

ALABAMA DEPARTMENT OF REVENUE  
REVENUE RULING 00-007

This Document may not be used or cited as precedent.  
Code of Alabama 1975, §40-2A-5(a).

**TO:**

**FROM:** Michael Patterson  
Commissioner, Alabama Department of Revenue

**Date:** August 31, 2000

**RE:** Taxation of common law trusts

**FACTS**

X Bancorporation, a Delaware corporation (“Holding Company”); Y Bank, a state bank organized under the laws of the State of Alabama and a wholly owned subsidiary of Holding Company (“Bank”); and LLC, a Delaware limited liability company and wholly owned special purpose subsidiary of Bank (“Seller”), request a ruling concerning the taxation of certain common law trusts.

Bank is a direct wholly owned subsidiary of Holding Company. Seller is a wholly owned special purpose, bankruptcy remote subsidiary of Bank. Seller proposes to form one or more New York or other state common law trusts (each a “Trust and, collectively, the “Trusts”) in order to effect one or more securitizations of Auto Receivables (as defined below) pursuant to a Registration Statement, including the relate base prospectus (the “Prospectus”) and forms of prospectus supplements (the “Supplements”), filed with the U.S. Securities and Exchange Commission (the “SEC”). The actual prospectus supplement relating to a particular securitization transaction will be filed with the SEC as a supplement to the Prospectus when such securitization transaction occurs.

A Trust will be formed as a New York or other state common law trust pursuant to a Trust Agreement between the Seller and a trustee (the “Trust Agreement”). A trustee of a Trust will purchase a pool of simple interest motor vehicle retail installment contracts (“Auto Receivables”) secured by new and used automobiles (the “Financed Vehicles”) from Seller for cash and one or more classes of asset backed

certificates (the "Certificates") pursuant to a Sale and Servicing Agreement between the trustee of a Trust, Bank as servicer, Seller and an indenture trustee (the "Sale and Servicing Agreement"). A Trust will acquire the funds necessary to purchase the Auto Receivables by issuing one or more classes of asset backed notes("Notes") to public and/or private investors. Seller will hold the Certificates for the duration of a Trust. After the initial acquisition of Auto Receivables and throughout the term of a Trust, the assets of such Trust will consist primarily of the Auto Receivables, payments (including interest) made with respect to such Auto Receivables, certain deposit accounts in which collections are held, security interest in the Financed Vehicles, any proceeds from claims on insurance policies, and any proceeds of the foregoing (collectively, the "Trust Assets"). After the initial acquisition period, no additional Auto Receivables in such Trust matures or is otherwise redeemed by Seller, the Notes and Certificates are paid in full, and the remaining Trust Assets are distributed to the holders of Certificates.

The Notes issued by a Trust will bear interest at specified interest rates. The Certificates issued by a Trust will receive distributions after payment of the Note obligations. The Certificates may or may not bear interest at specified interest rates. Payments on the Certificates and Notes will be made solely out of the monies received on the Auto Receivables. Neither the Notes nor the Certificates is guaranteed by Seller, Bank and any other Holding Company affiliate.

After formation, the only activities of a Trust will be related to (i) holding, managing and servicing the Auto Receivables and related assets, and the proceeds therefrom, (ii) making payments on the Certificates and Notes, and (iii) activities related thereto. However, all of the managing and servicing activities related to the Auto Receivables will be performed by Bank pursuant to a contractual relationship established pursuant to the Sale and Servicing Agreement, and Bank will be compensated therefor. The managing and servicing activities will include customer service, document file keeping, record keeping, credit underwriting, vehicle title processing, collecting payments on the receivables and other support services. The payments on the Certificates will be made by the trustee of the Trust. Payments on the Notes will be made by the indenture trustee to the holders of Notes in accordance with an Indenture between the Trust and the indenture trustee (the "Indenture"). In addition, Bank will perform certain duties related to the Notes and Indenture pursuant to the Administration Agreement between the Trust, Bank, as administrator, and the indenture trustee. Once the Notes and Certificates are paid in full and any remaining monies distributed the Trust will terminate.

The Auto Receivables held by a Trust will have originated in the regular course of business by affiliates of Holding Company, including Bank, or will have been acquired by affiliates of Holding Company, including Bank, from dealers or other third parties that regularly originate such contracts or are pursuant to portfolio acquisitions. The Auto Receivables to be acquired by a particular Trust from Seller will consist of Auto Receivables originated in various states, including the State of Alabama. Such

Auto Receivables will bear interest within a specified percentage range, mature within a specified period of time and satisfy other criteria established in the Sale and Servicing Agreement or Purchase Agreement. The Seller will have acquired the Auto Receivables from Bank in exchange for cash pursuant to a Purchase Agreement between Bank and Seller.

For Federal income tax purposes under the Internal Revenue Code of 1986, as amended (the "IRC"), (i) Seller will be treated as a disregarded entity, and (ii) the Seller and the trustees of each Trust will agree to treat each Trust as a disregarded entity. Thus, Seller and each Trust will be treated as divisions of Bank for federal income tax purposes. The Notes will be treated as debt of Bank for federal income tax purposes.

The most recent drafts of the forms of documents referenced in this ruling request are listed on Exhibit A attached hereto and copies are enclosed herewith. The documents in an actual transaction may vary. A diagram of the transaction structure is attached hereto as Exhibit B.

References to the "Code" refer to the Code of Alabama, 1975, as amended. References to the "Act" refer to the Alabama Business Privilege and Corporate Shares Tax Act of 1999, as amended.

### **ISSUE**

Whether or not a Trust is a corporation, limited liability entity or disregarded entity for purposes of the Act, and thus, a subject to the Business Privilege Tax levied pursuant to Code Section 40-14A-22 or the Shares Tax levied pursuant to Code Section 40-14A-31?

### **ANALYSIS**

The Act defines the term "corporation" to mean "[a]n entity, including a limited liability company electing to be taxed as a corporation for federal income tax purposes, through which business can be conducted while offering limited liability to the owners of the entity with respect to some or all of the obligations of the entity, other than a limited liability entity or a disregarded entity." Code Section 40-14A-1(d). The Act further provides that the term "corporation" includes but is not limited to the following: "corporations, professional corporations, joint stock companies, unincorporated professional associations, real estate investment trusts, limited liability companies electing to be taxed as corporations for federal income tax purposes, and all associations classified as corporations for federal income tax purposes." Id. The Act defines the term "disregarded entity" as "[a] limited liability company that is disregarded for purposes of federal income tax [additional language omitted]." Code Section 40-14A-1(g). The Act defines the term "limited liability entity" as "any entity, other than a

corporation, organized under the laws of this or any other jurisdiction through which business may be conducted while offering limited liability to the owners of the entity with respect to some or all of the obligations of the entity and which is taxable under subchapter K of the [Internal Revenue] Code, including, without limitation, limited liability companies, registered limited liability partnerships, and limited partnerships.” Code Section 40-14A-1(k).

A Trust is not a corporation, a limited liability entity or a disregarded entity for purposes of the Act. First, a Trust cannot be a limited liability entity because a Trust is not taxable under subchapter K of the Internal Revenue Code. Second, a Trust cannot be a disregarded entity because it is not a limited liability company. Finally, a Trust is not a corporation because it is not an “entity” as contemplated by the Act and because various provisions of the Act indicate that common law trusts were not intended to be treated as corporations for purposes of the Act, as discussed in more detail below.

For a Trust to be a corporation it would have to be an “entity” that offers “limited liability to the owners of the entity with respect to some or all of the obligations of the entity.” Code Section 40-14A-1(d). Unfortunately, there is no Alabama authority or guidance addressing the issue of whether a Trust or other common law trust is a corporation for purposes of the Act. In addition, there is no Alabama authority or guidance addressing whether a common law trust possesses the limited liability characteristics as contemplated in the definition of corporation. However, the list of “entities” included in the definition of corporation as examples of a corporation indicates that the term should not include the Trust and other common law trusts. Specifically, the list includes “corporations, professional corporations, joint stock companies, unincorporated professional associations, real estate investment trusts [REITs], limited liability companies electing to be taxed as corporations for federal income tax purposes, and all associations classified as corporations for federal income tax purposes.” Although the list is not exclusive, it does not expressly include common law trusts. Furthermore, those entities listed generally require some type of formal election or filing in order to be recognized as such or are otherwise taxable as corporations for federal income tax purposes. No election or filing is required in order to form a Trust, and a Trust will not be taxable as a corporation for federal income tax purposes. This more limited list indicates that the definition of corporation does not include the Trust and other common law trusts and that such trusts are not “entities” as contemplated by the Act.

A further reason that a Trust is not a corporation under the Act is because a Trust is a passive investment vehicle that is more analogous to investment trusts under the Internal Revenue Code, testamentary trusts and inter vivos trusts than the entities identified in the list. The investment of a Trust is limited to a particular pool of Auto Receivables and the trustees have limited powers. In addition, after formation, the activities of a Trust will be limited to (i) holding, managing and servicing the Auto

Receivables and related assets, and the proceeds therefrom, (ii) making payments on the Certificates and Notes, and (iii) activities related thereto. Moreover, as indicated above, all of the services will be performed by Bank, as servicer, pursuant to the Sale and Servicing Agreement, and Bank will be compensated therefore. Once the Notes have been paid in full after maturity of the pool of Auto Receivables and any remaining monies distributed to the holders of Certificates, a Trust will terminate. In addition, although Seller and the trustees of a Trust will agree to treat a Trust as a disregarded entity rather than as an investment trust for federal income tax purposes, there would be no material difference from a federal income tax perspective in the taxation of the Trust since a Trust would essentially be a disregarded entity under either characterization. This is because a Trust treated as an investment trust for federal income tax purposes would be treated as a grantor trust. Unfortunately, there is no definitive guidance as to whether a Trust could be classified as an investment trust for federal income tax purposes.

An additional factor indicating that the term corporation does not include a Trust and similar common law trusts is that the provisions in Code Section 40-14A-23 regarding the calculation of the net worth for purposes of the Business Privilege Tax only expressly address a business trust taxable as a corporation for federal income tax purposes. Code Section 40-14A-23(d). There is no express mention in Section 40-14A-23 of a common law trust or of a business trust taxable as a trust or a disregarded entity for federal income tax purposes. Code Section 40-14A-23(a)(2) does contain provisions for the calculation of net worth of a corporation” is expressly mentioned indicates that only certain specifically identified trusts were intended that is mentioned in the Act is a REIT. However, a REIT is distinguishable from a Trust because it may also be a corporation or another entity and formal registration provisions are provided in the Code for a REIT. See Code Section 10-13-1, et seq.

While there is no Alabama authority or guidance interpreting the definition of corporation for purposes of the Act, there is some authority involving the definition of corporation under Section 241 of the Alabama Constitution (contained in Article XII, Corporations) that would indicate that a Trust is not a corporation for such purposes. A corporation for purposes of Section 241 includes “all joint stock companies, and all associations having any of the powers and privilege of corporations not possessed by individuals or partnerships.” Although the definitions are not similar, the Act was enacted in part to comply with Section 229 and 232 of the Alabama constitution, and thus, the definition may provide some guidance. For example, an Alabama Attorney General Opinion dated February 24, 1997 determined that a foreign real estate investment trust (a “REIT”) organized as a foreign trust is not a corporation as defined in Section 241 of the Alabama Constitution. The Attorney General Opinion acknowledged that Alabama appellate courts have not specifically addressed whether the definition of corporation for Section 241 purposes includes trusts even though the definition of corporation in Section 241 does not expressly include trusts. Even though a REIT is expressly listed in Code Section 40-14A-1(d), a REIT is distinguishable from a Trust

because there are no formal registration requirements in order to be recognized as a Trust, but there are statutory registration requirements in Alabama for REITs, as noted in the preceding paragraph. Although this opinion does not relate to tax matter, it further indicates that a common law trust should not be a corporation for purposes of the Act unless express mention of such trust is included in the Act.

As noted above, the Shares Tax is levied on corporations and is not levied on limited liability entities and disregarded entities. A final factor indicating that a Trust is not a corporation is that the Code provides no method for calculating the Shares Tax liability of a Trust (assuming that a Trust were a corporation). The Shares Tax is levied on the taxable shares base of the Corporation. The taxable shares base consists of capital stock, additional paid-in capital and retained earnings of a corporation. The Act does not define those terms and there is no authority directly addressing whether a common law trust has capital stock, additional paid-in capital and retained earnings for purposes of the Act. Even if one were to assume no method for determining those amounts for a Trust. In addition, there are no alternative methods provided in the Act for calculating the Shares Tax. This further evidences an intent that a Trust and other common law trusts not be corporations under the Act.

### **CONCLUSION**

A Common Law Trust, as described hereinabove, is not a corporation, limited liability entity or disregarded entity for purpose of the Act. Thus, a Trust is not subject to the Business Privilege Tax levied on domestic or foreign corporations, limited liability entities and disregarded entities pursuant to Code Section 40-14A-22 or the Shares Tax on domestic or foreign corporations pursuant to Code Section 40-14A-31.

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