

Historical Note: Subsequent to the issuance of this Revenue Ruling, 2002 La. Acts 38 enacted La. Rev. Stat. Ann. § 47:603(5), which specifically excludes certain “floor plan” type financing arrangements that would otherwise meet the statutory definition of borrowed capital. For taxable periods beginning after the effective date of the Act, June 25, 2002, these statutory provisions will apply. See Revenue Ruling 02-015 for additional information.

**Revenue Ruling
No. 01-018
December 28, 2001**

Corporation Franchise Tax

Inclusion of Certain Indebtedness in the Franchise Tax Base

Purpose: The purpose of this revenue ruling is to inform those taxpayers that are subject to the corporation franchise tax that indebtedness that exists under a master loan agreement for more than a year is considered long-term debt and therefore is included in the borrowed capital component of the borrower’s franchise tax base.

Discussion:

The facts presented are as follows. Borrower is a business organization that is subject to the Louisiana corporation franchise tax. Borrower and lender have entered into a master loan agreement. The term of the master loan agreement is more than one year. During the term of the agreement the borrower has the right to borrow and repay funds, but at no time can outstanding borrowings exceed a set amount. Interest charges vary under the terms of the master loan agreement. The agreement requires the borrower to grant certain securities, maintain certain conditions, and make certain repayments. A portion of the loaned amount is borrowed and repaid within a year, however additional funds are borrowed under the agreement between the time the first amount was borrowed and repaid. During the borrower’s taxable year there is always some outstanding indebtedness. Although under the master loan agreement there are a series of payments and repayments that can appear to be short-term transactions between the parties, the master loan agreement is, in substance, used by the borrower to satisfy a need for continuous long-term financing of its operations.

The Louisiana corporation franchise tax was originally created with the enactment of the Louisiana Franchise Tax Act, 1932 La. Acts 8. The franchise tax is imposed on taxable capital employed in a domestic or foreign corporation’s business activities in this state. There are three components of taxable capital: issued and outstanding capital stock; surplus and undivided profits; and borrowed capital. Borrowed capital, which is the subject of this revenue ruling, is defined as “all indebtedness of the corporation, maturing more than one year from the date incurred, or which is not paid within one year from the date incurred regardless of maturity date.” At the time of its enactment, the inclusion of borrowed capital in the franchise tax base was a fairly new concept.

Shortly after the adoption of the tax, the Louisiana Supreme Court acknowledged that the Legislature included borrowed capital in the tax base in order to prevent corporations from reducing their base by issuing small dollar amounts of capital stock and borrowing large sums to finance their operations. The court recognized that if this were allowed, corporations would only be taxed on the amount of capital stock, despite the fact that the borrowed amounts significantly contributed to the profitability of the corporation. See State v. Banana Selling Co., 170 So. 30 (La.1936).

A fundamental principal in the application of tax laws is the elevation of the substance of a transaction over its form. Weiss v. Stearn, 265 U.S. 242 (1924), Diedrich v. C. I. R., 457 U.S. 191 (1982). This principal has been applied to Louisiana's corporation franchise tax. State v. Banana Selling Co., 170 So. 30 (La.1936), Collector of Revenue v. Maison Blanche Corp., 126 So.2d 704, (La.Ct.App.1961). In Collector of Revenue v. Maison Blanche Corp., 126 So.2d 704, 708 (La.App. 1961), the Fourth Circuit Court of Appeal stated that the Collector had the right to seek the substance of the transaction rather than its mere form, the former being controlling in the matter of establishing tax liability.

The measure of taxation for the franchise tax is the capital employed by the corporation, which includes indebtedness that is not paid within a year. Despite the fact that certain portions of the debt under the master loan agreement are paid within a year, the purpose of the transaction as a whole is to provide long-term financing to the borrower. Therefore, this debt must be included in the franchise tax base or a corporation could avoid inclusion of capital employed by the corporation by structuring transactions in such a way that they appear to be short-term debt. To find otherwise would allow the form of the transaction, rather than its substance, to control the tax consequences.

Conclusion:

Indebtedness that exists under a master loan agreement for more than a year is long-term debt and must be included in the borrowed capital component of the borrower's franchise tax base. The amount to be included in the base is the minimum loan balance outstanding at any point during the year. This is the amount by which the borrower has been indebted to the lender for the entire year.

Examples:

The following examples are provided to illustrate the application of this revenue ruling. They are not the only situations to which this revenue ruling applies.

1. The master loan agreement is between a lender and automobile dealership. The lender requires that the dealer give it a security interest in each vehicle purchased with the loaned funds. Each vehicle is identified by its vehicle identification number. The lender may require that an amount equivalent to the funds lent be repaid as each vehicle is sold. During the course of the dealer's taxable year, the total loan balance may fluctuate, but is never paid down to zero. Because the lender has provided capital to the dealer for more than one year, the indebtedness must be included in the dealer's franchise taxable base. The amount to be included in the base is the amount outstanding under the master loan agreement for more than a year, which is the minimum loan

balance outstanding at any point during the year. In keeping with the substance over form principal, the indebtedness to be included in the tax base is determined with reference to the loan agreement and the balance outstanding, without reference to any secondary or ancillary obligations securing the indebtedness, such as the security in each vehicle.

2. The master loan agreement is between a lender and a corporation. Under the terms of the master loan agreement, the borrower is entitled to borrow funds up to a set dollar amount. The borrower agrees that a specified maximum debt to equity ratio will not be exceeded and that in the event the borrower defaults on any of its loans, all amounts outstanding under the master loan agreement are immediately due and payable. The lender may require a security interest in anything purchased with the funds or may require some other type of security device such as a mortgage. During the course of the corporation's taxable year, the corporation regularly borrows and repays variable amounts depending on its cash needs. While the total loan balance may fluctuate during the year, it is never paid down to zero. Because the lender has provided capital to the corporation for more than one year, the indebtedness must be included in the corporation's franchise taxable base. The amount to be included in the base is the amount outstanding under the master loan agreement for more than a year, which is the minimum loan balance outstanding at any point during the year.

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