LDR State of Louisiana Department of Revenue

Statement of Acquiescence
No. 04- 001
March 30, 2004
Corporation Franchise Tax

***Entergy La., Inc. v. Kennedy,* 03-0166 (La.App. 1 Cir, 7/2/03), *writ denied,* 03-2201 (La. 11/14/03), 859 So.2d 74**

Purpose: This Statement of Acquiescence addresses whether or not the value of capitalized lease obligations should be included in the franchise tax base.

Authority: La. Rev. Stat. Ann. § 47:603(A)(West 2003)

La. Civ. Code Ann. arts. 2692(3), 2710, 2719, and 2720 (West 2003)

Angelle v. Energy Builders Company, 496 So.2d 509 (La. App. 1 Cir. 1986)

David S. Willenzik, *Personal Property Leases in Louisiana*, 44 La.L.Rev. 755 (1984)

Analysis/Discussion: La. Rev. Stat. Ann. § 47:603(A)(West 2003), provides in part that:

> "As used in this Chapter, 'borrowed capital' means all indebtedness of a corporation, subject to the provisions of this Chapter, 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."

In *Entergy La., Inc. v. Kennedy*, 03-0166 (La. App. 1 Cir. 7/2/03), *writ denied*, 03-2201 (La. 11/14/03), the Court of Appeal of Louisiana, First Circuit was called upon to determine whether Entergy's obligations pursuant to several sale and leaseback agreements constituted borrowed capital. Entergy had entered into three sale and leaseback agreements with an unrelated party.

The Court of Appeal of Louisiana, First Circuit found that a "true" or "genuine" lease had been created due to the fact that: 1) Entergy had sold the property for valid consideration of $353,600,000; 2) Entergy leased the property from the new owner; and 3) even though Entergy had the option to buy the property back at certain agreed upon intervals as well as at the termination of the agreement, it could only do so by paying the fair market value of the property to the new owner. The court found that there were no indicia that the agreements between Entergy and the unrelated party were disguised credit sales and not genuine leases.

Despite the existence of a "hell or high water" clause, the court concluded that Entergy did not have an absolute, unconditional obligation to pay. The court referred to *Angelle v. Energy Builders Company*, 496 So.2d 509, 513 (La. App. 1 Cir. 1986), which cited David S. Willenzik, *Personal Property Leases in Louisiana*, 44 La.L.Rev. 755, 780 (1984). According to Willenzik:

> "While such 'hell or high water' covenants are generally enforceable in Louisiana, arguably they may not be enforced in situations in which a lessee lawfully withholds rental payments as a result of the lessor's failure to provide the lessee with peaceable possession of the leased equipment over the lease term. The right of peaceable possession guaranteed by La. Civ. Code Ann. art. 2692(3) (West 2003) as a matter of public policy may not be waived."

The duties of a lessee, as set forth in La. Civ. Code Ann. arts. 2710, 2719, and 2720 (West 2003), include the obligation to pay rent according to the agreed upon terms. If the lessor fails to provide peaceable possession, the lessee's obligation to pay rent ceases. A "hell or high water" clause cannot be relied upon to resurrect such an obligation.

The court went on to state that:

> "… a 'true' or 'genuine' lease, by its very nature, is never an unconditional obligation to pay because a lease is a bilateral, or synallagmatic, contract whereby the lessee and the lessor obligate themselves reciprocally, so that the obligation of each party is correlative to the obligation of the other."

Following the court's reasoning, since a "true" or "genuine" lease is never an unconditional obligation to pay, it is logical to presume that property subject to a "true" or "genuine" lease is never an unconditional asset.

Conclusion: Since a "true" or "genuine" lease is never an unconditional obligation to pay, such a lease obligation would not be included within the definition of "borrowed capital" as used in La. Rev. Stat. Ann. § 47:603(A)(West 2003). As such, the value of a capitalized lease obligation should not be included in the franchise tax base. Likewise, the value of the leased asset should not be included in the property value.

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