

LADIE B. LACKEY
1465 W. COUNTY HIGHWAY 30A
SANTA ROSA BEACH, FL 32459-5112, §

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

Taxpayer, §

DOCKET NO. INC. 06-962

v. §

STATE OF ALABAMA §
DEPARTMENT OF REVENUE.

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Ladie B. Lackey (“Taxpayer”) for 1997, 1998, and 1999 income tax. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on April 20, 2007. CPA Benton Ramey represented the Taxpayer. Assistant Counsel David Avery represented the Department.

The Department initially contended that the Taxpayer resided in Alabama during the subject years, and was thus liable for Alabama income tax on all of her income earned in those years. It assessed the Taxpayer accordingly.

The Department now concedes that the Taxpayer moved to and was domiciled in Florida in the subject years. It argues, however, that the Taxpayer is still liable for Alabama tax on income she received in those years pursuant to a non-compete agreement because the income was sourced in Alabama.

The facts are undisputed.

Before 1996, the Taxpayer resided in Alabama and, with various family members, owned an Alabama-based business, Ridout’s-Browns Service, Inc. The corporation was in the funeral home, cemetery, and related businesses, with numerous locations in Alabama. The Taxpayer was also employed by the corporation.

The Taxpayer and her family members sold the corporation to an unrelated purchaser in 1996. The Taxpayer also signed a non-compete agreement with the purchaser in May 1996. The stated intent of the agreement was to insure that the purchaser retained the continued goodwill and reputation of the business in the areas that it operated.

Pursuant to the agreement, the Taxpayer agreed that for a period of 15 years, she would not directly or indirectly engage in the funeral home or related businesses within a 30 mile radius of any of the business's existing locations. She also agreed not to intentionally damage or harm the goodwill of the business, assist any competitor of the business, or otherwise take any action detrimental to the business. In return, the purchaser agreed to pay the Taxpayer \$1 million in 120 installments of \$8,337.33 per month. The agreement provided that if the Taxpayer died before the \$1 million was paid in full, the remaining payments would be paid to her estate.

As indicated, the parties agree that the Taxpayer was domiciled in Florida in the subject years. The issue is whether the non-compete payments received by the Taxpayer in those years constituted Alabama-sourced income. If so, the Taxpayer is liable for Alabama tax on the income.

The Taxpayer's representative contends that the non-compete agreement was separate from the sale of the business, and that the income from the agreement was sourced in Florida, the Taxpayer's state of domicile. "As the Taxpayer has clearly been domiciled in Florida throughout the time period in question and her forbearance from taking the prohibited actions has taken place where she resides, the income from the Noncompete must be sourced to Florida." Taxpayer's Response to Department Position at 4.

The Department contends that the non-compete payments were Alabama-sourced because the payments were in substance derived from the sale of the Alabama-based funeral home business. The Department cites the Taxpayer's March 1998 divorce decree in support of its position. One issue in the divorce was whether the non-compete payments were marital assets subject to division between the parties. The court found for the Taxpayer, holding that the husband was not entitled to a part of the payments because they were non-marital assets derived from the sale of the Taxpayer's family business.

Based upon the testimony given at trial, the Court finds that these (non-compete) payments, too, were proceeds from the sale and not marital assets. The price of the company was directly reduced by the amount of the covenant not to compete so these payments were merely a different form of paying the price for the ownership of the company, but with different income tax treatment.

Department's Response at 5.

The Department also argues in the alternative that the payments were Alabama-sourced because they were paid for the Taxpayer not to compete against the purchaser in Alabama. That is, the income was for personal services (the forbearance from competing) that were "performed" in or related to Alabama, and thus should be sourced to Alabama.¹

Concerning the Department's claim that the payments were derived from the sale of

¹ The Department also suggests that the Taxpayer moved to Florida in 1996 to avoid Alabama income tax on the income from the non-compete agreement. The Taxpayer's representative disputes that claim. In any case, if the Taxpayer moved to Florida with the intent to abandon Alabama and remain permanently in Florida, her motive for doing so would be irrelevant. Even if a taxpayer's primary or only motive in moving from Alabama to another state is to avoid Alabama tax on some future income, such income will not be subject to Alabama tax if the taxpayer in fact abandons Alabama and establishes a new domicile in the other state before receipt (or constructive receipt) of the income. This assumes, of course, that the income is not Alabama-sourced. The above statement is not intended to imply or indicate that a lack of economic substance or business purpose may not be relevant in a different tax-related context.

the business, the Taxpayer asserts that the “Department’s heavy reliance on the dicta of the judge in the divorce decree is misplaced.” Taxpayer’s Response at 2. She claims that the judge “was not determining the sourcing of the compensation to the Taxpayer for income tax purposes.” See again, Taxpayer’s Response at 2. Rather, she argues that the judge was only explaining why the ex-husband was not entitled to a portion of the payments in their divorce.

I agree that the judge in the divorce proceeding was not determining the source or nature of the non-compete payments for income tax purposes. But he nonetheless determined that based on the evidence, the payments constituted proceeds from the sale of the business. The Taxpayer presumably argued in the divorce case that the non-compete payments were from the sale of the family business, in which case they would not be marital assets that she would be required to share with her ex-husband. As indicated, the judge agreed.² The Taxpayer cannot assert a fact in one legal proceeding, i.e., that the non-compete payments were derived from the sale of the business, and then take a contrary position in this subsequent legal proceeding.

In any case, even if the judge’s factual finding in the divorce decree is ignored, the nature of the non-compete agreement itself establishes that the payments are Alabama-sourced.

² The judge stated that the non-compete payments “were merely a different form of paying the price for the ownership of the company, but with different income tax treatment.” Department’s Response at 5. However, because the payments were derived from the sale of the business, the tax treatment would be the same.

The agreement indicates that the Taxpayer's family business had 18 locations, all in Alabama and more than 30 miles from the Alabama State line, except a location in Decatur, Alabama, which is approximately 20 to 25 miles from Tennessee. The agreement prohibits the Taxpayer from competing with the purchaser within 30 miles of any of the locations. Consequently, although the Taxpayer resided in Florida in the subject years, the non-compete agreement required her not to take certain actions in Alabama. That is, the personal service rendered by the Taxpayer was her forbearance from competing with the purchaser in Alabama. Consequently, the Taxpayer is incorrect that her forbearance from taking the prohibited actions occurred at her residence in Florida. Rather, that forbearance occurred in Alabama.

Department Reg. 810-3-14-.05(1)(b) provides that "[c]ompensation for personal services rendered by a nonresident outside this State and not connected with the management or conduct of a business in this State is excluded from gross income. . . ." The above regulation does not apply because, as discussed, the Taxpayer's services, i.e., her agreement not to compete, were in effect performed in Alabama because she agreed not to compete with the purchaser in Alabama. In any case, the services were clearly connected with or related to a business in Alabama, and thus would not be excluded from income per the above regulation.

The final assessments in issue include penalties, which may be waived for reasonable cause. Code of Ala. 1975, §40-2A-7(h). The Taxpayer did not file Alabama returns for the subject years because she was domiciled in Florida in those years. The Taxpayer nonetheless still should have filed non-resident Alabama returns in those years and reported the non-compete payments as Alabama-sourced income. But her position

that the income was not Alabama-sourced is not unreasonable on its face.

It is also presumed that the CPA group that represented the Taxpayer in this appeal also prepared her income tax returns, and that they advised the Taxpayer that Alabama returns were not due in the subject years. Reliance on a competent tax advisor constitutes reasonable cause . Rev. Proc. 97-003. But even if the Taxpayer received no such advice, the penalties in issue should be waived for cause under the unusual circumstances of this case.

The Department is directed to notify the Administrative Law Division of the Alabama tax owed by the Taxpayer in the subject years on the non-compete income. A Final Order will then be entered for the tax due, plus applicable interest.

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 April 15, 2008.

BILL THOMPSON
Chief Administrative Law Judge

bt:dr

cc: David E. Avery, III, Esq.
Benton B. Ramey, CPA
Tony Griggs