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Alabama - Affiliated group members may share certain NOL carryovers even if a consolidated return is not filed in the loss year, and "lonely parent" exception is inapplicable

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In brief

Affiliated group members may share NOL carryovers on an Alabama consolidated return, subject to Alabama's SRLY limitation. SRLY applies if an NOL was incurred in a year before a member joined an "Alabama affiliated group." Because an "Alabama affiliated group" did not exist before 1999, all NOLs incurred before then were subject to the SRLY limitation. For a loss incurred in 1999 or later when the corporation that incurred the loss was a group member in the loss year, SRLY does not apply - even if the Alabama affiliated group did not file an Alabama consolidated return in the loss year.

Additionally, the federal SRLY "lonely parent exception," which would allow an NOL incurred by a common parent of a consolidated group to be shared with other members, is not applicable in Alabama. [*Coca-Cola Enterprises, Inc. v. State of Alabama*, Alabama Department of Revenue Administrative Law Division, Docket No. Corp. 09-641 (8/15/12)]

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In detail

Coca-Cola Enterprises, Inc. (Coca-Cola) was the common parent of an affiliated group of corporations that included Vending Holding Company and Robby Coca-Coca Bottling Company. All three entities filed separate Alabama income tax returns through 2006. Coca-Cola claimed NOLs on its separate entity 1992 through 2002 and 2004 Alabama returns. For the 2007 tax year, all three entities elected to file as part of the same Alabama consolidated return. On the 2007 consolidated return, the group's net taxable income was reduced by Coca-Cola's accumulated NOL carryover. On audit, the Alabama Department of Revenue disallowed the application of Coca-Cola's NOL carryover to the group's income. Coca-Cola paid the assessment and appealed to the Administrative Law Division following the Department's denial of Coca-Cola's refund claim.

Alabama's consolidated group filing and SRLY limitation

Prior to the 1999 tax year, Alabama required that all corporations subject to tax to file income tax returns on a separate company basis. Effective for tax years beginning in 1999, Alabama allowed an "Alabama affiliated group" of corporations to elect to file an Alabama consolidated return. The group was treated as a single taxpayer, therefore deduction and losses - including NOL carryovers - could be shared by group members.

Alabama's separate return limitation year (SRLY) provision limits a member's NOL carryover that can be used to offset the group's income. As applicable for the 2007 tax year, the SRLY limitation provides that (emphasis added):

"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. Section 1502 shall apply."

NOLs may be shared between group members even though, beginning in 2002, individual group members compute taxable income on a separate return basis

As noted above, when consolidated reporting was first enacted, starting in the 1999 tax year, a consolidated group filed as a single taxpayer that could share NOL carryovers among members, subject to the SRLY limitation.

Effective for the 2002 tax year, each Alabama group member computes its income or loss on a separate return basis. The Administrative Law Judge (ALJ) found that, despite the requirement to report on a separate return basis, group members may still share NOL carryovers, subject to the SRLY limitation that remained in place after the 2002 law change. The ALJ reasoned that the legislature's retention of a SRLY limitation evidenced an intent to generally allow taxpayers to continue to share NOLs among group members. In other words, there would be no reason for Alabama law to maintain a SRLY limit on shared NOLs if the general rule was to preclude NOLs from being shared among group members.

NOLs incurred before 1999 cannot be shared with other group members, reversing a 2005 ALJ decision

In *Weyerhaeuser USA Subsidiaries v. State of Alabama* (3/1/05), two of the taxpayer's subsidiaries incurred NOLs from 1985 through 1998. The *Weyerhaeuser* ALJ had found that the SRLY limitation did not apply because "the two subsidiaries that incurred the losses were members of the taxpayer's consolidated group in the loss years."

In *Coca-Cola*, the ALJ (the same ALJ who decided *Weyerhaeuser*) determined that *Weyerhaeuser* was decided incorrectly. The SRLY limitation is triggered if a loss is incurred ***before the corporation became a member of an Alabama affiliated group***. Because an "Alabama affiliated group" did not exist in Alabama law before 1999, the Weyerhaeuser subsidiaries could not have been a part of the Weyerhaeuser Alabama group before 1999. The *Coca-Cola* ALJ found that the SRLY limitation should have been applied in *Weyerhaeuser* because the subsidiaries incurred losses in tax years before they became members of the Weyerhaeuser Alabama affiliated group.

Accordingly, Coca-Cola's NOLs generated from 1992 to 1998 could not be used to offset the income of other group members.

NOLs incurred on and after 1999 may be shared with group members even when a consolidated return was not filed in loss years

While an NOL incurred by a group member may be shared with other group members on a consolidated return, such use is limited by under the SRLY rules. The ALJ recognized that the limitation applies to years ***before the corporation became a member of an Alabama affiliated group.*** The ALJ determined that a corporation is a member of an Alabama affiliated group when it satisfies the statutory requirements of an Alabama affiliated group - ***the filing of a consolidated return is not required to be a member of an "Alabama affiliated group."***

While Coca-Cola's group members did not file an Alabama consolidated return before 2007, the members factually met the statutory definition of an "Alabama affiliated group" during Coca'Cola's loss years. As a result, because Coca-Cola and its subsidiaries were members of an "Alabama affiliated group" during the loss years (even though they didn't file an Alabama consolidated return together), the SRLY limitation did not apply, and Coca-Cola's NOL carryover may be shared with other group members.

The "lonely parent exception" to the SRLY limitation does not apply

Coca-Cola argued that a federal carve-out to the IRC Sec. 382 limitation would allow pre-1999 NOLs to be shared by group members. The federal "lonely parent exception" generally allows (or excepts from the SRLY limitation) a parent's prior year NOL to be shared by group members on a consolidated return, even if the parent was not a group member in the loss year. The ALJ disagreed with Coca-Cola and held that amendments to Alabama's SRLY limitation, effective starting in the 2002 tax year, rendered the "lonely parent exception" inapplicable.

Actions to think about

Alabama taxpayers that followed the *Weyerhaeuser* guidance and have applied, or are applying, NOL carryovers for NOLs generated in pre-1999 years should reevaluate their positions in light of the ALJ's determination in *Coca-Cola*. Additionally, taxpayers should be aware that pre-consolidation NOLs may be available to offset consolidated group income.

One matter to consider is the 2002 law change referenced above. For 1999 through 2001 tax years, an "Alabama affiliated group" consisted of all corporations that filed a consolidated federal return. However, effective for tax years beginning in 2002, an "Alabama affiliated group" includes only those members of a federal affiliated group that have nexus with Alabama (i.e., nexus consolidation). Therefore, when determining whether a corporation was a member of an Alabama affiliated group in a loss year after 2001, nexus considerations may be required.

With neither party securing an outright victory, it is possible that either the taxpayer or the Department may decide to appeal. In addition, it is our understanding that the Department has not yet acquiesced to the decision. While *Coca-Cola* does move closer to resolving what has historically been a very contentious issue in Alabama, it very well may not be the last chapter in the SRLY drama.

Let's talk

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