

DANIEL E. & ALICE M. SKUTACK § STATE OF ALABAMA
807 East University Drive DEPARTMENT OF REVENUE
Auburn, Alabama 36830-6235, § ADMINISTRATIVE LAW DIVISION
Taxpayers, § DOCKET NO. INC. 96-234
v. §
STATE OF ALABAMA §
DEPARTMENT OF REVENUE.

OPINION AND PRELIMINARY ORDER

The Revenue Department denied refunds of 1988 and 1989 income tax requested by Daniel E. and Alice M. Skutack ("Taxpayers"). The Taxpayers appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(c)(5)a. A hearing was conducted on August 20, 1996. The Taxpayers represented themselves at the hearing. Assistant Counsel Antoinette Jones represented the Department.

This case involves three issues:

(1) Were the Taxpayers domiciled in Alabama in 1988 and 1989 and thus liable for Alabama income tax in those years;

(2) If domiciled in Alabama, were the Taxpayers liable for Alabama income tax on their foreign income earned in Saudi Arabia during those years; and

(3) Did the Taxpayers timely claim the refunds as required by Code of Ala. 1975, §40-2A-7(c)(2).

The Taxpayers lived and worked in Auburn, Alabama prior to 1988. Mr. Skutack accepted a job in Saudi Arabia, and the Taxpayers moved to Saudi Arabia in August 1988. They moved back to Alabama in late 1991 or early 1992.

The Taxpayers timely filed Alabama income tax returns for 1988 and 1989. However, they failed to report their foreign income earned in Saudi Arabia on the returns because they were involved in an ongoing dispute with the IRS concerning the federal foreign earned income exclusion allowed at 26 U.S.C.A. §911.

The Taxpayers subsequently reported the foreign income to Alabama by filing amended 1988 and 1989 Alabama returns in November 1990. The amended returns reported additional tax due of \$1,314.00 in 1988, and \$2,055.00 in 1989. The Taxpayers failed to pay the additional tax due because of the ongoing dispute with the IRS.

The Department accepted the amended returns and entered final assessments for the additional tax due, plus penalty and interest.

The 1988 assessment was entered on September 3, 1992. The 1989 assessment was entered on November 8, 1993.

The Taxpayers continued filing Alabama returns for 1990 and subsequent years. The 1993 and 1994 returns claimed refunds of \$1,214.00 and \$898.00, respectively. The Department applied the 1993 refund in July 1994 to pay the Taxpayers' 1988 liability in full and partially satisfy their 1989 liability. The Department applied the 1994 refund to the 1989 liability in July 1995. The Department also garnished \$1,570.51 from the Taxpayers' bank account in November 1995 to satisfy the 1989 assessment.

In the meantime, the IRS conceded in May 1994 that the Taxpayers were entitled to the federal foreign earned income

exclusion. The Taxpayers assumed that the foreign earned income also was not taxable in Alabama, and accordingly excluded the foreign income on a second set of amended 1988 and 1989 Alabama returns filed in May 1995. The 1988 amended return claimed a refund of \$978.00. The 1989 amended return claimed a refund of \$1,803.00. It is unclear how the Taxpayers computed the amount of the refunds claimed on the second amended returns. The refunds were also claimed before most of the subject tax was collected by the Department. In any case, the Department denied the refunds, and the Taxpayers appealed to the Administrative Law Division.

Issue 1 - Domicile.

The threshold issue is whether the Taxpayers were domiciled in Alabama during 1988 and 1989, and thus liable for Alabama income tax in those years pursuant to Code of Ala. 1975, §40-18-2(7).

The Taxpayers resided in Saudi Arabia for the last four months of 1988, and all of 1989. However, a person can reside outside of Alabama and still be domiciled in Alabama for tax purposes. A person's domicile is his true, fixed home to which he intends to return when absent. To change domiciles, an individual must (1) abandon Alabama with the intent never to return, and (2) establish a new domicile elsewhere with the intent to remain permanently. The presumption is in favor of the original or established domicile, and the burden is on the person claiming a change of domicile to prove that a change has in fact occurred. Whetstone v.

State, 434 So.2d 796 (1983).

Domicile can also be distinguished from a taxpayer's "tax home" or "bona fide residence" as those terms are used concerning the foreign earned income exclusion at 26 U.S.C.A. §911.

The foreign earned income exclusion is allowed for federal purposes if a taxpayer's tax home is a foreign country and the taxpayer is either (1) a bona fide resident of the foreign country for an uninterrupted period that includes an entire tax year, or (2) has a physical presence for at least 330 full days during any consecutive 12 month period. Federal Pub. 54 discusses the exclusion and distinguishes between an individual's tax home and bona fide residence and the individual's domicile, as follows:

. . . Your tax home is the place where you are permanently or indefinitely engaged to work as an employee or self-employed individual. Having a "tax home" in a given location does not necessarily imply that location is your residence or domicile for tax purposes.

. . .

Your bona fide residence is not necessarily the same as your domicile. Your domicile generally is your fixed permanent home, the place to which you always return, or intend to return. You could have a domicile in Cleveland, Ohio and a bona fide residence in London if you intend to return eventually to Cleveland.

The Taxpayers left Alabama in August 1988 and returned in late 1991 or early 1992. During the Taxpayers' stay in Saudi Arabia, they continued filing Alabama returns, they maintained and rented their home in Auburn, and they maintained their bank account in Auburn into which their military and school teacher retirement

checks were deposited. The Taxpayers testified that they intended to live and work in Saudi Arabia indefinitely. However, that claim alone is insufficient to establish a change of domicile to Saudi Arabia, especially considering the Taxpayers' continued ties to Alabama during the subject years. The Taxpayers offered no substantive evidence establishing or verifying their intent to remain permanently in Saudi Arabia. Consequently, they remained domiciled in Alabama and were subject to Alabama income tax during the years in question.

Issue 2 - The taxability of the foreign income.

The IRS conceded in May 1994 that the Taxpayers were entitled to the foreign earned income exclusion. However, Alabama does not recognize a similar exclusion from taxation. Consequently, the Taxpayers properly reported the foreign earned income on their amended Alabama returns filed in November 1990. Tax due on that income was correctly assessed and collected by the Department. Interest on the tax was also due.

However, concerning the penalties assessed by the Department, the Taxpayers reported the foreign income on their amended Alabama returns filed in November 1990, even though they believed the income was not taxable. According to the Taxpayers, they reported the income on the amended returns "to be safe."

The Taxpayers clearly acted in good faith in reporting the income. Consequently, any penalties assessed by the Department should be waived for reasonable cause and refunded to the Taxpayers. Code of Ala. 1975, §40-2A-11(h).

Issue 3 - The statute of limitations issue.

A taxpayer must claim a refund within two years from when the subject tax was paid. Code of Ala. 1975, §40-2A-7(c)(2). If a final assessment was entered for the tax, as in this case, the taxpayer may still apply for a refund within two years, but only if the assessment is paid in full. Code of Ala. 1975, §40-2A-7(c)(1).

The 1988 and 1989 final assessments, which included the penalties, were paid in full in 1994 and 1995 through collection by the Department. Consequently, the Taxpayers properly requested a refund of the penalties within the required two years.

The penalty amounts are not known because copies of the 1988 and 1989 final assessments were not offered at the August 20 hearing. The Department is directed to provide the Administrative Law Division with the amounts of the penalties collected, and any related interest. A Final Order will then be entered directing the Department to refund that amount to the Taxpayers.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered September 13, 1996.

BILL THOMPSON
Chief Administrative Law Judge