DIAL BANK 1600 Norwest Center Sixth and Marquette Minneapolis, MN 55479-1013,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NOS. INC. 95-289 F. 95-308
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Dial Bank ("Taxpayer") for foreign franchise tax for 1990 - 1993, and corporate income tax for 1991 - 1992. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. Assistant Counsel Mark Griffin and Dan Schmaeling represented the Department. Bruce Ely and Blake Madison represented the Taxpayer. Paul Frankel co-authored the briefs submitted by the Taxpayer.

ISSUES

The franchise tax issues are:

(1) Is the Alabama foreign franchise tax constitutional;

(2) Did the Taxpayer have nexus with Alabama during the years in issue so as to be subject to Alabama's taxing jurisdiction;

(3) Was the Taxpayer "doing business" in Alabama during the years in issue, and thus subject to Alabama's foreign franchise tax levied at Code of Ala. 1975, §40-14-41; and,

(4) If the Taxpayer had nexus with and was doing business in Alabama, did the Department properly compute the Taxpayer's "capital employed" in Alabama for the subject

years. This issue involves whether the Taxpayer is required to provide the Department with a composite 50-state apportionment spreadsheet.

The corporate income tax issues are:

(1) Did the Taxpayer have nexus with Alabama during the years in issue. (See franchise tax issue (2));

(2) Was the Taxpayer "doing business" or "deriving income from sources in Alabama", and thus subject to Alabama's corporate income tax levied at Code of Ala. 1975, §§40-18-2(3) and 40-18-31;

(3) If the Taxpayer was otherwise subject to Alabama corporate income tax, was the Taxpayer exempt from said tax pursuant to Code of Ala. 1975, §40-18-32(a)(9). That statute exempts from Alabama income tax all banks and other financial institutions that are subject to the Alabama financial institution excise tax ("FIET") levied at Code of Ala. 1975, §40-16-4; and,

(4) If the Taxpayer was subject to Alabama corporate income tax, and was not exempt under §40-18-32(a)(9), did the Department properly apportion the Taxpayer's income to Alabama in the subject years. Again, this involves the 50-state apportionment spreadsheet issue.

FACTS

The Taxpayer is a subsidiary of Norwest Corporation, and is a state banking corporation chartered and headquartered in South Dakota. The Taxpayer's banking operation lends money to individuals through Visa and MasterCard credit cards issued by mail. A number of the Taxpayer's credit card customers are located in Alabama. All credit cards issued by the Taxpayer are approved in South Dakota, all account billings are issued

from South Dakota, and all payments are received in South Dakota.[1]

The Taxpayer purchased a lease portfolio of approximately 400 leases in 1989. The Taxpayer owned the lease property, but the leases were managed by a sister corporation, Norwest Financial Leasing, Inc., in Chicago, Illinois. The Taxpayer's leasing income constituted approximately 40 percent of its total income in 1989. The Taxpayer's leasing income declined steadily, and the Taxpayer sold the remaining leases in August 1992.

The lease portfolio included two magnetic resonance imaging ("MRI") machines in Alabama. The Taxpayer sold the two MRI machines when it sold the lease portfolio in 1992. Other than its credit cards and the two MRI machines, the Taxpayer had no tangible property, employees, or other physical presence in Alabama during the subject years.

The Taxpayer filed Alabama corporate income tax returns for 1991 and 1992. The returns reported the Taxpayer's cost of the two MRI machines in Alabama to be $3,326,532. The Taxpayer reported its total credit card and leasing income on the returns, and apportioned that income to Alabama using the standard factors of property, payroll, and income. The Taxpayer reported a 2.61 percent apportionment factor in 1991, with Alabama taxable income of $178,706, and tax due of $8,935. It reported a 2.69 percent apportionment factor in 1992, with Alabama taxable income of $668,809, and tax due of $33,440. The Taxpayer argues that it should not have filed the returns because it had no nexus with and was not doing business in Alabama.

The Taxpayer failed to file Alabama franchise tax returns for the years in issue.

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[1]The specifics of the Taxpayer's credit card business were not offered into evidence. Typically, however, a credit card issuer participates in a bank interchange system, and receives annual fees and interest income from its cardholders.

The Department audited the Taxpayer and numerous other Norwest subsidiaries in 1995 for Alabama franchise and corporate income tax. The subsidiaries provided the Department with their federal income tax returns, the consolidated federal return for the group, the financial statements and balance sheets for each subsidiary, and the 1120 balance sheet. The Taxpayer also provided the federal Schedule M-1, which showed the tax paid by every subsidiary to every state during the subject years.

The parties settled the audits of all the Norwest subsidiaries, except concerning the Taxpayer. The Department demanded that the Taxpayer provide a 50-state apportionment spreadsheet. The Department had not required the other Norwest subsidiaries to provide a 50-state spreadsheet. The Taxpayer failed to comply, arguing (1) it did not maintain a 50-state spreadsheet, and (2) a spreadsheet was not necessary for the Department to compute or verify its Alabama tax liabilities.

Because the Taxpayer failed to provide a 50-state spreadsheet, the Department rejected the Taxpayer's income tax apportionment factors as reported, and instead imposed a 50 percent apportionment factor in each year. The 50 percent factors resulted in additional income tax due of $528,204 in 1991, and $1,115,837 in 1992.

Concerning the franchise tax audit, the Department computed the Taxpayer's total capital using the 1120 balance sheet. The Taxpayer agrees that the Department correctly computed its capital base. (Transcript, at 45). The Department also used the Taxpayer's income tax factors in computing its franchise tax liability. However, because the Taxpayer failed to provide a 50-state spreadsheet, the Department tripled the factor numerators (Alabama numbers) , and then applied the tripled factors to the Taxpayer's capital base, to arrive at capital employed in Alabama. The tripled factors resulted in franchise tax, penalty,

and interest due of $237,471.55. [2]

ANALYSIS - FRANCHISE TAX

(1) Is the Alabama foreign franchise tax constitutional?

The Taxpayer argues that the Alabama foreign franchise tax is unconstitutional. However, the Administrative Law Division, as part of an administrative agency, cannot declare a statute unconstitutional. Beaird v. City of Hokes Bluff, 595 So.2d 903 (1992). In any case, the Alabama Supreme Court recently upheld the constitutionality of the Alabama foreign franchise tax in South Central Bell Telephone Co., et al. v. State of Alabama and State Dept. of Revenue, _____ So.2d _____(Ala. 1998), decided March 20, 1998, on petition for certiorari filed with the U. S. Supreme Court, June 18, 1998.

(2) Did the Taxpayer have nexus with Alabama during the subject years?

The Taxpayer argues that it cannot be taxed by Alabama because it did not have nexus with Alabama during the subject years. I disagree.

In tax parlance, "nexus" is that minimum link or connection between a taxpayer and a state necessary to subject the taxpayer to the state's taxing jurisdiction. The leading nexus case is Quill Corporation v. North Dakota, 112 S.Ct. 1904 (1992).

Quill involved use tax. There is an on-going national debate whether Quill applies beyond use tax. The opinion includes language that could be construed as limiting the holding to use tax. I also understand the states' position that an out-of-state taxpayer that exploits a state's economic market and receives income from the state's residents should

[2]The Department claims it is not attempting to subject the Taxpayer's credit card business to Alabama franchise tax. (Transcript, at 13, 14.) It is unclear, however, whether the Department excluded the credit card business in computing the franchise tax final assessment. The tripled factors were apparently applied to the Taxpayer's total capital.

be required to pay a fair tax to the state. But all taxpayers deserve certainty of liability, and given the majority opinion, I can find no convincing argument why the benefits of the physical presence test affirmed in Quill, 112 S.Ct. at 1915, should not also apply to other taxes. Consequently, the Administrative Law Division has held that the Quill nexus standards also apply to the Alabama franchise and corporate income taxes. See, Cerro Copper Products, Inc. v. State of Alabama, F. 94-444 (Admin. Law Div. 12/11/95) (An out-of-state corporation that only held accounts receivable from Alabama residents did not have nexus with Alabama.); 9.4% Manufactured Housing Contract Pass-Through Certificate Series 1989A v. State of Alabama, CORP. INC. 95-162 (Admin. Law Div. 12/11/95)(An out-of-state taxpayer that owned financing contracts secured by mortgages on property located in Alabama did not have nexus with Alabama.) Those cases were not reversed on appeal.

Quill distinguished between Due Process Clause nexus and Commerce Clause nexus. [3] Due process nexus is established if a taxpayer purposely directs its activities toward residents of the taxing state, and avails itself of the economic benefits of the state. Physical presence in the state is not required for due process nexus. Rather, due process is satisfied if the taxpayer has "notice" and "fair warning" that it may be subject to tax in the state. Quill, 112 S. Ct., at 1913. The Taxpayer clearly had due process nexus with Alabama when it issued credit cards to its Alabama customers and leased the two MRI machines in Alabama.

For Commerce Clause purposes, however, Quill affirmed that a taxpayer must have

[3]The Due Process Clause is in the 14th Amendment to the U. S. Constitution. The Commerce Clause is at Article I, §8, cl. 3 of the U. S. Constitution.

"substantial nexus" with a state, which requires some physical presence in the state. The Supreme Court held in Quill that a "few floppy discs" maintained by Quill in South Dakota did not constitute substantial nexus for Commerce Clause purposes, noting that it had previously rejected the "slightest presence" nexus standard in National Geographic Soc. v. Cal. Bd. of Equalization, 97 S.Ct. 1386 (1977). Quill, 112 S. Ct., at 1914, fn. 8. The question is how much physical presence beyond a "slightest presence" is sufficient to constitute substantial nexus for Commerce Clause purposes.

The Taxpayer argues that the Alabama lessees owned the two MRI machines under generally accepted accounting principles ("GAAP"). The Taxpayer thus contends it did not have a physical presence in Alabama because it only held intangible accounts receivable in Alabama according to GAAP, citing Cerro Copper Products. I disagree.

GAAP is relevant for franchise tax purposes only in computing a foreign corporation's capital base pursuant to §40-14-41(b). GAAP is not relevant in determining if a corporation has sufficient physical presence in Alabama for nexus purposes.

The Taxpayer in this case had a physical presence in Alabama because it owned the two tangible MRI machines in Alabama. The machines cost over $3.3 million, and the Taxpayer derived substantial income from the machines. The physical presence of those machines in Alabama established substantial nexus for Commerce Clause purposes.

The Taxpayer also argues that its credit card business did not have nexus with Alabama, citing Siegelman v. Chase Manhattan Bank, 575 So.2d 1041 (1991). Again, I disagree.

Chase Manhattan was not a nexus case. Rather, the issue was whether Chase Manhattan's credit card business in Alabama was subject to Alabama's financial institution

excise tax. The Alabama Supreme Court ruled it was not. The Court presumed that the Alabama Legislature was aware when it enacted the FIET in 1932 that states were prohibited from taxing interstate commerce. [4] The Court thus reasoned that the Legislature could not have intended to include out-of-state banks doing interstate credit card business in Alabama within the scope of the FIET levy. The Court never addressed whether Chase Manhattan had nexus with Alabama. It can even be argued that in deciding the case as it did, the Court presumed that Chase Manhattan was otherwise subject to Alabama tax, i.e. had nexus with and was doing business in Alabama.

[4]The U. S. Supreme Court changed its position concerning the taxation of interstate commerce in Complete Auto Transit, Inc. v. Brady, 97 S.Ct. 1076 (1977).

The parties stipulated in Chase Manhattan that the bank owned the approximately 50,000 credit cards issued to its Alabama customers. Chase Manhattan, 575 So.2d, at 1042. There is no evidence whether the Taxpayer in this case owned the Visa and MasterCard credit cards issued to its Alabama customers. But if the Taxpayer owned the cards, the presence of presumably hundreds or thousands of tangible credit cards owned by the Taxpayer in Alabama could arguably constitute substantial nexus for Commerce Clause purposes. Certainly, the physical presence of numerous credit cards in Alabama is more substantial than the "few floppy discs" owned by Quill in South Dakota.[5]

Even if the Taxpayer's credit card activity in Alabama did not, by itself, establish nexus with Alabama, Alabama would still have authority to tax that activity.

Quill addressed the threshold nexus issue of whether a state has authority to tax a taxpayer. Transactional nexus is not required for Quill-type nexus. That is, nexus need not be established in conjunction with the activity to be taxed. National Geographic Society v. Cal. Bd. of Equal., 97 S.Ct., at 1392. Rather, once Quill-type nexus is established, a state is authorized to tax a fairly apportioned share of any business activity conducted by the

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[5]Whether an out-of-state bank that issues credit cards to in-state residents has nexus with the state is presently in issue in Tennessee. JC Penney National Bank v. Ruth E. Johnson, Comm. of Rev., State of Tennessee, No. 96-276-I, Davidson County Chancery Court. Tennessee argues that the physical presence of JC Penney's credit cards in Tennessee established substantial nexus for Commerce Clause purposes. Defendant's Pre-Trial Memorandum, at 15. However, Tennessee relies primarily on its theory that the physical presence test established in Quill does not apply to income or franchise taxes, citing Geoffrey v. South Carolina Tax Comm., 437 S.E.2d 13 (S.C. 1993), cert denied, 114 S.Ct. 550 (1993), and various U. S. Supreme Court cases. Hopefully, the U. S. Supreme Court will soon clarify whether its Quill analysis applies to other types of taxes.

taxpayer in the state, or any out-of-state activity that is part of a unitary business conducted by the taxpayer in the state. Allied-Signal, Inc. v. Director, Div. of Taxation, 112 S. Ct. 2251 (1992). This Allied-Signal-type nexus requirement --- that the activity or transaction to be taxed must have some minimum connection with the taxing state --- is discussed below concerning whether the Taxpayer was "doing business" in Alabama.

As indicated, the Taxpayer established Quill-type nexus with Alabama by the physical presence of its two MRI machines in Alabama, at least until it sold the machines in August 1992. The Department thus had jurisdiction to tax a fairly-apportioned amount of any business activity carried on by the Taxpayer in Alabama during that period, including its credit card business.

Finally, the Taxpayer argues that South Carolina Revenue Ruling 98-3 supports its claim that it had no nexus with Alabama. The Ruling gives examples of activities that South Carolina does not consider as establishing nexus. The specific example cited by the Taxpayer involves a New York company that sells packaged credit card and mortgage loans to passive investors throughout the United States. Some of the debtors and some of the property securing the loans are in South Carolina. The Ruling concludes that the out-of-state investors do not have nexus with South Carolina.

I agree with the above holding. The Administrative Law Division reached a similar conclusion in 9.4% Manufactured Housing. Ruling 98-3 assumes, however, that the taxpayer in the example has no other nexus creating activity in South Carolina. The example thus is not analogous because the Taxpayer in this case established nexus with Alabama through the two MRI machines. As discussed, the Taxpayer also may have established nexus by the physical presence of its credit cards in Alabama.

In summary, the Taxpayer had nexus with Alabama at least through August 1992, when it sold the two MRI machines. The Taxpayer may have had nexus after that time through the presence of its credit cards in Alabama, but there is no evidence supporting that conclusion. Consequently, I cannot find that the Taxpayer had nexus with Alabama after August 1992.

(3) Was the Taxpayer "doing business" in Alabama?

The Alabama foreign franchise tax is levied on foreign corporations "doing business" in Alabama. §40-14-41(a). A foreign corporation is doing business in Alabama if it is conducting some primary business activities or functions in Alabama. State v. Anniston Rolling Mills, 27 So. 921 (1900). A corporation engaged in an activity that is "merely incidental" to its primary business activity is not doing business in Alabama for franchise tax purposes. Omega Minerals, Inc. v. State of Alabama, 288 So.2d 145 (1973); State v. City Stores Company, 171 So.2d 121 (1965).

The concepts of "nexus" and "doing business" should be clarified. The Taxpayer interchanges the terms in its briefs, and the Administrative Law Division has also incorrectly equated the concepts in prior decisions. For example, in State of Alabama v. Prattville Manufacturing, Inc., F. 93-183 (Admin. Law Div. 10/27/93), at page 5, I held: "Certainly if a business does not have nexus with Alabama, it also cannot be doing business in Alabama..." That statement is incorrect. While the concepts are similar, they are not identical.

As discussed, nexus is a constitution-based concept involving whether a state has the authority to tax a taxpayer. A substantial physical presence is required to establish Quill-type nexus.

On the other hand, doing business in Alabama is a practical question of whether a taxpayer is engaged in a primary business activity in Alabama. A substantial physical presence is not required for some business activities.[6] Consequently, an out-of-state taxpayer may be conducting a primary business activity in a state, but still not have sufficient nexus to be subject to the state's taxing authority. For example, Quill was engaged in its primary business of selling products at retail in South Dakota. It was doing business in South Dakota, at least under the Alabama definition of "doing business". But Quill lacked nexus with South Dakota. The opposite may also be true. A corporation may have a substantial physical presence in a state, but not be engaged in a primary business activity in the state. In this case, however, the Taxpayer had nexus with Alabama by the presence of the two MRI machines in Alabama, and was also doing business in Alabama through both its credit card and leasing activities in Alabama.

The Taxpayer loaned money by issuing credit cards to customers in various states. The Taxpayer issued credit cards to and received substantial income from its customers in Alabama. The Taxpayer was clearly doing business through its credit card activities

[6]The U. S. Supreme Court recognized this in Quill - "...it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a state in which business is conducted." Quill, 112 S.Ct., at 1910, citing Burger King Corp. v. Rudzewicz, 105 S.Ct. 2174 (1985).

in Alabama during the subject years.

The Taxpayer's lease portfolio included the two MRI machines in Alabama. The Taxpayer derived a substantial portion of its total income (40 percent in 1989) from its leasing activities. The Taxpayer's leasing business was not a "merely incidental" activity. It constituted a second primary business activity. Consequently, the leasing of the two MRI machines in Alabama also constituted "doing business" in Alabama for franchise tax purposes. It is irrelevant that the leases were managed by an agent, Norwest Financial. It is also irrelevant that the leases constituted accounts receivable for financial accounting purposes under GAAP. GAAP is relevant only in computing a foreign corporation's capital base, not in determining nexus or whether the corporation is doing business in Alabama.

The Taxpayer claims that Prattville Manufacturing and State of Alabama v. Union Tank Car, Inc., F. 90-154 (Admin. Law Div. 03/19/92), support its position. I disagree.

In Prattville Manufacturing, the issue was whether Prattville Manufacturing's parent corporation, Echlin, Inc., was doing business in Alabama for franchise tax purposes. Echlin had an employee in Alabama, leased an automobile in Alabama, and invested in bonds in Alabama, but those activities did not involve Echlin's primary business activity. Echlin also made some sales to Alabama customers, but the Administrative Law Division held that "the sale and delivery of goods into Alabama by an out-of-state company does not create sufficient nexus to subject the out-of-state company to Alabama taxation", citing Quill. Prattville Manufacturing, at 9. The Administrative Law Division accordingly held that Echlin was not doing business in Alabama.[7]

[7]As discussed, the Administrative Law Division incorrectly held in Prattville Manufacturing that because the sale and delivery (presumably by mail or common carrier)

Union Tank Car was an Illinois-based corporation that leased rail cars outside of Alabama. The corporation had no property or employees in Alabama, although its rail cars occasionally traveled through Alabama. Union Tank Car was not doing business in Alabama because, unlike the Taxpayer in this case, it did not lease property (or conduct a credit card business) in Alabama.

On the other hand, LaSalle Chicago Leasing Corp. v. State of Alabama, F. 95-441 (Admin. Law Div. 03/18/96), is directly on point. LaSalle Chicago leased tangible property in Alabama, but had no other connections with Alabama. The Administrative Law Division held that LaSalle Chicago was doing business in Alabama.

> "The Taxpayer (LaSalle Chicago) is engaged in the business of leasing tangible personal property. The evidence is undisputed that the Taxpayer was engaged in that business in Alabama during the subject years. Having property located in Alabama and deriving income from the leasing of that property in Alabama, the Taxpayer was doing business in Alabama for franchise tax purposes."
> LaSalle Chicago, at 2.

The Taxpayer argues that even if its leasing activities can be taxed in Alabama, its credit card business cannot be taxed because it was not part of a unitary business with its leasing business, citing Allied Signal. I agree that the Taxpayer's leasing and credit card businesses were discrete business enterprises, but that is not relevant to this case.

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of goods into Alabama did not create nexus under Quill, that activity also did not constitute doing business in Alabama. That finding is wrong because if Echlin's primary business was making retail sales, then making sales in Alabama would constitute doing business in Alabama, even if that activity alone was insufficient to establish nexus. Land's End, Inc., L.L. Bean, Inc., and other out-of-state mail order companies certainly are doing business in Alabama when they make sales to Alabama residents. They cannot be taxed by Alabama only because they have no nexus with Alabama. Out-of-state businesses engaged solely in mail-order solicitation and sales within Alabama are also protected from Alabama income tax by P.L. 86-272 (26 U.S.C. §381).

The Administrative Law Division discussed the unitary-business principle in Pechiney Corp. v. State of Alabama, F. 96-106 (Admin. Law Div. 01/16/97), as follows:

> "To be included in a state's tax base, the unitary-based principle requires that the activity to be taxed, either income earned or capital employed, must be related to or a part of the taxpayer's unitary-business activity carried on in the taxing state. This is rooted in the due process requirement that there must be some 'minimum connection' or 'nexus' between the interstate activities sought to be taxed and the taxpayer's activities in the taxing state. In other words, a state cannot lasso into its apportionable tax base either income earned or capital employed by a foreign corporation in an unrelated business activity outside of the state."
> Pechiney, at 6.

The unitary-business principle is not relevant in this case because the Taxpayer actively conducted both its credit card and leasing activities in Alabama during the subject years. Both activities clearly had more than a minimum contact or due process nexus with Alabama. The Department is thus authorized to tax a fairly apportioned percentage of the Taxpayer's capital employed in conducting those activities in Alabama.

(4) Did the Department properly compute the Taxpayer's "capital employed" in Alabama?

The Taxpayer argues that it did not have capital employed in Alabama during the subject years because it did not own the two MRI machines according to GAAP. I disagree.

A corporation's capital is comprised of the various intangible items listed at §40-14-41(b). Capital is fungible, and may be used or employed for a variety of purposes. For example, debt may be employed to purchase tangible assets, or to pay wages and operating expenses. Capital employed in Alabama is not dependent on or tied to the physical presence of a corporation's tangible assets in Alabama. This was explained in

Cerro Copper Products:

> "I disagree that even if (the taxpayer) was subject to Alabama franchise tax, it did not have 'capital employed' in Alabama. The cases cited in the Taxpayer's brief were decided when 'capital' was defined as the value of all physical assets located in Alabama, and all intangibles with a situs in Alabama....
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> However, the franchise definition of 'capital' was changed by Act 912 in 1961 so that 'capital' now consists of the various items (profits indebtedness, etc.) specified in Code of Ala. 1975, §40-14-41(b).
>
> Under current law, the location of assets and intangibles is still relevant, but only in deciding the threshold issue of whether the foreign corporation has nexus with or is doing business in Alabama. But once it is established that a foreign corporation is subject to Alabama tax, then capital employed in Alabama is computed by taking total capital everywhere, as defined at §40-14-41(b), regardless of where it is 'located', and then apportioning a percentage of that total capital to Alabama."
> Cerro Copper Products, at 13, fn. 6.

Because capital employed in Alabama is not tied to the ownership of physical assets in Alabama, it is irrelevant that the lessees, not the Taxpayer, technically owned the MRI machines according to GAAP. The Taxpayer still employed a portion of its total capital in conducting its credit card and leasing activities in Alabama.

The Taxpayer concedes that the Department correctly computed its capital base using the federal 1120 balance sheet. The remaining issue is whether the Department correctly apportioned the Taxpayer's capital base to Alabama.

The Department concedes that it has no evidence that the income tax factors reported by the Taxpayer are incorrect, and certainly no evidence that the tripled factors are correct. Rather, the Department tripled the factors solely because the Taxpayer failed to provide a 50-state spreadsheet.

Is the Taxpayer required to provide a 50-state spreadsheet?

All Alabama taxpayers are required to keep accurate "records, books, and other information" sufficient to allow the Department to compute their correct liability. Code of Ala. 1975, §40-2A-7(a)(1). The Department is also authorized to subpoena records, or to summon any witness to testify and provide such records. Any witness that fails to comply with a subpoena may be subject to contempt proceedings in Alabama circuit court. Code of Ala. 1975, §40-2A-7(a)(4). The above Alabama statutes are similar in substance to the federal provisions at 26 U.S.C. §§6001 and 7602. In such cases, federal case law is relevant in interpreting the Alabama statutes. Best v. State, Dept. of Revenue, 423 So.2d 859 (Ala.Civ.App.1982).

The Taxpayer argues that a 50-state spreadsheet is not necessary or relevant. That argument has some validity, given the different types of taxes, apportionment methods, and sourcing rules used by the various states. I agree with the Department, however, that it is for the Department to determine the relevancy of any records maintained by a taxpayer. U. S. v. Norwest Corp., 116 F.3d 1227 (8th Cir. 1997).

> "'Relevance' under the *Powell* test does not depend, however, on whether the information sought would be relevant in an evidentiary sense, but merely whether that information might shed some light on the tax return. *Arthur Young*, 465 U.S. at 813-14 & n. 11, 104 S.Ct. at 1500-01 & n. 11. The IRS need not state with certainty how useful, if at all, the summoned material will in fact turn out to be. *Id*. at 814, 104 S.Ct. at 1501. Furthermore, it is for the agency, and not the taxpayer, to determine the course and conduct of an audit, and 'the judiciary should not go beyond the requirements of the statute and force the IRS to litigate the reasonableness of its investigative procedures.' *United States v. Clement*, 668 F.2d 1010, 1013 (8th Cir. 1982)." Norwest, 116 F.3d, at 1233.

The Department could have computed the Taxpayer's franchise liability using the federal tax information and the source documents provided or proffered by the Taxpayer. This is supported by the fact that the other Norwest audits were settled without a 50-state

spreadsheet. But it is irrelevant that other information is available. A taxpayer is required to produce any records that might "illuminate any aspect of the return". Norwest, 116 F.3d, at 1233, citing United States v. Arthur Young and Co., 104 S.Ct., at 1501.

On the other hand, there is no evidence that the Taxpayer maintained a 50-state spreadsheet for the subject years. While a taxpayer is under a broad duty to provide any records that it maintains, the government cannot require a taxpayer "to create new records or to alter the form of existing records to suit the government's convenience." United States v. Mobile Corp., 499 F. Supp. 479, 482 (1980); United States v. Davey, 543 F.2d 996 (1976).

Alabama's courts have also held that "no particular method of record-keeping has been established by the courts". State v. Mack, 411 So.2d 799, 802 (Ala.Civ.App.1982). As discussed in Mobil Corp, 499 F.Supp., at 482, the federal government can, on a prospective basis, require taxpayers to maintain records in a particular form as necessary to show their correct liability. Likewise, the Revenue Department has general rule-making authority, Code of Ala. 1975, §40-2A-7(a)(5), and may enact regulations requiring taxpayers to maintain particular records. Such regulations will be upheld if reasonable. Shellcast Corp. v. White, 477 So.2d 422 (Ala. 1985). But under current Alabama franchise tax statutes and regulations, a foreign corporation is not required to maintain, and thus is not required to create, a 50-state spreadsheet for franchise tax purposes. [8]

[8]Norwest's company policy is not to provide states with a 50-state spreadsheet. The Taxpayer claims that Idaho is the only state, besides Alabama, to challenge that policy. Idaho dropped its enforcement action, however, after Norwest agreed to provide its source documentation to Idaho. Idaho recently promulgated a regulation (Rule 35.01.01.450) requiring taxpayers to provide a 50-state spreadsheet. The Rule also imposes a 5 percent negligence penalty if a spreadsheet is not provided.

The Taxpayer maintains its apportionment information in its computer data base. The Department is authorized to review such information - "We therefore hold that the language of §7602 is sufficiently broad to encompass records or data stored in the form of computer tapes." Davey, 543 F.2d, at 999. It is unclear to what extent the Department attempted to obtain that source documentation. The Department could have subpoenaed the information, but elected not to.[9]

The issue, however, is not whether the Taxpayer improperly failed to provide a 50-state spreadsheet or any other records to the Department. Rather, the ultimate issue is whether the Department correctly computed the Taxpayer's liability in the absence of those records.

If a taxpayer fails to provide adequate records, the Department is authorized to compute the taxpayer's liability using the best available information. §40-2A-7(b)(1)a. A final assessment based on the best available information is *prima facie* correct, and the burden is on the taxpayer to prove that the final assessment is incorrect. §40-2A-7(b)(5)c. The Administrative Law Division has repeatedly affirmed the Department's authority to estimate a taxpayer's liability using the best available information. William T. Gipson v. Department of Revenue, Docket P. 95-210 (Admin. Law Div. 4/07/95); State v. Red Brahma Club, Inc., Docket S. 92-171 (Admin. Law Div. 4/07/95).

The Department's calculations, however, must be reasonable under the

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[9]The Department's failure to subpoena the Taxpayer's computer-based or other records is perhaps explained by the practical difficulties the Department would face in attempting to enforce its subpoena against an out-of-state corporation that currently has no agents or employees in Alabama.

circumstances, and must be based on some minimum evidentiary foundation. Where the government's assessment has no factual basis, the usual presumption of correctness does not apply. United States v. Janis, 96 S.Ct. 3021 (1976); Weimerskirch v. CIR, 596 F.2d 358 (1979);Leonard Jackson v. C.I.R., 73 T.C. 394 (1979); Denison v. CIR, 689 F.2d 771 (1982); Yoon v. CIR, 135 F.3d 1007 (5th Cir. 1998).

> "Where the record reflects no reasonable basis for the Commissioner's assessment, where the assessment cannot be deemed reasonable on its face, and where no finding is made in that regard, we cannot afford a presumption of correctness to attach automatically to the assessment."
> Denison, 689 F.2d, at 773.

> "Taxpayers do bear the burden of maintaining accounting records which enable them to file a correct tax return, *e.g., Webb*, 394 F.2d at 371, and in the absence of such records the IRS may compute the taxpayer's income by any reasonable method that clearly reflects income, 26 U.S.C.§446(b)(1997); however, a tax determination without rational foundation is 'not properly subject to the usual rule with respect to the burden of proof in tax cases.' *Janis*, 428 U.S. at 441, 96 S.Ct. At 3026 (citing *Helvering v. Taylor*, 293 U.S. 507, 514-15, 55 S. Ct. 287, 290-291, 79 L.Ed. 623 (1935)). As this Court eloquently noted in *Carson*: 'The tax collector's presumption of correctness has a herculean muscularity of Goliathlike reach, but we strike an Achilles' heel when we find no muscles, no tendons, no ligaments of fact.' 560 F.2d at 696; *see also Portillo*, 932 F.2d at 1133."
> Yoon, 135 F.3d, at 1013, 1014.

> "Suffice it to say, however, that...having by these two witnesses convinced us that the determination was arbitrary, the Government is elevated on its own powder charge and we are required to decide nothing beyond our present finding that the determination was arbitrary."
> Jackson, 73 T.C., at 403.

There is no evidence supporting the Department's suspicion that the Taxpayer's income tax factors are incorrect, and certainly there is no evidence that the tripled factors applied by the Department are correct --- "...proof that an assessment is utterly without foundation is proof that it is arbitrary and erroneous". Janis, 96 S.Ct., at 3026. Consequently, the franchise tax final assessment based on the arbitrarily-applied tripled factors cannot be affirmed.

This case does not involve a situation where a taxpayer failed to offer any records, and the Department was otherwise unable to obtain information relating to the taxpayer's liability. In such a case, a rough estimate of the taxpayer's liability would be affirmed if reasonable under the circumstances. The Taxpayer in this case, however, provided or offered to provide the Department with its federal returns, financial records, and all other source documents. The Department, having elected not to subpoena the Taxpayer's records, should either accept the Taxpayer's apportionment factors as reported, or review the same information used to settle the other Norwest audits, as offered by the Taxpayer.

Finally, while the Department claims it is not attempting to tax the Taxpayer's credit card business, it appears the Department applied the tripled factors to the Taxpayer's entire capital base. In any case, the Administrative Law Division has a statutory duty to recompute a taxpayer's liability to reflect the correct tax due. Code of Ala. 1975, §40-2A-7(b)(5)d.1. Because the Taxpayer's capital employed in both its credit card and leasing businesses in Alabama were subject to Alabama franchise tax from 1990 through August

1992, the Department should apportion a part of the Taxpayer's entire capital base to Alabama for those years.

ANALYSIS - INCOME TAX

(1) Did the Taxpayer have nexus with Alabama?

Yes. The Quill nexus standards apply equally to Alabama's corporate income and franchise taxes. As discussed, the Taxpayer had nexus with Alabama at least through August 1992.

(2) Was the Taxpayer "doing business" in Alabama or "deriving income from sources in Alabama"?

Any corporation "doing business" in Alabama is subject to Alabama income tax. §40-18-2(3). The concept of "doing business" is the same for both Alabama franchise tax and corporate income tax. State of Alabama v. Seneca GP, Inc., INC. 94-285 (Admin. Law Div. 06/20/95). Consequently, the Taxpayer was doing business in Alabama for income tax purposes through both its credit card and leasing activities in Alabama.

Any corporation "deriving income from sources in Alabama" is also subject to Alabama's corporate income tax. §40-18-2(3). The Taxpayer clearly was deriving income from Alabama sources when it received interest and fee income from its Alabama credit card customers, and also lease income from the Alabama lessees.

The Taxpayer again argues that its credit card business was not subject to Alabama income tax because it was not unitary with its leasing business. That issue was adequately addressed in the above franchise tax analysis. The Taxpayer's credit card and leasing activities, while distinct businesses, both had Allied-Signal-type nexus with Alabama during the subject years.

(3) Is the Taxpayer subject to the Alabama FIET, and thus exempt from corporate income tax?

The Taxpayer argues that if it was subject to Alabama tax at all, it was subject to the FIET, and thus exempt from income tax pursuant to §40-18-32(a)(9). The Taxpayer clearly was subject to Alabama taxation, but it was not exempt from Alabama corporate income tax.

Section 40-18-32(a)(9) exempts banks and other financial institutions from Alabama corporate income tax if they are subject to the Alabama FIET. I agree with the Taxpayer that it is a "financial institution" as defined for FIET purposes at Code of Ala. 1975, §40-16-1(1). However, while the Taxpayer discusses the Chase Manhattan decision in its briefs, it ignores the clear holding in Chase Manhattan that an out-of-state financial institution engaged in the interstate credit card business in Alabama, as was the Taxpayer, is not subject to the Alabama FIET. Consequently, because the Taxpayer was not subject to the Alabama FIET, it was not exempt from corporate income tax pursuant to §40-18-32(a)(9).

(4) Did the Department properly apportion the Taxpayer's income to Alabama?

Instead of tripling the Taxpayer's income tax factors, as it did in computing the Taxpayer's franchise tax liability, the Department applied a 50 percent factor for income tax purposes, again solely because the Taxpayer failed to provide a 50-state spreadsheet.

The franchise tax analysis of this issue also applies for income tax purposes. The only difference is that for income tax purposes, the Department is authorized to require a taxpayer to provide a statement "in such manner and form and setting forth such facts as the Department of Revenue shall deem necessary to enforce" the income tax laws. Code of Ala. 1975, §40-18-55. The Department thus is authorized to require any corporation, including the Taxpayer, to provide a 50-state apportionment spreadsheet for income tax purposes.

As with the franchise tax assessment, however, the ultimate issue is not whether the Taxpayer should have provided a 50-state spreadsheet. It is whether the Department correctly computed the Taxpayer's liability without that information. Again, because the arbitrarily-applied 50 percent factor is unsupported by any evidence, the income tax final assessments cannot be affirmed.

The Taxpayer correctly reported its total credit card and leasing income to Alabama on its 1991 and 1992 Alabama returns. As with the franchise tax audit, the Department can either accept the Taxpayer's income tax factors as reported, or review those numbers using the information provided or proffered by the Taxpayer.

The Department should notify the Administrative Law Division within 30 days whether (1) it will accept the Taxpayer's apportionment factors as reported, or (2) it intends to review the Taxpayer's records. An appropriate Order will then be issued.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered August 10, 1998.

BILL THOMPSON
Chief Administrative Law Judge

BT:ks

cc: Mark Griffin, Esq.
Dan Schmaeling, Esq.
Bruce Ely, Esq.
Paul Frankel, Esq.
Chris Sherlock
Voncile Catledge