COCA-COLA ENTERPRISES, INC. P.O. BOX 723040 ATLANTA, GA 31139-0040,	§ §	STATE Of ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. CORP. 09-641
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department partially denied a refund of 2007 corporate income tax requested by Coca-Cola Enterprises, Inc. ("Taxpayer"). The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(c)(5)a. The case was submitted on a joint stipulation of facts and briefs. The parties also orally argued the case at a January 19, 2012 hearing. Chris Grissom and Jimmy Long represented the Taxpayer. Assistant Counsel Mark Griffin represented the Department.

ISSUE

The Taxpayer reported net operating losses ("NOLs") on its separate entity Alabama income tax returns in 1992 through 2002 and 2004. The Taxpayer and its two subsidiaries, as an Alabama affiliated group of corporations, filed the group's initial Alabama consolidated return in 2007. The issue is whether the group can deduct the Taxpayer's prior NOLs on its consolidated 2007 return to offset the taxable income of one of the Taxpayer's consolidated subsidiaries.

Two sub-issues are involved. First, does Alabama's corporate income tax consolidated return statute, Code of Ala. 1975, §40-18-39, as amended by Act 2001-1089, generally allow an Alabama affiliated group that files a consolidated return to deduct the NOLs incurred by one group member in a prior year to offset the current year income of

another member. Second, if §40-18-39 generally allows consolidated group members to share NOLs on a consolidated return, were some or all of the Taxpayer's prior year NOLs claimed on the 2007 consolidated return limited by Alabama's separate return limitation year ("SRLY") rule at §40-18-39(h), as amended by Act 2001-1089. As discussed below, that subsection prohibits consolidated group members from sharing prior year NOLs on a consolidated return under certain circumstances.

FACTS

The facts are undisputed.

In 2007, the Taxpayer was the common parent in an Alabama affiliated group of corporations that included Vending Holding Company ("VHC") and Roddy Coca-Cola Bottling Company ("Roddy"). VHC and Roddy had also been subsidiaries of the Taxpayer in the years before 2007, and were thus included on the Taxpayer's federal consolidated income tax returns in those years.

The Taxpayer, VHC, and Roddy all filed separate entity Alabama income tax returns through 2006. The Taxpayer had claimed NOLs on its separate entity 1992 through 2002 and 2004 Alabama returns. The amount of the losses in each year is not in evidence.

As an Alabama affiliated group, the Taxpayer, VHC, and Roddy elected to file a 2007 Alabama consolidated return. As required by Code of Ala. 1975, §40-18-39(c)(5), as amended by Act 2001-1089, the Taxpayer, VHC, and Roddy were each required to compute their taxable income or loss on the consolidated return on a separate return basis. The Taxpayer reported negative taxable income of ($989,993) on its pro forma separate 2007 return submitted with the group's 2007 consolidated return; VHC reported negative taxable income of ($37,342) on its pro forma separate 2007 return; and Roddy reported

Alabama taxable income of $11,371,206 on its pro forma separate 2007 return. The group members' individual taxable income and losses were netted, as required by Alabama law, which resulted in group taxable income of $10,343,871 ($11,371,206 less $989,993 and $37,342 = $10,343,871).

The consolidated return also deducted the separate return NOLs incurred by the Taxpayer in 1992 through 2002 and 2004 in the amount of $10,249,031. The NOL carryover reduced the group's consolidated income to $94,840. The Taxpayer had made 2007 estimated payments and was due credits totaling $1,860,099. The consolidated return consequently claimed a refund of $978,934.

The Department reviewed the 2007 consolidated return and disallowed the NOLs in full, stating that "[t]here are no consolidated net operating losses to be utilized by the Alabama Affiliated Group as 12/31/2007 is the first tax year that the taxpayer has filed an Alabama consolidated return." The Department accordingly partially denied the Taxpayer's refund claim. This appeal followed.

ANALYSIS

Before 1999, all corporations subject to Alabama corporate income tax were required by §40-18-39 to file separate entity returns. Section §40-18-39 was amended in 1998 by Act 98-502, effective for tax years beginning in 1999. That Act for the first time allowed an Alabama affiliated group of corporations that filed a consolidated federal return to also elect to file an Alabama consolidated return. See, §40-18-39(c)(1). Act 98-502 also defined the term "Alabama affiliated group" to include all members of the group's federal consolidated group; provided, that at least one group member was subject to Alabama income tax. See, §40-18-39(b)(1). Act 98-502 further required that an Alabama affiliated

group that elected to file an Alabama consolidated return should be treated as a single taxpayer for purposes of computing the group's taxable income or loss. See, §40-18-39(c)(3). That is, the deductions and losses, including NOL carryovers, attributable to one group member could be applied to offset the income of the other group members in computing the group's net taxable income or loss.

Act 98-502 also added §40-18-39(h), which in substance adopted the federal SRLY rules at 26 U.S.C. §1502. The federal SRLY rules limit a federal consolidated group's use of a group member's prior NOLs under certain circumstances. Specifically, the SRLY rules provide that an NOL incurred by a group member in a separate return limitation year, i.e., a year before the corporation that incurred the loss became a group member, can only be used on a consolidated return to reduce the loss corporation's income to zero. The balance of the NOL, if any, cannot be applied to reduce the current year income of the other group members. Section 40-18-39(h), as originally enacted in 1998, read as follows:

> If, in a taxable year before the corporation became a member of an Alabama affiliated group that has elected to file an Alabama consolidated return, the corporation incurred a net operating loss, the deductibility of the loss on the Alabama consolidated return shall be limited in accordance with the separate return limitation year ("SRLY") rules contained in 26 U.S.C. § 1502.

The Administrative Law Division addressed the 1998 version of §40-18-39(h) in *Weyerhaeuser USA Subsidiaries v. State of Alabama*, Docket 04-511 (Admin. Law Div. 3/11/2005). In that case, two Weyerhaeuser subsidiaries had incurred NOLs in the years 1985 through 1998. The Weyerhauser group filed a consolidated 1999 Alabama return and deducted the subsidiaries' prior NOLs against the income of the parent.

The Department argued in *Weyerhaeuser* that the §40-18-39(h) limitation applied, and thus allowed the NOLs only to reduce to zero the 1999 taxable income of the two

subsidiaries that had incurred the NOLs. In substance, the Department construed the §40-18-39(h) phrase "that has elected to file an Alabama consolidated return" as referring to a consolidated return filed in the prior loss year. The Department thus asserted that even if the member that had incurred the NOL was a group member in the loss year, the §40-18-39(h) SRLY limitation still applied if the group had not also filed an Alabama consolidated return in the loss year. The Department consequently contended that the SRLY limitation applied in *Weyerhaeuser* because the Weyerhaeuser group had not filed Alabama consolidated returns in the pre-1999 loss years.

The Administrative Law Division disagreed, holding that the §40-18-39(h) phrase "that has elected to file an Alabama consolidated return" refers to the Alabama consolidated return on which the NOL carryforward is claimed. "Consequently, the more reasonable interpretation is that the phrase 'that has elected to file an Alabama consolidated return' refers to the current tax year in which the NOL is being claimed." *Weyerhaeuser* at 4. The Division thus held that even though the Weyerhaeuser group had not filed Alabama consolidated returns in the pre-1999 loss years, the SRLY limitation did not apply because the two subsidiaries that incurred the losses were members of Weyerhaeuser's consolidated group in the loss years.[1]

I now believe that *Weyerhaeuser* was incorrectly decided. As explained below, I still interpret the §40-18-39(h) phrase "that has elected to file an Alabama consolidated return" as referring to the current year consolidated return on which the NOL carryover is claimed. But I erroneously assumed in *Weyerhaeuser* that because the two subsidiaries were

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[1] The Department appealed *Weyerhaeuser* to circuit court, but the parties settled while the case was still pending.

members of Weyerhaeuser's federal consolidated group in the pre-1999 loss years, they were also members of Weyerhaeuser's Alabama affiliated group in those years. That assumption was incorrect.[2]

An "Alabama affiliated group" did not exist before the term was defined by Act 98-502, which became effective for tax years beginning in 1999. The two Weyerhaeuser subsidiaries that incurred the NOLs thus could not have been members of Weyerhaeuser's Alabama affiliated group in the pre-1999 loss years. Consequently, the §40-18-39(h) SRLY limitation should have been applied in *Weyerhaeuser* because the subsidiaries had incurred the losses in tax years before they became a member of Weyerhaeuser's Alabama affiliated group. The *Weyerhaeuser* decision is discussed further below.

The Alabama Legislature amended §40-18-39 in 2001 by Act 2001-1089, effective for tax years beginning in 2002. The 2001 Act made three substantive changes to §40-18-39 that are relevant to this case.

First, the Act changed the §40-18-39(b)(1) definition of "Alabama affiliated group" to now include only the members of a federal affiliated group that have nexus with and are subject to Alabama's corporate income tax, i.e., nexus consolidation.

Second, while Act 98-502 required an Alabama affiliated group to compute its income as a single corporation, the 2001 amendment now requires that each member of an Alabama affiliated group that files a consolidated return must compute its Alabama taxable income or loss on a separate return basis. See, §40-18-39(c)(5) ("For purposes of allocation and apportionment, each member of an Alabama affiliated group shall be

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[2] The Department never raised the issue in *Weyerhaeuser* that the two subsidiaries were not members of an Alabama affiliated group in the pre-1999 loss years.

considered a separate taxpayer.")

Third, Act 2001-1089 amended the §40-18-39(h) limitation to read as follows:

> If, in a taxable year before the corporation became a member of an Alabama affiliated group that has elected to file an Alabama consolidated return, the corporation incurred a net operating loss, the deductibility of the loss on the Alabama consolidated return shall be limited to only the amount necessary to reduce to zero the Alabama taxable income, calculated on a separate return basis, of the corporation that incurred the net operating loss. Except as provided in the preceding sentence, the separate return limitation year ("SRLY") rules contained in 26 U.S.C. § 1502 shall apply.

The threshold issue is whether §40-18-39, as amended by Act 2001-1089, still generally allows members of an Alabama affiliated group to share prior year NOLs, i.e., claim a group NOL on a consolidated return. As discussed, §40-18-39, as amended by Act 98-502, allowed Alabama affiliated groups to share NOLs on a consolidated return, subject to the §40-18-39(h) limitation, because the group members computed their consolidated income or loss as a single corporation. But Act 2001-1089 amended §40-18-39 to now require each group member to compute its income or loss on a separate return basis. Consequently, under the current version of §40-18-39, it could be argued that there is no statutory authority for the sharing of prior year NOLs between group members on a consolidated return.

But Act 2001-1089 also created an inherent conflict in §40-18-39 because while it now requires the individual group members to compute their taxable income on a separate return basis, it also retained the NOL limitation provision at §40-18-39(h). If the Legislature had intended by Act 2001-1089 to prohibit consolidated group members from sharing NOLs, then the Legislature would not have retained §40-18-39(h), which limits the sharing of NOLs between group members in certain circumstances. It cannot be presumed that

the Legislature included a meaningless provision in a statute. *Druid City Hospital Board v. Epperson*, 378 So.2d 696 (Ala. 1979). Consequently, by retaining the §40-18-39(h) NOL limitation in Act 2001-1089, it must be presumed that the Legislature also intended to still allow the sharing of NOLs between affiliated group members in some circumstances.

The Department also recognized the inherent conflict created by Act 2001-1089, and attempted to administratively fix the problem. Beginning in 2005, the Department included a line on its consolidated return form that allows an NOL incurred by a consolidated group in a prior year to be carried over and claimed as a group NOL on the return, but only if the group had also filed an Alabama consolidated return in the prior loss year. Joe Garrett, the Department's Director of Tax Policy, explained at the January 19, 2012 hearing as follows:

> Mr. Garrett: What the Department has done and I think largely done administratively – I don't think there is guidance in the statute that provides for this. Administratively we have said if the groups' current year income and loss nets to a loss, then we will allow that loss to carry forward as a group loss, as a loss that belongs to the group but not to any particular member and so that that group loss that occurred during the consolidated filing year the following year could be used to offset group income. We don't SRLY or in any other way limit the use of that group loss.
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> * * *
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> ALJ Thompson: This isn't written down anywhere? Y'all don't have a regulation?
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> Mr. Garrett: It shows up – The only place it shows up is in our forms and instructions. Maybe in 2005 a group loss line showed up on our consolidated form. And that's the purpose for that line was for a group loss, a loss that originated in an Alabama consolidated return.
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> ALJ Thompson: And the prior discussion only related to years in which all of the affiliated group file a consolidated return and were members of an Alabama affiliated group? It wouldn't apply pre '99?

Mr. Garrett: That's right.

ALJ Thompson: You're talking about post '99, the way (the Department does) it now?

Mr. Garrett: It would not apply to any loss that accrued outside of an Alabama consolidated return.

(T. 30 – 32)

The Taxpayer agrees that pursuant to Act 2001-1089, Alabama affiliated group members must separately compute their taxable income on a consolidated return. It argues, however, that group members should still be allowed to share NOLs on an Alabama consolidated return because §40-18-39(c)(5), as amended by Act 2001-1089, provides that "[a]ny taxable loss of a member of the Alabama affiliated group shall be deductible against the taxable income of any other member of the Alabama affiliated group. . . ." The Taxpayer asserts that "[a]ny taxable loss" includes any current year loss, and also any available NOL carryover loss.

When read in context, the phrase "[a]ny taxable loss" in §40-18-39(c)(5) could most reasonably be construed as any current year taxable loss of a group member computed on a separate return basis. For example, if four Alabama affiliated group members each reported $1,000 in taxable income on an Alabama consolidated return, and the fifth group member reported a loss of $3,000 on the return, all as computed on a separate return basis, the $3,000 current year loss of the one group member could be deducted to reduce the group's taxable income to $1,000 ($4,000 in total income less $3,000 loss = $1,000).

But the separate provisions in a statute must be construed in pari materia to reflect the intent of the Legislature. *McDonald's Corp. v. DeVenney*, 415 So.2d 1075 (Ala. 1982). As discussed, it must be presumed that the §40-18-39(h) NOL limitation is not

meaningless, and thus must have some field of operation. That section can only have meaning if there is a group NOL carryover deduction that can be limited. Consequently, the phrase "[a]ny taxable loss" in §40-18-39(c)(5) must be construed to include an NOL incurred by a group member in a prior year. The deductibility of such an NOL is, however, still subject to the §40-18-39(h) limitation.

The next issue is whether any or all of the Taxpayer's NOLs incurred in 1992 through 2002 and 2004 are subject to the §40-18-39(h) limitation. Concerning the NOLs incurred before 1999, that issue turns on whether the Taxpayer was a part of an Alabama affiliated group in those years.

The Taxpayer argues that the Legislature's intent in enacting Act 98-502 was to adopt the federal consolidated filing regime, and that to satisfy that intent, the term "Alabama affiliated group" must be applied to the years before 1999.

> CCE's NOLs are not limited by either the federal or Alabama SRLY rules because the NOLs were incurred while CCE was a member of the Taxpayers' federal and Alabama affiliated group. The term "Alabama affiliated group" must be applied to tax periods prior to 1999 in order to accomplish the Legislature's incorporation of the federal SRLY rules for purposes of Alabama's consolidated filing regime.

Taxpayer's Post-Hearing Brief at 1.

First, I disagree that the Taxpayer's NOLs incurred before 1999 were incurred while the Taxpayer was a member of an Alabama affiliated group because, as discussed, an Alabama affiliated group, as first defined in Act 98-502, could not have existed before 1999. (The Taxpayer's NOLs incurred in 1999 and later years were incurred while the Taxpayer was a member of an Alabama affiliated group, and are addressed below.)

Second, there is no language in §40-18-39, or specifically in §40-18-39(h), indicating that the Legislature intended to apply the term "Alabama affiliated group" to the years before the 1999 effective date of Act 98-502. The Legislature could have easily included language to that effect if it had so intended. It did not. And there is also nothing in §40-18-39 indicating that the Legislature intended to allow an Alabama affiliated group to file consolidated Alabama returns in 1999 and later years and carryover and share the unused separate return NOLs incurred by the individual group members going back 15 years.[3]

The Legislature intended by enacting Act 98-502 to generally adopt the federal consolidated filing scheme, but on a prospective only basis beginning in 1999. Consequently, if a group of corporations qualified as an Alabama affiliated group in 1999 and later years, Act 98-502 allowed the group to file Alabama consolidated returns in those years, but it did not allow the group to retroactively file amended Alabama consolidated returns for the years before 1999. That is, Act 98-502 allowed consolidated filing on a prospective only basis. Likewise, any NOL incurred by a group member can only be shared by group members on an Alabama consolidated return on a prospective only basis, beginning with losses incurred in 1999. As explained below, this is confirmed by the language used in the §40-18-39(h) limitation.

Section 40-18-39(h), as originally enacted by Act 98-502, generally adopted the federal SRLY rules, but also included an important caveat. Under both the Act 98-502 and

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[3] See, Code of Ala. 1975, §40-18-35.1, which allows corporations to carryover NOLs for 15 years. There is no question that consolidated group members that incurred an NOL in a prior year can carryover the loss in computing their separate entity income on an Alabama consolidated return. The issue here is whether the NOL can also be shared or applied to offset the income of the other group members.

Act 2001-1089 versions of §40-18-39(h), the limitation applied, and applies, if the NOL was incurred "in a taxable year before the corporation (that incurred the loss) became a member of an Alabama affiliated group." It is presumed that the Legislature is aware of the existing law when it enacts or amends a statute. *City of Pinson v. Utilis. Bd.*, 986 So.2d 367 (2007). Consequently, it must be presumed that when the Legislature enacted Act 98-502, and specifically §40-18-39(h), it was aware that an Alabama affiliated group of corporations did not exist before 1999. Consequently, by specifically wording §40-18-39(h) so as to apply the SRLY limitation to NOLs incurred by group members before they became a member of an Alabama affiliated group, the Legislature clearly expressed its intent to limit the sharing of NOLs incurred by group members before 1999, i.e., before they became a member of an Alabama affiliated group.

The Taxpayer also argues that "the definition of an Alabama affiliated group can be applied to tax periods prior to 1999 because an election to file a consolidated return is not required in order to qualify as an Alabama affiliated group." Taxpayer's Post-hearing Brief at 1.

I agree that "an election to file (an Alabama) consolidated return is not required in order to qualify as an Alabama affiliated group." A group of corporations qualifies as an Alabama affiliated group if it meets the definition of the term at §40-18-39(b)(1). From 1999 through 2001, pursuant to Act 98-502, the term included all members of a federal affiliated group, if at least one member was subject to Alabama tax. From 2002 forward, pursuant to Act 2001-1089, the term has been defined to include only those federal affiliated group members that had nexus with and were subject to Alabama tax. Under both definitions, the Taxpayer was a member of its Alabama affiliated group from 1999

forward, even though the group did not elect to file an Alabama consolidated return until 2007. But the fact that an Alabama affiliated group can exist without the group having filed an Alabama consolidated return in no way supports the Taxpayer's claim that the term "Alabama affiliated group" should be applied to the years before 1999.

The Department's argument that the §40-18-39(h) limitation applies if the group did not file an Alabama consolidated return in the loss year is, in substance, the same argument that the Administrative Law Division correctly rejected in *Weyerhaeuser*. As it did in *Weyerhaeuser*, the Department contends in this case that the §40-18-39(h) phrase "that has elected to file an Alabama consolidated return" refers to a consolidated return filed in the loss year. See, Department's Brief at 3 – 8. I again disagree for the reasons discussed above and as explained in the March 11, 2005 Final Order in *Weyerhaeuser*. To repeat, the phrase "that has elected to file an Alabama consolidated return" must be referring to the current year consolidated return on which the NOL is claimed, and not the return for the prior loss year. The Legislature's use of the word "has" is key.

"Has" is the present tense of "have." Consequently, when §40-18-39(h) refers to "an Alabama affiliated group that *has* elected to file an Alabama consolidated return," it must be referring to the present or current year filing of such a return. The Department's argument would be correct only if the Legislature had used the past tense "had" instead of "has." It did not.

Section 40-18-39(h) further provides that "the deductibility of the loss on the Alabama consolidated return shall be limited. . . ." By using the phrase "the Alabama consolidated return," the Legislature was referring to a specific return, which must be the previously referenced Alabama consolidated return which the affiliated group "has elected

to file," i.e., the current year consolidated return on which the group claimed the NOL carryover.

Act 2001-1089 did not change the first part of §40-18-39(h), as originally enacted by Act 98-502. "If, in a taxable year before the corporation became a member of an Alabama affiliated group that has elected to file an Alabama consolidated return, the corporation incurred a net operating loss, the deductibility of the loss on the Alabama consolidated return shall be limited. . . ."

The above language identifies the NOLs that are subject to the limitation, i.e., those NOLs incurred by a group member in a year before the loss corporation became a member of the group. The limitation does not apply if the corporation that incurred the loss was a group member in the loss year, even if the group did not file an Alabama consolidated return in the loss year.

The last part of §40-18-39(h), as originally enacted by Act 98-502, simply adopted the federal SRLY rules at 26 U.S.C. §1502. As discussed, the general SRLY rule is that if the limitation applies, the amount of the NOL that can be claimed on a consolidated return is "limited" to the amount of the current year taxable income of the group member that incurred the NOL.

An exception to the general federal SRLY rule is the so-called "lonely parent exception." See, Treas. Reg. §1.1502-1(f)(2)(i). That exception in substance allows, or excepts from the limitation, an NOL incurred by a common parent of a consolidated group. That is, the parent's prior year NOL can be shared by the group members on a consolidated return, even if the parent was not a group member in the loss year. See, *Wolter Construction Company v. Comm.*, 634 F.2d 1029, 1034 (6th Cir. 1980) ("a NOL

sustained in a separate return year by the common parent of an affiliated group is not subject to the limitation of Reg. 1.1502-21(c). The net effect is to allow pre-affiliation NOL's of the common parent to be used to offset post-affiliation profits of any member of the group").

Act 98-502 directed the Department to promulgate regulations "that are consistent, to the maximum extent possible, with applicable Treasury regulations." Section 40-18-39(j). The Department subsequently promulgated Reg. 810-3-35.1-.03, effective July 11, 2001. That regulation generally adopted the federal SRLY rules, and specifically included the lonely parent exception. See, Reg. 810-3-35.1-.03(2)(a)3.(i). The regulation was not repealed until November 19, 2010, and was thus in effect during the year in issue. The effect of the regulation, and specifically the lonely parent exception, is discussed below.

Act 2001-1089 amended the second part of §40-18-39(h) so that instead of simply adopting the federal SRLY rules at 26 U.S.C. §1502, the section, as amended, now spells out the general federal SRLY rule. That is, if the limitation applies, the NOL "shall be limited to only the amount necessary to reduce to zero the Alabama taxable income, calculated on a separate return basis, of the corporation that incurred the net operating loss." Importantly, subsection (h), as amended by Act 2001-1089, then goes on to provide – "Except as provided in the preceding sentence, the separate return limitation year ("SRLY") rules contained in 26 U.S.C. §1502 shall apply."

I agree with the Department that the substantive effect of the Act 2001-1089 amendment to subsection (h) is that the lonely parent exception no longer applies in Alabama. The Legislature clearly specified in Act 2001-1089 that if an NOL is subject to the limitation, then in all cases the general SRLY rule "shall" apply that the NOL can only

be used on a consolidated return to offset the current year income of the loss corporation. The federal SRLY rules still apply, but only "[e]xcept as provided in" the above general rule. Because the federal SRLY lonely parent exception is an exception to the general rule, it conflicts with the controlling general rule, and thus no longer applies in Alabama.

Act 2001-1089 provided that "[t]he amendment to Section 40-18-39(h) is intended to clarify, not change, existing law." Relying on that statement, the Taxpayer argues that because §40-18-39(h), as first enacted by Act 98-502, adopted in full the federal SRLY rules, including the lonely parent exception, and because Act 2001-1089 only clarified and did not change subsection (h), then the subsection must still be construed as allowing or recognizing the lonely parent exception. I disagree.

With due respect to the Legislature's statement that Act 2001-1089 was intended to clarify, not change, §40-18-39(h), the Act clearly changed the substance of the statute. Before Act 2001-1089, the federal SRLY rules, including the lonely parent exception, applied. After Act 2001-1089, if the limitation applies, then the NOL is, without exception, subject to the general SRLY rule. Because the federal lonely parent exception is an exception to the general rule, it no longer applies in Alabama.

And if Act 2001-1089 only clarified §40-18-39(h), then the clarification only shows that the Legislature did not intend to fully adopt the federal SRLY rules when it enacted Act 98-502. That is, despite the language used in Act 98-502, what the Legislature actually intended, as "clarified" by Act 2001-1089, was to adopt the general SRLY rule, but not the lonely parent exception or any other portion of the federal SRLY rules that conflicts with the general rule.

The fact that the Department did not repeal or amend Reg. 810-3-35.1-.03 until after the year in issue also does not change the above conclusion. Alabama law is clear that a regulation cannot subvert, restrict, or enlarge upon a statute. *Ex parte Uniroyal Tire Co.*, 779 So.2d 227 (Ala. 2000).[4] As discussed, §40-18-39(h), as last amended by Act 2001-1089, clearly provides that if a current member of an Alabama affiliated group incurred an NOL in a year before the member became a member of the group, the NOL "shall" be limited on a consolidated return to only the amount required to reduce the loss member's current year income to zero. The lonely parent exception in Reg. 810-3-35.1-.03(2)(a)3.(i) is contrary to the controlling general rule specified in the current version of subsection (h), and must be rejected.

To summarize, §40-18-39 must be construed as allowing Alabama affiliated group members to share NOL carryovers on an Alabama consolidated return, but only if the §40-18-39(h) limitation does not apply. The subsection (h) limitation applies if an NOL was

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[4] The Alabama Supreme Court has held that a Revenue Department regulation must be followed if it is not inconsistent with a statute and is reasonable under the circumstances. *Shellcast v. White*, 477 So.2d 422 (Ala. 1985). As indicated, however, the lonely parent exception in Reg. 810-3-35.1-.03(2)(a)3.(i) is contrary to §40-18-39(h), as amended by Act 2001-1089, and must be rejected.

The Administrative Law Division has held that a Department regulation that provides for an exclusion not authorized by statute should be followed, but only for equal protection purposes because other similarly situated taxpayers had been allowed the exclusion for the tax period. "In addition, presumably all other foreign corporations . . . (were allowed the exclusion provided by the regulation) during the subject period. Consequently, the taxpayer would be denied equal protection if it was not also allowed (the exclusion) during the same period." *State of Alabama v. American Fructose Decatur, Inc.*, Docket F. 94-125 (Admin. Law Div. 12/14/1994) at 9, 10. But there is no evidence in this case that the Department has recognized or given a taxpayer the benefit of the lonely parent exception to the federal SRLY rules since Act 2001-1089 was enacted. Denial of equal protection thus is not an issue.

incurred by a group member in a year before the member became a member of the Alabama affiliated group. Because an Alabama affiliated group did not exist before 1999, all NOLs incurred before 1999 are subject to the subsection (h) limitation. If, however, the loss was incurred in 1999 or later, and the corporation that incurred the loss was a group member in the loss year, the subsection (h) limitation does not apply, even if the Alabama affiliated group did not file an Alabama consolidated return in the loss year.

The Taxpayer incurred the NOLs in issue in 1992 through 2002 and 2004. The §40-18-39(h) limitation applies to the 1992 through 1998 NOLs. Those losses thus cannot be used on the group's 2007 Alabama consolidated return because the Taxpayer had negative taxable income in that year.

The Taxpayer's 1999 through 2002 and 2004 NOLs can be allowed as group NOLs on the 2007 consolidated return because the Taxpayer was a member of the Alabama affiliated group in those loss years. Again, it is irrelevant that the Taxpayer's Alabama affiliated group did not file Alabama consolidated returns before 2007.

The Department is directed to recompute the additional 2007 refund due the Taxpayer as indicated above. A Final Order will then be entered.

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 15, 2012.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr

cc: Mark Griffin, Esq.
Christopher R. Grissom, Esq.
Melody Moncrief
Angela Cumbie