

STATE OF ALABAMA  
DEPARTMENT OF REVENUE,

§  
§

STATE OF ALABAMA  
DEPARTMENT OF REVENUE  
ADMINISTRATIVE LAW DIVISION

v.

§

DOCKET NO. F. 94-184

U.S. STEEL MINING CO., INC.  
Post Office Box 4660  
Montgomery, Alabama 36103-4660,

§  
§

Taxpayer.

§

### FINAL ORDER

The Revenue Department assessed franchise tax against U. S. Steel Mining Company, Inc. ("Taxpayer") for the years 1989 through 1992. The Taxpayer appealed to the Administrative Law Division and the matter was submitted on a joint stipulation of facts. Robert D. Shattuck, Jr. represented the Taxpayer. Assistant Counsel Dan Schmaeling represented the Department.

This case involves generally the method by which the Taxpayer should be required to apportion capital to Alabama for franchise tax purposes. The specific issues are as follows:

(1) In apportioning capital to Alabama for the years 1989 through 1991, should the Taxpayer be required to average the separate factors of property and inventory into a single apportionment factor, as required by the Alabama franchise tax return during those years, or should property and inventory be included together as a single factor, as argued by the Taxpayer;

(2) Should the Taxpayer be treated for apportionment purposes as a corporation which employs capital in Alabama primarily in "manufacturing, processing or fabricating, and selling", as specified in category 2 on Schedule D of the Alabama return, or primarily in "selling", as set out in category 3 of Schedule D;

(3) Should the Department be required to waive the penalty included in the final assessment.

The facts as stipulated by the parties are set out below. Exhibits 1, 2 and 3 referred to in the stipulation are attached to and made a part of this Final Order.

"STIPULATION OF FACTS"

For purposes of the within proceeding and the within proceeding only, the Department of Revenue of the State of Alabama (the "Department") and U.S. Steel Mining Co., Inc. (the "Taxpayer") hereby stipulate the following facts:

1. The Taxpayer is a Delaware corporation that is headquartered in and whose commercial domicile is in Pittsburgh, Pennsylvania. The Taxpayer's principal business is the mining and selling of coal. The Taxpayer has coal mines mainly in Alabama and two other states and sells coal to customers in the United States, including Alabama, and throughout the world. In mining and selling coal, the Taxpayer mines, sorts and washes coal in the following steps:

Step No. 1: Mine raw coal ("run of the mine").

Step No. 2: Raw coal sorted by size and hardness in rotary breaker system.

Step No. 3: Sorted raw coal transported via conveyor belt to preparation plant.

Step No. 4: Preparation plant:

a. Raw coal further sorted by screening into three different sizes.

b. Each of the three different size groups goes to different coal cleaning.

c. Each of the three different size groups are further sorted into clean raw coal and refuse.

Step No. 5: Mechanical de-watering:

a. Screens, or

b. Centrifuge.

Step No. 6: Thermal de-watering:

- a. Applies only to clean raw coal;
- b. Refuse goes to storage pile.

Step No. 7: Salable product.

2. The Taxpayer was required to file Alabama foreign corporation franchise tax returns for years 1989, 1990, 1991, and 1992.

3. The form of Schedules C and D of the Department's foreign franchise tax return form for each of the years 1989, 1990, and 1991, relating to apportionment factors and apportionment categories for foreign corporations engaged in a multi-state business, was set forth in Exhibit 1 hereto.

4. Effective November 12, 1991, for 120 days, as an emergency rule, and effective March 6, 1992, the Department promulgated Reg. 810-2-3-.11, a copy of which is attached hereto as Exhibit 2.

5. Effective December 15, 1992, as an emergency rule for 120 days, and effective April 22, 1993, the Department promulgated Reg. 810-2-3-.13, a copy of which is attached hereto as Exhibit 3.

6. For purposes of the 1989, 1990, 1991, and 1992 Alabama foreign corporation franchise tax returns, but subject to paragraph 7 hereof, the cost of manufacturing factor, the sales factor, the payroll factor, the property factor (separately and excluding inventories), the inventories factor (separately and excluding property), and the property and inventory factors (on a combined basis) for the Taxpayer were as follows:

<b>1989</b>			
<b>Factor</b>	<b>Everywhere</b>	<b>Alabama</b>	<b>Alabama Percent</b>
Cost of Manufacturing	\$309,334,535	\$ 50,376,873	16.2856%
Sales	\$309,334,535	\$ 17,082,044	5.5222%
Payroll	\$ 97,350,563	\$ 19,107,931	19.6280%
Property	\$300,834,163	\$ 86,635,006	28.7983%
Inventories	\$ 2,639,195	\$ 671,719	25.4517%

<b>1989</b>			
Property & Inventories	\$303,473,358	\$ 87,306,725	28.7692%

<b>1990</b>			
<b>Factor</b>	<b>Everywhere</b>	<b>Alabama</b>	<b>Alabama Percent</b>
Cost of Manufacturing	\$385,898,831	\$ 57,811,011	14.9809%
Sales	\$385,898,831	\$ 17,355,585	4.4974%
Payroll	\$ 97,493,785	\$ 19,786,825	20.2955%
Property	\$304,009,263	\$ 90,048,174	29.6202%
Inventories	\$ 2,387,253	\$ 1,992,481	83.4633%
Property & Inventories	\$306,396,516	\$ 92,040,655	30.0398%

<b>1991</b>			
<b>Factor</b>	<b>Everywhere</b>	<b>Alabama</b>	<b>Alabama Percent</b>
Cost of Manufacturing	\$371,041,514	\$ 57,132,365	15.3978%
Sales	\$371,041,514	\$ 24,300,457	6.5493%
Payroll	\$108,600,075	\$ 22,877,452	21.0658%
Property	\$348,572,300	\$ 92,777,733	26.6165%
Inventories	\$ 5,545,659	\$ 3,255,782	58.7087%
Property & Inventories	\$354,117,959	\$ 96,033,515	27.1191%

<b>1992</b>			
<b>Factor</b>	<b>Everywhere</b>	<b>Alabama</b>	<b>Alabama Percent</b>
Cost of manufacturing	\$ 318,797,434	\$ 55,003,538	17.2534%

Sales	\$ 318,797,434	\$ 16,936,247	5.3125%
Payroll	\$ 100,020,563	\$ 21,301,388	21.2970%
Property	\$ 522,990,003	\$ 109,755,812	20.9862%
Inventories	\$ 28,609,510	\$ 15,378,565	52.2990%
Property & Inventories	\$ 551,599,513	\$ 125,134,377	22.6857%

7. The cost of manufacturing factors stated in paragraph 6 above are as shown in the Department's assessment and are derived from sales, the denominator being sales everywhere and the numerator being sales of coal mined in Alabama and sold to customers in Alabama, plus sales of coal mined in Alabama and sold to customers outside of Alabama. It is understood and agreed that the stipulations contained herein concerning the cost of manufacturing factors do not extend to a stipulation that the Taxpayer is engaged in manufacturing or that the cost of manufacturing factors are to be utilized in allocating Taxpayer's capital to Alabama."

The Taxpayer apportioned capital to Alabama during the subject years using the general three-factor formula of sales, payroll and property (the property factor included inventory). The Department adjusted the returns by treating the Taxpayer as a corporation primarily engaged in manufacturing, processing or fabricating, and selling pursuant to category 2 on Schedule D of the Alabama returns in those years. That category required use of the average of factors (1) and (2), factor (6), and the average of factors (7) and (8) from Schedule C. The additional tax in issue resulted from the Department's use of the category 2 apportionment formula in lieu of the formula used by the Taxpayer.

The Taxpayer first argues that averaging factors (7) and (8) (the property and inventory factors) in the years 1989 through 1991 to get a single factor does not accurately reflect the Taxpayer's capital employed in Alabama in those years. Rather, the Taxpayer argues that a single combined inventory and property factor should be used. As indicated, the Department adopted the single property apportionment factor pursuant to Reg. 810-2-

3-.11 in 1992 in lieu of the previously used averaged property and inventory factor.

A brief history of Alabama's franchise tax will help the reader in understanding the case.

Alabama's franchise tax is measured by capital employed in Alabama. See, §232 of 1901 Alabama Constitution and Code of Ala. 1975, §40-14-41(a). "Capital" was not defined by statute for franchise tax purposes prior to 1961. Rather, the courts defined capital as "the property of the corporation that is within the state and is used in business transacted within the state. . .". State v. Travelers Insurance Co., 53 So.2d 745, at p. 748 (1951). The Supreme Court in Travelers rejected an apportionment formula approach for computing capital employed in Alabama as then defined. Travelers, at p. 750.

"Capital" was first defined by statute for franchise tax purposes by Act 912 in 1961. That definition includes various intangible items such as surplus, profit, indebtedness, etc., and is presently codified at Code of Ala. 1975, §40-14-41(b). The 1961 Act did not, however, provide a method for determining what portion of a foreign corporation's intangible capital items were employed in Alabama. The Department accordingly developed the apportionment factors and categories presently set out on Schedules C and D of the Alabama franchise return.

Apportionment formulas are widely accepted as the most accurate method for computing a multi-state corporation's income or franchise tax liability in a particular state. The reasoning is that a corporation earns income, creates value, or employs capital within a state in proportion to its overall business activities within the state. See generally,

Container Corporation of America v. Franchise Tax Board, 103 S.Ct. 2933 (1983); Moorman Manufacturing v. Bair, 98 S.Ct. 2340 (1978). The Taxpayer in this case does not dispute that some formula for apportioning capital to Alabama is appropriate.

Apportionment formulas are by their nature imprecise. Moorman Manufacturing Co., at p. 2344. No particular apportionment formula is required. Goldberg v. Sweet, 109 S.Ct. 582 (1989). Rather, "the States have wide latitude in the selection of apportionment formulas and that a formula-produced assessment will only be disturbed when the taxpayer has proved by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportion to the business transacted'. . . in that State". Moorman Manufacturing, at p. 2345, citing Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell, 51 S.Ct. 385, at p. 389.<sup>1</sup>

Most states use the standard three factor formula of sales, property and payroll for both income and franchise tax purposes because those factors "appear in combination to reflect a very large share of the activities by which value is generated". Container Corp., at p. 2949. Alabama uses the standard three factor formula primarily for corporate income tax purposes.

During the years 1989 through 1991, the Department used eight different factors on Schedule C of the franchise return. Schedule D included seven different categories of business activities, each of which specified the factors from Schedule C applicable to that category. Use of a large number of different factors and categories by the Department more specifically and thus more accurately apportions a foreign corporation's capital to

---

<sup>1</sup>In Moorman Manufacturing Co., a single-factor sales formula employed by Iowa to apportion income to Iowa was upheld.

Alabama than a more general apportionment method.

Concerning the issue at hand, in my opinion the Taxpayer has not established by clear evidence that averaging the separate property and inventory factors into a single factor resulted in a formula out of all proportion to the Taxpayer's actual capital employed in Alabama. As pointed out in the Taxpayer's brief, in some cases the averaged factor may result in less capital apportioned to Alabama, and in some cases more. A formula should not be rejected because it apportions more capital to Alabama in some cases than would another formula.

The Department changed to the combined property and inventory factor pursuant to Reg. 810-2-3-.11 in 1992, presumably because it more accurately apportioned capital to Alabama. However, that does not mean that averaging the two factors did not at least adequately approximate a corporation's capital employed in Alabama, especially given that the property/inventory factor is only one of three factors used by the Department, the other two of which are not disputed by the Taxpayer.

The Taxpayer next argues that as a mining company, it is not primarily engaged in "manufacturing, processing or fabricating, and selling". Rather, the Taxpayer argues that it is primarily engaged in "selling", in which case the factors applicable to that category should be used.

As stated, the business categories on Schedule D of the Alabama return are broad, general categories. The category of "manufacturing, processing or fabricating, and selling" is sufficiently broad to include the Taxpayer's activities of mining coal, processing coal and selling coal, as described in paragraph 1 of the stipulation of facts. Consequently, the



Department's treatment of the Taxpayer as primarily engaged in manufacturing, processing or fabricating, and selling during the years in issue is affirmed.

Finally, the Taxpayer argues that the penalty included in the final assessment should be waived. A penalty may be waived for reasonable cause. Code of Ala. 1975, §40-2A-11(h). However, the Taxpayer admittedly failed to report and pay franchise tax during the subject years as instructed on the Alabama franchise tax return. In any case, the discretion to waive a penalty is solely with the Department, unless the Department somehow materially contributes to the taxpayer's failure to timely report or pay the tax. State v. Mack, 411 So.2d 799 (Ala.Civ.App. 1982). The Department did not contribute to the Taxpayer's failure to properly apportion its capital to Alabama in this case.

The Taxpayer also contends that the failure to timely pay penalty cannot be assessed because it paid the tax due as reported on its returns. That argument is correct for federal tax purposes. See, 26 U.S.C. §6651. However, it is not correct for Alabama purposes. Under current Alabama law, the failure to timely pay penalty can be applied even if the additional tax was not reported on a return. Code of Ala. 1975, §40-2A-11(b). The penalty in issue is accordingly affirmed.

The above considered, the final assessment in issue is affirmed. Judgment is entered against the Taxpayer for franchise tax for the years 1989 through 1992 in the amount of \$120,148.02, plus applicable interest.

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

Entered May 30, 1995.

---

BILL THOMPSON  
Chief Administrative Law Judge