



**Statement of Acquiescence
No. 05-001
June 2, 2005
Corporation Income Tax**

**Ampacet Corporation v. Cynthia Bridges, Secretary of the Department of Revenue
and Taxation, BTA Docket No. 4975 (Sept. 27, 2004)**

Purpose: This Statement of Acquiescence addresses the determination of whether interest expense paid by the taxpayer to satisfy the obligations of debt relative to industrial revenue bonds is direct or indirect for purposes of attribution of the expense to allocable or apportionable income.

Authority: La. R. S. 47:287.94 A (1)

Factual Analysis: Ampacet is a non-Louisiana corporation located in New York which owned and operated a plant in Louisiana for the production of chemical products. Ampacet obtained financing for a plant expansion project to its De Ridder manufacturing facilities through a loan from the Parish of Beauregard. The Parish of Beauregard obtained the funds to loan by issuing industrial revenue bonds. Ampacet accorded its interest expense on the proceeds of the loan to apportioned income as a direct expense of its operations and activities occurring at the facility which produced apportionable income.

Analysis/Discussion: The issue in *Ampacet Corporation v. Cynthia Bridges, Secretary of the Department of Revenue and Taxation*, BTA Docket No. 4975 (Sept. 27, 2004) concerned whether or not interest expense subject to certain restrictions may be classified as a direct expense. Generally, interest expense of borrowed money for investment in property is includable in the calculation of both net apportionable and net allocable income as an indirect expense. La. R.S. 47:287.93(B)(2) and 47:287.94(A)(2). Ampacet urged that interest expense on borrowed money obtained through industrial revenue bonds was a direct expense and therefore allowed to be treated differently from ordinary interest. Ampacet further claimed the expense as attributable to income earned through its manufacturing activities pursuant to La. R.S. 47:287.94 (A)(1), which provides that the expenses, losses, and other deductions defined in R.S. 47:287.63¹ are to be deducted from the total net apportionable income or loss for computation of total net apportionable income.

The Department took the position that the interest expense was includable in the calculation of both net apportionable and net allocable income from Louisiana sources pursuant to LAC 61:I 1130 (B)(2). LAC 61:I 1130 (B)(2) sets forth the theory of fungibility of money, which requires that:

A Statement of Acquiescence or Nonacquiescence (SA/SNA) is issued under the authority of LAC n 61:III.101(C). It is a written statement to provide guidance to the public and to Department of Revenue employees. An SA/SNA is a written statement issued to announce the Department's acceptance or rejection of specific unfavorable court or administrative decisions. If a decision covers several disputed issues, and SA/SNA may apply to just one issue, or more, as specified. An SA/SNA is not binding on the public, but is binding on the Department unless superceded by a later SA/SNA, declaratory ruling, rule, statute, or court case.

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interest expense ordinarily be allocated to all of the taxpayer's income-producing activities and properties, regardless of the specific purpose for which the borrowing was incurred; it does not directly require allocation of interest deductions to income. That is, these regulations assume that: (a) money is fungible in that all of the taxpayer's activities and properties need funds; (b) the taxpayer's management has substantial flexibility in the source and use of its funds; (c) the creditors of the taxpayer look to its general credit for repayment and thereby subject the money loaned to the risk of all of the taxpayer's activities; and (d) the use of money for one purpose frees funds for other purposes. Accordingly, the reasoning continues, it is appropriate to associate part of the cost of money borrowed for a specific purpose to other purposes as well.

Prior to the decision of the Board in this matter, interest expense on borrowed money obtained through industrial revenue bonds has been treated as an indirect expense by the Department and attributed to the computation of both net allocable and net apportionable.

The Board found that the borrowed funds were used for one specific purpose, that of expansion of the facilities at the De Ridder plant. The Board found there was no evidence showing that Ampacet had used the borrowed money for any purpose other than the expansion of its facilities. The Board noted that money loaned on industrial revenue bonds is burdened with many restrictions. In the instant matter, the borrowed funds were restricted to improving Ampacet's facility in De Ridder as stated in the bond indenture. The Board noted that use of the funds for any other purpose was a violation of the indenture. The Board further noted that the bondholder creditors would not look to the general assets of Ampacet, but would have a security interest in the facilities that were created with the borrowed money. The Board cited R.S. 47:287.94(A)(1) as the provision under which the above facts were to be applied.

IRC Regulation §1.861-10T(b) provides exceptions to occurrences when interest expense is treated as an indirect expense for federal income tax purposes. Qualified non-recourse indebtedness as defined in §1.861-10T(b)(2) allows the direct deduction for interest "directly allocable solely to the gross income which the property acquired, constructed, or improved with the proceeds of the indebtedness generates, has generated, or could reasonably be expected to generate" where 1) "(i) [t]he borrowing is specifically incurred for the purpose of purchasing, constructing, or improving identified property . . ."; 2) "(ii) [t]he proceeds are actually applied to purchase, construct, or improve the identified property"; 3) "(iii) . . . the creditor can look only to the identified property . . . as security for payment of the principal and interest on the loan and, thus, cannot look to any other property, the borrower, or any third party with respect to repayment of principal or interest on the loan . . ."; 4) "(iv) [t]he cash flow from the property . . . is reasonably expected to . . . fulfill the terms and conditions of the loan agreement with respect to the amount and timing of payments of interest. . ."; and 5) "(v) [t]here are restrictions in the loan agreement on the disposal or use of the property. . .". Restrictions on the use of loan proceeds of industrial revenue bonds are substantially similar to those of §1.861-10T(b).

Conclusion: The *Ampacet* decision treats interest expense on borrowed money obtained through industrial revenue bonds differently than other interest expenses of a corporation for applying the method of computation to be used in determining net income from Louisiana sources. Effective with the publication date of this Statement of Acquiescence, the interest expense incurred in similar circumstances will be treated as a direct expense. The Department will concur with the analysis of the Board given that the basis for the decision substantially comports with the IRS

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rule governing the application of interest as an expense for non-recourse debt. Further, the Department will follow the federal exceptions to treatment of interest expense as an indirect expense as provided by IRC Section 861 and the regulations thereunder.

Cynthia Bridges
Secretary

¹ R.S. 47:287.63 defines “allowable deductions” for the taxable year as those deductions from federal gross income allowed by federal law in the computation of taxable income of a corporation for the same taxable year. . . ”