formulas on Schedule D is more precise than use of a single formula for all corporations because corporations engaged in different business activities normally employ capital differently. For example, the capital of a category 3 sales corporation is most accurately apportioned by the payroll, property and sales factors, whereas the capital of a category 5

transportation company is best apportioned 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 business activity everywhere, not its primary activity in Alabama only. Because the factors from Schedule C 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 Taxpayer filed its 1987 and 1988 Alabama returns based on its primary activities everywhere, sales and manufacturing. Although no evidence was submitted showing what percentage of the Taxpayer's activities involved sales and what percentage involved manufacturing, apparently the Department does not dispute that the Taxpayer was primarily engaged in both sales and manufacturing

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[1] Apportioning capital using a corporation's primary activity in Alabama only 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 page 589; see also Container, supra, at page 2242. An apportionment formula based on a corporation's primary activity in a particular state would most likely result in multiple taxation.

Schedules C and D and the Department's procedure for apportioning capital were also in issue in three other cases recently decided by the Administrative Law Division, Department v. Intergraph Corporation, Docket F91-171, decided on October 19, 1993; Department v. Aristech Chemical Corporation, Docket F. 92-350, decided on November 16, 1993; and Department v. Automotive Rentals, Inc., Docket F. 89-173, decided on January 5, 1994.

everywhere during the subject years.[2] Accordingly, the Taxpayer's returns should be accepted as filed.

[2] The Department has never defined "primarily" for franchise tax purposes. The dual manufacturing and sales category in issue was eliminated from Schedule D by Department Reg. 810-2-3-.13 in early 1993. Currently, each of the Schedule D categories involve only one primary activity.

In the West Point Pepperell case cited above, the Alabama Supreme Court upheld the holding of the Court of Civil Appeals that a foreign corporation's long-term reserve accounts should not be included as "capital" as defined at Code of Ala. 1975, §40-14-41(b). The long-term accounts in issue in this case are in substance the same as the long-term accounts in West Point Pepperell. Accordingly, the long-term reserve accounts in issue should not be included by the Taxpayer as capital for franchise tax purposes.[3]

In light of the above, the Taxpayer's contentions concerning the pre-emption clause of the Supremacy Clause of Article VI of the U. S. Constitution, and also 29 U.S.C. §1144(a), are moot.

The above considered, the assessment in issue is vacated and no additional franchise tax is owed by the Taxpayer for the years in question.

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 13, 1994.

[3] Some of the accounts in issue involve employee benefit plans under the Employee Retirement Income Security Act of 1974 (ERISA). Those accounts also constitute long-term reserve accounts covered by the West Point Pepperell case. The Department concedes as much in its post-hearing brief, at page 3.

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BILL THOMPSON
Chief Administrative Law Judge