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ALABAMA DEPARTMENT OF REVENUE
REVENUE RULING 93-011

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

TO:

FROM: Commissioner of Revenue
Alabama Department of Revenue

DATE: October 25, 1993

RE: Abatement of Taxes

FACTS

The Company, Inc. ("the Company"), an Alabama corporation, is considering the acquisition of, and construction upon, property located within the jurisdiction of the County Industrial Development Authority (the "IDA"). Specifically, the Company desires to construct and equip a manufacturing facility ("the Project") on the IDA's property ("the Property").

Pursuant to a resolution of its directors, the IDA proposed various incentives, including tax incentives, to induce the Company to locate the Project in the County. This inducement and its proposed transactions, according to facts as presented to the Alabama Department of Revenue, are described as follows:

First, the Company will submit to the IDA a Petition for Bond Inducement and Abatement of taxes, an Application for Abatement, an Abatement Agreement, an Inducement and Loan Agreement, and a Land Sales Agreement. Pursuant to the Land Sales Agreement and a separate "Letter License Agreement," the Company has been granted authority to commence construction, and already has commenced construction, on the Property prior to taking title. The Company was induced to commence construction by promises made by the IDA, prior to commencement, to provide certain tax and financing incentives.

After purchasing the Property from the IDA pursuant to the Land Sales Agreement, the Company will deed the Property back to the IDA. The IDA will issue bonds to finance the Project, and the IDA then will lease the Project to the Company. The IDA's bonds will be supported by a pledge of the rents and revenues from the

Project. The terms of the lease provide that the rents to be paid from the Company to the IDA will be equal to the debt service to be paid on the bonds. The bonds issued by the IDA will be sold to the Company and, at the Company's instruction, a trustee as named in a mortgage and trust indenture, pursuant to which the bonds will be issued, will invest the proceeds from the sale of the bonds in a demand promissory note of the Company's parent corporation (the "Parent") during the Project's construction. To obtain the monies necessary for the Company to purchase the IDA bonds and to fund the Demand Promissory Note, the Parent will receive advances pursuant to a Credit Agreement with the Parent's primary lenders. An agent for these primary lenders, and for certain other financial institutions to whom the Parent owes financial obligations (the "Lenders' Agent"), will take a leasehold and accommodation fee mortgage from the Company and the IDA, respectively, to secure the obligations of the Company and the Parent to the lenders and such other financial institutions (the "Accommodation Mortgage").

Prior to the closing on the bond issue and prior to the execution of the Accommodation Mortgage, the Lenders' Agent may advance a portion of the funds to the Parent for the benefit of the Company. If so, the Lenders' Agent will take an interim mortgage (The "Interim Mortgage"), which will be replaced by the Accommodation Mortgage at the bond closing.

QUESTIONS/RULINGS

You have requested that I rule on the following questions, which are restated verbatim.

1. Will there be a deed tax payable with respect to (a) the deed from the IDA to the Company upon the initial purchase of the property by the Company, (b) the deed back to the IDA by the Company in association with the issuance of the Bond, or (c) the deed granted by the IDA to the Company upon the exercise of an option to repurchase the property by the Company at the expiration of the lease term?

The Tax Incentive Reform Act of 1992 (hereinafter referred to as "the Act"), §40-9B-1 et seq., Code of Alabama 1975, authorizes the abatement of non-educational ad valorem taxes, construction-related transaction taxes, and mortgage and recording taxes, in certain situations. In §40-9B-4(d), an abatement for deed recording tax is provided as follows:

> "(d) Mortgage and recording taxes with respect to mortgages, deeds, and documents relating to issuing or securing obligations and conveying title into or out of the public authority or county or municipal government with respect to a private use industrial property may be abated by

complying with the procedures set forth in this chapter."

In subsection (e), an abatement pursuant to the provisions of §40-9B-4 "may be granted only with respect to private use industrial property that has not previously been placed in service by the private user who is applying for the abatement or by a person who is a related party." Furthermore, in §40-9B-5(b)(3), an abatement may be granted, as in this case, by "the governing body of a public industrial authority, with respect to private use industrial property located within the jurisdiction of the public industrial authority." To receive such abatements, any person who proposes to become a private user of industrial development property files an application with the public industrial authority, pursuant to §40-9B-6.

As to Question 1(a), I rule as follows, based on information provided by you to the Alabama Department of Revenue:

First, the deed from the IDA to the Company upon the Company's initial purchase of the Property is an instrument contemplated in §40-9B-4(d), in that it relates to "issuing or securing obligations," i.e., the Petition for Bond Inducement and the Inducement and Loan Agreement, and in that it conveys "title into or out of the public authority," or the IDA. Second, the Property fits within the statutory definition of "private use industrial property," as that term is defined in §40-9B-3(m). Third, the Property has not been placed in service previously by the Company or a related party. Finally, the granting of abatement by the IDA is authorized by §40-9B-5(a) and (b)(3), in that the Property is located within the IDA's jurisdiction.

Based on the foregoing, no deed recording tax will be due with respect to the deed from the IDA to the Company upon the Company's initial purchase of the property.

Concerning Question 1(b), no deed recording tax will be due with respect to the deed back to the IDA by the Company in association with the issuance of the IDA's bonds. This ruling is based on the rationale expressed in the ruling on Question 1(a).

Concerning Question 1(c), no deed recording tax will be due with respect to the deed granted by the IDA to the Company, upon the Company's exercise of its option to repurchase the Property at the expiration of the lease. Again, this ruling is based on the rationale expressed in the ruling on Question 1(a).

2. Will there be a mortgage tax payable on the mortgage from the IDA in association with the issuance of its Bond, the Interim Mortgage, or the Accommodation Mortgage?

Concerning the mortgage from the IDA in association with its bond issue, no mortgage recording tax will be due upon recordation since the mortgage is one which relates to the

issuing or securing of an obligation and since the mortgage conveys title out of the IDA. See §35-10-26, Code of Alabama 1975, and Dominex, Inc. v. Key, 456 So.2d 1047 (Ala. 1984) (stating that legal title passes to mortgagee upon real property being mortgaged).

Concerning the Interim Mortgage, mortgage recording taxes will be due and payable upon recordation, as provided in §40-22-2, Code of Alabama 1975. The Interim Mortgage involves the Company, the Parent, and the Parent's lenders, and does not convey title "into or out of" the IDA. Therefore, an abatement of recording taxes concerning the Interim Mortgage is not contemplated by the provisions of §40-9B-4(d).

Concerning the Accommodation Mortgage, no mortgage recording tax will be due since the Accommodation Mortgage secures the obligations of the Company and the Parent to the Parent's lenders, and since the Accommodation Mortgage conveys title out of the IDA.

3. Will the sales and use taxes payable on the manufacturing equipment and construction materials be abated as stated in the Abatement Agreement? Are the sales and use taxes payable net of the abatement correctly stated in the Abatement Agreement?

Section 40-9B-4(c), Code of Alabama 1975, provides for an abatement of construction-related transaction taxes in certain situations. As such, the Company is to be allowed an abatement of construction-related transaction taxes, only with respect to tangible personal property and taxable services incorporated into the private use industrial property, if the cost may be, but not necessarily is, capitalized. Also, an abatement is allowable only to the date that the private use industrial property is placed in service. According to the Application for Abatement, filed by the Company with the IDA, the estimated date the Property is to be placed in service is _____. Thereafter, the Company shall not receive further abatement, unless the applicable taxes are incurred in connection with a "major addition," as that term is defined in §40-9B-3(g). Despite the foregoing, the Company shall not be allowed an abatement of local construction-related transaction taxes which are levied for educational purposes or for capital improvements for education. Therefore, the Company is entitled to an abatement of construction-related transaction taxes as noted previously, and as specifically addressed in §40-9B-4(c), notwithstanding the language of the Abatement Agreement.

Concerning applicable sales and use taxes, the State rate of taxation, for tangible personal property is 4 percent, pursuant to §40-23-2(1) and §40-23-61(a). Pursuant to §40-23-2(3) and §40-23-61(b), the State rate of taxation for machinery is 1½ percent. All of these amounts may be abated. For the County, the rates of sales and use taxation are 2 percent for tangible personal property and .75 percent for machinery. Of the proceeds based on these rates, 40 percent is allocated for

educational purposes. Therefore, this 40 percent shall not be abated. Also, any taxes arising from transactions which were subject to the special school tax in the County are not to be abated. Finally, the rates of sales and use taxation for the City are 2 percent for tangible personal property and .75 percent for machinery. All of these amounts may be abated.

4. Will ad valorem taxes on the Project be abated as described in the Abatement Agreement? Is the rate of taxation net of the abatement correctly stated in the Abatement Agreement?

Section 40-9B-4(b) allows an abatement of "noneducational ad valorem taxes," as that term is defined in §40-9B-3(j), provided that the abatement shall not exceed the "maximum exemption period," as defined in §40-9B-3(h). According to information provided by you to the Alabama Department of Revenue, it is the intention of the IDA to issue bonds to finance the Project. If such bonds are issued, the "maximum exemption period" for the abatement of noneducational ad valorem taxes will be 10 years from the date of initial issuance by the IDA of these bonds. In such case, no abatement of ad valorem taxes would be applicable until such date of issuance. If, however, these bonds are not issued, then the "maximum exemption period" would be redetermined, pursuant to the remaining provisions of §40-9B-3(h). Afterwards, no further abatement would be allowed to the Company, unless the applicable taxes would be incurred in connection with a "major addition." See §40-9B-3(g).

Here, the ad valorem tax rate will be X mills on 20 percent of the Property's fair market value. Of the X mills, Y mills are allocated for educational purposes or for capital improvements for education. Therefore, the Company will be entitled to an abatement of X mills - Y mills.

5. Will the Company be permitted to deduct for Alabama income tax purposes rent payments paid to the IDA that reimburse the IDA for interest paid on the Bond?

Section 40-18-35, Code of Alabama 1975, allows certain specific deductions to corporations in computing net income. In §40-18-35(2), the following deduction is allowed:

> All interest paid or accrued within the taxable year on its indebtedness except on indebtedness incurred or continued to purchase or carry obligations or securities, other than obligations of the United States issued after September 24, 1917, the interest upon which is wholly exempt from taxation under this title as income to the taxpayer.

(Emphasis added.)

Since the Company's "indebtedness" is embraced by the exception provision in §40-18-35(2), no deduction will be allowed for rent payments which reimburse the IDA for interest paid on the bond issue held by the Company.

6. Will the Company, as the holder of the Bond, be permitted to exclude interest income paid on the Bond for Alabama income tax purposes?

Pursuant to §11-92A-16(e) and §11-92A-18, Code of Alabama 1975 (1993 Cum. Supp.), the interest income received by the Company, as holder of the bond issue, shall be exempt from Alabama income tax.

7. Will the IDA be required to pay a lease tax for rents received by it under its lease with the Company with respect to tangible personal property leased by the IDA to the Company?

Ordinarily, persons leasing or renting tangible personal property within the State of Alabama must pay a privilege or license tax, as provided in §40-12-222, Code of Alabama 1975. In this situation, however, the IDA shall not be subject to any such tax, according to the following provision in §40-12-222: "provided further, that the tax levied in this article shall not apply to any leasing or rental, as lessor, by . . . any public corporation organized under the laws of the state." Accordingly, the IDA shall not be subject to the lease tax of §40-12-222 for rents received by it from the Company, with respect to tangible personal property which the Company leases from the IDA.

8. Are any of the rulings on the foregoing questions affected by the fact that the Company has commenced construction pursuant to the letter license agreement?

Commencement of construction by the Company, in and of itself, does not affect the rulings in Questions 1 through 7. Subject, of course, to other requirements of the Act, §40-9B-4(e) provides that an abatement may be granted only to property which has not previously been "placed in service." Accordingly, commencement of construction is of no effect. However, if any abatements are granted pursuant to the provisions of the Act, then those abatements are effective only after the date of execution of the Abatement Agreement. If, however, any abatements are granted pursuant to authority other than the Act, then the effective dates of those abatements do not depend on the date of execution of the Abatement Agreement. Instead, the effective dates of such abatements would be determined pursuant to the particular authority granting those abatements.

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