

STATE OF ALABAMA, § STATE OF ALABAMA  
V. § DEPARTMENT OF REVENUE  
CARL A. & CLAUDINE R. MCGREW § ADMINISTRATIVE LAW DIVISION  
4851 Bethany Lane  
Santa Maria, CA 93455, § DOCKET NO. INC.85-147  
Taxpayers. §

ORDER

This matter involves two disputed preliminary assessments entered by the Revenue Department against the Taxpayers for the calendar years 1982 and 1983. A hearing was scheduled by the Administrative Law Division for 10:00 a.m., September 19, 1985. Notice of said hearing was sent to the Taxpayers by certified mail on August 14, 1985. The notice was received by the Taxpayers on August 19, 1985, as evidenced by the certified mail return receipt card. On the date set for the hearing, the Taxpayers, without explanation, failed to appear. The Revenue Department was present through assistant counsel Mark Griffin. The hearing proceeded, and based on the evidence submitted therein, the following findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

On August, 1981, the Taxpayers moved from Alabama to the Marshall Islands. The Taxpayers resided and worked in the Marshall Islands until 1984, at which time they moved to California. During the years 1982 and 1983, the Taxpayers owned property in Alabama and also maintained a bank account in the State in which they periodically deposited money. For 1982 and 1983, the Taxpayers

filed resident Alabama income tax returns. On said returns, the Taxpayers reported their entire gross income, but also claimed a foreign earned income exclusion for all income earned in the Marshall Islands.

The Revenue Department reviewed the Taxpayers' returns for 1982 and 1983 and disallowed the foreign income exclusions claimed thereon. The Department argues that Alabama law does not recognize such an exclusion. The preliminary assessments in issue were entered as a result of the disallowed exclusions. At the hearing, the Department conceded that the penalties included as part of the assessments should not have been levied.

The Taxpayers, through a written response to the Department's position, which was filed prior to the hearing, in this matter, argue that their entire foreign income should be exempt from Alabama tax. The Taxpayers also argue that they weren't domiciled in Alabama during the years in dispute. Finally, the Taxpayers contend that they should be allowed a credit under §40-18-21 for taxes paid by them to the Marshallese government. However, on the credit question, no evidence is before the Court indicating that the Taxpayers did in fact pay income tax to the Marshall Islands government.

#### CONCLUSIONS OF LAW

This case presents three legal issues. The first is whether the Taxpayers were domiciled in Alabama during the tax years in

question. The second is whether the Marshall Islands qualify as a territory of the United States within the purview of Code of Alabama 1975, §40-18-21. The third is whether the Taxpayers' foreign Income is exempt from income tax in Alabama.

On the question of domicile, based on the facts before the Court it must be found that the Taxpayers were domiciled in Alabama during the years 1982 and 1983. During that period, the Taxpayers maintained contact with the State of Alabama through the ownership of property and the maintenance of a bank account in the State. In addition, the Taxpayers also failed to establish the Marshall Islands as a subsequent domicile of choice.

Under Alabama law, for a change of domicile to occur, the former domicile must be abandoned and a new residence must be established, along with the Intention to remain permanently at the new location. Further, the burden is on the one asserting a change to establish the existence of a new domicile. State ex rel. Rabren v. Baxter, 239 So.2d 206; Whetstone v. State, 434 So.2d 796.

In the present case, there is no evidence to indicate that the Taxpayers intended to establish the Marshall Islands as their permanent domicile. Indeed, the Taxpayers moved from the Marshall Islands in 1984 and now reside in California. Clearly the Taxpayers' temporary stay in the Marshall Islands in 1982 and 1983 cannot be said to have effected a change of domicile from Alabama.

The second question is whether the Marshall Islands is a

territory of the United States under the provisions of Code of Alabama 1975, §40-18-21. That section provides a tax credit for "income tax actually paid by such a resident to any state or territory . . ."

The exact status for the Marshall Islands is uncertain. As part of the Trust Territory of the Pacific Islands, the governmental authority for the Islands is set out at 48 U.S.C. §§1681-1695. Under those sections, and by certain presidential proclamations and executive orders, the United States Congress and the President are granted various powers and controls over the administration of the government of the Trust Territory. In Sablan Construction Company v. Government of Trust Territory, Etc., 526 F.Supp. 135 (1981), the court described the unique position of the Trust Territory as follows:

[31 At most the Trust Territory has "quasi-sovereignty," which courts also describe interchangeably, more frequently, and more precisely as "qualified sovereignty." This qualified sovereignty is the right to exercise local governmental authority delegated by the United States Congress pursuant to its legislative powers under the Trusteeship Agreement. People of Saipan, 356 F.Supp. at 658-659; Calvo v. Trust Territory, 4 T.T.R. 506, 511-512 (H.C.App. Div. 169). It is limited sovereignty which is similar but not identical to that of a state government. See People of Saipan, 356 F.Supp. at 658. To an even greater degree than state government authority, it yields to the will of Congress.

In People of Saipan v. U.S. Department of Interior, 356 F.Supp. 645 (1973), the court, after documenting the United States' significant control over the Trust Territory, found that the

Territory was not a foreign government for purposes of immunity from suits in the United States courts.<sup>1</sup> However, after refusing to determine exactly what status the Trust Territory occupies, the court did recognize, at page 656, that the Trust Territory was not a territory or possession of the United States because the United States does not have sovereignty.

In spite of the fact that the Marshall Islands has many of the characteristics of a U.S. territory, it must be found, as held in People of Saipan v. United States Department of Interior, supra, that the Trust Territory of the Pacific Islands, which includes the Marshall Islands, is not a territory of the United States. Accordingly, the Taxpayers should not be allowed a credit for taxes paid to the Marshallese government. In any case, even if the Marshall Islands qualified as a U.S. territory, there is no evidence to indicate that the Taxpayers did in fact pay an income tax to the Marshallese government.

On the third issue raised by the Taxpayers, Alabama law does not provide for an exclusion or exemption for income earned outside of the United States. Accordingly, the Taxpayers' claim of an exclusion for income earned while in the Marshall Islands is not

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<sup>1</sup> In Callas v. U.S., 253 F.2d 838, 840 (Second Circuit 1958), cert. denied 357 U.S. 936, 78 S.Ct. 1384, 2 L.Ed.2d 1550 (1958), and Brunell V. U.S., 77 F.Supp. 68, 72 (1948) it was determined that the Trust Territory was a "foreign country" for purposes of the Federal Tort Claims Act. However, the People of Saipan court made it clear that those cases were relative to only the Federal Tort Claims Act.

proper and cannot be allowed.

Based on the above findings and conclusions, the Revenue Department is hereby directed to make final the preliminary assessments in issue, with appropriate interest as required by law.

As conceded by the Revenue Department, the penalty included in both assessments should be omitted.

Done this 24th day of September, 1985.

BILL THOMPSON  
Chief Administrative Law Judge