

ALABAMA DEPARTMENT OF REVENUE  
REVENUE RULING 98-004

**This document may not be used or cited as precedent. Ala. Code §40-2A-5(a) (1993 Replacement Volume).**

TO: Taxpayer

FROM: Commissioner of Revenue  
Alabama Department of Revenue

DATE: May 27, 1998

- RE:
1. Whether a foreign corporation may deduct its investment in industrial development bonds in a 100% owned subsidiary in determining its franchise tax base.
  2. Whether a foreign corporation must include a capital lease entered into in connection with the IDB in determining its franchise tax base if the lease is with a 100% owned subsidiary.

**FACTS**

Company A, a Foreign Corporation, is the parent company of an affiliated group of corporations and business entities engaged in the manufacturing of forestry and paper products.

The Industrial Development Board of the City of Z ("IDB") issued the following bonds on behalf Company A to finance the reconfiguration of a mill in City Z, Alabama.

<b>Amount</b>	<b>Issuer</b>	<b>Date</b>	<b>Owner</b>
\$50,000,000	The Industrial Development Board of the City of Z, 1984 Series B	November 1, 1984	B Corporation
\$50,000,000	The Industrial Development Board of the City of Z, 1985 Series A	February 6, 1985	B Corporation
\$70,000,000	The Industrial Development Board of the City of Z, 1985 Series B	May 1, 1985	B Corporation

\$70,000,000      The Industrial Development Board      October 8, 1985      B Corporation

\$60,000,000	of the City of Z, 1985 Series C The Industrial Development Board of the City of Z, 1987 Series A	February 5, 1987	B Corporation
\$ 8,000,000	The Industrial Development Board of the City of Z, 1988 Series A	January 14, 1988	B Corporation

The industrial development bonds were purchased by B Corporation ("B"), a 100 percent owned subsidiary of Company A. Company A transferred cash to B in exchange for equity in order to finance the purchase of the bonds. B holds no assets other than the industrial development bonds.

The IDB maintains title to the assets added during the reconfiguration of the mill ("the mill assets"), and leases them to Company A through a capital lease. Structuring the reconfiguration of the mill in this manner entitled Company A to sales tax exemptions on purchases related to the mill assets and a property tax abatement. B is considering selling the bonds to Company A or merging into Company A, resulting in Company A owning the bonds.

### **ISSUES**

Whether Company A will be entitled to deduct its investment in the above referenced industrial development bonds from its capital employed in Alabama in determining its Alabama franchise tax base if such bonds are purchased from B or B is merged into Company A.

Whether Company A will be required to include the capital lease Company A has entered into with the IDB as capital employed in the state in determining its Alabama franchise tax base if the above referenced industrial development bonds are purchased from B or B is merged into Company A.

### **ANALYSIS**

Alabama Code §40-14-41(b) defines the capital of a foreign corporation to include outstanding capital stock and any additional paid-in capital and retained earnings. Alabama Code §40-14-41(b)(3) provides that the total capital of a foreign corporation also includes "The amount of bonds, notes, debentures, or other evidences of indebtedness maturing and payable more than one year after the first day of the franchise tax year, but not including deposit liabilities of banks and other financial institutions as defined by state or federal law."

Alabama Code §40-14-41(b) provides a deduction from the amount of capital employed in Alabama for "The amount invested by the taxpayer in bonds or other securities issued by the state of Alabama, or any county, municipality, or other political subdivision of the State of Alabama, or any public corporation organized under the laws of the State of Alabama, unless such corporation is a dealer in

securities."

In *Mead Coated Board Inc. v. Alabama Department of Revenue*, 701 So.2d 10 (1997) the Court of Civil Appeals held that Mead Coated Board Inc. ("MCBI") was allowed a deduction for bonds purchased from the Alabama IDB. MCBI built a manufacturing facility in Phenix City through a typical IDB financing lease, with the IDB constructing the facility and leasing it to MCBI, while issuing its bonds to finance the construction. In turn, MCBI purchased the bonds from the IDB. Typically, an IDB lease is considered a capital lease in which the plant financed through the bond issue is treated for tax and accounting purposes as owned by the taxpayer, subject to a liability equal to the amount of bonds outstanding. Since MCBI owned the bonds as a creditor for accounting purposes, the liability (debt) and asset (investment in bonds) canceled each other out and the facility was reflected as being owned outright by MCBI, the lessee. The plant was included in the assets of MCBI as a capital lease while the capital contributed by its parent in order to purchase the bonds was included in paid-in capital.

When computing its Alabama franchise tax base, MCBI included the capital contribution from its parent in capital and deducted the investment in IDB bonds from its apportioned capital base in accordance with the statute. The Court of Civil Appeals held that the bonds held by MCBI were deductible from the franchise tax base and the lease was not a long term liability in determining capital employed in Alabama.

The IDB issued bonds on behalf of Company A to finance the reconfiguration of the mill in Alabama. The IDB holds title to the mill assets, which it leased to Company A under a capital lease. The mill assets were recorded on the books of Company A in addition to the lease liability. B, a subsidiary of Company A, purchased the bonds. The bonds will be transferred to Company A, making it both the bond owner as well as the lessee of the assets. The facts in this revenue ruling request are identical to the facts set forth in *Mead*.

### **CONCLUSION**

Company A is entitled to deduct the investments in bonds issued by a political subdivision of the State of Alabama under Alabama Code §40-14-41(d)(4) on its Alabama franchise tax return and will not have to include the capital lease as capital employed in Alabama in determining its apportioned capital.

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H. E. "GENE" MONROE, JR.

HEM:DES:pj

