

ALABAMA DEPARTMENT OF REVENUE
REVENUE RULING 98-002

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(1993 Replacement Volume).**

TO: Taxpayer

FROM: Commissioner of Revenue
Alabama Department of Revenue

DATE: May 4, 1998

RE: Whether a foreign corporation or business trust which has a limited partnership interest in a limited partnership holding real estate in Alabama is subject to Alabama franchise tax by virtue of its limited partnership interest.

FACTS

Taxpayer is a foreign (non-Alabama) corporation qualified as a real estate investment trust ("REIT") pursuant to section 856 of the Internal Revenue Code. Taxpayer holds various real estate interests, as well as controlling interests in several subsidiaries, three of which are relevant for purposes of this ruling request. One subsidiary is a State "A" business trust ("Trust"), the second is a State "B" corporation ("B' Corp."), and the third subsidiary is a State "C" corporation ("C' Corp."). All three subsidiaries are qualified REIT subsidiaries as defined by I.R.C. §856(i).

Trust is a ninety-nine percent (99%) limited partner in a State "D" limited partnership ("D' LP"). "C" Corp. holds the one percent (1%) general partnership interest in "D" LP. "D" LP, in turn, holds a one percent (1%) general partnership interest in a State "B" limited partnership ("B' LP"). "C" Corp. holds approximately a forty to fifty percent (40% -50%) limited partnership interest in "B" LP, and unrelated third parties hold the remaining balance of ownership in "B" LP as limited partners. "D" LP and "B" LP have organized various joint ventures to hold title to real estate holdings located throughout the United States, including Alabama. Ownership percentages in the joint ventures varies by property. ("D" LP, "B" LP and the joint

ventures are hereinafter referred to collectively as "the partnerships.")

The joint ventures own certain real estate facilities that are leased to the general public. Taxpayer has the management contracts on these facilities. Employees of Taxpayer perform all management and decision-making activities outside of Alabama. Taxpayer contracts with another corporation to supply on-site facility managers. Although Taxpayer indirectly owns a significant percentage of the corporation which provides the on-site management services, Taxpayer does not exercise control over this corporation due to the fact that all of its ownership is in the form of nonvoting stock.

Neither Taxpayer, Trust, "B" Corp. nor "C" Corp. will hold a direct ownership interest in real property located in Alabama. In addition, none of the four entities will have employees who perform services in Alabama. All four entities' contacts with Alabama will be limited to their respective general or limited partnership interests in the partnerships. Only the joint ventures and, possibly, "D" LP will own Alabama real estate.

ISSUE

Whether the ownership of a limited partnership interest by "C" Corp. or Trust constitutes "doing business" in Alabama for franchise tax purposes.

ANALYSIS

Alabama Code §40-14-41 imposes a franchise tax on every corporation doing business in the State. A definition of the term "doing business" is not provided in either the Alabama Code or the regulations promulgated thereunder. Alabama Supreme Court decisions have defined "doing business" as requiring the "doing of some of the works, or an exercise of some of the functions, for which the corporation was created" State Dept. of Revenue v. Sonat, Ala. Ct. of App., No. 2950865 (Feb. 21, 1997), *citing* Beard v. Union & Am. Publishing Co., 71 Ala. 60, 62 (1881). It has been recognized by the court that the mere investment or ownership of property interests in the State by a foreign corporation does not subject that corporation to the franchise tax. State of Alabama v. State Stores Company, 171 So.2d 121 (Ala. 1965).

Alabama's foreign franchise tax is based on the actual capital employed by the taxpayer in the conduct of its business within the State. Id.

Pursuant to the Alabama Limited Liability Company Act, the relationship between an LLC member and the LLC itself is more in the nature of a mere investment, an activity historically recognized as insufficient to rise to the level of actually doing business within the State. The instant fact situation differs from the situation

addressed in an earlier court decision, American Television & Communications Corp. v. State of Alabama Dept. of Revenue, where the issue was whether a general partner in a limited partnership was required to report, as capital, its percentage share of the partnership's long term debt. Dept. of Revenue, Admin. Law Division, Docket No. F.95-258 (Aug. 29, 1995). The interest held by a general partner differs from that of an LLC member based in part on the general partner's direct ownership interest in specific partnership property. In contrast, the interest held by an LLC member is just an ownership interest in the LLC as a whole. Pursuant to Alabama law, LLC members do not have any direct ownership interest in the specific property owned by an LLC.

Pursuant to Ala. Code §10-12-20, a member of an Alabama LLC is not liable under any judgment, decree, or order of a court, or in any other manner, for a debt, obligation, or liability of the LLC, whether arising in contract, tort, or otherwise. In contrast, under Ala. Code §10-8-52, general partners are jointly and severally liable for all debts and obligations of the partnership. Based on these facts, the LLC member's interest in the LLC was more akin to that of an investment. State of Alabama v. State Stores Company stands for the proposition that the mere ownership of an investment in Alabama property does not rise to the level of doing business and, as such, the LLC member, assuming it performed all of its management functions outside the State, would not be subject to the Alabama franchise tax.

Trust, as a mere limited partner in "D" LP, and "C" Corp., as a limited partner in "B" LP, are not "doing business" for Alabama franchise tax purposes. These entities' limited partnership interests are substantially more similar to the membership interest of a limited liability company member, than they are like the active management interest held by a general partner. The limited partner has made only an investment in the partnership, rather than participating in its management or control. Similar to the treatment of members of an LLC, Ala. Code §10-9A-42(a) provides that a limited partner is not liable for the obligations of the limited partnership, unless he is also a general partner, or in addition to the exercise of his rights and powers as a limited partner, takes part in the control of the business. Neither of these additional requirements will be met by either Trust or "C" Corp.

Likewise, a limited partner's interest in the partnership is defined as being merely "the partner's share of the capital and profits and losses of a limited partnership, the right to receive distributions of partnership assets, and the right to receive any allocation of income, gain, loss, deduction, credit or similar items" Ala. Code §10-9A-1(10). That section goes on to provide that the limited partnership interest is itself a form of personal property. *Id.* Accordingly, like an LLC member, a limited partner has no direct ownership interest in the specific assets of the partnership. This should be contrasted with the rule provided under Ala. Code §10-8-72 which states that the general partner is a co-owner of the partnership's property.

Trust and "C" Corp. are not "doing business" in Alabama for franchise tax purposes. Trust and "C" Corp. merely hold an investment interest in the partnerships which own Alabama real estate. Like the member of an LLC, a limited partner's interest in the partnership is more in the nature of an investment, similar to that of a corporate shareholder. In addition, neither Trust nor "C" Corp. are exercising corporate functions or transacting the business for which they were created in Alabama. For these reasons, Trust and "C" Corp. should not be subject to Alabama's franchise tax.

CONCLUSION

The mere ownership of a limited partnership interest in the partnerships by Trust and "C" Corp. does not constitute doing business in Alabama for purposes of imposition of Alabama's foreign franchise tax. Alabama case law has held that the mere ownership of investment in Alabama property does not rise to the level of doing business for franchise tax purposes. As such, Taxpayer is not liable for or required to file returns as a foreign corporation doing business in the State of Alabama.

H. E. "GENE" MONROE, JR.

HEM:DES:pj