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Alabama Tax Legislative Summary: 2011 Regular Session

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The Alabama Legislature adjourned *sine die* at midnight on June 9, with final passage of the two budgets and the remaining "Handshake with Alabama" bills, concluding what many are calling one of most productive legislative sessions in recent history. Several important economic development proposals designed to encourage job creation and attract foreign investment in Alabama crossed the finish line during the last two weeks of the session. Unfortunately, several Senate Democrats slowed the debate on the last day of the session, and thus several critical tax bills failed to cross the finish line before the session adjourned, including **HB 427**, the Alabama Taxpayers' Bill of Rights II/Alabama Tax Appeals Commission Act, and **HB 548**, the Gross Income Regulation Compromise; but we expect these proposals to be re-introduced next session, perhaps with amendments.

The following is a summary of the tax bills of **statewide importance** that were passed by the Legislature this session and either signed into law or are expected to be signed into law by Governor Bentley in the next few days.

Act 2011-17 (SJR 4) – Rejection of Business Privilege Tax ("BPT") Regulation: sustains the Legislative Council's unanimous decision last summer to reject the Department of Revenue's controversial regulation that attempted to repeal the statutory deduction for the book value of a taxpayer's investments in the equity of another business entity that's also doing business in Alabama.

Act 2011-155 (HB 61) - Small Business Health Care Deduction: increases the state income tax deductions for both qualifying employees' and employers' (*i.e.*, those with less than 25 employees) payments of health insurance premiums to 200% of the health insurance premiums. A qualifying employee must be employed by a qualified employer, earn no more than \$50,000 of annual wages, and report no more than \$75,000 of adjusted gross income (\$150,000 if married filing jointly) during the applicable tax year. This Act was one of the top legislative priorities of the Business Council of Alabama (BCA), House Speaker Mike Hubbard, and Governor Bentley.

Act 2011-551 (HB 230) – The Full Employment Act of 2011: as promised by Governor Bentley in his State of the State speech, offers a one-time income or financial institution excise tax credit of \$1,000 for each new job created by small businesses (*i.e.*, less than 50 employees). To be eligible for the credit, wages for the new employee must exceed \$10 per hour. The credit is available in the tax year in which the new hire completes 12 months of consecutive employment, provided that the employer has a net increase in the total number of full-time employees in Alabama on the last day of such tax year. The credit is not refundable or transferrable, but it is available to owners of pass-through entities on a *pro rata* basis. The credit may also be combined with the deduction available for hiring unemployed workers under the Reemployment Act of 2010, which applies to tax years 2011 and 2012.

Act 2011-648 (SB 477) – The Tariff Credit Act of 2011: has a limited focus and is designed to encourage foreign manufacturers to locate in Alabama by providing an income tax credit to companies investing in qualifying projects that meet certain minimum requirements. The minimum capital investment in order to qualify is \$100 million and the project would have to create at least 100 new jobs, with a base wage at least equal to the state's individual median income. Approved investing companies would be eligible to receive a transferrable income tax credit up to the amount of certain Federal tariff costs during the term of the qualifying project, but the amount of the credit shall not exceed the lesser of \$20 million or 25 percent of the total amount of an investing company's capital investment in the qualifying project. Any project seeking the credit must go through a recommendation process involving the Alabama Development Office, the Alabama Department of Revenue (ADOR), and the Governor's office.



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Act 2011-616 (HB 434) – Double-Weighted Sales Factor and Market Sourcing: amends Article IV of Alabama Code § 40-27-1, *i.e.*, Alabama’s version of the Multistate Tax Compact, to double-weight the sales factor in the currently equally-weighted three-factor formula used to apportion business income to Alabama. In addition, the bill would amend Alabama’s apportionment methodology by converting Alabama from a “cost of performance” state to a “market source” state for certain receipts from intangibles or services. This bill provides that sales of services and other intangible property would be sourced to Alabama if the taxpayer’s market for the sales is in Alabama (*e.g.*, the customer is located in Alabama, regardless of where the service is performed).

Act 2011-563 (HB 355) – Streamlined Sales Tax Study Commission: establishes the Alabama Streamlined Sales and Use Tax Commission to develop, implement, and administer the programs necessary for Alabama to come into compliance with the Streamlined Sales and Use Tax Agreement (“SSUTA”), in the event that federal legislation implementing the agreement becomes law. The Commission would be required to submit a report and draft legislation regarding the necessary changes to Alabama’s sales and use tax laws in order to comply with the SSUTA.

Act 2011-644 (SB 395): provides a state income tax credit to individual homeowners who retrofit their homes to help resist wind and storm damage. The credit would be the lesser of 25 percent of the cost to retrofit the home or \$3,000.

Act 2011-565 (HB 399): substantially revises the motor fuel tax laws, including the collection and enforcement process, by imposing the tax on the removal or withdrawal of motor fuel from the terminal using the terminal rack and not by bulk transfer or when motor fuel is imported into the state other than by bulk transfer.

Act 2011-544 (HB 179): expands the ad valorem property tax definition of “residential property” to include single-family dwellings and lots under construction until sold or otherwise put to a use other than as a single-family dwelling for a period of up to two years.

SB 493: Tornado Recovery Tax Incentive Protection Act of 2011: provides that any tax abatement that may be otherwise granted pursuant to the Tax Incentives Reform Act of 1992 shall not be subject to disqualification solely because the underlying property or transaction relates to repairs or replacement of property damaged in the devastating tornado outbreaks this Spring, as

opposed to new construction. This expansion of TIRA is effective for any property acquired or transactions entered into before December 31, 2012. The Act also provides that the wage and employment requirements for Alabama’s capital credit are tolled for two years for otherwise qualifying projects that were damaged by the tornadoes.

SB 506: amends Ala. Code §§ 40-8-1 and 40-9-19 to provide that the ad valorem tax classification of property as residential property or a homestead would not be affected under certain conditions when the property is damaged by a natural disaster, rendering it uninhabitable.

Act 2011-689 (SB 158): establishes the Neighborhood Infrastructure Incentive Plan Act of 2011, which would provide for an annual income tax credit over a period of 10 years for contributions made by members of an authority for completing a neighborhood infrastructure project.

Act 2011-695 (SB 255): makes several technical corrections to the film incentives portion of the Entertainment Industry Incentive Act of 2009, including clarifying the qualified expenditures applicable to a television series or commercial, and providing that the income tax credits are available in the year in which the production activity concludes. This bill would also clarify that the sales, use and lodgings tax exemption only applies to the *state* portion of these taxes, and provides maximum expended amounts beyond which rebates and exemptions are not allowed.

Act 2011-254 (SJR 97): establishes the Alabama Video Tax and Fee Study Committee “for the purpose of studying the current tax and fee disparities in the Alabama video services market place.” The study committee is to recommend legislation that would eliminate this disparity “so that Alabama consumers may realize the benefits of lower and fairer government-mandated fees on their video services and have a tax and fee-neutral choice for such services.”

Act 2011-537 (HB 76) – Surplus Lines Insurance Multi-State Compliance Compact Act: implements the provisions of the Non-admitted and Reinsurance Reform Act (NRRRA) that is intended to simplify the web of taxing, licensing and eligibility rules for surplus lines insurance across all 50 states. The NRRRA was enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, and is effective July 21, 2011. Once another state adopts a similar compact, the Act will provide an allocation of premium taxes paid by surplus line insurers in accordance with uniform allocation formulas to be developed by the Commission.

Tax Legislation Likely to Be Introduced Next Session

We expect the following 2011 bills, or similar proposals, to be re-introduced, perhaps with amendments, next session:

HB 427 – “Alabama Taxpayers’ Bill of Rights II” / Alabama Tax Appeals Commission Act: would create an independent tax tribunal, known as the Alabama Tax Appeals Commission (“ATAC”), by abolishing the current Administrative Law Division and transferring both the personnel (including its only Administrative Law Judge) to a newly-formed state agency under the executive branch. This bill also contains several important changes and updates to the Alabama Taxpayers’ Bill of Rights Act of 1992 (“TBOR”), such as extending the time period for filing an appeal or petition for review from 30 to 60 days and eliminating the \$50 failure-to-file penalty for any individual income taxpayer that is owed a refund on the delinquent return and otherwise requiring a 30-day notice from the ADOR. Since the enactment of the TBOR, its federal counterpart has been amended several times, and numerous Administrative Law Division and ADOR rulings interpreting the Act have been issued. Also, the bi-annual Council On State Taxation (COST) “Due Process Scorecard” gave Alabama a “D” grade, pointing out several deficiencies or taxpayer inequities that should be remedied.

HB 427 was passed unanimously by the House last session and received a favorable vote from the Senate Judiciary Committee before stalling in the Senate logjam during the last few days of the session. The Alabama State Bar was a strong advocate for the bill, and special thanks are due to President Alyce Spruell, President-Elect and mediator Jim Pratt, and of course, the lead sponsors, Rep. Paul DeMarco and Sen. Ben Brooks. Messrs. DeMarco and Brooks have already indicated they plan to reintroduce HB 427, with agreed amendments, early next session.

HB 548 – “Gross Income Regulation” Compromise: would modify the definition of “gross income,” override the inconsistent ADOR “Gross Income Regulation” and affirm a recent Administrative Law Division *McNees* ruling so that resident individuals who own interests in partnerships, LLCs, or S corporations, or who are beneficiaries of estates or trusts, operating a multistate business, must include their proportionate share of income from the pass-through entity, regardless of where the income is earned. Conversely, resident individual-owners would receive an income tax credit for certain taxes paid by the entity to other states or foreign

countries on behalf of the individual owner because the other state imposes an income tax withholding or composite return obligation or certain types of entity-level taxes on the pass-through entity. The amount of the credit would be limited to the amount of tax that would have been paid on the same income using the applicable Alabama income tax rates, similar to the rule for individual taxpayers.

HB 485 – Alabama Data Processing Center Economic Incentive Enhancement Act of 2011: In order to encourage data centers to locate in Alabama, this bill would extend the time period for abatements of certain noneducational sales, use, and property taxes from the current 10 years to as long as 30 years, depending on the total capital investment, and would also allow abatements for recurring capital investment in a data center during the abatement period. This bill would also reduce the employment threshold to a minimum of 20 new jobs.

HB 365: would require notification to certain Alabama purchasers of tangible personal property (*i.e.*, with a delivery location in Alabama) regarding their obligation to remit sales or use taxes, including a “pop-up” notification in the case of retail sales facilitated through an internet website. This bill would also provide a mechanism for the Department of Revenue to collect and remit not only the state but the county and municipal use tax from Alabama residents through their individual income tax return. This bill, championed by the Alabama Retail Association, was amended by the Senate Commerce, Transportation and Utilities Committee to more clearly explain in the “pop-up” notification that the seller is not collecting sales tax on the transaction and to reflect that the customer’s use tax obligation is a long-standing part of Alabama law.

HB 478 and SB 373: would allow Alabama companies that undertake certain qualifying projects, similar to those provided by the Tax Incentives Reform Act of 1992, to also qualify for “withholding incentives,” which would be in the form of a percentage of the state income taxes withheld from the wages of eligible employees. The incentives are designed to encourage the retention of existing jobs and create new jobs by increasing development and growth of industry within the state. The State Industrial Development Authority would determine whether a project qualifies for the withholding incentives.

HB 301 – Mandatory Unitary Combined Reporting: Similar to the proposals introduced in the 2008 and 2009 regular sessions, this bill would require the Commissioner of Revenue to impose unitary combined

reporting "when an Alabama taxpayer is part of a unitary business consisting of multiple business entities." Very little detail regarding the mechanics of the unitary report is provided by the bill, which directs the ADOR to fill in the gaps with regulations. Taxpayers do not appear to have the option under this unique (to say the least) bill to elect unitary combined reporting, which is a fundamentally unfair result.

Uniformity of Tax Classification of Pass-through Entities (not introduced in 2011): At the request of the ADOR, this legislation would harmonize the classification of various pass-through business entities (e.g., LLCs and LPs) for Alabama state and local tax purposes by limiting conformity with the federal "check the box" regulations to only Alabama *income and financial institution excise taxes*, while preserving the sales, use and rental tax exclusions for certain intercompany transactions and the property, business privilege, and sales and use tax exemptions for disregarded entities that exist under Alabama's current classification regime. Two of the authors are members of an Alabama State Bar Task Force that's working with representatives of the ADOR, the Alabama Society of CPAs, the Business Council of Alabama and the Alabama League of Municipalities to develop a fair and balanced legislative proposal.

The proposal would also clarify that members of a multi-member LLC are not personally liable for the LLC's sales, use, payroll and other non-income taxes solely because their LLC is classified as a partnership for federal and Alabama tax purposes, thereby codifying the ruling by the Administrative Law Division in *Nonna Rose Kingsley, LLC*, now pending in Jefferson County Circuit Court.

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