

BENJAMIN F. & CAROL HARRISON	§	STATE OF ALABAMA
312 Beaumont Drive		DEPARTMENT OF REVENUE
Birmingham, Alabama 35209,	§	ADMINISTRATIVE LAW DIVISION
Taxpayers,	§	DOCKET NO. INC. 95-156
v.	§	
STATE OF ALABAMA	§	
DEPARTMENT OF REVENUE.		

FINAL ORDER

The Revenue Department denied refunds of income tax requested by Benjamin F., Jr. and Carol M. Harrison (together "Taxpayers") for the years 1990, 1991, and 1992. The Taxpayers appealed to the Administrative Law Division, and a hearing was conducted on August 3, 1995. Ben L. Zarzaur and Donna Byrd represented the Taxpayers. Assistant Counsel Jeff Patterson represented the Department.

Benjamin F. Harrison, Jr. (individually "Taxpayer") was 100 percent shareholder of Peerless Electric, Inc. ("Peerless"), an S corporation organized in the State of Florida. Peerless incurred losses during the years in question. The issue in this case is whether those losses incurred by Peerless can be passed through as a loss on the Taxpayers' individual Alabama income tax returns for the subject years. That issue turns on whether Peerless was "doing business" in Alabama during the subject years so as to qualify as an "Alabama S corporation" pursuant to Code of Ala. 1975, §40-18-160. If so, then the pass-through losses should be allowed.

The Taxpayer purchased Peerless in 1985. Peerless was an S corporation organized in Florida, with its headquarters in Pompano

Beach, Florida. For all relevant years, Peerless elected to be recognized as an S corporation for federal income tax purposes under 26 U.S.C. §1362.

Peerless was engaged in electrical subcontracting work in Florida. In that capacity, Peerless contracted to do electrical work on the Dade County, Florida prison. Problems arose with the contract, and Peerless suffered a loss on the project of over three million dollars. As a result, Peerless ceased operating as an electrical subcontractor in late 1988 or early 1989. Peerless, the general contractor, and the other subcontractors subsequently sued Dade County concerning the prison project.

Ed McGarity, Jr. ("McGarity") served as vice president of Peerless from 1985 until late 1988, when he took over as president.

McGarity testified that after March 1989, Peerless performed administrative functions only in addition to pursuing its litigation against Dade County.

McGarity moved to Rainbow City, Alabama in April 1990 so he could take a job with an unrelated business. The corporate documents of Peerless moved with him.

McGarity continued to perform the administrative functions of Peerless after moving to Alabama in 1990. He also actively pursued the Dade County litigation, which was decided against Peerless in late 1993. Peerless liquidated in late 1994. McGarity was not paid by Peerless after moving to Alabama, although he continued to

be paid a salary by Harrison Industries, Inc., which is a "holding company" also owned by the Taxpayer.

McGarity's activities on behalf of Peerless in Alabama are set out in the Taxpayer's brief, at page 2, as follows:

The testimony of Mr. Ed McGarity, Jr., revealed that as president of Peerless, he spent fifty percent (50%) or more of his time involved in the above mentioned litigation. The duties of Mr. McGarity, in relation to the lawsuit in Dade County, Florida, included hiring and educating expert witnesses, coordinating the testimony and scheduled appearances of former Peerless employees, preparing and analyzing losses, analyzing exhibits, depositions, and making litigation decisions on behalf of Peerless. He also spent a great deal of time involved in other corporate matters; including, but not limited to, filing tax returns, paying and approving bills, posting ledgers, preparing financial statements, receiving and mailing correspondence, handling worker's compensation claims, attending corporate meetings, recording and storing corporate minutes and records. From March 31, 1990 through 1992, all corporate administrative matters were performed in Rainbow City, Alabama.

At all times from March 31, 1990 through 1992, all corporate records and other documents of Peerless were maintained in Alabama - either Rainbow City, Birmingham, or Greenville. Further, all banking activities were conducted with Central Bank of the South, now known as Compass Bank, in Alabama.

However, despite the above, Peerless was not qualified to do business in Alabama and failed to file Alabama franchise or income tax returns during the subject years.

Peerless incurred losses in 1990 through 1992. The Taxpayers claimed the losses on their individual Alabama returns for those years. The Department disallowed the pass-through losses, and consequently denied the refunds claimed on the returns. The Taxpayers appealed to the Administrative Law Division.

An Alabama individual taxpayer can deduct the pass-through losses of an S corporation only if the corporation is an "Alabama S corporation". Section 40-18-160(a). An "Alabama S corporation" is defined at §40-18-160(a) as any domestic or foreign corporation "qualified to do business or doing business" in Alabama. Peerless was not qualified to do business in Alabama during the subject years. Consequently, the losses incurred by Peerless can only be passed through to the Taxpayers if Peerless was "doing business" in Alabama during those years.

"Doing business" is not defined by Alabama income tax law. However, the term has been defined by the Alabama Supreme Court for franchise tax purposes as follows:

What acts constitute "doing business" in this State by a foreign corporation cannot be judicially defined with precision. The question must be determined by the facts of each particular case. It is clear under our decisions however that before the acts done by the foreign corporation in this State can be said to fall within the purview of our constitutional and statutory provisions, such acts performed in this State must be in the exercise of some of the functions for which the corporation was organized, that is, in the transaction of the real or chief business of the corporation rather than the performance of acts merely within the corporate powers. (Cites omitted).

J. R. Watkins Co. v. Hamilton et al., 26 So.2d 207 (1946).

In State v. City Stores Co., 171 So.2d 121 (1965), the taxpayer, a department store, was qualified to do business in Alabama and owned real estate in Alabama. The Supreme Court held that the taxpayer was not "doing business" in Alabama:

We have held that the franchise tax does not apply to acts done by a foreign corporation within this state which are merely incidental to the exercise of the ordinary corporate business. *Friedlander Bros. v. Deal*, 218 Ala. 245, 1882 So. 508; *State v. Anniston Rolling Mills*, 125 Ala. 121, 27 So. 921.

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Specific examples from some of our cases follow. In *State v. Anniston Rolling Mills*, 125 Ala. 121, 27 So. 921, this court held that a corporation organized for the purpose of buying, manufacturing and sale of iron and manufactured iron products was not doing business as a corporation in this state although it leased its plant, collected the rent and lent some of it at interest, paid taxes, held directors' meetings and did other acts of corporate concern intended mainly for the protection of its property, all within the State of Alabama. The reason given was that none of these things "constituted a doing of the business, or any part of the business, for which it was created, and were mere incidents for the preservation of its property".

City Stores, at page 123.

The above definition has been followed in numerous other cases, see generally, Omega Minerals, Inc. v. State, 288 So.2d 145 (1973); State v. Seneca GP, Inc., Admin. Law Docket Inc. 94-285, decided June 20, 1995. Consequently, it will also be applied for income tax purposes in this case.

The Taxpayer argues that Peerless was "doing business" in Alabama during 1990 through 1993 because pursuit of the Dade County litigation was Peerless's only business activity during those years. The Taxpayer cites the numerous activities performed by McGarity in Alabama in support of its case. However, Peerless's business was electrical subcontracting. Peerless was not engaged in electrical subcontracting in Alabama, or anywhere, after 1989.

McGarity's activities in Alabama during 1990 through 1993 relating to the Dade County lawsuit were only incidental to what had been Peerless's primary business. Those activities "were mere incidents for the preservation of (Taxpayer's) property" and thus did not constitute "doing business" in Alabama. City Stores, supra, at page 123, citing State v. Anniston Rolling Mills, supra.

The Taxpayer argues that if pursuing litigation is not "doing business" in Alabama, then none of the lawyers in Alabama are "doing business" in Alabama. However, the obvious difference is that the primary business of lawyers is the pursuit of litigation. That was not true of Peerless.

The above considered, Peerless was not "doing business" in Alabama and thus cannot be recognized as an "Alabama S corporation" pursuant to §40-18-160. The Department thus correctly disallowed the losses incurred by Peerless to be carried through to the Taxpayers' individual returns. The refunds in issue are accordingly denied.

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

Entered December 14, 1995.

BILL THOMPSON
Chief Administrative Law Judge