

STATE OF ALABAMA
DEPARTMENT OF REVENUE,

§

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

§

v.

§

DOCKET NO. INC. 88-127

ESTATE OF NORMAN J. WALTON,

§

Taxpayer.

§

ORDER

The Revenue Department denied a petition for refund of income tax filed by the Estate of Norman J. Walton ("Estate") for the fiscal year ending January 31, 1985. the Estate appealed to the Administrative Law Division and the matter was submitted on a joint stipulation of facts. Joseph R. Sullivan, Esq., represented the Estate. Assistant counsel Mark Griffin acted for the Department.

Based on the facts and legal arguments submitted by the parties and the recommended order entered by the Administrative Law Division, the following findings of fact and conclusions of law are hereby entered.

FINDINGS OF FACT

The relevant facts are undisputed.

The last will and testament of Norman J. Walton made no provision for his widow, Mrs. Martha Walton. Mrs. Walton filed an action in circuit court seeking her statutory share as an omitted spouse under Code of Ala. 1975, §43-8-90. The Estate and Mrs. Walton subsequently reached a settlement which provided in part that Mrs. Walton would receive a lump sum payment of \$78,000.00 and other property during the fiscal year ending January 31, 1985. The

payment of the \$78,000.00 was not contingent upon the Estate receiving taxable income during the subject year, but instead, represented her share of the Estate provided under §43-8-90. The distributions to the widow provided in that section represent a portion of the Estate in lieu of a legacy and are not taxable income to the recipient.

The Estate filed an Alabama income tax return for the fiscal year ending January 31, 1985 and reported distributable net income of \$59,528.00 derived from dividends, interest, rents and gains on stock. The Estate also claimed a deduction of \$59,528.00 based on the \$78,000.00 distribution to Mrs. Walton, which resulted in no taxable income to the Estate for the year. The Estate claims that the \$78,000.00 paid to Mrs. Walton should be allowed as a deduction up to the amount of the Estate's distributable income (\$59,528.00) pursuant to Code of Ala. 1975, §40-18-25(c).

The Department denied the deduction, arguing that the \$78,000.00 was not a distribution of income by the Estate, but instead a compromise settlement between the Estate and Mrs. Walton. The Estate paid the resulting deficiency and filed an amended return seeking a refund of the tax. The Department denied the refund and the Estate appealed to the Administrative Law Division.

CONCLUSIONS OF LAW

Code of Ala. 1975, §40-18-25(a) imposes an income tax on the income of all estates. However, subsection (c) also provides a

deduction to the estate for "the amount of any income properly paid or credited to any legatee, heir, or beneficiary".

The Estate argues that the \$78,000.00 paid to Mrs. Walton constituted income paid to an heir, and as such is deductible up to the amount of the Estate's income for the year. The Estate cites 26 U.S.C. §661 in support of its argument. Section 661 is the federal counterpart to §40-18-25 and provides that any amount (either income or corpus) paid by an estate to an heir or beneficiary is deductible up to the amount of the estate's distributable income. However, while the Alabama and federal statutes relate to the same subject matter, the language of the Alabama statute does not provide for the same deduction as currently allowed by the federal statute.

The predecessor to §40-18-25(c) was enacted in 1935 by Acts of Alabama 1935, No. 194, §345.18, and provided a deduction for "the amount of any income properly paid or credited to any legatee, heir or beneficiary". That section was modeled after the federal statute on point, Revenue Act of 1932, §162(b), which also provided in substance for a deduction for income distributed to a beneficiary or heir. For a history of the federal section, see Anderson's Estate v. C.I.R., 126 F.2d 46.

The old federal statute was interpreted so that only distributions of income were deductible, and not distributions from corpus. That is, if a distribution was not conditioned upon the

receipt of sufficient income by the estate, then it was not deductible. Richards v. C.I.R., 111 F.2d 374, Anderson's Estate v. C.I.R., supra, Craig v. United States, 69 F.Supp. 229 (1946), Bishop Trust Company v. Commissioner of Internal Revenue, 92 F.2d 877 (1937). As stated in Craig v. United States, supra, at p. 241:

It is a well settled principal of law that if the various legacies and bequests together with the annuity to Elsie Craig Simpson were to be paid to the respective parties in all events, said payments would be a charge upon the principal and corpus of said estate. In other words, if said payments are to be made to any of the beneficiaries in any event and are not conditioned upon the existence of sufficient trust income, they are not deductible in computing the taxable net income of the trust estate. Helvering v. Pardee, 290 U.S. 365, 54 S.Ct. 221, 78 L.Ed. 365; Bishop Trust Co. v. Commissioner of Internal Revenue, 9 Cir., 92 F.2d 877; Burnett v. Whitehouse, 283 U.S. 148, 51 S.Ct. 374, 75 L.Ed. 916, 73 A.L.R. 1534; Bush et al. v. Commissioner of Internal Revenue, 9 Cir. 89 F.2d 596. (emphasis added).

The above system created problems in that all distributions had to be traced back to either corpus (nondeductible) or income (deductible), see United States Trust Co. v. U.S., 803 F.2d 1363, 1366 at footnote 6.

However, the problem was rectified when Congress included §661 in the Revenue Code of 1954. Section 661 eliminated the tracing problem by providing that any amount paid to a beneficiary, heir or legatee is deductible up to the amount of the estate's distributable income. Under §661, it is irrelevant whether the distribution is from income or corpus. Lemle v. U.S., 419 F.Supp. 68; Mott v. U.S., 462 F.2d 512; U.S. v. S. Trust Company v. IRS,

supra.

The Estate would prevail if §661 were applicable in Alabama. However, §40-18-25(c) has not been amended to conform to §661 and thus still reads as did the pre-1954 federal law. Consequently, the pre-1954 federal law upon which the Alabama statute was modeled must control. As shown, the cases interpreting the pre-1954 law provided that if the distributions are not conditioned on the receipt of sufficient income by the estate, then the distributions are not deductible.

In the present case, the \$78,000.00 paid to Mrs. Walton was an absolute obligation and was not premised on the receipt of income by the Estate. Thus, under §40-18-25(c) the distribution cannot be deducted by the Estate. As stated in Bishop Trust Company v. Commissioner of Internal Revenue, supra, at page 878:

The Supreme Court has held that, if such payments are to be made to the beneficiaries in any event and are not conditioned upon the existence of sufficient trust income, they are not deductible in computing the taxable net income of the trust estate. Helvering v. Pardee (1933) 290 U.S. 365, 370, 54 S.Ct. 221, 78 L.Ed. 365. The fact that payments were in fact made out of income is immaterial. Bush et al. v. Commissioner of Internal Revenue, (C.C.A.9 1937) 89 F.(2d) 596.

The above considered, the refund claimed by the Estate should be denied. This final order may be appealed pursuant to Code of Ala. 1975, §41-22-20.

Entered this the 14th day of July, 1989.