

## *Ruling 91-02*

Vermont Department of Taxes

Date: March 25, 1991

Written By: Mary L. Bachman, Special Assistant Attorney General

Approved By: Joyce H. Errecart, Commissioner of Taxes

You have requested a formal ruling on the application of two provisions of Chapter 151 of Title 32 of Vermont Statutes Annotated ("Vermont Tax Law") to your clients, [Company] (the "Company") and certain of its employees. This ruling relies on representations contained in your letters dated March 7, 1991, and March 22, 1991. The Facts: The Company is duly incorporated in the State of [State]. Its federal employer identification number is [Number]. The Company's shares are publicly held and traded on the [Name] Stock Exchange and the [Name] Stock Exchange. The Company's only office is located at [Address].

The Company has six wholly-owned active subsidiaries: [Corporation], a [State] corporation ("S1"), that owns, inter alia, approximately 95.2 percent of the outstanding common stock of [Corporation], a [State] corporation ("S1a"); [Corporation], a [State] corporation ("S2"), which holds limited partnership interests in oil and gas producing properties; [Corporation], a [State] corporation ("S3"), which holds certain partnership interests; [Corporation], a [State] corporation ("S4"), which holds securities; and two small insurance companies domiciled in [State] ("S5" and "S6"), which are in the process of being sold.<sup>1</sup> S1, S2, S3 and S4 are nonoperating companies whose only assets are in the form of intangible investments (such as stocks, partnership interests and royalty trust interests). The companies are not directly involved in the business activities of any operating company in which they may have an interest.

The Company's Board of Directors consists of: [Name], ("A"), Chairman; [Name] ("B"); [Name] ("C"); [Name] ("D"); [Name] ("E"); and [Name] ("F"). S1's Board of Directors consist of A, Chairman; [Name] ("G"); [Name] ("H"); [Name] ("I"); and [Name] ("J"). S1a's Board of Directors consists of: A; C; H; J; [Name] ("K"); [Name] ("L"); [Name] ("M"); [Name] ("N"); and [Name] ("O").

The Company would retain its present structure immediately following relocation to Vermont, although all the Company's subsidiaries would be disposed of in connection with the liquidation plan discussed below. The Company expects to file its Vermont income tax returns on a separate (i.e., nonconsolidated) basis.

The Company's assets consist primarily of (i) 100 percent of the outstanding shares of S1, S2, S3, S4, S5, S6, S7, S8 and S9, with an aggregate value of approximately [dollar

amount]; (ii) approximately 23.6 percent of the outstanding common stock of [Corporation], with an aggregate value of approximately [dollar amount]; (iii) a portfolio of common equity securities and interests in royalty trusts (involving oil and gas producing properties located outside Vermont), with an aggregate value of approximately [dollar amount]; (iv) interests in certain partnerships (which hold intangible securities) and miscellaneous other long-term investments (such as bonds and other investment securities), with an aggregate value of approximately [dollar amount]; and (v) cash and short-term investments, with an aggregate value of approximately [dollar amount].

Under the terms of a plan of complete liquidation adopted by the Company's Board of Directors on [Date] and approved by the Company's shareholders on [Date] (the "Liquidation Plan"), the Company expects to sell, exchange or otherwise dispose of all its assets over a period that began on [Date] and will end on [Date] and to distribute all the proceeds and its remaining assets to its shareholders (after making adequate provisions for payment of the Company's liabilities). Through the liquidation period, all of the Company's assets (apart from its office leasehold, office equipment and other tangible personal property necessary to conduct its day-to-day operations) will continue to be in the form of securities, partnership interests, royalty trust interests and other intangibles.

The Company plans to relocate to Vermont, with which it has no present contacts. Once located in Vermont, the Company will continue to implement the Liquidation Plan described above. Consistent with that plan, the Company's activities in the State will be limited to managing and disposing of its investments, collecting income from those investments, maintaining corporate records, communicating with and making distributions to the Company's shareholders and making and implementing other decisions in furtherance of the Liquidation Plan. Under the terms of a written agreement, S1 will provide certain financial management and administrative support services to the Company and its subsidiaries in exchange for certain fees. Personnel of the Company will not be directly involved in the business activities of any operating company in which the Company may have an interest. One officer of the Company will perform services for S1 under a separate employment contract, as explained below.

Following its relocation to Vermont, the Company expects to employ no more than eight persons; A, as Chairman and Chief Executive Officer; H, as Executive Vice President and Chief Financial Officer; G as Vice President, Secretary and Treasurer; one or two professional money managers; and two or three support

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<sup>1</sup> In addition, [Company] has three subsidiaries that are inactive and are expected to remain inactive. Those three subsidiaries are: [Corporation], a [State] corporation ("S7"); [Corporation], a Vermont corporation ("S8"); and [Corporation], a [Country] corporation ("S9").

personnel. Pursuant to the terms of a separate employment contract with S1, H also will act as President of S1 and perform services for S1.

A (Social Security Number [number]) has been an employee of the Company since 1985; H (Social Security Number [number]) has been an employee of the Company since 1986. Both expect to continue in their respective positions with the Company following its relocation to Vermont. A is, and expects to remain, a resident of [State]; H is, and expects to remain, a resident of [State].

During the periods of their employment by the Company or its affiliates, A and H were granted a number of options and warrants to purchase stock of the Company at specified prices as compensation for their services. The options and warrants were not subject to federal income tax when granted. Most of these options and warrants will have become fully vested (i.e., nonforfeitable) and exercisable prior to the Company's move to Vermont. A and H expect to exercise all their options and warrants subsequent to the Company's relocation to Vermont. Under the current federal tax law, exercise of the options and warrants will give rise to ordinary income to the extent that the market price of the Company stock at the time of exercise exceeds the option or warrant price. Thus, A and H will recognize, for federal income tax purposes, income from the options and warrants at a time when they are working in Vermont and subject to Vermont tax. Issues:

1. Whether following its relocation to Vermont, the Company would qualify as an investment or holding company for purposes of Section 5837 of the Vermont Tax Law and would have its Vermont corporate income tax liability limited by that section.
2. Whether following the Company's relocation to Vermont, certain Company employees who are not residents of Vermont, but who work for the Company in Vermont would be subject to Vermont income tax on any income they realize from the exercise of certain options and warrants to purchase Company stock, which were received and became fully vested and exercisable prior to the Company's relocation to Vermont.

#### Discussion and Ruling

1. **Corporate Income Tax Liability.** Section 5837 of Title 32 limits the liability of investment and holding companies under Vermont Tax Law: The tax imposed by this subchapter as it applies to corporations whose activities are confined to the maintenance and management of their intangible investments and the collection and distribution of the income from such investments or from tangible property physically located outside this state shall not exceed the \$75.00 minimum tax provided by section 5832 [tax on income of corporations] of this title. For purposes of this section "intangible investments" shall include without limitation investments in stocks, bonds,

notes and other debt obligations (including debt obligations of affiliated corporations), patents, patent applications, copyrights, trademarks, trade names and similar types of intangible assets.

The Company's activities, as set out above, will consist entirely of managing the portfolio investments that it holds and overseeing the activities of its subsidiaries. The Company will not be directly involved in the business activities of any operating company in which the Company may have an interest. The Company's investments include only intangibles, such as stocks, bonds, interests in royalty trusts and interests in partnerships that hold securities. Thus, for purposes of determining its Vermont corporate income tax liability, the Company will qualify as an investment or holding company under Section 5837 of Vermont Tax Law.

2. **Personal Income Tax Liability.** Vermont imposes its personal income tax as a percentage of an individual's federal income tax liability. According to Section 5822 of Title 32, the Vermont income tax rate applicable to nonresidents of Vermont is the Vermont resident rate (currently 28 percent) reduced by a percentage "equal to the percentage of the taxpayer's adjusted gross income for the taxable year which is not Vermont income." Section 5823(b) defines "Vermont income" of nonresident individuals as the sum of: "wages, salaries, commissions or other income...received with respect to services performed within [Vermont]"; "income...derived from [a] business, trade, occupation or profession ...carried on within [Vermont]"; and other types of Vermont-related income not relevant here.

Because A and H will not be residents of Vermont, the rate of Vermont income tax applicable to them will depend upon the percentage of their income that is Vermont income under Section 5823(b). Any income that may be realized from the exercise of the options and warrants that were granted and became fully vested and exercisable prior to the Company's relocation to Vermont will not be "wages, salary, commissions or other income ...received with respect to services performed within this state". Those options and warrants clearly represent compensation for services rendered outside Vermont. Similarly, because A and H were working exclusively outside Vermont when those options and warrants were granted and became fully vested and exercisable, the income will not be "derived from [a] business, trade, occupation or profession ... carried on within this state". Thus, for purposes of determining the Vermont income tax liability of A and H, none of the income they may realize from the exercise of the options and warrants that were granted, vested and exercisable prior to the Company's move to Vermont will be considered to be Vermont income.

This ruling is issued solely to the clients on whose behalf you have made your request and is limited to the facts presented as affected by current statutes and regulations. Other taxpayers may refer to this ruling to determine the Department's general approach, but the Department will not be bound by this ruling in the case of any other taxpayer or in the case of any change in the relevant statute or regulations.