

STATE OF ALABAMA,
DEPARTMENT OF REVENUE,

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

§

vs.

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DOCKET NO. INC. 92-128

MICHAEL D. & NETAGENE THOMPSON
1725 Somerset Circle
Birmingham, AL 35213,

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Taxpayers.

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FINAL ORDER

The Revenue Department assessed income tax against Michael D. and Netagene Thompson (Taxpayers) for the year 1990. The Taxpayers appealed to the Administrative Law Division. CPA J. Andy King represented the Taxpayers. Assistant counsel Beth Acker represented the Department.

The issue in this case is whether a loss incurred by an irrevocable trust can be passed through and deducted by the individual beneficiary of the trust in the year the trust is terminated.

Michael D. Thompson was the beneficiary of the Michael Thompson Share Trust. The irrevocable trust was created in 1975 and terminated in 1990.

The trust suffered a loss of \$81,822.00 for the calendar year ending 12/31/89. The trust also suffered a loss of \$13,173.00 for the 1990 year ending 5/31/90. The trust carried the 1989 loss over to 1990 and claimed the combined loss of \$94,995.00 on its final trust return for the period ending 5/31/90.

Michael D. Thompson, as beneficiary of the trust, subsequently deducted the loss on his individual 1990 Alabama return. The Department disallowed the pass-through deduction and entered the assessment in dispute.

Under federal law, the unused portion of a trust loss is allowed as a deduction to the succeeding trust beneficiaries. 26 U.S.C. §642(h). The Taxpayers concede that Alabama has no statute corresponding to IRC §642(h). Nonetheless, the Taxpayers argue that the pass-through should be allowed based on Department Reg. 810-3-25-.05(7)(a). That regulation reads as follows:

(a) A loss on the final return of a revocable trust is allowed to pass on to the grantor unless the trust is irrevocable as to income, then the loss is allowed to pass on to the beneficiary.

The last part of subparagraph (a) does indicate that a loss from an irrevocable trust can be passed through to the succeeding beneficiary.

The Department argues that the last part of subparagraph (a) is wrong and has no basis in the law. Rather, the Department contends that subparagraph (b) of Reg. 810-3-25-.05(7) is controlling. Subparagraph (b) reads as follows:

(b) A loss on an irrevocable trust cannot be passed on to the grantor or the beneficiary.

The function of a declaratory regulation is to interpret a statute. A regulation cannot limit or deny a deduction that is otherwise allowed by statute. Boswell v. Bonham, 247 So.2d 379. By the same logic, a regulation cannot create or allow a deduction that is not already authorized by statute.

Deductions are allowed only as a matter of legislative grace, and can be granted only where clearly allowed by statute. State v. Sprinkle Net Shop, Inc., 351 So.2d 608. The Taxpayers concede that Alabama does not have a statute allowing a pass-through of a irrevocable trust loss to a beneficiary.

Consequently, notwithstanding subparagraph (a) of Reg. 810-3-25-.05(7), the claimed pass-through deduction in issue was properly disallowed.

The assessment in issue is upheld and judgment is entered against Michael D. & Netagene Thompson for 1990 Alabama income tax in the amount of \$5,477.05, with additional interest computed from December 24, 1991.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered on January 3, 1994.

BILL THOMPSON
Chief Administrative Law Judge