

STATE OF ALABAMA
DEPARTMENT OF REVENUE,

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

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v.

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DOCKET NO. INC. 85-178

NANCY M. PARKER TRUST
No. 21-3239-02
c/o Merchants National Bank,
as Executor/Trustee
P.O. Drawer 2527
Mobile, AL 36622,

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Taxpayer.

ORDER

This case involves a preliminary assessment of income tax entered by the Revenue Department against Nancy M. Parker Trust No. 21-3239-02 (Taxpayer) for the fiscal year ending 3/31/84. A formal hearing was conducted by the Administrative Law Division on April 10, 1986. Representing the parties at said hearing were attorney F. M. Keeling, for the Taxpayer, and assistant counsel Adolph Dean. for the Department. Based on the evidence of the case, and in consideration of the arguments and authorities submitted by the parties, the following findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

The relevant facts of the case are undisputed. and, as stated by the Taxpayer in TAXPAYERS RESPONSE TO NOTICE OF HEARING, are as follows:

Statement of Facts - The Taxpayer in the proceeding, Nancy M. Parker Trust, No. 21-3239-02, was formed on August 10, 1971 by M.P. McLean of the State of New York,

as the Settlor, and The Merchants National Bank of Mobile, Alabama (now known as "First Alabama Bank"), as the Trustee. The Beneficiary of the Trust was Nancy McLean Parker, who is Mr. McLean's oldest daughter. At the time the trust was established, the Beneficiary was a resident of the State of Alabama. In the Spring of 1979, the Beneficiary's husband accepted a position in New Jersey, and the Beneficiary and her husband moved to New Jersey. The trust agreement provides that the net income of the Trust was to be distributed currently to the Beneficiary thereof and that one-third of the Trust principal was to be distributed to the Beneficiary when she attained the age of thirty-five, one-half of the remaining Trust principal was to be distributed to the Beneficiary when she attained the age of forty-five and that all of the remaining principal of the Trust was to be distributed to the Beneficiary at the time she attained the age of fifty-five. The Trust is irrevocable and the Settlor of the Trust relinquished all rights, powers and privileges of whatsoever kind in connection with the administration of the Trust and the principal and income thereof. The Trust was funded primarily with RJR stock and the RJR stock was held in trust from 1971 until the time it was sold in 1984. The only transaction in question in this proceeding concerns the gain generated by the sale of the RJR stock by the Trustee during the fiscal year ending March 31, 1984. As a result of the sale of the RJR stock, approximately \$832,584 of gain was generated. The State of Alabama has issued an assessment against the Taxpayer of approximately \$41,514 plus interest.

At the administrative hearing, Mr. Peter Sherman, Trust officer with the Trustee, First Alabama Bank, testified that in 1981, the stock certificates in issue were delivered outside of the State and held continuously thereafter by the Depository Trust Company in New York City. The sale of the stock was directed by the Trustee and was effected on the New York Stock Exchange, with the proceeds of the sale being transmitted to the Trustee in Alabama for reinvestment. None of the present trust investments are in Alabama

based securities, nor are the security certificates physically located within the State.

CONCLUSIONS OF LAW

The income tax liability of trusts is governed in Alabama by Code of Alabama 1975, §40-18-25. Subsection (a) thereof sets out four types of income that are subject to taxation. The third and fourth categories are pertinent in the present case.

(3) Income held for future distribution under the terms of a will or trust; and

(4) Income which is to be distributed to the beneficiary periodically, whether or not at regular intervals. . .

Subsection (a)(3) income is controlled by §40--18-25(c) and is imposed on the trust, to be paid by the fiduciary. Subsection (a)(4) income is controlled by §40-18-25(d) and is taxed against the trust beneficiary. Although subsections (a)(3) and (a)(4) are similar in substance and to some extent overlapping in scope, the parties agree that the income in question comes under subsection (a)(3). As stated, such income is governed by §40-18-28(c), which states in pertinent part as follows:

. . . and in such cases the estate or trust created by a person not a resident and an estate of a person not a resident shall be subject to tax only to the extent to which individuals other than residents are liable under subdivision (3) of 540-18-14.

The effect of the above section is that a trust created by a non-resident is taxed in the same manner as a non-resident individual, regardless of the domicile of the trust or trustee.

The section makes reference to the liability of non-residents under Code of Alabama 1975, §40-18-14(3). That section provides a broad, all-inclusive definition of "gross income" to include all income received by both residents and non-residents. Nonetheless, §40-18-25(c) is clear that a trust created by a non-resident "shall be subject to tax only to the extent to which individuals other than residents are liable"

The taxation of non-residents is governed by Code of Alabama 1975, §40-18-2(6), which levies a tax on "[E]very non-resident individual receiving taxable income from property owned or business transacted in Alabama". Alabama Income Tax Reg. 810-3-14-.05 relates to the gross income of non-residents and provides in subsection (4)(b) as follows:

(b)The gain or profit of a nonresident from the sale, exchange or other disposition of intangible personal property, including stocks, bonds and other securities, ordinarily is not taxable and should not be included in gross income, except to the extent that such intangible personal property has acquired a business situs in this State.

The trust in question, although physically located in Alabama, is by operation of law under §40-18-25(c) taxable in Alabama as a non-resident. Thus, for the trust income derived from the sale of the R. J. Reynolds stock to be taxable in the State, it must have acquired a business situs in the State as set out by Reg. 810-3-14-.05(4)(b).

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 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.

The Kentucky Court of Appeals, in Kentucky Department of Revenue v. Bomar, supra, citing 51 Am.Jur. Taxation §469, stated as follows:

The existence of a "business situs" on intangibles depends on the different combinations of facts, and statements of the courts as to the circumstances which suffice to create a business situs should not be accepted without qualification, so far as they imply that the facts and circumstances which they embody are essential for the assumption of a business situs. The doctrine is ordinarily formulated so as to limit its application to cases where the possession and control of the property right have been localized in some independent business or investment away from the owner's domicile so that its substantial use and value primarily attach to and become an asset of the outside business

The concepts of "localization" and "integration" of an intangible asset into the local business are integral parts of the "business situs" doctrine and, as discussed at 71 Am.Jur.2d 673, provide as follows:

The trend of modern decisions is to use as a test for the legal existence of a business situs of intangible property. for the purposes of property taxation in a state other than the domicil of the owner, the concept of "localization" of the intangibles and their "integration" with local business in the state. Instead of holding one particular outstanding fact or circumstance as an indispensable condition of such a situs, it is necessary

under the "integration doctrine," in order to authorize taxation. that the intangibles have become an integral part of some business activity, and that their possession and control be localized in some independent business or investment away from the owner's domicile so that their substantial use and value primarily attach to and become an asset of the outside business, or, in other words, that the local independent business controls and utilizes in its own operation and maintenance the intangible property and its income. The courts, although not stating it expressly, usually recognize a business situs of intangibles for the purposes of taxation only when the credits of a nonresident owner are in the possession and control of a more or less independent local agent who holds them for the purpose of transacting a permanent business and of investing and reinvesting the proceeds from the principal or interest in such a manner that the property comes in competition with the capital of the citizens of the state in which the agent resides. To overcome the presumption of domiciliary location, the proof of business situs must definitely connect the intangibles as an integral part of the local activity.

The Department bases its case on the fact that the Trustee in control of the trust assets was located in Alabama. It has been held that the trustee of property held in trust is the owner of the trust assets and that all trust income derived therefrom is taxable in the domicile of the trustee. Curry v. McCanless, 307 U.S. 357, 83 L.Ed. 1339, 59 S.Ct. 900. That position is also consistent with the legal maxim "mobilia sequuntur personam". i.e. movables follow the law of the person. However. 540-18-25(c) requires that the trust in question, having been created by a non-resident, must be taxed in the same manner as a non-resident individual. Consequently, the actual presence of the trustee in Alabama is made irrelevant. Thus, as discussed, only if the stock had a business situs within Alabama prior to its sale would the income derived

from such sale be subject to Alabama income tax. From the facts of the case, the stock clearly had not acquired a business situs in Alabama.

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.

Based on the above, it is hereby determined that the income in issue is not taxable gross income in Alabama. and accordingly, that the assessment in dispute is incorrect. The Department is hereby directed to reduce and make final the assessment in the amount of zero.

Done this 30th day of May, 1986.

BILL THOMPSON
Chief Administrative Law Judge