



RALPH P. EAGERTON, JR.
Commissioner

State of Alabama Department of Revenue

Montgomery, Alabama 36132
ALABAMA DEPARTMENT OF REVENUE
REVENUE RULING 95-009

GEORGE E. MINGLEDORFF III
Assistant Commissioner
LEWIS A. EASTERLY
Secretary

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TO: Company A

FROM: Commissioner of Revenue
Alabama Department of Revenue

DATE: December 12, 1995

RE: Company A's dividend income subtraction to Alabama corporate income tax.

FACTS

Company A (hereinafter referred to as "Taxpayer") is a foreign corporation qualified to do business and doing business in the State of Alabama. Its wholly-owned subsidiary corporation, Company B (hereinafter referred to as "Subsidiary") is a foreign corporation not qualified to do business and not doing business in the State of Alabama. Both Taxpayer and Subsidiary are in the same business enterprise and are commercially domiciled in another state. Each corporation is a calendar year taxpayer.

Taxpayer contemplates that Subsidiary will pay a cash dividend to Taxpayer before December 31, 1995 (hereinafter referred to as the "Dividend").

LAW AND ANALYSIS

The Alabama Supreme Court has previously ruled that the Multistate Tax Compact and its inherent UDITPA provisions have been effective since 1977 by stating that the Alabama legislature adopted it in the 1977 recodification of Alabama laws. See State Department of Revenue v. MGH Management, Inc., 627 So.2d 408 (Ala. Civ. App. 1993) cert denied. (Aug. 27, 1993.)

The practical effect of this court opinion was to make UDITPA the law of Alabama during open tax years that the Department is bound to enforce by Section 100 of the Constitution of Alabama

1901.¹ Thus, after the enactment of UDITPA by the Alabama legislature in 1977, dividends from subsidiaries involved in the same business enterprise constitute business income, as defined by the UDITPA statute and interpreted by the U.S. Supreme Court, and are apportionable.

The U.S. Supreme Court ruled on the constitutionality of the apportionment of dividends when it decided in Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 100 S.Ct. 1223 (1980), that Vermont's power to include foreign source dividends in the apportionable tax base is not precluded by their source:

"so long as the intra-state and extra-state activities form a part of a single unitary business. . . . As these cases indicate, the linchpin of apportionability in the field of state income taxation is the unitary business principle. In accord with this principle, what [taxpayer] must show, in order to establish that its dividend income is not subject to an apportioned tax in Vermont, is that the income was earned in the course activities unrelated to the sale of petroleum products in [Vermont]."

Two cases decided by the U.S. Supreme Court in 1982, *ASARCO* and *Woolworth*, stated that dividends are apportionable if the dividend payors are part of the taxpayer's same business activity with nexus in the taxing state. ASARCO Inc. v. Idaho State Tax Commission, 458 U.S. 307 (1982), and F.W. Woolworth Co. v. Taxation and Revenue Department of New Mexico, 458 U.S. 354 (1982). Later in 1992, the Supreme Court decide *Allied-Signal* and reaffirmed the tests of apportionability of income that it had enunciated in earlier decisions. Allied-Signal, Inc. v. Director, Div. of Taxation, 112 S.Ct. 2251 (1992). Since the Supreme Court in the *Mobile* case found no basis for extending to foreign source dividends special protection against State income taxation, either due to the Commerce Clause or Congressional legislation, the apportionability of dividends under the U.S. Constitution would be the same whether the dividends are derived from foreign or domestic earnings, or in international or interstate commerce.

Alabama is required, therefore, to follow the statutes which provide that dividends from foreign or domestic subsidiary payors

¹Taxpayers have no vested right to rely upon an incorrect interpretation of a statute exempting them from taxation, and under Section 100, the taxing authority has no discretion in a matter of this kind. The reason for this rule is that in the assessment and collection of taxes, the state is acting in its governmental capacity and it cannot be estopped about the enforcement of taxes, even when the taxpayer was advised that it was not responsible for a tax. Were this not the rule, the taxing officials could waive most of the state's revenue. Boswell v. Abex Corp., 317 So.2d 317 (1975).

are presumed to be apportionable income unless a taxpayer can provide evidence showing that the dividend payors, including the foreign subsidiaries, were not part of its discrete business enterprise conducted in Alabama. The Department of Revenue, in presuming that dividends are apportionable income, is following state and federal court decisions.

Before the adoption of the Multistate Tax Compact, Alabama statutes defined neither "business income" nor "nonbusiness income." The Department in the early 1970's, therefore, adopted regulations that defined the "business income" of a corporate taxpayer engaged in multistate operations as:

"income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations."²

The "nonbusiness income" of a corporate taxpayer engaged in multistate operations was defined as "all income other than business income."³ Over the years, the regulations provided for dividend income to be treated presumptively as "nonbusiness income, unless clearly established otherwise."⁴ This rebuttable presumption, however, conflicted with the business income treatment required by the statute and court rulings discussed above.

Considerable discussion developed concerning the Department's enforcement of the statute's treatment of dividends, when received from subsidiaries involved in the same business enterprise as the taxpayer corporation, as business income rather than as nonbusiness income. The Alabama Legislature on July 31, 1995, in Ala. Acts No. 95-591 (1995) effectively provided that the treatment of dividends received before July 31, 1995, by foreign corporations commercially domiciled outside Alabama was to be left as the taxpayer had filed. The statute also provided that the 'as filed' treatment was binding on both the taxpayer and the Department. In limiting the treatment of dividends to those paid or deemed to be paid before July 31, 1995, the Legislature affirmed the future business income treatment

²Alabama Income Tax Regulation ("Inc. Tax Reg..") 810-3-31-.02(a). The identical definition of business income is contained in the Multistate Tax Compact, ALA. CODE §40-27-1, Art. IV.1(a) (1993 Repl.), and the regulations promulgated thereunder. Multistate Tax Compact Regulation ("MTC Reg.") 810-27-1-.01(a).

³Inc. Tax Reg. 810-3-31-.02(1)(e). This definition was adopted without change by the Multistate Tax Compact and the regulations promulgated thereunder. ALA. CODE §40-27-1, Art. IV.1(e) (1993 Repl.); MTC Reg. 810-27-1-4-.01(a).

⁴Inc. Tax Reg. 810-3-31-.02(4); MTC Reg. 810-27-1-4-.01(c).

of dividends that the Department would make explicit by promulgating an amended regulation clearly indicating such business income treatment.

The Department proposed and published an amended Reg. 810-27-1-4-.01 effective for all tax years beginning after July 31, 1995. This amended regulation correctly defined business and nonbusiness income to which section 40-27-1, Code of Alabama 1975, applied and was done in conjunction with Act 95-591. The amendments to the regulation provided a business income rule as uniform as possible with the other member states of the Multistate Tax Compact. Additionally, since the examples in the prior regulation were for illustrative purposes only and never purported to set forth all pertinent facts, they were amended to better explain the regulation's application and to provide guidance as to the proper business income treatment of dividend income.

An inconsistency arose between Act 95-591 and the effective date of Reg. 810-27-1-4-.01 as pertains to the treatment of dividends received after July 31, 1995, but during tax years beginning before August 1, 1995. To harmonize both the intent of the Legislature and the Department's regulatory efforts with the specific language of Act 95-591 and Reg. 810-27-1-4-.01 in a way so as to treat all dividends received in any tax year the same, the Department intends to permit foreign corporations commercially domiciled outside Alabama the same elective treatment, as permitted under Act 95-591, for dividends received from a subsidiary after July 31, 1995, during tax years beginning before August 1, 1995.

HOLDING

Company A, a calendar year taxpayer, contemplates receiving a cash dividend before December 31, 1995, from its wholly-owned subsidiary corporation. Based on the above analysis, the Department issues the following ruling:

The Taxpayer in the 1995 calendar tax year may elect, in the same manner as provided in Act 95-591 for dividends paid before July 31, 1995, to characterize the Dividend for Alabama corporation income tax purposes either as "business income" or as "nonbusiness income" for the tax years which began prior to August 1, 1995.

Ralph P. Eagerton, Jr.
Commissioner

DES:pj