



State of Alabama Department of Revenue

Montgomery, Alabama 36132

GEORGE E. MINGLEDORFF III
Commissioner (Acting)

GEORGE E. MINGLEDORFF III
Assistant Commissioner

LEWIS A. EASTERLY
Secretary

ALABAMA DEPARTMENT OF REVENUE REVENUE RULING 93-001

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: February 12, 1993

SUBJECT: (1) Exception to the "Throwback Rule" For
Corporate Income Tax and
(2) Proper Franchise Tax Classification

ISSUES AND FACTS

Company A is a State Y corporation doing business in State Y and State Z. Company A's headquarters are located in State Y. Company A designs, contracts for the manufacture of, distributes and markets an extensive range of Product X. Currently, all of the merchandise is warehoused and shipped from State Y to retail department stores throughout the United States. Sales to Company A's department and special store customers are made through showrooms in State Z. Company A has recently purchased a distribution facility in the State of Alabama. This facility will support the continued growth of Company A.

(1) Whether the "throwback rule" distorts income of Company A attributable to Alabama by artificially inflating the sales apportionment factor.

(2) Whether the franchise tax classification of Company A as employing capital in Alabama primarily in selling is the appropriate classification under the circumstances described.

LAW AND ANALYSIS

ISSUE (1)

Alabama Corporate Income Tax Regulation §810-3-31.02(5)(c)(9)(vii) provides, "If a taxpayer is not taxable in the state of the purchaser, the sale is attributable to this state if the property is shipped from an office, warehouse, factory or other place of storage in this state." This is the "throwback rule." Regulation 810-3-31.02(6) contains an exception to the "throwback rule". Regulation 810-3-31.02(6) provides, "If the allocation and apportionment provisions of this regulation do not fairly represent the extent of a taxpayer's business in this State, the taxpayer may petition for or the Commissioner may require, in respect to all or a part of the taxpayer's business activity, if reasonable:

(a) Separate accounting;

(b) The exclusion of 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 the State; or

(d) The employment of any other method to effectuate an equitable allocation and apportionment of a taxpayer's income.

Company A conducted a study and provided the Alabama Department of Revenue with the following information comparing a sales apportionment factor using sales by destination and a

sales apportionment factor using the "throwback rule." Company A provided the following table as its best estimate of what its apportionment factors would be. Company A provided a range for the "throwback rule".

	<u>DESTINATION BASIS</u>	<u>THROWBACK RULE</u>	
		<u>LOW</u>	<u>HIGH</u>
<u>SALES APPORTIONMENT FACTOR</u>			
Initial Year	1.7%	13.6%	35%
Third year	1.7%	13.6%	35%
<u>OVERALL APPORTIONMENT FACTOR</u>			
Initial Year	12.6%	16.5%	23.7%
Third year	22.5%	26.5%	33.6%

Based on this study by Company A and assuming the projections actually materialize, the "throwback rule" would distort the overall apportionment factor, because the sales factor would not reflect Company A's true activity in the State of Alabama. Based upon this information, Company A is authorized to report its sales for sales apportionment purposes on a destination basis, exclusive of the "throwback rule". This change properly reflects its tax liability to Alabama.

ISSUE (2)

Alabama Franchise Tax Emergency Regulation 810-2-3-.12ER enumerates the classification of foreign corporations doing business in Alabama as either (1) manufacturing, (2) selling, (3) contracting, (4) transportation, (5) services or (6) rentals and/or leasing. For Alabama franchise tax

purposes, Company A would be classified as a "manufacturer" assuming 50% or more of the items sold by Company A are manufactured, processed or fabricated by Company A. Emergency Regulation 810-2-3-.12ER(1)(d)1. Classification for franchise tax purposes is an annual determination. Taxpayers employing capital primarily in manufacturing, processing, or fabricating are to determine their Alabama franchise tax liability as follows: use the average of the Alabama percentages determined by averaging the "cost of manufacturing, processing or fabricating" allocation factor and the "sales by destination" allocation factor, the "total salaries, wages, and/or salesmen, brokers or agents commissions" allocation factor and the "tangible property (original cost) and inventories" allocation factor. To determine the Alabama allocation factor taxpayers divide the sum of the allocation factors by three (3). See id.

HOLDING

Based on the projection presented by Company A, the Department agrees that the use of the "throwback rule" would distort the overall apportionment factor, because the sales factor would not reflect Company A's true activity in the State of Alabama. The Department concurs that this would result in an improper representation of income earned in Alabama, and therefore, authorizes Company A to report its sales on a destination basis as requested.

For Alabama franchise tax purposes, Company A would be classified as a "manufacturer" assuming 50% or more of the

items sold by Company A are manufactured, processed, or
fabricated by Company A. Classification for franchise tax
purposes is an annual determination.

STAN MCDONALD
Commissioner of Revenue

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