



State of Alabama Department of Revenue

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ALABAMA DEPARTMENT OF REVENUE REVENUE RULING 94-008

This document may not be used or cited as precedent. Code of Alabama 1975, §40-2A-5(a).

TO:

FROM: Commissioner of Revenue (Acting)
Alabama Department of Revenue

DATE: July 15, 1994

RE: (1) Applicability of Exception To "Throwback" Rule
For Corporate Income Taxation and
(2) Proper Franchise Tax Classification

ISSUES AND FACTS

The facts as represented by Requestor are as follows:

Corporation "A" is a holding company whose stock is publicly held and listed on the X Exchange. Its business is primarily the design, manufacture and sale of fine quality men's active wear, sports wear, outer wear, robes, and furnishings, which businesses are conducted through two wholly owned subsidiaries, Sub "A" and Sub "B". Through another wholly owned subsidiary, Sub "C" the name and other associated trademarks are licensed in the United States and throughout the world. Additionally, another wholly owned subsidiary, Sub "D", holds the stock of various corporations located throughout the United States whose businesses are the operation of retail stores. These corporations collectively are referred to as the "Companies."

The corporate headquarters for the Companies are located in City "A". The design studios for the Companies are located in City "A". The sales and marketing staff for the Companies are located in City "A" and throughout the nation, in showrooms located in locations A, B, C, and D. Regional sales managers and sales representatives are located in various places across the United States. The customer base is located throughout the United States, and consists primarily of department store chains such as Stores A, B, C, D, E, and F, as well as other specialty stores.

Goods are produced entirely abroad by a large number of contractors located primarily in locations E, F, G, H, I, J, K, L, and M. The Companies locate for many of their manufacturers a broad range of natural and synthetic fabrics primarily from foreign textile mills and converters. The Companies separately negotiate with fabric suppliers for the sale of the required fabric, which is then purchased by their contract manufacturers in accordance with the Companies' specifications. In addition, retail and outlet stores are located in various states throughout the U.S. Both domestic and international licensing activities are managed from City "A".

A distribution facility, which will be owned by a new subsidiary, Sub "E", and operated by its employees may be established in Alabama. Nearly all of the inventory of Sub "A" and Sub "B" will be received and stored at this facility, and sales orders will be shipped from this location to customers throughout the United States.

The Companies provided the following table as their best estimate as to what the apportionment factors would be using the "throwback" rule.

	Throwback Rule	Destination
Sales Apportionment Factor		
Sub "B"	75.4745%	1.6274%
Sub "A"	77.4258%	1.6274%
Overall Apportionment		
Sub "B"	68.5799%	43.9642%
Sub "A"	46.0749%	20.8088%

The "throwback" percentages are based upon a study of the Companies' actual historical experience in storing and shipping goods from a facility in a state with a "throwback" rule. The "destination" figures reflect the Companies' best estimate of the Alabama percentage of total U.S. population according to the 1990 U.S. Census. The Companies represent that since they sell consumer goods, this demographic percentage is statistically accurate.

The Companies will receive, store, pack and ship consumer goods from the proposed Alabama distribution facility. The goods will already be finished when received in Alabama and no specific economic value will be added to them in Alabama.

The Companies' products are designed entirely by their in-house design staffs in City "A". The Companies' representatives based in several overseas locations monitor production at each facility of the contract manufacturers employed by the Companies in order to ensure compliance with the Companies' design specifications and quality standards and to

provide for timely delivery of finished garments. They are assisted by employees of the Companies based in City "A" who regularly visit manufacturing contractors to monitor production. Since the Companies feel that their design, supply, supervision and quality control functions are the equivalent of those conducted by an actual factory operator, the Companies hold themselves out as manufacturers to investors and regulatory bodies alike.

The issues are as follows:

(1) Whether Sub "A" and Sub "B" should be granted relief from the "throwback rule".

(2) Whether Sub "A" and Sub "B" should be classified as employing capital primarily in manufacturing for franchise tax classification.

LAW AND ANALYSIS

Issue (1)

Code of Alabama 1975 §40-27-1 Multistate Tax Compact
Article IV Division of Income, provides in pertinent part:

16. Sales of tangible personal property are in this state if:

(a) The property is delivered or shipped to a purchaser, other than the United States government, within this state regardless of the f.o.b. point or other conditions of the sale; or

(b) The property is shipped from an office, store, warehouse, factory, or other place of storage in this state and (1) the purchaser is the United States government or (2) the taxpayer is not taxable in the state of the purchaser.

[Subsection (b) is the throwback rule].

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18. If the allocation and apportionment provisions of this article do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) Separate accounting;

(b) The exclusion of any one or more of the factors;

- (c) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or
- (d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Based only on the percentages of distortion in the study provided by Sub "A" and Sub "B", they would not be entitled to relief from the throwback rule. However, based upon the particular facts of this case, Sub "A" and Sub "B" are granted relief from the "throwback" rule and are authorized to report their sales for sales apportionment purposes on a destination basis, exclusive of the "throwback" rule. The only significant activity Sub "A" and Sub "B" have within the State of Alabama is the temporary storage of their finished goods (which are manufactured entirely outside the State of Alabama) by Sub "E" awaiting shipment to their final sales destination point.

Issue (2)

Franchise Tax Reg. 810-2-3.13 Determination of Franchise Tax Allocation Factors by Taxpayers Engaged in Multistate Operations provides in pertinent part:

(1) Purpose - To establish a regulation to define the appropriate Allocation Factors and procedures for use in determining the Alabama Allocation Factor for foreign franchise tax.

(a) A taxpayer employing capital both within and without Alabama must complete Schedules C and D of the annual foreign franchise tax return.

(b) A taxpayer's primary use of capital shall determine the appropriate Allocation Factors to be used in Schedule C of the foreign franchise tax return.

(c) Schedule C. - Allocation Factors

1. Cost of manufacturing, processing or fabricating (for a taxpayer engaged in manufacturing)

2. Sales by destination (for a taxpayer engaged in selling activities)

6. Total salaries, wages, and/or salesmen, brokers or agents commissions

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7. Total property (original cost) and inventories

(d) Schedule D. - Allocation Categories

1. Manufacturing -- A taxpayer employing capital primarily in Manufacturing, Processing, or Fabricating shall use the average of the Alabama percentages determined by averaging Allocation Factors 1 and 2, Allocation Factor 6, and Allocation Factor 7, Schedule C. To determine the Alabama Allocation Factor in Schedule D., divide the sum of the Allocation Factors by three (3). A taxpayer shall be deemed to be employing capital primarily in Manufacturing, Processing or Fabricating if 50% or more of the items sold by the taxpayer are Manufactured, Processed or Fabricated by the taxpayer.

2. Selling -- A taxpayer employing capital primarily in Selling shall use the average of the Alabama percentages determined by averaging Allocation Factor 2, Allocation Factor 6, and Allocation Factor 7, Schedule C. To determine the Alabama Allocation Factor in Schedule D, divide the sum of the Allocation Factors by three (3).

Based upon the particular facts of this case, Sub "A" and Sub "B" should be classified as employing capital primarily in selling for franchise tax purposes. Sub "A" and Sub "B" purchase finished goods from their contract manufacturers for resale. Although Sub "A" and Sub "B" design the clothes, locate fabric for, and monitor the manufacturing process of their contract manufacturers, these activities do not constitute "manufacturing, processing or fabricating by the taxpayer" within the meaning of the regulation.

HOLDING

Based upon the particular facts of this case, Sub "A" and Sub "B" are granted relief from the "throwback" rule and are authorized to report their sales for sales apportionment purposes on a destination basis, exclusive of the "throwback" rule.

For Alabama franchise tax purposes, Sub "A" and Sub "B" would be classified as "employing capital primarily in selling", because Sub "A" and Sub "B" purchase finished goods from their contract manufacturers for resale.

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