

**Alabama Corporate Taxpayers and CPAs Beware: House Bill Targets
Unitary Combined Reporting, the Section 199 Deduction and Bonus Depreciation**

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On February 7, the first day of the Alabama Legislature's 2012 regular session, Representative Richard Lindsey (D-Cherokee, Cleburne, and DeKalb Counties) introduced a lengthy bill of significant interest to Alabama corporate income taxpayers. House Bill 199 would limit the Domestic Production Activities Deduction ("DPAD") under IRC Section 199, partially decouple from the 100% bonus depreciation provisions enacted by Congress in 2010, and mandate combined reporting ("MUCR") for certain unitary business entities. HB 199 has been assigned to the House Ways and Means-Education Committee, and is essentially a combination of three bills sponsored by Rep. Lindsey during the 2011 regular session (HB 299 through 301). It is likely that, as in past years, the Alabama Education Association teachers union is advocating these proposals. A summary of each major provision of HB 199 is provided below.

Imposition of MUCR

Similar to the proposals introduced in the 2008, 2009 and 2011 legislative sessions, this bill would require the Commissioner of the Alabama Department of Revenue to impose mandatory unitary combined reporting "when an Alabama taxpayer is part of a unitary business consisting of multiple business entities." The bill essentially adopts the Multistate Tax Commission's familiar and broad definition of a "unitary business," as contained in its Model Combined Reporting Act. In addition, the bill provides that the term "unitary business" shall be interpreted as broadly as possible, limited only by the bounds of the U.S. Constitution, as a backstop to the MTC definition.

The combined report must include all members of the unitary group doing business in the United States or commercially domiciled in foreign "tax havens." The bill does not provide any qualitative requirement for a foreign entity's activities within the United States as compared to its activities abroad. Apparently, simply maintaining a commercial domicile in a disfavored country will subject the entity's income to apportionment by Alabama via a combined return, which is a constitutionally suspect provision.

The combined group of business entities would apportion their total income to Alabama using the group's Alabama "source apportionment data relative to the combined group's apportionment data from all sources." The remaining details and mechanics of the unitary report must be promulgated by the Department of Revenue through regulations.

Perhaps the most frightening feature of this bill is its lack of detail. The bill is silent regarding the calculation of tax liability, the impact on credits and other tax attributes by the unitary group's members, the effect on Alabama's existing consolidated return filing regime (the

bill does not propose any amendments to this section), and whether it could apply to the current tax period. The bill is also silent with respect to any equity ownership requirement or threshold for inclusion in the Alabama combined group, which is a deviation from the vast majority of state combined reporting schemes that typically require a 50% threshold equity interest before an entity is included in the combined group.

Additionally, taxpayers do not appear to have the option to elect unitary combined reporting, which is a fundamentally unfair result. Interestingly, the proposed bill would require combined reporting without repealing or amending *Alabama Code* section 40-18-39(i), which expressly prohibits unitary combined reporting, either forced or elective.

Limitation of the DPAD

Alabama levies an income tax on all corporations doing business within the State, and the tax base is tied directly to the federal definition of “taxable income.” One deduction that is currently allowed to taxpayers in determining their federal taxable income is the IRC Section 199 DPAD, which is equal to 9% of the lesser of the taxpayer’s qualified production activities income or its taxable income. Currently only “C” corporations doing business in Alabama can claim the Alabama equivalent deduction. This bill would limit an Alabama corporate taxpayer’s DPAD to one-third of its federal DPAD by requiring them to add-back any amount deducted in accordance with IRC Section 199 in excess of 3% of the lesser of qualified production activities income or taxable income. This provision would apply *retroactively* to all tax years beginning on or after January 1, 2011.

Preemptive Decoupling from Bonus Depreciation

Another deduction currently available to Alabama taxpayers by virtue of the link to federal “taxable income” is the temporary 100% bonus depreciation deduction for qualified property granted by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312). While the 100% bonus depreciation allowed under the Tax Relief Act is scheduled to expire in 2012, in the event that Congress enacts a similar provision this year, the bill would limit the depreciation to 50% by requiring taxpayers to add-back in amount deducted in accordance with IRC section 168 that is in excess of 50% of the adjusted basis of qualified property. This provision of the bill would also apply retroactively to all tax years beginning on or after January 1, 2012.

Interestingly, the expected increase in revenue from these three proposals would be used to provide a four percent cost-of-living salary increase for certain state and public education employees (introduced as HB 183).