

JOHN A. & ANN A. GASSER
9310 SW 46TH PLACE
GAINESVILLE, FL 32608-7111,

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§

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

Taxpayers, §

DOCKET NO. INC. 11-489

v. §

STATE OF ALABAMA §
DEPARTMENT OF REVENUE.

FINAL ORDER

The Revenue Department assessed John A. and Ann A. Gasser (“Taxpayers”) for 2002 Alabama income tax. The Taxpayers appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. The case was submitted on a joint stipulation of facts, briefs, and reply briefs. Tom Brinkley and David Humber represented the Taxpayers. Assistant Counsel Billy Young represented the Department.

ISSUE

John Gasser (individually “Taxpayer”) resided in Florida in 2002 and had no business contacts with Alabama in that year. He sued various individuals in circuit court in Alabama for fraud and other claims relating to stock he owned in a Delaware C-corporation headquartered in Alabama. He settled the lawsuit in 2002. The issue is whether the Taxpayer is liable for Alabama income tax on the lawsuit settlement proceeds.

FACTS

The stipulated facts are as follows:

1. John A. Gasser and Ann A. Gasser have been individual residents of the State of Florida (and non-residents of the State of Alabama) from March of 1997 to the present.
2. On March 17, 1997, Owensboro Investment Company, Inc., a Kentucky S-corporation (“Owensboro”), sold its athletic footwear business assets to Athletic Attic Retail Company, a Florida corporation (and an affiliate

of Just for Feet, Inc., an Alabama corporation ("JFF"), in exchange for the JFF Stock (the "Asset Sale").

3. Owensboro was incorporated and governed under the laws of the Commonwealth of Kentucky. All of Owensboro's business activities occurred in Kentucky. Owensboro's sole business activity was the operation of three separate athletic apparel stores as a franchisee in Kentucky. Owensboro's bank account was located in Kentucky, its corporate books and records were maintained in Kentucky, its tax returns were prepared and filed in Kentucky and its manager lived in Kentucky.

4. The assets sold by Owensboro in the Asset Sale consisted solely of the leasehold interests in real property located in the Commonwealth of Kentucky, inventory located in Kentucky and other assets located in Kentucky.

5. None of the assets of Owensboro sold in the Asset Sale were located or used in any business in the State of Alabama.

6. On or around October 31, 1997, all Stock in JFF owned by Owensboro ("JFF Stock") was distributed to Gasser, as a result of the dissolution of Owensboro, which dissolution occurred on or about December 31, 1997 under the laws of the Commonwealth of Kentucky.

7. JFF Stock held by Owensboro, and then distributed to Gasser, was at all times an intangible asset.

8. At all times after the distribution of the JFF Stock, Gasser held the JFF Stock as an investment.

9. While owned by Gasser, the JFF Stock was not used by Gasser in the day-to-day operations of a trade or business in the State of Alabama or operationally related to sources within the State of Alabama.

10. At all times upon and after the distribution of the JFF Stock to Gasser, Gasser had no Alabama commercial domicile.

11. At all times after the distribution of the JFF Stock to Gasser, such JFF Stock was not used in connection with any business conducted in the State of Alabama; employed as capital in the State of Alabama; pledged as collateral for any business in the State of Alabama; or owned within the State of Alabama.

12. JFF was formed as a corporation under the laws of the State of Alabama on September 14, 1977.

13. On June 26, 1998, JFF merged with and into Just For Feet, Inc., a Delaware corporation (the combined entity hereinafter referred to as "JFF").

14. JFF filed for bankruptcy in November of 1999 and the JFF Stock then-held by Gasser lost significant value. At that time, JFF was a publicly-traded corporation existing and governed under the laws of the State of Delaware and headquartered in the State of Alabama.

15. The location of the JFF business office was 7400 Cahaba Valley Road, Birmingham, Alabama 35242.

16. On March 16, 2000, Gasser and Owensboro filed an action (the "Lawsuit") in the Circuit Court for Shelby County, Alabama for claims related to the JFF Stock received due to the Asset Sale by Owensboro in March of 1997. The Lawsuit was filed against Harold Ruttenberg, an Alabama resident, and various other defendants that included both Alabama residents and Alabama non-residents (collectively, the "Defendants").

17. On or about April 1, 2002, Gasser and Owensboro reached a settlement as to the Lawsuit with all of the Defendants except Deloitte & Touche LLP ("JFF Stock Settlement #1").

18. In connection with JFF Stock Settlement #1, on or about April 1, 2002, Gasser and Owensboro executed a Mutual Release Agreement with all of the Defendants but for Deloitte & Touche LLP and signed and delivered to the Shelby County Circuit Court a Stipulation of Dismissal and Proposed Order to that effect.

19. On or about August 15, 2002, Gasser and Owensboro reached a settlement as to the Lawsuit with Deloitte & Touche LLP related to the JFF Stock ("JFF Stock Settlement #2"). The terms of the written settlement agreement among Gasser, Owensboro and Deloitte & Touche LLP were governed under the laws of the State of Alabama.

20. In 2002, Gasser was issued an Internal Revenue Service Form 1099-MISC in the amount of \$435,000 pertaining to JFF Stock Settlement #1 and JFF Stock Settlement #2 for the tax period ending December 31, 2002.

21. Amounts received by Gasser in JFF Stock Settlement #1 and JFF Stock Settlement #2 were solely paid in connection with and in settlement of damages owed to Owensboro and Gasser from the ownership of the JFF Stock.

ANALYSIS

Nonresident individuals are liable for Alabama income tax on income received “from property owned or business transacted in Alabama.” Code of Ala. 1975, §40-18-2(a)(6). The first question is whether the settlement proceeds were derived from “property owned” by the Taxpayer in Alabama.

The Taxpayer received the income in issue as a result of his ownership of stock, which is an intangible asset. Income derived from an intangible asset is generally taxable in the home state or domicile of the owner. But if an intangible asset has acquired a business situs in another state, any income derived from the asset may be taxed by the other state. In *Anniston Sportswear Corp. v. State of Alabama*, 151 So.2d 778 (1962), the Alabama Supreme Court, quoting *United Gas Corporation v. Fontenot*, 129 So.2d 776, 778 – 779, explained the state taxation of income from intangibles, as follows:

Universal recognition has been given to the general rule, established by a fiction of the law, that the situs of intangibles (with which we are here dealing) is at the legal domicile of the owner - - ‘Mabilia sequuntur personam’ However, the courts have also recognized an exception to such rule which is that where certain circumstances exist a state may look behind the mentioned fiction to the realities of the situation to the end that a foreign corporation receiving the benefits furnished by that governmental subdivision may be required to pay its fair and just share of the cost of such benefits.

* * *

Also it has often been held that, despite the above mentioned fiction, intangibles (for tax purposes) may acquire a situs of their own in a state other than that of the legal domicile of the owning corporation when they are also used as an integral part of its business conducted in such other state. This is known, as the ‘business situs’ of the intangibles. It may be at the ‘commercial domicile’ of the owner, or it may exist independently of either the legal or commercial domicile of such corporation, since the business situs depends solely on the use of the intangibles in the corporation’s activities and in carrying out the scheme of its corporate functions within the taxing

state. (cites omitted)

Anniston Sportswear, 151 So.2d at 782.

Following the Supreme Court's holding in *Anniston Sportswear*, Department Reg. 810-3-14-.05(2)(a) correctly states that the "[g]ross income of a nonresident includes income from . . . intangible property with a business situs in Alabama." As stipulated, the Taxpayer resided in Florida at all times after 1997. Consequently, as an Alabama nonresident, the Taxpayer would be liable for Alabama income tax on the settlement proceeds only if the underlying stock had acquired a business situs in Alabama.

The Administrative Law Division addressed the issue of when an intangible acquires a business situs in *State of Alabama v. Nancy M. Parker Trust*, Docket Inc. 85-178 (Admin. Law Div. 5/30/1986), as follows:¹

Alabama statutory law does not address the question of the business situs of intangible personal property. Also, no Alabama case has effectively addressed the issue. Consequently, general common law principles and the case law from other jurisdictions must be looked to for guidance.

Black's Law Dictionary, Revised Fourth Edition, defines "business situs" as follows:

A situs acquired for tax purposes by one who has carried on a business in the state more or less permanent in its nature. *Endicott, Johnson & Co. v. Multnomah County*, 96 Or. 679, 190 P. 1109, 1111. A situs arising when notes, mortgages, tax sale certificates and the like are brought into the state for something more than a temporary purpose, and are devoted to some business use there and thus become incorporated with the property of the state for revenue purposes. *Lockwood v. Blodgett*, 106 Conn. 525, 138 A. 520, 525. A situs arising where possession and control of property right has been localized in some independent business or investment away from owner's domicile so that its substantial use and value

¹ The statement in the following quote that "no Alabama case has effectively addressed the issue" is clearly not correct, see *Anniston Sportswear*.

primarily attach to and become an asset of the outside business. *State v. Atlantic Oil Producing Co.*, 174 Okl. 61. 49 P.2d 534, 538.

The elements and nature of the "business situs" doctrine as it relates to intangible property is discussed at length at 71 Am.Jur.2d §§671. 672. 673 and 674. In addition, a number of cases cited in brief by the Taxpayer offer a clear understanding of the concept. *Tennessee Coal, Iron and R. Co., v. State*. 193 So. 143 (1940); *Alabama Textile Products Corp. v. State*, 83 So.2d 42 (1955); *Kentucky Department of Revenue v. Bomar*, 486 S.W.2d 532 (1972); and *John C. Humpage v. Robards*, 625 P.2d 469 (1981), among others.

Succinctly stated, the above authorities provide that for intangible property to acquire a business situs in a jurisdiction other than the domicile of the owner, the intangible asset must have some substantial and integral connections with local business activities. The asset must be actually used and have some active and necessary part in a business venture.

* * *

To begin, the stock certificates in question were not physically located within Alabama at the time of sale. More importantly, there is no evidence that the stock was even remotely used or otherwise involved in a local business activity within Alabama. It is unclear as to what extent and in what manner an intangible asset must be involved in a business activity so as to make the business situs rule applicable. That is a question of fact that must be decided on the particular circumstances of each case. However, if the asset is not located within the State, and there is no indication that the asset was used even indirectly in conducting a business within the State, clearly the asset would not have a business situs in the State.

Parker at 4 – 7.

The parties stipulated that the stock in issue was held by the Taxpayer as a passive investment, and that it was not used either directly or indirectly in any business in Alabama or elsewhere. The stock thus had not acquired a business situs in Alabama. The settlement resulting from the Taxpayer's ownership of the stock thus was not derived from property owned in Alabama.

The next question is whether the proceeds were derived from “business transacted” in Alabama. That is, was the Taxpayer doing business in Alabama when he filed and subsequently settled the lawsuit in the State.

“Doing business” is not statutorily defined for Alabama tax purposes. The Alabama Supreme Court has held, however, that a corporation is doing business in Alabama if it is “engaged (in Alabama) in the transaction of business, or any part of the business, for which it was created.” *State v. Anniston Rolling Mills*, 27 So. 921, 922 (1900); See also, *State v. City Stores Co.*, 171 So.2d 121 (Ala. 1965); *Dial Bank v. State of Alabama*, Docket Inc. 95-289 (Admin. Law Div. 8/10/1998) (“On the other hand, doing business in Alabama is a practical question of whether a taxpayer is engaged in a primary business activity in Alabama.” *Dial Bank* at 13). “Alabama courts have, on occasion, construed the term ‘engage in business’ . . . to indicate a regular and legal employment. . . .” *Scott & Scott, Inc. et al. v. City of Mountain Brook*, 844 So.2d 577, 591 (Ala. 2002).

The Taxpayer is not an attorney, and there is no evidence that the Taxpayer has ever filed other lawsuits in Alabama or elsewhere. Consequently, because the Taxpayer was not in the business of filing lawsuits, his filing and subsequent settlement of the lawsuit did not constitute “business transacted” in Alabama. The settlement proceeds thus were not derived from property owned or business transacted in Alabama, and consequently are not subject to Alabama income tax.²

² The Taxpayer also argues that the settlement income was non-business income, and thus allocable to Florida, his state of residence, citing the definition of “business income” at Code of Ala. 1975, §40-27-1.1. I agree that the income was not business income as defined at §40-27-1.1. The Department is also correct, however, that §40-27-1.1, which is part of the Multistate Tax Compact (“MTC”), Code of Ala. 1975, §40-27-1 et seq., does not apply to individuals, see Code of Ala. 1975, §40-27-1, Art. II, 3., which defines “Taxpayer”

The Department cites *Hutson v. State of Alabama*, Docket Inc. 05-505 (Admin. Law Div. 3/2/2006), and *Prince v. State Dept. of Revenue*, 55 So.3d 273 (Ala. 2010) in support of its position. Neither case is applicable.

In *Hutson*, a South Carolina attorney tried a class action lawsuit in federal court in Alabama. The case settled, and the attorney received a fee from the settlement proceeds.

The Administrative Law Division held that the taxpayer was subject to Alabama tax on the fee because it was derived from business transacted by the taxpayer in Alabama.

The Taxpayer was also subject to Alabama tax on the income earned in Alabama in 1995. Code of Ala. 1975, §40-18-2(6) levies an income tax on every nonresident individual receiving income from property owned or business transacted in Alabama. The Taxpayer transacted business in Alabama when he filed a class action lawsuit in Alabama and represented numerous Alabama residents in the lawsuit. The fee his partnership received in 1995 as a result of that business transacted in Alabama clearly constituted Alabama-sourced income subject to Alabama income tax. The Taxpayer also had sufficient contacts with Alabama so as to be subject to Alabama's taxing jurisdiction.

Hutson at 2 -3.

This case can be factually distinguished from *Hutson* because the taxpayer in *Hutson*, as an attorney, was in the business of representing clients and filing and settling lawsuits. The Taxpayer in this case is not an attorney, and the lawsuit in issue and the underlying stock were unrelated to any business conducted by the Taxpayer in Alabama or elsewhere.

Prince can also be distinguished. In that case, an Alabama S-corporation merged with another company. The S-corporation shareholders elected under 26 U.S.C. §338(h)(10) to treat the transaction as a sale of the S-corporation's Alabama assets to the

to include various business entities, "but does not include any individual."

other corporation. The issue was whether a Mississippi shareholder was liable for Alabama income tax on his distributive share of the transaction proceeds.

The Court of Civil Appeals held that because the shareholders had made the §338 election, the transaction must be treated as a sale by the S-corporation of its Alabama assets. Consequently, because the income was derived from property owned in Alabama, i.e., the physical assets of the S-corporation located in Alabama, it was taxable to the nonresident shareholder pursuant to §40-18-2(a)(6).³ In this case, the settlement proceeds were not derived from property owned in Alabama or, as discussed, from business transacted in the State. *Prince* is thus inapplicable

The final assessment in issue is voided. Judgment is entered accordingly.

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

Entered October 15, 2012.

BILL THOMPSON
Chief Administrative Law Judge

bt:dr

cc: Warren W. Young, Esq.
Thomas H. Brinkley, Esq.
Brenda Lausane

³ The Court in *Prince* also rejected the taxpayer's arguments that the Revenue Department was prohibited from taxing the income by the Due Process Clause of the Fourteenth Amendment to the U.S. Constitution, and also the Commerce Clause, art. I, §8, cl. 3, of the Constitution. Those constitutional arguments need not be addressed in this case because, unlike the income in *Prince*, the income in issue was not subject to the Alabama income tax levied against nonresidents at §40-18-2(a)(6).