

ALABAMA DEPARTMENT OF REVENUE
REVENUE RULING 00-005

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TO:

FROM: Michael Patterson
Commissioner, Alabama Department of Revenue

DATE: June 28, 2001

RE: Treatment of Delaware Business Trusts

FACTS

Corporation X is a nation-wide lessor of motor vehicles. CORPORATION X plans on forming two new subsidiary entities, X-1 and X-2, that will be used to hold title to certain motor vehicles that will be leased throughout the United States. Both entities will be formed as Delaware business trusts, pursuant to Chapter 38 of Title 12 of the Delaware Code, Section 3801. X-1 will be a direct subsidiary of CORPORATION X and will be the beneficial owner of X-2. X-2 will be a direct subsidiary of X-1 and will have beneficial ownership and legal title to the vehicles being leased. CORPORATION X will service the leases (i.e., to include the performance of all of the obligations of the lessor under the leases and the making of advances in respect of delinquent monthly payments and certain expenses relating to X-2).

Under the terms of a trust agreement, CORPORATION X will segregate certain portfolios of leased assets to X-2 representing special units of beneficial interest (each a "SUBI"). Under Delaware law, SUBIs are not liable for the debt of other separate portfolios or for X-2 as a whole. Under the trust agreement, X-1 will have unlimited liability with respect to assets not assigned to a SUBI. CORPORATION X will form a special purpose entity ("SPE") that will be a Delaware business trust and a wholly-owned subsidiary of CORPORATION X or one of its affiliates. X-1 will be the initial beneficiary of X-2 and CORPORATION X will be the sole beneficiary of X-1. From time to time, X-1 will cause beneficial interests in the leased assets owned by X-2 to be issued in the form of a SUBI. X-2 will issue the SUBIs to X-1, which in turn will assign/pledge them to the SPE. The SPE will assign/pledge the SUBI to a securitization trust which will issue securities, the payments on which are backed by

payments made on or in respect of the related leases and leased vehicles. Although SUBIs will be pledged to investors, title and legal ownership of the vehicles will remain with X-2.

Currently, CORPORATION X receives a Manufacturer's Statement of Origin ("MSO") or Certificate of Origin ("CO") to represent ownership of the vehicle prior to procuring a title. Once the vehicle is either leased or sold, the back of the MSO is completed and the MSO is then assigned to the purchaser. Title to the vehicle is then issued to the purchaser.

As part of the new lease-financing program, CORPORATION X will assign the MSO for each vehicle to X-2. In addition, a certificate of title and registration will be issued in the name of X-2 as the owner of each motor vehicle. As beneficiary, X-1 will have the right to assign/pledge all or part of its beneficial interest in X-2 (represented by the SUBIs).

As a result of this new arrangement, X-2 may have title to certain vehicles that are leased to persons located in Alabama. This will require X-2 to obtain a Certificate of Authority of a Foreign Corporation to Transact Business in Alabama.

For federal income tax purposes, X-1 and X-2 will not be classified as associations (or publicly-traded partnerships) taxable as corporations under the federal "check-the-box" regulations. Instead, X-1 and X-2 will be classified as disregarded entities for federal income tax purposes.

ISSUES

1. Whether the classifications of X-1 and X-2 for Alabama corporate income tax purposes will conform to their classifications for federal income tax purposes under the "check-the-box" regulations?

2. Whether X-1 and X-2 will be classified as corporations for Alabama corporate franchise tax purposes?

ANALYSIS

Concerning the first issue, the tax treatment for corporate income tax purposes of X-1 and X-2, as business trusts, is governed by §19-3-67, Code of Alabama 1975. This section states that "[t]he income of a business trust shall be taxed as property held in trust in accordance with the provisions of Section 40-18-25."

In your ruling request, you reference the Department's pronouncement concerning the federal "check-the-box" regulations, as expressed in Revenue Procedure 98-001. However, that procedure deals only with the classification of limited liability companies. Concerning business trusts, it is the statutory directive of §19-3-67 that must be followed.

The second issue concerns Alabama's foreign corporation franchise tax in §40-14-41(a). Alabama's franchise tax scheme was declared unconstitutional by the Supreme Court of the United States in South Central Bell Telephone Company, et al. v. Alabama, 119 S.Ct. 1180 (1999). Subsequently, the Alabama legislature rendered §40-14-41 "ineffective after December 31, 1999," pursuant to Act 99-665. Therefore, the second issue is moot and will not be addressed.

CONCLUSION

The federal classifications of X-1 and X-2 pursuant to the "check-the-box" regulations will not be followed for Alabama's corporate income tax purposes. Instead, the income of a business trust shall be taxed as property held in trust, pursuant to §19-3-67. Based on that section, therefore, the income of the business trusts in your ruling request will be taxed in accordance with §40-18-25. Your second issue is moot, because §40-14-41 is ineffective.

Michael Patterson
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