**RULES OF THE ALABAMA DEPARTMENT OF REVENUE**

# Chapter 810 – 3
# Income Tax

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ALABAMA DEPARTMENT OF REVENUE
ADMINISTRATIVE CODE

CHAPTER 810-3-1.1

Operating Rules

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810-3-1.1-.01. Operating Rules.

(1) For purposes of this chapter in which the legislature has adopted a specified section or sections of Title 26, United States Code ("26 U.S.C.") or a federal public law (Pub. L. or P.L.) such references shall be to those specified sections of the Internal Revenue Code, Title 26 of the United States Code, or to the specified federal public law as in effect from time to time.

(2) For all taxable years beginning after December 31, 1984, when any gain, loss, income, basis, earnings and profits, or any other item is to be determined in accordance with the provisions of federal law (Title 26, United States Code or public law) which have been adopted, by reference or otherwise, into Alabama law; such computations shall be applied in the manner provided in the pertinent federal laws and regulations, but shall be applied to the amounts determined under Alabama law.

(3) For example, §40-18-35(10), Code of Alabama 1975 as amended by the Corporate Income Tax Reform Act of 1985, provides a deduction for contributions for corporations to the extent deductible for federal purposes under 26 U.S.C. §170 (as in effect on January 1, 1985). The federal provision limits the deduction to 10% of taxable income. In computing the limitation for Alabama purposes, "taxable income" would be computed under Alabama law - not federal law.

Author: Income Tax Division
Authority: Section 40-18-1.1, Code of Alabama 1975
History: Effective December 4, 1992.
Amended September 18, 1996, effective date October 23, 1996.

RULES OF
DEPARTMENT OF REVENUE

CHAPTER 810-3-2

Persons and Subjects Generally Subject to Tax

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810-3-2-.01 Individuals Subject to Alabama Income Tax.

(1) Individuals domiciled within Alabama (residents) are taxable on their income, whether earned within or without Alabama, subject to certain exclusions and exemptions as provided under Alabama income tax law, regardless of their physical presence within Alabama at any time during the taxable year. Individuals domiciled within Alabama should file a Resident Individual Income Tax Return, Form 40 or 40A each year.

(a) Domicile is the home, the fixed place of habitation; while residence is a transient place of dwelling. Domicile is the place where one lives and has his permanent home and principal establishment, and to which he has the intention of returning when he is absent. Domicile may be established by birth, by choice, or by operation of law.

(b) Each person has one and only one domicile. Once established, a domicile continues until a new one is established coupled with the abandonment of the old.

1. Domicile is established by physical presence in a jurisdiction, coupled with the present intent to establish domicile in the subject jurisdiction.

(i) A person's intent will be ascertained by examining his actions.

2. A taxpayer has the burden of proof in establishing a change in domicile.

(c) Federal employees, including military personnel, domiciled in Alabama continue to be so domiciled, irrespective of their period of absence or actual place of residence, and are subject to the Income Tax Law of Alabama until proof of change of domicile has been made.

(d) A husband and wife will be presumed to have the same domicile, unless clearly established otherwise.

1. An Alabama resident who marries a nonresident will continue to be an Alabama resident until and unless a new domicile is established as provided in subparagraph (b) above.

2. A nonresident who marries an Alabama resident will continue to be a nonresident until and unless a new domicile is established in Alabama as provided in subparagraph (b) above.

(e) A minor child will be presumed to have the same domicile as the custodial parent or guardian.

(2) Individuals not domiciled within Alabama who maintain a permanent place of abode within Alabama, or who spend more than a total of seven months (whether or not consecutive) of the taxable year within Alabama shall be presumed to be residents, and taxable on their net income from within and without Alabama during the taxable year. They should file Resident Individual Income Tax Return, Form 40 or Form 40A each year. For instructions for individuals who are residents for less than one year(part-year residents), see Reg. 810-3-2-.01(4).

(a) A permanent place of abode is interpreted to mean a dwelling place permanently maintained by the taxpayer; it is not necessary that he be the owner, or that he occupy it himself.

(b) The Department may require individuals claiming domicile outside the State of Alabama to furnish a statement of information with details to support their claim.

(3) Nonresident individuals receiving taxable income from property owned or business transacted (including wages for personal services) within Alabama are taxable on such income from within Alabama. They should file Nonresident Individual Income Tax Returns, Form 40NR, each year. See Regs. 810-3-14-.05 (relating to taxable income of nonresidents) and 810-3-15-.21 (relating to allowable deductions of nonresidents).

(a) Resident individuals living in federal areas located within Alabama or any other state over which the United States exercises exclusive or concurrent jurisdiction, such as the Muscle Shoals reservation and military areas such as Maxwell Air Force Base and Redstone Arsenal, are taxable on their entire net income. See Reg. 810-3-2-.01(2).

(b) Nonresident individuals (other than military personnel) living in federal areas located within Alabama over which the United States exercises exclusive or concurrent jurisdiction are taxable on income earned in such areas; including income from business transacted in these areas.

(c) This paragraph (3) applies only to income or receipts received after December 31, 1940, the effective date of Public Law No. 819, known as the Buck Act. Under this act the United States has ceded to the States the jurisdiction to tax persons residing within or receiving income from transactions occurring or services performed, in all federal areas heretofore or hereafter acquired by the United States. The term "Federal Area" means any land or premises held or acquired by or for the use of the United States, or any Department, Establishment, or Agency thereof, and over which the United States exercises exclusive or concurrent jurisdiction.

(d) 1. Military personnel who are not residents of Alabama and who receive military pay while stationed in Alabama, shall be deemed not to have received such income for services performed within, or from sources within Alabama. This subparagraph (d) applies to all military compensation received after September 8, 1939, in accordance with Section 514 of Public Law 732.

2. Wives of military personnel who earn income in Alabama, and military personnel who earn nonmilitary income in Alabama, are taxed on such income.

(e) Spouses will be presumed to have the same domicile, unless proven otherwise.

| 1. EXAMPLE: | Income Resident (or includable as Income from all sources if Nonresident) | Taxable to Nonresident | Taxable to |
|---|---|---|---|
| Income During Taxable Year | | | |
| Husband | | | |
| Military | | | |
| Not in combat zone | $ 6,000 | $ 6,000 | $ -0- |
| In combat zone | 1,000 | -0- | -0- |
| Quarters allowance | 1,500 | -0- | -0- |
| Subsistence allowance | 600 | -0- | -0- |
| Uniform allowance | 100 | -0- | -0- |
| Travel allowance | 100 | -0- | -0- |
| Flight pay | 200 | 200 | -0- |
| Sea duty | 200 | 200 | -0- |
| Trailer allowance | 100 | -0- | -0- |
| Dislocation allowance | 100 | -0- | -0- |
| Income from Other States | | | |
| Compensation | 200 | 200 | -0- |
| Business, Interest, Dividends, Rents, etc. | 800 | 800 | -0- |
| Income from Alabama | | | |
| Compensation | 700 | 700 | 700 |
| Business, Rental Income, etc. | 300 | 300 | 300 |
| Total Income | $11,900 | | |
| Taxable if Taxpayer is a resident | $ 8,400 | | |
| Taxable if Taxpayer is not a resident | | | $ 1,000 |
| Wife | | | |

| | | | |
|---|---|---|---|
| Income from Other States | | | |
| Compensation (Including Federal Civil Service) | $ 500 | $ 500 | $ -0- |
| Business, Interest, Dividends, Rents, etc. | 500 | 500 | -0- |
| Income from Alabama | | | |
| Compensation (Including Federal Civil Service) | 5,600 | 5,600 | 5,600 |
| Business, Rental Income, etc. | 400 | 400 | 400 |
| Total Income | $ 7,000 | | |
| Taxable if Taxpayer is a resident | $ 7,000 | | |
| Taxable if Taxpayer is not a resident | | | $ 6,000 |

(4) An individual who becomes a resident of Alabama must include in gross income all income from sources both within and without Alabama for the period of residence. A resident moving away from Alabama during the year includes in gross income only income from sources both within and without Alabama until date of termination of his residence in this state. The Department should be notified of the termination of taxpayer's residence, including all pertinent facts relating to the termination.

(a) EXAMPLE: Taxpayer moved from New York to Alabama on September 1. Prior to that date he had no Alabama income. After moving to Alabama, he had an income of $5,000. He must file a return on Form 40, (Resident Individual Income Tax Return) reporting the $5,000, but need not report any income earned before September 1. He is entitled to the same annual exemptions as a resident for a full year. See Reg. 810-3-19-.02(3).

(b) EXAMPLE: Taxpayer moved from Alabama to Mississippi on November 1. Prior to that time he earned $8,000 taxable income in Alabama, and had no Alabama income during November and December. He should notify the Department of the termination of his residence in Alabama, and file a resident's return on Form 40 (Resident Individual Income Tax Return) reporting the $8,000 income. He may claim the annual exemptions to which he would be entitled were he a resident for the entire year.

(c) An individual, a resident for part of the taxable year and a nonresident for the other part of the taxable year, having taxable income in both periods, should file two returns:

1. One return should be filed on Form 40 as a resident, covering the period of residence. All income, from whatever source within or without the state,

earned during such period of residence should be included in this return, and exemptions should be claimed for the total annual exemptions to which the taxpayer is entitled.

2. A second return should be filed on Form 40NR as a nonresident, covering income from sources in Alabama for the period of nonresidence.

(ii) EXAMPLE: Taxpayer, married and having two dependents, moved from Alabama to Tennessee on April 1. Prior to April 1, his income from Alabama sources amounted to $2,000. After April 1, his Alabama income was $3,000 and his income from other sources was $6,000, or a total income from all sources of $9,000 after April 1. Taxpayer must file two returns:

(I) His return as a resident (Form 40) should report income of $2,000, and the annual exemption he could claim were he a resident for the entire year.

(II) His return as a nonresident (Form 40NR) would report $3,000. His personal exemptions and/or credit for dependents would be on the nonresident return as the full annual amount would have been allowed on the resident return.

(Adopted September 30, 1982; amended: effective April 24, 1989)
Authors: Rebecca S. Whisenant Auth: § 40-18-2
and John H. Burgess
Income Tax Division

810-3-2-.02. Corporations Subject to Alabama Income Tax.

(1) Corporations, associations or joint-stock companies subject to tax in this state only are taxable on income from all sources, both within the without Alabama. Corporations, associations or joint-stock companies subject to tax in this state and another state shall allocate and apportion their income as defined in the statute and regulations under Section 40-27-1, Code of Alabama 1975.

(2) For a corporation acting in a fiduciary capacity in Alabama, see Reg. 810-3-2-.03.

(3) For tax years beginning after December 31, 1984, and before January 1, 1990, a qualified corporation, either domestic or foreign, may elect to be an Alabama S corporation under the provisions of Sec. 40-18-160, et seq., Code of Alabama 1975. For tax years beginning after December 31, 1989, a corporation qualified to do business or doing business in this state and having a valid S election U.S.C. § 1362 shall be an Alabama S corporation under the provisions of Sec. 40-18-160, et seq. An S corporation will not pay income tax at the corporate level, but will act as a conduit to pass through income to its shareholders. See §40-18-160, Code of Alabama 1975, and related regulations.

(4) (a) For tax years beginning after December 31, 1984, every organization described in subdivisions (1), (2), (3), (4), (5), (6), (7), (11), and (12) of § 40-18-32(a), which receives "unrelated business taxable income" as defined in 26 U.S.C. § 512, shall file an income tax return reporting such "unrelated business taxable income" and pay any tax due thereon.

(b) Any organization, whether incorporated or not, which receives such "unrelated business taxable income" shall file Form 20C and report income and deductions in the same manner as a corporation. Any organization subject to income tax which receives such "unrelated business taxable income" shall file Form 20C and report the income and deductions attributable to Alabama. See the statute and regulations under Section 40-27-1 for rules on apportionment and allocation of income and deductions.

Author: Verlon R. Frost, Jeff Taylor
Authority: Section 40-18-2, Code of Alabama 1975
History: Filed with LRS, July 22, 1992.
Amended March 4, 1997, effective date April 8, 1997.

810-3-2-.03. Estates, Trusts and Fiduciaries Subject to Alabama Income Tax.

(1) Every individual or corporation acting in a fiduciary capacity, receiving income from sources within the State of Alabama, is subject to the Alabama income tax with respect to such income. For definitions of resident individuals and resident corporations, see Regs. 810-3-2-.01 and 810-3-2-.02.

(2) An estate or trust resident in the State of Alabama, or having a resident fiduciary, is subject to the Alabama income tax. An estate or trust having income from sources within the State is subject to tax on such income. For a discussion of the situs of income, see Reg. 810-3-14-.05(2). For specific rules with respect to estates, trusts and fiduciaries, see §§40-18-25 and 40-18-29, Code of Alabama 1975.

Author: Roy Wiggins
Authority: §40-18-2, Code of Alabama 1975
History: Effective September 30, 1982.
Amended August 31, 1988.
Amended September 18, 1996, effective October 23, 1996.

RULES OF
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CHAPTER 810-3-2.1

# EXEMPT INCOME FOR FOREIGN MISSIONARY SERVICE

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810-3-2.1-.01 Exempt Income for Foreign Missionary Service

810-3-2.1-.01. Exempt Income for Foreign Missionary Service.

(1) After December 31, 1983, all missionary service income earned by a person engaged in foreign missionary service is exempt (excluded from gross income) if -

(a) the person is physically present in a foreign country or countries for a minimum of twenty-four (24) months, and

(b) the person is appointed or employed by a church or other like religious organization.

(2)(a)1. Only service as a foreign missionary qualifies for the exclusion in paragraph (1) above. Other foreign service, such as governmental appointments, does not qualify for the exclusion.

2. Missionary service not performed in a foreign country or countries does not qualify for the exclusion or for the computation of the 24 month qualifying period.

3. Service as a missionary in a territory or possession of the United States or within the Commonwealth of Puerto Rico does not qualify as foreign service.

(b)1. The 24 months of qualifying service need not be performed consecutively nor must the 24 month period begin on or after January 1, 1984.

(i) EXAMPLE: The taxpayer has served 24 months (not necessarily consecutively) as a foreign missionary prior to January 1, 1984. The taxpayer returns to foreign missionary service during 1984. All income earned as a foreign missionary in 1984 may be excluded from the Alabama income tax return for that period.

2. If a taxpayer receives foreign missionary service income, but has not met the 24 month foreign service requirement on or before the date the return for such year is filed (including extensions of time to file), such foreign missionary service income shall be included in gross income for the year earned. However, if the 24 month foreign service requirement period is subsequently met before the expiration of the statute of limitations for claiming a refund for such year, an amended return may be filed to exclude such prior foreign missionary service income and a claim for refund filed. Generally, such a refund claim must be filed within three years of the date the tax for such year was paid (or deemed to be paid, if paid by withholding or estimated payments). See Reg. 810-14-1-.19 for limitations on refund claims.

(3) Income earned from foreign missionary service for periods prior to January 1, 1984, may not be excluded from gross income even though such service may qualify for the 24 month period of required foreign service.

Author: Income Tax Division
Authority: Section 40-18-2.1, Code of Alabama 1975
History: Effective August 31, 1988.
Amended September 18, 1996, effective date October 23, 1996.

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CHAPTER 810-3-3

Income of Officers or Agents of the United States, Etc.

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810-3-3-.01 Compensation of Federal Employees

810-3-3-.01. Compensation of Federal Employees.

(1) Salaries, fees, commissions and other income received by officers or agents of the United States, its agencies, instrumentalities, or contractees from the United States or from its agencies and instrumentalities are subject to income taxes levied by the State of Alabama.

(a) These income taxes must be levied only as the State of Alabama is constitutionally or legally authorized to tax such income, and must be taxed without discrimination and only to the same extent and in the same manner other income is taxed.

(2) Compensation received from the United States for active service as a member of the Armed Forces in a combat zone designated by Executive Order of the President of the United States is not taxable under the Alabama income tax laws. Prior to January 1, 1965, all military pay was taxable except during a period of hostilities.

(a) For deferment of tax in hardship cases under Soldiers' and Sailors' Civil Relief Act, Public Law No. 861, see Reg. 810-3-42-.03. For definition of gross income, see Reg. 810-3-14-.01. For exclusions from gross income, see Reg. 810-3-14-.02. For domicile of military personnel and federal civilian employees, see Reg. 810-3-2-.01.

Author: Rebecca S. Whisenant.
Authority: Section 40-18-3, Code of Alabama 1975
History: Effective September 30, 1982.
Amended July 27, 1988.
Amended September 18, 1996, effective date October 23, 1996.

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CHAPTER 810-3-4

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810-3-4-.01 Interest or Other Income Received from Obligations of the United States or its Possessions, Agencies, or Instrumentalities

810-3-4-.01. Interest or Other Income Received from Obligations of the United States or its Possessions, Agencies or Instrumentalities. Section 40-18-4, Code of Alabama 1975 is superseded by §40-18-14(2)d which excludes this interest income from obligations of the United States or its possessions, agencies or instrumentalities from gross income.

Author: Income Tax Division.
Authority: §§40-18-4 and 40-18-57, Code of Alabama 1975
History: Adopted September 22, 1982. Readopted through APA October 1, 1982.
Amended November 21, 1986.
Amended September 18, 1996, effective date October 23, 1996.

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810-3-6-.01. Basis in Property.

(1) For the purposes of Chapter 6 of these regulations, the following definitions apply:

(a) Unadjusted basis in property - The original cost of the property if acquired after January 1, 1933. If the property was acquired prior to January 1, 1933 the unadjusted basis is the fair market value on January 1, 1933.

(b) Adjusted basis in property (for transactions before January 1, 1985) - The unadjusted basis in the property, plus the cost of improvements of a permanent character made to the property that have been properly classified as a capital expenditure, minus prior return of investment, depreciation, amortization, depletion, and other reductions in the original cost.

(c) Fair market value - The price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and each having knowledge of all relevant facts.

1. The determination of the fair market value of property is generally a question of fact and shall be established by competent evidence. The general way of determining the fair market value of stock, in the absence of knowledge of sales on any given date, is to value the stock on the basis of the corporate assets underlying the stock as disclosed by a balance sheet as of this date.

(2) The general rule is that the unadjusted basis of property is its cost. The term "adjusted basis" means, in substance, the original capital investment ("unadjusted basis") adjusted to the date the taxpayer disposes of the property. "Basis" for determining gain or loss on sale or other disposition is also the "basis" for computing depreciation, and in some cases, depletion.

(a) The adjusted basis for determining the gain or loss from the sale or other disposition of property is the basis of the property defined in §40-18-6(a), Code of Alabama 1975, adjusted to the extent provided in §40-18-6(b)(1) as in effect prior to January 1, 1985, or adjusted to the extent provided in §40-18-6(b) as in effect after December 31, 1984; and interpreted below:

1. Expenditures made by the taxpayer after acquisition of a property for improvements, additions or betterments of a relatively permanent character, such as to prolong the life or increase the utility of the property in substantial degree beyond the life or utility reasonably to be expected from properties of like age and character, shall be added to and increase the original basis of such property for the purpose of determining gain or loss upon the disposition thereof. No adjustment shall be made in respect of any item which, under any applicable provision of law or regulation, is treated as an item not properly chargeable to a

capital account but is allowable as an expense deduction in computing net income for the taxable year.

2. Adjustments to basis may be made for carrying charges such as taxes and interest, with respect to unimproved and unproductive real property, if the taxpayer elects to treat these items as chargeable to asset accounts rather than as an allowable expense deduction. The term "taxes" for this purpose includes duties and excise taxes but does not include income taxes.

3. In any case in which a portion of the taxpayer's cost or investment has been returned to him in any form or manner since acquisition, or any losses have been incurred, or other items or events have transpired, resulting in a return of capital, the amount thereof shall apply against and reduce the original basis to the taxpayer. Thus, any receipts or credits arising from or related to the ownership of an item of property, which receipts or credits do not constitute income taxable under the law, are to be treated as a refund of a portion of the original cost.

(3) If a casualty loss has been sustained, the cost basis in the property must be reduced by the amount of the casualty loss claimed as a deduction in the computation of net income. If the loss is reimbursed, in part or total, by insurance proceeds; the insurance proceeds must be used to repair the property to its original state. For losses occurring in tax years ending before January 1, 1985, if the insurance proceeds are not used to repair the property to its original state, the casualty must be treated as an involuntary conversion and any gain recognized and reported as income. See Reg. 810-3-8-.06 for involuntary conversions. For losses in tax years beginning after December 31, 1984, see Reg. 810-3-8-.06(2) for determination of recognizable gain, if any.

(a) EXAMPLE: A rental dwelling was partially destroyed by fire. The fair market value of the property immediately before the fire was $20,000.00 ($2,000.00 for the land and $18,000.00 for the dwelling). The fair market value just after the fire was $12,000.00 ($2,000.00 for the land and $10,000.00 for the dwelling). The insurance reimbursement was $5,000.00. The entire amount of the insurance proceeds were used to repair the property to its original state. Taxpayers adjusted cost basis in the property before the casualty was $6,000.00 ($1,000.00 for the land and $5,000.00 for the dwelling). The adjusted basis in the property following the casualty is as follows:

| | Land | Building |
|---|---|---|
| a. Cost/basis | $ 1,000 | $ 5,000 |
| b. Fair market value before | 2,000 | 18,000 |
| c. Fair market value after | 2,000 | 10,000 |
| d. Change in fair market value | 0 | 8,000 |
| e. Smaller of cost or change in market value | 0 | 5,000 |

| | | |
|---|---|---|
| f. Less insurance proceeds | 0 | 5,000 |
| g. Casualty loss (e - f) | 0 | 0 |
| h. New adjusted basis before repairs | $ 1,000 | 0 |

(b) EXAMPLE: Same facts as in example (3)(a) above, except the dwelling is a personal residence. The casualty loss and adjusted basis would be computed as follows:

| | Homesite |
|---|---|
| a. Cost/basis | $ 6,000 |
| b. Fair market value before | 20,000 |
| c. Fair market value after | 12,000 |
| d. Change in market value | 8,000 |
| e. Smaller of cost or change in market value | 6,000 |
| f. Less insurance proceeds | 5,000 |
| g. Casualty loss (e - f) | $ 1,000 |
| h. New adjusted basis before repairs | 0 |

(4) The original basis must also be decreased by the amount of maximum allowable deductions for exhaustion, wear and tear, obsolescence (these three items hereinafter referred to as "depreciation"), amortization, and depletion under the law applicable to the periods of time prior to January 1, 1935 and subsequent to January 1, 1935. Deductions allowable shall reduce the original basis of the property to the adjusted basis for determining gain or loss. These deductions shall be the greater of the following two amounts:

(a) the amount allowed as deductions in computing taxable income to the extent resulting in a taxpayer's income taxes, or

(b) the amount allowable for the years involved.

(c) The general rule is "Always in the amount allowed, but never less than the amount allowable."

(d) It is not necessary for this depreciation, amortization, or depletion to have been claimed on tax returns or entered in taxpayer's records. It shall be assumed that the taxpayer has claimed maximum allowable deductions regardless of the expiration of the statutory period for claiming deductions. A taxpayer is not permitted to take advantage in a later year of his prior failure to take any such allowance or his taking an allowance plainly inadequate under the known facts in prior years. In the case of depreciation, if in prior years the

taxpayer has consistently taken proper deductions under one method, the amount allowable for such prior years shall not be increased even though a greater amount would have been allowable under another proper method.

(5) In the case of stock, the original basis must be decreased by the amount of distributions previously made which at the date of distribution were either tax free or applicable in the reduction of basis. This does not apply to exempt dividends paid from income earned since January 1, 1933, by the corporations paying the dividend.

(6) For transactions occurring in a tax year beginning before January 1, 1985, whenever it appears that the basis of property of the taxpayer is a substituted basis, then the adjustments provided in §40-18-6(b) and this regulation shall be made after first making, in respect to such substituted basis, proper adjustments of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor, or during which the other property was held by the person from whom the basis is to be determined. A similar rule shall be applied in case of a series of substituted bases.

Author: Roy Wiggins
Authority: §40-18-6, Code of Alabama 1975
History: Effective September 30, 1982.
Effective August 30, 1988.
Amended September 18, 1996, effective October 23, 1996.

810-3-6-.02 Basis for Computing Gain or Loss - Exceptions.

(1) The basis of property shall be the cost of the property with the following exceptions:

(a) Inventory - If the property should have been included in the last inventory, the basis shall be the amount used in the last inventory.

(b) Gifts or Transfer in Trust - See Rule 810-3-6-.04.

(c) Property Transmitted at Death - See Rule 810-3-6-.05.

(d) Property Acquired Upon Like-Kind Exchange - See Rule 810-3-06.

(e) Transfers to a Corporation - See Rule 810-3-6-.07.

(f) Property Acquired on Liquidation of a Subsidiary - See Rule 810-3-6-.08.

(g) Basis of Property of Subsidiary After Acquisition - See Rule 810-3-6-.09.

(h) Basis of Property Received in Liquidation in which a Gain or Loss was Recognized- See Rule 810-3-6-.10.

(i) Basis of Stock after a Stock Dividend - See Rule 810-3-6-.11.

(j) Involuntary Conversion - See Rule 810-3-6-.12.

(k) Property Acquired Before January 1, 1933 - See Rule 810-3-6-.13.

(l) Property Acquired from a Spouse or Former Spouse - See Rule 810-3-6-.14.

(m) Basis of Replacement Property in Sale of Stock to ESOP orCooperative - See Rule 810-3-6-.15.

(n) Basis of Property to Subchapter K Entity - See Rule 810-3-6-.03.

(o) Basis of Interest in a Subchapter K Entity - See Rule 810-3-6-.03.

(p) Basis of Property Distributed by a Subchapter K Entity - See Rule 810-3-6-.03.

(q) Basis of Property - Individuals Establishing Alabama Domicile - See Rule 810-3-6-.16.

(r) Allocation of Basis - See Rule 810-3-6-.17.

Author: Ed Cutter, CPA
Authority: Sections 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975
History: Adopted through APA September 30, 1982.
Amended July 27, 1998.
Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-6-.03 Basis in Subchapter K Entity.

(1) For all taxable years with respect to which a preliminary assessment of income tax could be made under the provisions of §40-2A-7, Code of Alabama 1975, as of May 27, 1997, and thereafter:

(a) Basis of property to subchapter K entity - A subchapter K entity's basis in property contributed to it under §40-18-8(o),Code of Alabama 1975, by a partner or member shall be determined according to 26 U.S.C. § 723.

(b) Basis of interest in subchapter K entity -

1. A contributing partner's or member's initial basis in a subchapter K entity interest acquired by a contribution of property (including money as described in §40-18-8[o]) to the subchapter K entity shall be determined according to 26 U.S.C. § 722.

2. Increases and decreases to the initial basis determined under paragraph 1 shall be made according to 26 U.S.C. § 705, and those adjustments to the initial basis shall be determined without regard to the allocation and apportionment rules of Section 40-18-22.

3. Special basis adjustments - The basis of the property of the subchapter K entity shall be determined according to 26 U.S.C. §§ 734 and 743, if the subchapter K entity has in effect an election under 26 U.S.C. § 754 (relating to optional adjustment to basis of partnership property).

(c) Basis of property distributed by subchapter K entity - The basis of property (other than money) distributed by a subchapter K entity to a partner or member other than in liquidation of the partner's or member's interest shall be determined according to 26 U.S.C. §732.

(2) No refunds shall be due or issued by reason of this regulation with respect to taxable years beginning before January 1, 1997.

(3) For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

Author: Ann Fondren Winborne, CPA, Nancy D. Hatfield.
Authority: §§40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975.
History: New rule filed March 26, 1998, effective date April 30, 1998.
Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-6-.04 Basis of Property Acquired by Gift or Transfer in Trust.

(1) **Property Acquired After December 31, 1997.** The basis of property acquired by gift or by a transfer in trust shall be determined according to 26 U.S.C. §1015. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(2) **Property Acquired After March 14, 1985, but before January 1, 1998.** The basis shall be the same as the basis would be in the hands of the donor or the last preceding owner from whom the property was not acquired by gift; except that if such basis is greater than the fair market value of the property then for the purpose of determining the amount of loss the basis shall be the fair market value.

(a) Donor's Basis Unknown. If the basis of the property acquired by gift or transfer in trust after March 14, 1985, is unknown to the donee, the Department will attempt to obtain such facts as to determine the basis in the hands of the donor or the last owner who did not receive the property by gift or a transfer in trust. If the Department is unable to obtain such facts, the basis of the property will be determined, according to the best information available to the Department, to be the fair market value of the property at the time acquired by the donor or last preceding owner.

(b) Transfer in Trust Other Than Gift, Bequest, or Devise. If the property was acquired by a transfer in trust, other than a transfer in trust by a gift, bequest or devise, the basis shall be the same as in the hands of the grantor, increased by the amount of gain (or decreased by the amount of loss) recognized by the grantor on such transfer of the property.

(3) **Property acquired after December 31, 1932, but prior to March 15, 1985.** The basis shall be the fair market value of the property at the date of acquisition.

(4) **Property acquired prior to January 1, 1933.** The basis shall be the fair market value at the close of December 31, 1932.

Author: Lloyd B. Byrd, Judy A. Robbins.
Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975.
History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.05 Property Transmitted at Death.

(1) After December 31, 1997: The basis of property acquired from a decedent will be determined according to 26 U.S.C. §1014. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(2) Prior to January 1, 1998: Basis for the following shall be the fair market value of the property at the time of decedent's death:

(a) Personal property acquired by specific bequest,

(b) Real property acquired by general or specific devise or by intestacy,

(c) Property acquired by the decedent's estate from the decedent.

(d) In all other cases of property acquired by will or intestacy, basis shall be the fair and reasonable market value of the property at the time of distribution to the taxpayer.

(e) The value of property as of the date of the decedent's death as appraised for the purpose of the federal estate tax or the alternate value as appraised for such purpose, whichever is applicable, shall be deemed to be its fair market value.

Authors: Lloyd B. Byrd, Judy A. Robbins.
Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975.
History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.06 Basis of Property Acquired Upon Like-Kind Exchange.

(1) **After December 31, 1984:** The basis of property acquired in a like-kind exchange shall be determined according to 26 U.S. C. §1031. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(2) **Prior to January 1, 1985:** The basis of property acquired in a like-kind exchange is the same as that of the property exchanged less the amount of money and the fair market value of other property received, less any loss (or plus any gain) recognized on the exchange.

(a) Corporate Stock. This rule does not apply in case of property received by a corporation in whole or in part in exchange for the stock or securities of that corporation.

(b) Mixed Exchanges. If the property acquired consisted of both like and unlike property, the basis shall be allocated between the properties (other than money) received, and for the purpose of allocation there shall be assigned to the unlike property an amount equal to its fair market value at the date of the exchange.

Authors: Lloyd B. Byrd, Judy A. Robbins.
Authority: §§ 40-2a-7(a)(5) and 40-18-6, Code of Alabama 1975.
History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.07 Basis of Property Transferred to a Corporation.

(1) For tax periods beginning after December 31, 1984:

(a) the basis of property received by a distributee in a transaction described in subsection (e) or (f) of § 40-18-8, Code of Alabama, 1975 shall be determined in accordance with 26 U.S.C. § 358. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(b) the basis of property acquired by a corporation in a transaction described in subsection (e) or (f) of § 40-18-8, shall be determined in accordance with 26 U.S.C. § 362. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(c) Transactions described in subsection (e) or (f) of § 40-18-8 are those transactions meeting the requirements of 26 U.S.C. § 351, where property is transferred to a corporation controlled by the transferor, or those reorganizations as defined by 26 U.S.C. § 368.

(2) Transfers to corporation where control of property remains in same person - prior to January 1, 1985. Property transferred to a corporation in connection with a reorganization as defined in § 40-18-8(f) after December 31, 1932, but before January 1, 1985, where control as defined in 26 U.S.C. § 368(c) remains with the transferor, shall have the same basis as it would have in the hands of the transferor together with gain or loss recognized to the transferor on the transfer. This rule does not apply if the property acquired consists of stock or securities in a corporation, a party to the reorganization, unless the consideration in whole or in part is the stock or securities of the corporation acquiring the property.

Author: Ed Cutter, CPA
Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975
History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.08 Basis of Property Acquired on Liquidation of a Subsidiary.

(1) Basis of Property Acquired on Liquidation of Subsidiary. The basis of property acquired by a corporation as a result of a liquidation of a subsidiary to which § 40-18-8(h), Code of Alabama 1975, applies shall be determined in accordance with 26 U.S.C.§ 334(b). For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(2) § 40-18-8(h) concerns the complete liquidation of subsidiaries satisfying the requirements of 26 U.S.C.§ 332.

Author: Ed Cutter, CPA
Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975
History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.09 Basis of Property of a Subsidiary after Acquisition. If an election under 26 U.S.C. § 338 is in effect for federal income tax purposes, the basis of property owned by a corporation shall be determined under 26 U.S.C. § 338 relating to the treatment of certain stock purchases as asset acquisitions. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

Author: Ed Cutter, CPA
Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975
History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.10 Basis of Property Received in Liquidation in Which Gain or Loss is Recognized. If property is received in a distribution in complete liquidation in which a gain or loss is recognized on receipt of the property, the basis of the property received shall be determined in accordance with 26 U.S.C. § 334(a). For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

Author: Ed Cutter, CPA
Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975
History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.11 Basis of Stock After Stock Dividend. The basis of stock with respect to which a corporation makes a distribution of its stock and the basis of the stock distributed shall be determined in accordance with 26 U.S.C. § 307. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

Author: Ed Cutter, CPA
Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975
History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.12 Basis of Property Acquired in Connection with an Involuntary Conversion.

(1) After December 31, 1984. The basis of property acquired in connection with an involuntary conversion in which a gain or loss was not recognized shall be determined according to 26 U.S.C. §1033. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(2) Prior to January 1, 1985. The basis of property acquired in connection with an involuntary conversion (as described in §40-18-8(f), Code of Alabama 1975, in effect prior to January 1, 1985) shall be the same as the property converted, less the amount of money received but not expended by the taxpayer, increased by any recognized gain or decreased by any recognized loss upon the conversion.

Author: Judy A. Robbins.
Authority: §§ 40-2A-7(a(5) and 40-18-6, Code of Alabama 1975
History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.13 Basis of Property Acquired before January 1, 1933. If property was acquired prior to January 1, 1933, the basis for determination of gain, loss, depreciation or depletion is the fair market value on January 1, 1933.

Author: Ed Cutter
Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975
History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.14 Basis of Property Acquired from a Spouse or Former Spouse.

(1) The basis of property received from a spouse or former spouse in a transaction in which a gain or loss was determined under § 40-18-8(m), Code of Alabama 1975, shall be determined in accordance with 26 U.S.C. § 1041. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(2) Section 40-18-8(m) concerns the transfer of property to a spouse or former spouse.

Author: Ed Cutter, CPA
Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975
History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.15 Basis of Replacement Property in Sale of Stock to an Employee Stock Ownership Plan or Cooperative. If securities are sold to an employee stock ownership plan or an eligible work-owned cooperative, and gain was not recognized pursuant to § 40-18-8(n), Code of Alabama 1975, the basis of the qualified replacement property, as defined by 26 U.S.C. § 1042, shall be determined in accordance with 26 U.S.C. § 1042(d). For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

Author: Ed Cutter, CPA
Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975
History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.16 Basis of Property of Individuals Establishing Alabama Domicile.

(1) Effective for tax years beginning after December 31, 1997, the basis of both real and personal property owned by an individual on the date Alabama domicile is established shall be the same basis as is used for federal income tax purposes on that date.

(2) Example 1: Taxpayer owns an IRA for which all contributions made were deducted from the taxpayer's income for federal income tax purposes. The taxpayer establishes Alabama domicile on January 1, 1998. The basis for the IRA for Alabama income tax purposes is zero, upon the establishment of Alabama domicile.

(3) Example 2: Taxpayer owns a truck with an original cost of $100,000 and an adjusted basis of $80,000 as of December 31, 1997. On January 1, 1998, the taxpayer establishes Alabama domicile. The adjusted basis in the truck for Alabama income tax purposes is $80,000, upon the establishment of Alabama domicile.

Author: Ed Cutter, CPA
Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975
History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.17 Allocation of Basis. Effective for tax years beginning after December 31, 1997, if property is acquired in an applicable asset acquisition as defined by 26 U.S.C. § 1060, the basis of the acquired property shall be determined in accordance with 26 U.S.C. § 1060. Federal regulations and determinations for 26 U.S.C. § 1060 will be followed in the administration of this section.

Author: Ed Cutter, CPA
Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975
History: New rule filed April 28, 1999, effective June 2, 1999.

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810-3-8-.01. Recognition of Gain or Loss.

(1) For transactions closed before January 1, 1985, gain or loss shall be recognized in accordance with the following rules:

(a) The Federal Internal Revenue Code contains provisions similar to those in §40-18-8, Code of Alabama 1975. Decisions and interpretations of the federal courts and agencies will be given due weight in interpreting this section. The terms "property of like kind", "for productive use", and "party to a reorganization" are considered to have the same meaning as in Federal taxation. The terms "control" and "reorganization" as defined in §40-18-8 have a somewhat different meaning from the same terms as used in Federal taxation.

(b) The entire amount of gain or loss realized upon the sale or exchange of property shall normally be recognized on the tax return for that year. Exceptions from the general rule are made in §40-18-8 with respect to certain exchanges of property in which at the time of the exchange the particular differences existing between the property disposed of and the property acquired are more formal than substantial. The law provides that such differences shall not be deemed controlling and that gain or loss shall not be recognized at the time of the exchange. The underlying assumption of these exceptions is that the new property is substantially a continuation of the old investment.

(c) The exceptions from the general rule requiring the recognition of all gains and losses are strictly construed. Nonrecognition is accorded by the law only if the exchange is one which satisfies both the specific description in the law of an excepted exchange, and the underlying purpose for which such exchange is excepted from the general rule.

(d) The law makes specific provision for the case in which, in addition to property which may be received tax-free on the exchange, additional money or property is received. In such a case, gain is recognized to the extent of the additional property or money, but no loss of any kind is recognized.

(e) To constitute an exchange within the meaning of this section the transaction must be a reciprocal transfer of property, as distinguished from a transfer of property for money consideration only.

(f) For nonrecognition of gain on the sale of a personal residence in the year of the sale, see §40-18-14, Code of Alabama 1975, Regs. 810-3-14-.07 and 810-3-14-.08.

(2) For transactions closed after December 31, 1984, upon the sale, exchange, or other disposition of property the entire amount of the gain or loss realized shall be recognized on the current year tax return, except as provided in Regs. 810-3-8-.02, et seq.

Author: Income Tax Division
Authority: §40-18-8, Code of Alabama 1975
History: Effective December 4, 1992.
Amended September 18, 1996, effective date October 23, 1996.

810-3-8-.02 Like-Kind Exchanges of Property Held for Productive Use in Trade or Business or for Investment.

(1) If an exchange of property occurring after December 31, 1984, satisfies the requirements of 26 U.S.C. § 1031, relating to like-kind exchanges, then the amount of gain or loss recognized in the exchange shall be determined in accordance with 26 U.S.C. § 1031. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(2) Transactions occurring prior to January 1, 1985: As used in §40-18-8(b)(1), Code of Alabama 1975, the words "like kind" have reference to the nature of the property and not to its grade or quality. One kind or class of property may not, under such subsection, be exchanged for property of a different kind or class. The fact that any real estate involved is improved or unimproved is not material, for such fact relates only to the grade or quality of the property and not to its kind or class. Unproductive real estate held by one, other than a dealer, for future use or future realization of the increment in value comes within the meaning of this subsection.

(a) No gain or loss is recognized if:

1. a taxpayer exchanges property held for productive use in his trade or business, together with cash, for other property of like kind for the same use, such as a truck for a new truck to be used for a like purpose, or

2. a taxpayer, who is not a dealer in real estate, exchanges city real estate for a farm, or improved real estate for unimproved real estate, or

3. a taxpayer exchanges investment property and cash for investment property of a like kind.

Author: Edward F. Cutter, CPA.
Authority: §§40-2A-7(a)(5) and 40-18-8, Code of Alabama 1975
History: Adopted through APA September 30, 1982.
Amended July 27, 1988.
Amended December 4, 1992.
Amended: Filed September 18, 1996, effective October 23, 1996.
Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-8-.03 Stock for Stock of the Same Corporation. Federal regulations and decisions of federal courts and agencies regarding the exchange of stock for stock of the same corporation will generally be followed in the interpretation of this rule. See also Rule 810-3-1.1-.01, Operating Rules, for interpretation of federal statutes adopted by the Alabama Legislature.

Author: Verlon R. Frost, Jeff Taylor, and Ed Cutter, CPA
Authority: §§ 40-2A-7(a)(5), 40-18-8 and 40-18-5, Code of Alabama 1975
History: Adopted through APA September 30, 1982.
Amended July 27, 1988.
Amended: Filed March 4, 1997, effective April 8, 1997.
Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-8-.04 Exchanges in Pursuance of a Plan of Reorganization.

(1) For transactions after December 31, 1984, federal interpretations pertaining to 26 U.S.C. §§ 354, 355, 356, 361, 371 and 374 will be followed in determining the amount of gain or loss recognized as the result of a reorganization specified in 26 U.S.C. § 368 or a distribution that qualifies under 26 U.S.C. § 355. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(2) For transactions before January 1, 1985 -

(a) For the purpose of this rule the term "reorganization" means:

1. The merger of one or more corporations in accordance with statutory authority into another;

2. The consolidation pursuant to statutory authority of two or more corporations into a new corporation;

3. The acquisition by one corporation of at least a majority of the voting stock, or substantially all the properties of another corporation;

4. The transfer by one corporation of all or a part of its assets to another, if immediately after the transfer the first corporation or its stockholders, or both, are in control of the second corporation (control for this purpose being defined in §40-18-8(j), Code of Alabama, 1975, as the ownership by the first corporation or its stockholders, or both, of the second corporation to the extent of at least fifty-one percent of the voting stock and at least eighty percent of the total number of shares of all other classes thereof);

5. A recapitalization;

6. A mere change in identity, form or place of organization, however effected.

(b) No taxable income is received, nor is a deductible loss sustained, when a corporation exchanges property solely for stock or securities in another corporation, if

1. the exchange is in pursuance of a plan of reorganization, and

2. the corporation receiving the stock is a party to a plan of reorganization, and

3. the stock received is of a corporation which is a party to the same plan of reorganization.

(c) If in any transaction, which would fall within §40-18-8(b)(4) if the exchange were solely in kind, there is received by the taxpayer other property (in addition to property permitted to be received by the taxpayer without recognition of gain) and/or money, then -

1. if the corporation receiving such other property or money distributes it in accordance with the plan of reorganization, no gain from the exchange will be recognized to the corporation, or

2. if such distribution is not made, the gain to the corporation shall be recognized in an amount not in excess of the sum of money and the fair and reasonable market value of such other additional property received.

(d) If a shareholder in a corporation, in a reorganization, surrenders none of his stocks or securities but receives stocks or securities in any corporation which is a party of the reorganization no gain is recognized.

1. The distribution shall not be considered a distribution of earnings and profits within the meaning of §40-18-8(b)(4) for determining the taxability of subsequent distributions by the corporation.

Author: Verlon R. Frost, Jeff Taylor
Authority: Sections 40-2A-7(a)(5) and 40-18-8, Code of Alabama 1975
Adopted through APA December 4, 1992.
Amended: Filed March 4, 1997, effective April 8, 1997.
Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-8-.05 Transfer of Property to Corporation Controlled by Transferor.

(1) For transactions occurring after December 31, 1984.

(a) If property is transferred to a corporation in a transaction which satisfies the requirements of 26 U.S.C. § 351, relating to transfers to corporations controlled by the transferor, the amount of gain or loss shall be determined in accordance with 26 U.S.C. § 351, as modified by 26 U.S.C. § 357, relating to the recognition of gain as a result of the transferee corporation's assumption of liabilities.

(2) For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

Author: Nancy D. Hatfield
Individual and Corporate Tax Division
Authority: Sections 40-2A-7(a)(5) and 40-18-8, Code of Alabama 1975
History: Adopted through APA September 30, 1982.
Amended: Filed July 27, 1988, effective August 30, 1988.
Amended: Filed September 18, 1996, effective October 23, 1996.
Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-8-.06 Involuntary Conversions. For transactions occurring after December 31, 1984, if a taxpayer makes a valid election under 26 U.S.C. § 1033 (relating to involuntary conversions) for federal income tax purposes , the amount of gain recognized for Alabama income tax purposes shall be determined according to 26 U.S.C. § 1033. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

Author: Edward F. Cutter, CPA.
Authority: §§40-18-8, 40-18-57, Code of Alabama 1975.
History: Adopted September 30, 1982.
Amended June 17, 1988; filed with LRS July 27, 1988.
Amended: Filed September 18, 1996, effective October 23, 1996.
Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-8-.08 Exchange of Stock for Property. For transactions occurring after December 31, 1984, no gain or loss will be recognized by a corporation on the receipt of money or other property in exchange for the stock of the corporation, including treasury stock or with respect to the acquisition or lapse of an option to buy or sell its stock. Federal regulations and decisions of federal courts and agencies regarding the exchange of stock for property will generally be followed in the administration of this regulation.

Author: Verlon R. Frost, Jeff Taylor.
Authority: Sections 40-18-8, 40-18-57, Code of Alabama 1975.
History: Effective July 27, 1988.
Amended: Filed March 4, 1997, effective April 8, 1997.
Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-8-.09 Complete Liquidation of Subsidiaries.

(1) For transactions occurring after December 31, 1984, no gain or loss shall be recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation as described in 26 U.S.C. § 332. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(2) See Reg. 810-3-6-.02 for determining the basis of property received by a corporation in a distribution under this rule.

Author: Verlon R. Frost, Jeff Taylor
Authority: Sections 40-18-8, 40-18-57, Code of Alabama 1975
History: Effective July 27, 1988.
Amended: FiledMarch 4, 1997, effective April 8, 1997.
Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-8-.10. Gain or Loss on Certain Liquidations.

(1) For transactions after December 31, 1984, and before August 1, 1986 -

(a) If, within the twelve (12) month period beginning on the date on which a corporation adopts a plan of complete liquidation, all of the assets of the corporation are distributed in complete liquidation (except for assets retained to meet claims), then no gain or loss shall be recognized to such corporation from the sale or exchange of property within such twelve (12) month period.

1. For the purposes of this subparagraph (1)(a), the term "property" does not include -

(i) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sales to customers in the ordinary course of its trade or business.

(ii) installment obligations acquired in respect to the sale or exchange (without regard to whether such sale or exchange occurred before, on, or after the date of the adoption of the plan referred to in this subparagraph (1)(a)), of stock in trade or other property described in subparagraph (1)(a)1.(i) above.

(iii) installment obligations acquired in respect of property (other than property described in subparagraph (1)(a)1.(ii) above) sold or exchanged before the date of the adoption of such plan of liquidation.

2. Notwithstanding subparagraph (1)(a)1. above, if substantially all of the property described in subparagraph (1)(a)1.(i) above, which is attributable to a trade or business of the corporation is sold or exchanged to one person in one transaction, then for purposes of this subparagraph (1)(a), the term "property" includes such property so sold or exchanged and installment obligations acquired in respect of such sale or exchange.

(b) Subparagraph (1)(a) above does not apply to the following liquidations described in this subparagraph (1)(b):

1. Any sale or exchange made by a collapsible corporation (as defined in 26 U.S.C. § 341(b)).

2. Any sale or exchange made by a corporation following the adoption of a plan of complete liquidation if §40-18-8(k), Code of Alabama 1975, (relating to election as to recognition of gain in certain liquidations as defined in 26 U.S.C. § 333) applies with respect to such liquidation.

3. In the case of any sale or exchange following the adoption of a plan of liquidation if §40-18-8(i) (relating to liquidation of subsidiaries pursuant to 26 U.S.C.§ 332) applies to such liquidation.

4. This subparagraph (1)(b) shall not apply to a sale or exchange by a corporation (referred to herein as the "selling corporation"), if -

(i) within the twelve (12) month period beginning on the date of the adoption of a plan of complete liquidation by the selling corporation, the selling corporation and each distributee corporation is completely liquidated, and

(ii) none of the complete liquidations are liquidations to which §40-18-8(k) (and 26 U.S.C.§ 333) applies.

(I) The term "distributee corporation" means a corporation in the chain of includ able corporations to which the selling corporation or a corporation above the selling corporation in such chain makes a distribution in complete liquidation within the twelve (12) month period referred to in subparagraph (1)(a).

(II) The term "chain of includable corporations" includes, in the case of any distribution, any corporation which (at the time of such distribution) is in a chain of includable corporations for purposes of Reg. 810-3-6-.02(1)(k) 7.(x). Such term includes, where appropriate, the common parent corporation.

(c) If a corporation adopts a plan of complete liquidation, and if subparagraph (1)(a) of this rule does not apply to sales or exchanges of property by such corporation solely by reason of the application of subparagraph (1)(b)4.(i) of this rule (relating to liquidations of subsidiaries under §40-18-8(i) and 26 U.S.C. § 332), then for the first taxable year of any shareholder (other than a corporation which meets the eighty percent (80%) stock ownership requirement in paragraph (1) of this rule), in which he receives a distribution in complete liquidation -

1. the amount realized by such shareholder on the distribution shall be increased by his proportionate share of the amount by which the tax imposed by Chapter 18 of Title 40, Code of Alabama, 1975, on such corporation would have been reduced if subparagraph (1)(b)4.(ii)had not been applicable, and

2. for purposes of Chapter 18 of Title 40, such shareholder shall be deemed to have paid, on the last day prescribed by law for the payment of the tax imposed by said Chapter 18 on such shareholder, an amount of tax equal to the amount of the increase described in subparagraph (1)(c)1. above.

(d) If there is an involuntary conversion (within the meaning of §40-18-8(d) and 26 U.S.C.§ 1033), and there is a complete liquidation of such corporation which qualifies under subparagraph (1)(a) above of this rule -

1. the disposition of the converted property occurs within the sixty (60) day period which ends on the last day before the first day of the twelve (12) month period, and

2. such corporation elects the application of §40-18-8(j) and this rule in accordance with regulations prescribed by the United States Secretary of the Treasury, then for purposes of §40-18-8(j) and this rule, such disposition shall be treated as a sale or exchange occurring within the twelve (12) month period specified in paragraph (1) above.

(e) In the case of a corporation inventorying goods under the LIFO (last-in, first-out) method, subparagraph (1)(a) above shall apply to gain from the sale or exchange of inventory assets only to the extent that such gain exceeds the LIFO recapture amount with respect to such assets.

1. The term "LIFO recapture amount", as used in this subparagraph (1)(e), means the amount, if any, by which the inventory amount of the inventory assets under the FIFO (first-in, first-out) method exceeds the inventory amount of such assets under the LIFO method.

(f) If a corporation completely liquidates pursuant to a plan of complete liquidation adopted in a federal bankruptcy case under Title 11, U.S.C., or a receivership, foreclosure, or similar proceeding in a federal or state court, then -

1. for the purpose of subparagraph (1)(a) above, the term "property" shall not include any item acquired on or after the date of the adoption of the plan of complete liquidation if such item is not property within the meaning of subparagraph (1)(b)2. above, and

2. subparagraph (1)(a) above shall apply to sales and exchanges by the corporation of property within the period beginning on the date of the adoption of the plan and ending on the date of the termination of the case in federal or state court.

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| Author: | Verlon R. Frost, Jeff Taylor |
| Authority: | Section 40-18-8, Code of Alabama 1975 |
| History: | Effective December 4, 1992. |
| | Amended March 4, 1997, effective date April 8, 1997. |

810-3-8-.11 Election to Recognize Gain on Certain Liquidations.

(1) For transactions occurring after July 31, 1986 - the election to recognize gain on certain liquidations pertaining to 26 U.S.C.§ 333 has been repealed under the provisions of Act 90-583 and Public Law 99-514.

(2) For Transactions after December 31, 1984, and before August 1, 1986 - In the case of a shareholder who has made a valid election pursuant to 26 U.S.C.§ 333 to recognize gain in certain liquidations for federal income tax purposes, then in the case of property distributed in complete liquidation of a corporation incorporated under the laws of the United States, or any state or political subdivision thereof, if -

(a) the liquidation is made in pursuance of a plan of liquidation adopted, and

(b) the distribution is in complete cancellation or redemption of all the stock, and the transfer of all the property under the liquidation occurs within some one calendar month, then in the case of each qualified electing shareholder (as defined in 26 U.S.C. § 333), gain on the shares owned by him at the time of the adoption of the plan of liquidation shall be recognized only to the extent provided in paragraph (2) below.

(3) (a) In the case of a qualified electing shareholder other than a corporation -

1. there shall be recognized, and treated as a dividend, so much of the gain as is not in excess of his ratable share of the earnings and profits of the corporation accumulated after December 31,1932. Such earnings and profits are to be determined as of the close of the month in which the transfer in liquidation occurred under subparagraph (1)(b) above, but without diminution by reason of distributions made during such month; but by including in the computation thereof all amounts accrued up to the date on which the transfer of all the property under the liquidation is completed; and

2. there shall be recognized, and treated as a gain from the sale or exchange of property, so much of the remainder of the gain as is not in excess of the amount by which the value of that portion of the assets received by him which consists of money, or of stock or securities acquired by the corporation after December 31, 1932, exceeds his ratable share of such earnings and profits.

(b) In the case of a qualified electing shareholder which is a corporation, the gain shall be recognized only to the extent of the greater of the following -

1. the portion of the assets received by it which consists of money, or of stock or securities acquired by the liquidating corporation after December 31, 1932; or

2. its ratable share of the earnings and profits of the liquidating corporation accumulated after December 31, 1932, such earnings and profits to be determined as of the close of the month in which the transfer in liquidation occurred under subparagraph (1)(b) above, but without diminution by reason of distributions made during such month, but by including in the computation thereof all amounts accrued up to the date on which the transfer of all the property under the liquidation is completed.

Author: Verlon R. Frost, Jeff Taylor
Authority: Sections 40-2A-7(a)(5) and 40-18-8, Code of Alabama 1975
History: Effective December 4,1992.
Amended: Filed March 4, 1997, effective April 8, 1997.
Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-8-.13 Recognition of Gain by Target Corporations. If an acquiring corporation makes a valid election under 26 U.S.C.§ 338, the amount of gain recognized by the target corporation shall be determined in accordance with 26 U.S.C.§ 338. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

Author: Verlon R. Frost, Jeff Taylor
Authority: Section 40-18-8, Code of Alabama 1975
History: Effective December 4, 1992.
Amended: Filed March 4, 1997, effective April 8, 1997.
Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-8-.14 Taxability of Corporation on Distribution. The amount of gain recognized by a corporation on the distribution of its stock, rights to acquire its stock, or property shall be determined in accordance with 26 U. S. C. § 311, relating to the taxability of corporations on distributions. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

Author: Verlon R. Frost, Jeff Taylor
Authority: Sections 40-2A-7(a)(5) and 40-18-8, Code of Alabama 1975
History: Effective December 4, 1992.
Amended: Filed March 4, 1997, effective April 8, 1997.
Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-8-.16 Gain or Loss Recognized on Property in Complete Liquidation.

(1) Gain or loss shall be recognized to a liquidating corporation on the distribution of property in complete liquidation as described in 26 U.S.C. § 336 and shall be subject to the same treatment, limitations and exceptions as set forth in 26 U.S.C. § 336 and in accordance with § 40-18-8(l), Code of Alabama 1975.

(2) For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

Author: Verlon R. Frost, Jeff Taylor
Authority: Sections 40-2A-7(a)(5) and 40-18-8, Code of Alabama 1975
History: Effective December 4, 1992.
Amended: Filed March 4, 1997, effective April 8, 1997.
Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-8-.18 Recognition of Gain or Loss on Transfer of Property to a Spouse or Former Spouse. The amount of gain or loss on the transfer of property to a spouse or former spouse shall be determined in accordance with 26 U.S.C. § 1041. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

Author: Brenda J. Fincher, Judy A. Robbins.
Authority: Sections 40-2A-7(a)(5) and 40-18-8, Code of Alabama 1975.
History: Effective December 4, 1992.
Amended: Filed September 18, 1996, effective October 23, 1996.
Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-8-.19 Sales of Stock to Employee Stock Ownership Plans or Certain Cooperatives.

(1) The amount of gain recognized by a taxpayer who has made a valid election under 26 U.S.C. § 1042, relating to sales of stock to employee stock ownership plans or certain cooperatives, shall be determined in accordance with 26 U.S.C. § 1042.

(2) If a taxpayer disposes of qualified replacement property, as defined by 26 U.S.C. § 1042, and recognizes gain under 26 U.S.C. § 1042(e), then the gain shall be recognized to the same extent and at the same time as under 26 U.S.C. § 1042(e).

(3) For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

Author: Verlon R. Frost, Jeff Taylor, and Ed Cutter, CPA
Authority: Sections 40-2A-7(a)(5) and 40-18-8, Code of Alabama 1975
History: Effective June 19, 1992.
Amended: Filed March 4, 1997, effective April 8, 1997.
Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-8-.20 Recognition of Gain or Loss on Transfer of Property to and Distribution of Property by a Subchapter K Entity.

(1) For all taxable years with respect to which a preliminary assessment of income tax could be made under the provisions of Section 40-2A-7, Code of Alabama 1975, as of May 27, 1997, or thereafter:

(a) Contribution of property to a subchapter K entity - The amount of gain or loss recognized on the contribution of property to a subchapter K entity in exchange for an interest in the subchapter K entity shall be determined in accordance with 26 U.S.C. § 721.

(b) Distribution of property by a subchapter K entity - The amount of gain or loss recognized on the distribution of property by a subchapter K entity shall be determined in accordance with 26 U.S.C. § 731.

(2) No refunds shall be due or issued by reason of this regulation with respect to taxable years beginning before January 1, 1997.

(3) For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

Author: Ann Fondren Winborne, CPA and Nancy D. Hatfield
Individual and Corporate Tax Division
Authority: §§ 40-2A-7(a)(5) and 40-18-8, Code of Alabama 1975
History: New rule filed March 26, 1998, effective date April 30, 1998.
Amended: Filed April 28, 1999, effective June 2, 1999.

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CHAPTER 810-3-10

# DISTRIBUTION OF STOCK PURSUANT TO ORDER ENFORCING THE FEDERAL ANTI-TRUST LAWS

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810-3-11-.01 Inventory Procedures. When the production, purchase, or sale of merchandise is an income producing factor, inventories at the beginning and ending of each taxable year are necessary in order to correctly compute income. In these cases, inventories shall be taken, computed and used in accordance with the methods prescribed or permitted by the Internal Revenue Service pursuant to 26 U.S.C. §§ 263A, 471, 472 and 474 and regulations thereunder.

Author: Ewell Berry, Ann F. Winborne, CPA, and Ed Cutter, CPA
Authority: §§40-2A-7(a)(5) and 40-18-11, Code of Alabama 1975
History: Effective October 1, 1982.
Amended July 27, 1988.
Amended June 19, 1992.
Amended: Filed September 18, 1996, effective October 23, 1996.
Amended: Filed April 28, 1999, effective June 2, 1999.

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CHAPTER 810-3-13

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810-3-13-.01 Taxable Year.

(1) Taxable income shall be computed and a return shall be made for a period known as the "taxable year." The taxable year may be a calendar year, a fiscal year, an elected 52-53 week year, or an accounting period of less than twelve months resulting from a change in accounting periods.

(2) A taxpayer elects a taxable year when the first return is filed. This election should be consistently followed in filing subsequent returns. Any change in accounting period must have the approval of the Department of Revenue as described in Rule 810-3-30-.01.

(a) A calendar year is the twelve consecutive month period beginning January 1 and ending December 31.

(b) A fiscal year is the twelve consecutive month period ending on the last day of any month other than December.

(c) There is no provision in Alabama income tax law for the 52-53 week year; however, the Department does permit the election of the 52-53 week year. When this election is made, the Department will follow the methods prescribed by the Internal Revenue Service pursuant to 26 U.S.C. §441(f).

(3) An accounting period of less than twelve months is one that results from changing the accounting period from the calendar year to the fiscal year, from fiscal year to calendar year, from one fiscal year to another, when the taxpayer is not in existence for the entire taxable year, when the taxpayer goes out of business, or when there is a change in entity. These changes are further described in §40-18-30, Code of Alabama 1975.

(4) Effect of election under §40-18-8(j), Code of Alabama 1975, (and 26 U.S.C. §338), for entities filing separate returns. The making of an election for a deemed liquidation of a target corporation as provided in §40-18-8(j) does not operate to terminate the tax year of the target corporation. If the target corporation must change its taxable year to conform to that of a new consolidated parent company for federal purposes, the rules in paragraph (2) above for change in accounting period apply.

(a) Unlike the federal rules, the target corporation is not required to file a "one-day" return for taxable gains. Such gains are included in the return for the period which otherwise includes the "one-day" federal return period.

1. For example, if the target corporation is filing on a calendar year basis, and will continue to file on a calendar year basis following the 26 U.S.C. § 338 deemed liquidation, there is only one taxable year for Alabama purposes, even though the corporation may have 3 taxable periods for federal purposes:

(i) the short period return from the beginning of the calendar year to the last day before the deemed liquidation,

(ii) the "one-day" return for the day of the deemed liquidation, and

(iii) the short period return from the first day after the deemed liquidation to the end of the calendar year.

(5) If the taxpayer's accounting period is other than the taxable year as described in this rule, or if the taxpayer has no accounting period or does not keep records, the net income shall be computed on the basis of the calendar year.

(6) For tax years beginning after December 31, 1989, a taxpayer must use the same accounting period for Alabama purposes as that used for federal income tax purposes, except as otherwise provided in paragraph (4) above.

(7) For tax years beginning after December 31, 1998, a taxpayer making an election to file an Alabama consolidated return, as provided in §40-18-39, must use the same taxable year as employed for federal income tax purposes.

Authors: Cindy D. Norwood, Jeffrey Taylor, Carmen Mills, Anne Glenn
Authority: Section 40-18-13, Code of Alabama 1975
History: Amended: Filed June 17, 1988; filed July 27, 1988.
Amended: Filed October 30, 1992, effective December 4, 1992.
Amended: Filed September 18, 1996, effective October 23, 1996.
Amended: Filed March 31, 2000, effective May 5, 2000.

810-3-13-.02 Maintenance of Accounting Records.

(1) Each taxpayer must maintain such accounting records as will clearly reflect his income for each accounting period, and must file his returns based on these records.

(2) If the taxpayer does not maintain such accounting records, or if such records do not clearly reflect the income or deductions of the taxpayer for any given taxable year, the Department may prescribe the method and basis for computation of such income. A taxpayer who does not keep adequate accounting records will be required to report his income on the calendar year basis and use the cash receipts and disbursements method of accounting.

(3) For record keeping requirements, see §40-2A-7(a)(1), Code of Alabama 1975.

Author: Rebecca S. Whisenant, Cynthia D. Norwood, Carmen Mills, Anne Glenn

Authority: Sections 40-2A-7(a)(5), 40-18-13 and 40-1-5, Code of Alabama 1975

History: Adopted September 30, 1982.
Amended: Filed June 17, 1988, effective July 27, 1988.
Amended: Filed September 18, 1996, effective October 23, 1996.
Amended: Filed March 31, 2000, effective May 5, 2000.

810-3-13-.03 Method of Accounting.

(1) For tax years beginning after December 31, 1998, a taxpayer making an election to file an Alabama consolidated return, as provided in §40-18-39, Code of Alabama 1975, must use the same method of accounting as employed for federal income tax purposes.

(2) For tax years beginning after December 31, 1989, a taxpayer must use the same accounting method for Alabama purposes as that used for federal income tax purposes.

Author: Cindy D. Norwood, Jeffrey Taylor, Carmen Mills, Anne Glenn
Authority: Sections 40-2A-7(a)(5) and 40-18-13, Code of Alabama 1975
History: Adopted: Filed June 17, 1988, effective July 27, 1988.
Amended: Filed October 30, 1992, effective December 4, 1992.
Amended: Filed September 18, 1996, effective October 23, 1996.
Repealed and New: Filed March 31, 2000, effective May 5, 2000.

810-3-13-.04 Change in Method of Accounting.

(1) For tax years beginning before January 1, 1990, a taxpayer desiring to change his method of accounting should request permission from the Department of Revenue to make the change. Applications for such change should set forth clearly the nature of the business, the method of accounting used in keeping the books, and the reasons for changing the method of reporting.

(2) For tax years beginning after December 31, 1989, the accounting method used for Alabama purposes will automatically change whenever a different method is permitted or required for federal income tax purposes.

(3) Alabama law has no counterpart to 26 U.S.C. § 481; therefore, any increase or decrease in income resulting from a change in accounting method must be taken into account in full in the year of change. There is no provision in Alabama law to defer the effect of a change in accounting method over a number of years. In changing from a cash method of accounting to an accrual method, income accrued but not yet collected as of the close of the year of change shall be added to income actually received in cash during the year, and expenses accrued but not yet paid as of the close of the year shall be added to expenses actually paid during the year. In making a change from accrual to cash method of accounting, items previously reported as income and expenses should be excluded from the cash basis return.

Author: Cindy D. Norwood, Jeffrey Taylor, Carmen Mills, Anne Glenn
Authority: Section 40-18-13, Code of Alabama 1975
History: Adopted: Filed June 17, 1988, effective July 27, 1988.
Amended: Filed October 30, 1992, effective December 4, 1992.
Amended: Filed September 18, 1996, effective October 23, 1996.
Amended: Filed March 31, 2000, effective May 5, 2000.

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CHAPTER 810-3-14

Gross Income of Individuals

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810-3-14-.01 Gross Income in General.

(1) The term "gross income" means all wealth flowing to the taxpayer from whatever source derived other than as a return of his capital and other than those items exempted by Sec. 40-18-14(2), Code of Alabama 1975. Gross income includes income realized in any form, whether in money, property, or services. Income may be realized in the form of services, meals, accommodations, stock, or other property, as well as in cash. Such income is to be reported for the year in which received, or accrued and reported in accordance with accepted accounting procedures applicable to the taxpayer's particular type of business. See Reg. 810-3-13-.03 for discussion of accounting methods.

(2) In the case of a manufacturing, merchandising, or mining business, gross income means the total sales less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources. In determining the gross income of a business, subtraction should not be made for losses, or for items not ordinarily used in computing the cost of goods sold.

(3) Earnings constitute gross income before deductions for withholding for federal income tax, social security tax, insurance and retirement programs (including those allowable as a deduction under Code Sec. 40-18-15(11)) or other voluntary or involuntary withholdings.

(4) Income actually received or accrued must be included in gross income, although losses may later incur against this income. An exception to this general rule occurs in situations involving the renegotiation of war contracts under federal statutes. Where repayment is made to the government as a result of renegotiation, the amount of income for the year of original payment is the amount of such payment less the amount refunded to the government, even though the repayment is made to the government in a later year. As long as the matter of renegotiation is open, the extent of the gain or profit of the contractor, if any, for that year of payment remains undetermined.

(5) If services are paid for with something other than money, the fair market value of the property or services taken in payment is the amount to be included as gross income. If living quarters or meals are furnished to employees for the convenience of the employer, the ratable value need not be added to the compensation of the employees, but if a person receives a compensation for service rendered compensation in the form of living quarters or meals, the value to such person of the quarters furnished constitutes income subject to tax. For living quarters furnished to ministers, see Reg. 810-3-14.02(1)(g).

(6) (a) An employee who is given an annuity by his employer must pay income tax on the amount of the premium in the year in which the premium is paid. The annuity is considered as additional compensation for services rendered and not as a gratuity. The payments that qualify as a deduction under Code Sec. 40-18-15(11) shall be included in gross income.

(b) An employee who is the insured or owner of a group life insurance policy with a face value in excess of $50,000, and the premiums on such policy are paid by the employer, must include in gross income the value of such premiums for coverage in excess of $50,000.

(7) For procedure in reporting the income of minors, see Sec. 40-18-27 and regulations thereunder.

(8) The Federal Internal Revenue Code contains provisions similar to those of Sec. 40-18-14(1). Decisions and interpretations of the federal courts and agencies will be given due weight in interpreting this section.

(9) Gross income includes recovery of items deducted in previous years. See Reg. 810-3-14-.04.

(10) For tax years beginning after December 31, 1981, gross income includes alimony and separate maintenance according to I.R.C. § 71 in effect January 1, 1982. For tax years beginning after December 31, 1984, gross income includes alimony and separate maintenance payments as defined in I.R.C. § 71, as in effect on January 1, 1985. For tax years beginning after December 31, 1989, gross income includes alimony and separate maintenance payments as defined in I.R.C. § 71, as in effect from time to time. Decisions and interpretations of the federal courts and agencies interpreting I.R.C. § 71 will be given due weight in interpreting Code Sec. 40-18-14(1) and this regulation as it relates to alimony and separate maintenance payments. Regulations pertaining to I.R.C. § 71 are hereby made a part of this regulation.

(a) Alimony or separate maintenance payments received under a divorce or separation instrument executed after March 1, 1954, but prior to January 1, 1985, will be included in gross income as follows:

1. (i) Periodic payments, (for definition of periodic payments see section 2. below) whether or not received at regular intervals, received after January 1, 1982 are includible in gross income if -

(I) Payments received are in discharge of (or attributable to property transferred, in trust or otherwise, in discharge of) a legal obligation, and

(II) the obligation is imposed on or incurred because of a marital or family relationship, and

(III) the legal obligation is under the decree, or written agreement incident to divorce or separation, and

(IV) the payment received does not represent payment in support of minor children, and

(V) the payment received does not represent a settlement of property rights.

(ii) The source of the payments is immaterial. The payments may be from property held in trust, life insurance, endowment or annuity contract, any other interest in property or from income or capital of the payor whether paid directly or indirectly by him.

(iii) If the decree or written agreement specifies an amount to be paid in support of minor children, the payment received goes first to satisfy this obligation. If the payment is less than the amount specified as support of minor children, then the payment received shall be considered a payment of support of minor children.

(I) If the decree or written agreement specifies one amount as payment of both alimony or separate maintenance and child support, the entire amount will be considered as alimony or separate maintenance and will be included in gross income of the recipient.

2. In general, periodic payment means "payable over a period of indefinite duration". Payments made for an unspecified principal amount are considered periodic payments even if, by provision of the decree or written agreement or local law, payments will be terminated by death of either spouse, remarriage, or change in economic status of either spouse.

3. Payment of a specified amount, in terms of money or property, under the decree or written agreement to be made over a period of 10 years or less from the date of the decree or agreement will be considered periodic payments if -

(i) payments are subject to one or more of the contingencies of death, remarriage, or change in the economic status of either spouse, and

(ii) payments are in the nature of alimony or an allowance for support.

4. If payment of a specified amount, in terms of money or property, under the decree or written agreement, is to be made over a period of more than 10 years from the date of the decree or agreement, payments will be considered periodic payments but only to the extent that the installment payment, or sum of the installment payment, received during the recipient's taxable year does not exceed 10 percent of the principal sum. This 10 percent limitation applies to installment payments made in advance, but does not apply to delinquent installment payments for a prior taxable year of the recipient made during the current taxable year.

5. A transfer of property in settlement of marital rights may result in a recognizable gain or loss. The gain or loss is the difference between the adjusted basis of the property and its fair market value at the time of the transfer.

(i) If the property has appreciated, there may be a taxable gain on the transfer. Property has appreciated if its fair market value is more than its adjusted basis. The difference is a gain.

(ii) If the fair market value is less than the adjusted basis, a loss is realized. Such a loss is deductible if it is on business or investment property, but is not deductible if it is on property held for personal use.

(iii) An equal division of property that is co-owned by husband and wife does not result in a gain or loss.

(iv) If husband and wife each keep their separately owned property in a divorce settlement, there is no taxable gain or loss.

(v) If one spouse transfers separately owned property to the other spouse, the spouse transferring the property realizes a gain or loss. The spouse receiving the property has no gain or loss on the transaction. The basis of the property to the receiving spouse is its fair market value on the date of the transfer.

(vi) Taxpayers report the gain or loss in a property settlement the same as any sale or exchange of an asset.

(b) Alimony or separate maintenance payments received from divorce or separation instruments executed after December 31, 1984, (and to divorce or separation agreements executed prior to January 1, 1985, if modified to expressly provide for the application of this subparagraph) is includible in gross income as follows:

1. the term "alimony or separate maintenance payment" means any payment in cash, if -

(i) such payment is received by (or on behalf of) a spouse under divorce or separation instrument, and

(ii) the divorce or separation instrument does not designate such payment as a payment which is not includible in gross income under §40-18-14 and not allowable as a deduction under §40-18-15, and

(iii) in the case of an individual legally separated from his spouse under a separate maintenance instrument or decree of divorce, the payee and payor are not members of the same household at time such payment is made and do not file a joint income tax return, and

(iv) there is no liability to make any such payment for any period after the death of the payee spouse and there is no liability to make any payment (in cash or other property) as a substitute for such payments after the death of the payee spouse.

2. The term "divorce or separation instrument" means:

(i) a decree of divorce or separate maintenance or a written instrument incident to such a divorce, or

(ii) a written separation agreement, or

(iii) a decree (not described in subsection (I) above) requiring a spouse to make payments for the support of the other spouse, such as temporary alimony.

3. The term "alimony or separate maintenance" shall not apply to that part of any payment which the terms of the divorce or separation instrument designates (in terms of an amount of money or a part of a payment) as a sum which is payable for the support of children of the payor. If any amount specified in the instrument will be reduced -

(i)(I) on the happening of a contingency specified in the instrument relating to a child (such as attaining a specified age, marrying, dying, leaving school, or a similar contingency), or

(II) At a time which can be clearly associated with a contingency of a kind specified in (I); an amount equal to the amount of such reduction will be treated as an amount designated or fixed as payable for the support of children of the payor.

(ii)(I) If any payment is less than the amount specified in the instrument as support of the children of the payor, then so much as such payment as does not exceed the sum payable for support shall be considered a payment for such support.

(II) If the instrument specifies a single amount in payment of both alimony or separate maintenance and child support with no more contingency of the type provided in sections 3. (I)(I) or (II) above, or no support of money or part of the payment specifically designated as child support, the entire payment will be considered as alimony or separate maintenance and will be included in gross income of the recipient.

4. Alimony or separate maintenance payments in excess of $10,000 during any calendar year paid to a single payee will not be treated as alimony or separate maintenance unless such payments are to be made by the payor to the payee in each of the six (6) post-separation years (not taking into account any termination contingent on the death of or remarriage of either spouse).

5. If there is an excess amount determined under section 6. below for any computation year -

(i) the payor spouse shall include such excess in gross income for the taxable year beginning in the computation year, and

(ii) the payee spouse shall be allowed a deduction in computing adjusted gross income for such excess amount for the taxable year which ends on or after the taxable year of the payor spouse beginning in the computation year.

6.(i) The excess amount determined under this section for any computation year is the sum of -

(I) the excess (if any) of -

I. the amount of alimony or separate maintenance payments paid by the payor spouse during the immediately preceding post-separation year, over

II. the amount of alimony or separate maintenance payments paid by the payor spouse during the computation year increased by $10,000, plus

(II) a like excess for each of the other post-separation years.

(ii) In determining the amount of alimony or separate maintenance payments made by the payor spouse during any preceding post-separation year, the amount paid during such year shall be reduced by any excess previously determined in respect of such year under this section 6.

(I) EXAMPLE: H makes alimony payments to W of $25,000 in 1985 and $12,000 in 1986. The excess amount with respect to 1985 that is recaptured in 1986 is $3,000 ($25,000 - ($12,000 + $10,000)). For purposes of subsequent computation years, the amount deemed paid in l985 is $22,000. If H makes alimony payments to W of $1,000 in 1987, the excess amount that is recaptured in 1987 will be $12,000. This is the sum of an $11,000 excess amount for 1985 ($22,000 - $1,000 + $10,000)) and a $1,000 excess amount with respect to 1986 ($12,000 - ($1,000 + $10,000)). If, prior to the end of 1990 (the end of the six year post-separation period), payments decline further, additional recapture will occur.

7. For purposes of this subparagraph, the term "post-separation year" means any calendar year in the six (6) calendar year period beginning with the first calendar year in which the payor spouse paid alimony or separate maintenance payments to the recipient spouse, and the term "computation year" means the post-separation year for which the excess under section 6. above is being determined.

8. The recapture rule provided in section 5. above shall not apply to any post-separation year (and subsequent post-separation years).

(i) either spouse dies or the payee spouse before the close of such post-separation year, and

(ii) the alimony or separation maintenance payments cease by reason of such death or remarriage, or

(iii) the payments are received under a decree described in section 2. (iii) above, or

(iv) the payment is made pursuant to a continuing liability (over a period not less than six years) to pay a fixed portion of the income from a business or property or from compensation or employment or self-employment.

9. To qualify for the deduction provided in §40-18-15, alimony or separate maintenance payments may not be made in any form other than cash. Transfers of services or property (including a debt instrument of a third party or any annuity contract), executing of a debt instrument by the payor, or the use of property of the payor, do not qualify as alimony or separate maintenance payment. See §§40-18-8(p) and 40-18-6(a)(15) for treatment of gain or loss on transfers of property incident to a divorce.

(c) Alimony or separate maintenance payments received from divorce or separation instruments executed after December 31, 1989 (and to divorce or separation agreements executed prior to January 1, 1990, if modified to expressly provide for the application of this subparagraph (is includible in gross income in the same manner as provided in subparagraph (b) of this regulation with the following exceptions;

1. the payments must be cash payments received by (or on behalf of) a spouse or former spouse:

2. the payments must be under a divorce or separation instrument;

3. the payments must not extend after the death of a payee-spouse (need not be expressly stated in the instrument);

4. the spouses (or former spouses) must not be members of the same household and must not file joint returns;

5. the divorce or separation instrument can designate such payment which is not includible in gross income under I.R.C. § 71 and not allowable as a deduction under I.R.C. § 215 (if so designated, the payments are not considered as alimony):

6. the payment must not be for child support; and

7. the payments need not be made in discharge of marital obligations imposed by state law, nor need the payments be "periodic."

(11) Except for plans specifically exempt by law from tax, payments received from pension, profit-sharing, stock bonus, retirement, annuity, or bond purchase plans, in excess of the taxpayer's investment in such plans, shall be included in gross income.

(a) This includes all payments received, not just those received upon completion of the plan.

(b) The taxpayer's investment in the above plans is the taxpayer's contributions to such plans, excluding those allowable as a deduction under Sections 40-18-15(a)(11) and

40-18-15(a)(12) and/or those allowable as an exclusion from gross income under §40-18-14(1)(I). See also Reg. 810-3-14-.10.

(c) Those employer contributions previously included in gross income of the taxpayer but not allowable as a deduction by the taxpayer are included in the taxpayer's investment.

(12) (a) For tax years beginning after December 31, 1981, but before January 1, 1990, in accordance with §40-18-14(2)e (I.R.C. § 105 as in effect January 1, 1982), any amount an employee receives for disability through an accident and health insurance plan that is attributable to his employer's contributions is included in gross income except:

1. Payments for permanent loss of, or loss of use of a member or function of the body, or for permanent disfigurement,

2. Payments under a plan as reimbursement for expenses incurred by the employee for medical care for himself, spouse or dependents, or

3. Payments, within limits that are in lieu of wages for a period during which an employee is absent from work on account of permanent and total disability if the employee has not attained age 65 before the close of the taxable year and has retired on disability.

(i) The disability income exclusion of this paragraph (c) is limited to $100 per week, and

(ii) The disability exclusion to which the taxpayer would be entitled shall be reduced by the amount that adjusted gross income, including disability income, exceeds $15,000.00.

(iii) EXAMPLE: A disabled taxpayer under age 65 received $6,000.00 in disability retirement income in lieu of wages. He also had $10,000.00 of other income which, together with the $6,000.00 of disability payments in lieu of wages, gave him an adjusted gross income of $16,000.00. Assume that before reduction the taxpayer is entitled to an exclusion of $5,200.00 for the year. Since the taxpayer's adjusted gross income exceeds $15,000.00, his exclusion is reduced by the $1,000.00 excess. Consequently, his maximum exclusion is $4,200.00 ($5,200.00 minus $1,000.00).

(b) The exclusion provision of paragraph (a) above does not apply to disability income received after December 31, 1989.

(13) Gross income includes the fair market value of the personal use (including commuting) of an employer (including a governmental employer) owned automobile, together with the fair market value of any fuel furnished by the employer. The rates and methods for determining the values for this paragraph will be as provided in I.R.C. § 61(a)(1) (and I.R.C. Reg. 1-61-2T) as in effect January 1, 1985.

(14)(a) For taxpayers who are shareholders of an Alabama S corporation with a tax year which began before January 1, 1990 -

1. Gross income includes the deemed distributive share of separately stated and nonseparately stated income (or loss) for shareholders of an electing Alabama S corporation.

(i) For electing Alabama S corporations with income from more than one state, gross income includes only the deemed distributive share attributable to Alabama.

2.(i) Gross income does not include actual distributions from electing Alabama S corporations which have been previously included in gross income under subparagraph (a) 1. above.

(ii) For resident shareholders, all other actual distributions from a S corporation, including distributions representing income taxable in other states, is included in gross income.

3. Gross income does include actual distributions from S corporations which have not elected to be Alabama S corporations, but does not include deemed distributive shares of income (or losses) of such corporations.

4. See § 40-18-160, et seq., and regulations thereunder, relating to Alabama S corporations.

(b) For taxpayers who are shareholders of an Alabama S corporation with a tax year which began after December 31, 1989 and before January 1, 1997 -

1. Gross income includes the deemed distributive share of separately stated and nonseparately stated income (or loss) of the Alabama S corporation.

2. Gross income does not include actual distributions from an Alabama S corporation which have been previously included in gross income under subparagraph (a) 1. above.

(c) For taxpayers who are shareholders of an Alabama S corporation with a tax year which began after December 31, 1996 -

1. Gross income includes the shareholder's pro rata share of separately stated and nonseparately stated items of income, loss, deduction, or credit attributed to Alabama by the Alabama S corporation for the corporation's taxable year which ends with or during the individual's tax year.

2. Gross income does not include actual distributions from an Alabama S corporation which have been previously included in gross income under subparagraph (a) 1. above.

3. Gross income does not include actual distributions from an Alabama S corporation which are determined to be nontaxable under the provisions of §40-18-165 and the regulations thereunder.

(15)(a) For taxpayers providing foster care services who are not engaged in the trade or business of providing such services, gross income includes payments received in excess of expenses incurred in providing such services but does not include expenses in excess of receipts.

(b) For taxpayers engaged in the trade of business of providing foster care services, gross income includes all payments received for such services, less expenses incurred in the performance of such services. A taxpayer will be presumed to be engaged in the trade or business of providing foster care services when such services are provided for more than ten (10) minors or more than five (5) adults.

(c) The provisions of this paragraph are substantially similar to the provisions of I.R.C. § 131, and regulations and decisions regarding the interpretation and implementation of I.R.C. § 131 will be given due consideration in the administration of this paragraph.

(16) Gross income for a resident partner or member of a subchapter K entity includes the following:

(a) For a multi-state subchapter K entity doing business within and without the State of Alabama, only that income which is required to be allocated and apportioned to Alabama under the rules of Section 40-18-22. (If the multi-state subchapter K entity is not doing business in Alabama, no income is reportable to Alabama from that subchapter K entity.)

(b) For a subchapter K entity doing business in only one state, whether the State of Alabama or another state, the distributive share of the entire income from that subchapter K entity.

(17) Property transferred in connection with performance of service-Tax years beginning after December 31, 1989.

(a) Inclusion in gross income.

1. If stock or other property is transferred to any person other than the person for whom the services are performed, the excess of -

(i) the fair market value of such property (determined without restrictions other than restrictions that will never lapse) at the first time the rights of the person having beneficial interest in such property are transferable or are not subject to substantial risk of forfeiture, whichever occurs first, over

(ii) the amount actually paid for such property,

shall be included in the gross income of the transferee who performed the service in the first tax year during which a fair market value under provisions of (a)(I) above can be determined.

2. Paragraph (a)1 shall not apply if the transferee sells or otherwise disposes of such property in an arms length transaction before his rights in such property become transferable or not subject to substantial risk of forfeiture.

(b) Election to include in gross income in the year of transfer.

1. The transferee may elect to have paragraph (a) above apply in the year of transfer.

2. The election must be made in the same manner and within the same time frame as required by regulations pertaining to 26 U.S.C. § 83.

3. The statement of election required by regulations pertaining to 26 U.S.C. § 83 shall be made a part of the Alabama income tax return for the year of transfer.

(c) Special rules - For the purpose of this regulation -

1. Substantial risk of forfeiture. - The rights of a person in property are subject to a substantial risk of forfeiture if such person's rights to full enjoyment of such property are conditioned upon the future performance of substantial services by the individual.

2. Transferability of property - The rights of a person in property are transferable only if the rights in such property of the transferee are not subject to substantial risk of forfeiture.

3. Sales which give rise to suit under section 16(b) of the Securities Exchange Act of 1983. - So long as the sale of property at a profit could subject a person to suit under section 16(b) of the Securities Exchange Act of 1934, such person's rights in such property are -

(i) subject to substantial risk of forfeiture, and

(ii) not transferable.

(d) Restrictions which will never lapse.

1. Valuation - Property subject to restrictions which by its terms will never lapse, and which allows the transferee to see such property for a price determined under some formula, the formula price shall be determined to be the fair market value of the property.

2. Cancellation - If, property subject to a restriction which by its terms will never lapse has the restriction canceled, then unless the transferee establishes -

(i) that such cancellation was not compensatory, and

(ii) that the taxpayer, if any, who would be allowed a deduction for compensation, will treat the transaction as non-compensation:

(I) the excess of the fair market value of the property (computed without regard to the restrictions) at the time of the cancellation over the fair market value of the property (computed by taking the restriction into account) immediately before the cancellation plus the amount paid for the cancellation, shall be treated as compensation for the tax year in which the cancellation occurs.

(e) Applicability, - This regulation shall not apply to -

1. a stock option to which 26 U.S.C. § 421 applies.

2. a transfer to or from a trust described in 26 U.S.C. § 401(a) or a transfer under an annuity plan which meets the requirements of 26 U.S.C. § 404(a)(2).

3. the transfer of an option without a readily ascertainable fair market value.

4. the transfer of property upon the exercise of an option with a readily ascertainable market value at the date of the grant, or

5. group term life insurance to which 26 U.S.C. § 79 applies.

(f) Code section 40-18-14(1) stipulates that 26 U.S.C. § 83 will be the guiding document for determining amount and time that income under this regulation is to be included in gross income; therefore, regulations pertaining to 26 U.S.C. § 83 are hereby made a part of this regulation. Judicial and administrative decision of Federal agencies will govern in administering this regulation.

Authors: Rebecca Whisenant, Roy Wiggins, and Ann Fondren Winborne, CPA,
Individual and Corporate Tax Division
Authority: §40-18-14, *Code of Alabama 1975*
History: Adopted September 30, 1982.
Amended February 8, 1989.
Amended December 4, 1992.
Amended March 26, 1998, effective date April 30, 1998.

810-3-14-.02 Exclusions from Gross Income.

(1) Items which are excluded from gross income are listed in § 40-18-14(3), Code of Alabama 1975, as follows:

(a) Amounts received under life insurance policies and contracts paid by reason of the death of the insured, in accordance with 26 U.S.C. § 101.

(b) Amounts received, other than amounts paid by reason of the death of the insured, under life insurance, endowment or annuity contracts determined in accordance with 26 U.S.C. § 72.

(c) The value of property acquired by gift, bequest, devise, or descent, in accordance with 26 U.S.C. § 102 - the income from such property shall be included in gross income.

1. Gross income does not include a fellowship or grant that is an outright gift with no obligation on the part of the recipient. Payments to an individual as a scholarship at an educational institution or as a fellowship grant are excluded from the gross income of the student to the extent that services are not required of the student in order to receive the payments. The value of contributed services and accommodations are also excluded from gross income. If there is a condition that a person must teach or enter into employment, payments are not gifts.

2. Payments for teaching, research, or other services in the nature of part-time employment required as a condition to receiving the scholarship or fellowship grant are not exempt and should be included in gross income.

3. Prizes, awards, and scholarships are not specifically addressed by Alabama income tax law. The Department will look to 26 U.S.C. § 74, Prizes and Awards, and 26 U.S.C. § 117, Qualified Scholarships, as guidance to determine whether specific prizes, awards, and scholarships are excluded from gross income.

(d) Interest upon obligations of the United States or its possessions; or securities issued under provisions of the Federal Farm Loan Act of July 18, 1916. Examples of exempt obligations include U.S. Savings Bonds, U.S. Treasury Notes or Bills, obligations of the Bank for Cooperatives, Federal Land Banks, Federal Intermediate Credit Banks, Federal Home Loan Banks, Productions Credit Associations, Federal Financing Bank, and the Tennessee Valley Authority. Interest received from the United States government earned on other than investment obligations, such as interest on tax refunds, is subject to Alabama income tax and should be included in gross income.

(e) Amounts received which are excludable from gross income under 26 U.S.C. § 104, relating to compensation for injuries or sickness.

(f) Amounts received which are excludable from gross income under 26 U.S.C. § 105, relating to amounts received from accident or health plans.

(g) Interest on obligations of the State of Alabama and any county, municipality, or other political subdivision thereof. It should be noted that interest on obligations of other states and political subdivisions thereof is taxable.

(h) The rental value of a parsonage provided to a minister of the gospel, to the extent excludable under 26 U.S.C. § 107.

(i) Income from discharge of indebtedness to the extent allowed by 26 U.S.C. § 108, with the exception that the reductions in tax attributes required by 26 U.S.C. § 108 shall be applied only to the net operating losses determined under Alabama income tax law and to the basis of depreciable property. The basis reductions of depreciable property shall not exceed the basis reductions for federal income tax purposes. All other tax attribute reductions required by 26 U.S.C. § 108 shall not be recognized.

(j) Gain from the sale of a personal residence to the extent excludable for federal income tax purposes under 26 U.S.C. § 121.

(k) Contributions made by an employer on behalf of an employee to a trust which is a part of a qualified cash or deferred arrangement, as defined in 26 U.S.C. § 401(k)(2) or 5 U.S.C. § 8437, subject to the limitations of 26 U.S.C. § 402(g).

(l) Contributions, made by an employer for an employee for an annuity contract, which would be excludable from the gross income of the employee, in accordance with 26 U.S.C. § 403(b), subject to the limitations of 26 U.S.C. § 402(g).

(m) Amounts excludable in accordance with 26 U.S.C. § 125, relating to cafeteria plans.

(n) Amounts excludable in accordance with 26 U.S.C. § 132, relating to certain fringe benefits.

(o) Amounts excludable in accordance with 26 U.S.C. § 129, relating to dependent care expenses.

(2) In addition, items of income which federal law prohibits the states from taxing, or which are otherwise exempt from taxation by the Code of Alabama 1975, are excluded from gross income. For example, the daily subsistence allowance paid to state law enforcement officers pursuant to § 36-21-2, Code of Alabama 1975, is excluded from gross income. Also, federal law exempts from taxation allowances for quarters, subsistence, uniforms and travel furnished military personnel by the United States Government.

(3) Other items of income are exempt:

(a) Income of foreign missionaries - see § 40-18-2.1, Code of Alabama 1975.

(b) Certain retirement allowances, net income realized from a financial business, personal exemptions and dependent exemptions - see § 40-18-19.

(c) Certain severance payments - see § 40-18-19.1.

(d) Military retirement benefits - see § 40-18-20.

(4) For interpretation of federal statutes adopted by the Alabama legislature, see Rule 810-3-1.1-.01, Operating Rules.

(5) The provisions of the federal "Taxpayer Relief Act of 1997" which were adopted by Alabama Act 98-502 have the same effective date for Alabama income tax purposes as they do for federal income tax purposes.

Authors: Ann F. Winborne, CPA, Ed Cutter, CPA, John Danziger, and Rebecca S.Whisenant
Authority: §§ 40-2A-7(a)(5) and 40-18-14, Code of Alabama 1975
History: Adopted through APA October 1, 1982.
Amended: Filed July 27, 1988.
Amended: Filed May 15, 1992, effective June 19, 1992.
Repealed and New: Filed May 3, 2000, effective June 7, 2000.

810-3-14-.03 Gross Income of Farmers.

(1) A taxpayer is engaged in the business of farming if he cultivates, operates, or manages a farm for gain or profit, either as owner or tenant. A taxpayer who receives a rental (either in cash or in kind) which is based upon farm production is engaged in the business of farming. However, a taxpayer who receives a fixed rental (without reference to production) is engaged in the business of farming only if he participates to a material extent in the operation or management of the farm. A taxpayer engaged in forestry or the growing of timber is not thereby engaged in the business of farming. A person cultivating or operating a farm for recreation or pleasure rather than a profit is not engaged in the business of farming. For the purpose of this rule, the term "farm" is used in its ordinary, accepted sense and includes stock, dairy, poultry, fish, fruit, and truck farms, and also plantations, ranches, ranges, and orchards.

(2) A farmer shall make a return using the same taxable year and in accordance with the same method of accounting that the farmer uses for federal income tax purposes, as provided for under §40-18-13, Code of Alabama 1975.

(3) Crop shares shall be included in gross income as of the year in which the crop shares are reduced to money or the equivalent of money.

(4) If farm produce is exchanged for merchandise, groceries, or the like, the market value of the articles received in exchange is to be included in gross income.

(5) Proceeds of insurance, such as hail and fire insurance on growing crops, should be included in gross income, whether received in cash or its equivalent for the crop injured or destroyed.

(6) Inventory shall be taken by a farmer in accordance with the methods and procedures prescribed under § 40-18-11.

Author: Ann F. Winborne, CPA, John Danziger, and Rebecca S. Whisenant
Authority: §§40-2A-7(a)(5) and 40-18-14, Code of Alabama 1975
History: Effective September 30, 1982.
Amended July 27, 1988.
Amended September 18, 1996, effective date October 23, 1996.
Amended: Filed May 3, 2000, effective June 7, 2000.

810-3-14-.04 Collections of Items Previously Deducted.

(1) If an amount which was properly allowed as a deduction in a prior year is subsequently recovered or refunded, the amount recovered or refunded must be included in income for the year of recovery to the extent that a tax benefit resulted from the deduction.

(2) A tax benefit includes a net operating loss available for carryback or carryforward.

(3) The phrase "recovery of an amount properly allowed as a deduction" does not include the "recovery" of depreciation on the sale or other disposition of an asset for more than its depreciated basis. Such "recovery" is included in the amount of gain to be recognized pursuant to §40-18-8, Code of Alabama 1975, and regulations thereunder.

Author: Ann F. Winborne, CPA, John Danziger, and Rebecca S. Whisenant
Authority: §§ 40-2A-7(a)(5) and 40-18-14, Code of Alabama 1975
History: Effective September 30, 1982.
Amended December 2, 1988.
Amended September 18, 1996, effective October 23, 1996.
Amended: Filed July 26, 1999, effective August 30, 1999.

810-3-14-.05 Gross Income of Nonresidents.

(1) (a) The gross income of a nonresident includes compensation for personal services only to the extent that the services were rendered in this State.

(b) Compensation for personal services rendered by a nonresident outside this State and not connected with the management or conduct of a business in this State is excluded from gross income even if payment is made from a point within this State or the employer is a resident individual, partnership or corporation.

1. Compensation for personal services rendered by a nonresident within this State is to be included in gross income although payment is received at a point outside this State or from a nonresident individual, partnership or corporation.

2. Where compensation is received for personal services rendered partly within and partly without this State, that part of the income attributable to this State is included in gross income. In such cases the test of physical presence is used to determine the situs of the rendition of the services, except where the peculiar nature of such services causes the objective of the employment to be accomplished or to take effect within this State, as, for example, where a nonresident acts as a fiduciary of an Alabama estate or trust. The gross income from commissions earned by a nonresident traveling salesman, agent, or other employee for services performed or sales made, whose compensation is in the form of a specified commission on each sale made, or service rendered, includes the specific commissions earned on sales made, or services rendered, in this State; and allowable deductions must be computed on the same basis. The gross income of all other nonresident employees, including corporate officers, includes that portion of the total compensation for services which the total number of working days employed within this State bears to the total number of working days employed both within and without this State during the taxable period. In the case of corporate officers and executives who spend only a portion of their time within this State, but whose compensation paid by a corporation operating in Alabama is exclusively for managerial services rendered by such officers and executives while within this State, the entire amount of compensation so earned is taxable without apportionment.

(2) (a) Gross income of a nonresident includes income from real and/or tangible personal property located within Alabama, or intangible personal property with a business situs in Alabama.

(b) The income from property may be derived from the operation of the property, from rents or royalties for its use, or from the sale, exchange or other disposition of the property.

1. For real property located within Alabama, gross income includes gains or losses from the sale, exchange or disposition of such property. See Chapters 6 and 8 of these regulations for computation of gains and losses to be recognized.

2. For tangible personal property located within Alabama, gross income includes gains from the sale, exchange or disposition of such property. Losses are included in gross income from the sale, exchange or disposition of such property only if such property was "business income" producing property (as defined in Reg. 810-3-31-.02).

3. For intangible personal property which has a business situs in Alabama, gross income includes gains from the sale, exchange or disposition of such property. Losses are included in gross income from the sale, exchange or disposition of such property only if such property was "business income" producing property (as defined in Reg. 810-3-31-.02).

4. As a general rule, for the purpose of determining the source of income attributable to the sale of personal property, a sale is consummated at the place where the seller surrenders all his right, title, and interest to the buyer. Where bare legal title is retained by the seller, the sale will be deemed to have occurred at the time and place of passage to the buyer of beneficial ownership and risk of loss.

(3) (a) Gross income includes the deemed distributive share of separately stated and nonseparately stated income (or loss not to exceed basis) for shareholders of an electing Alabama S corporation.

1. For electing Alabama S corporations with income from more than one state, gross income includes only the deemed distributive share attributable to Alabama.

(b) Gross income does not include actual distributions from electing Alabama S corporations which have been previously included in gross income under subparagraph (3)(a) above.

(c) Gross income of a nonresident does not include actual distributions from S corporations which have not elected to be Alabama S corporations, nor does it include deemed distributive shares of income (or losses) of such corporations.

(d) See §§40-18-160, et seq., Code of Alabama 1975, and regulations thereunder, relating to Alabama S corporations.

(4) Gross income of a nonresident partner of a partnership includes the distributive share of the partnership income (or loss not to exceed basis), plus any "Guaranteed Payments to Partner". See Regs. 810-3-24-.01(3) and 810-3-24-.03. If the partnership has income from Alabama and any other state, Alabama gross income includes only the amount attributed to Alabama as provided in Reg. 810-3-24-.02(2).

(5) Gross income of a nonresident beneficiary of an estate or trust includes income from such estate or trust attributable to Alabama. See Reg. 810-3-25-.05.

Author: Rebecca S. Whisenant, Amanda G. Scott, CPA
Authority: §40-18-14, Code of Alabama 1975

History: Effective September 30, 1982.
Amended July 27, 1988.
Amended September 18, 1996, effective date October 23, 1996.

810-3-14-.06 Payments by Employers for Past Services to Those No Longer in Their Employment; Payments to Widows of Deceased Employees.

(1) Bonus or other post-employment payments made by an employer to his employee in the military service are considered to be compensation for services and includible in gross income, where the plan and agreement are that the employee is to return to his position when discharged from military service. If the payments are made as a gift, then the payments are not includible in gross income of the recipient. The deduction by the payer of the payments as a business expense is prima facie evidence that the payments are not gifts.

(2) Payments made by an employer to the widow of a deceased officer or employee as additional compensation, in recognition of and in consideration of services of said deceased officer or employee, are includible in the gross income of the widow.

(3)(a) Payments received by the widow of a deceased partner from a partnership are includible in gross income to the extent the payments represent a distribution of profits.

(b) If the payments represent a purchase or cancellation of the deceased partner's interest in the partnership, gain or loss will be recognized as provided in § 40-18-8, Code of Alabama 1975.

(c) Any payments which constitute a gift from the partnership to the widow are not includible in gross income.

Author: Ann F. Winborne, CPA, John Danziger, and Rebecca S. Whisenant
Authority: §§ 40-2A-7(a)(5) and 40-18-14, Code of Alabama 1975
History: Effective September 30, 1982.
Amended July 27, 1988.
Amended: Filed September 18, 1996, effective October 23, 1996.
Amended: Filed May 3, 2000, effective June 7, 2000.

810-3-14-.11 Severance Pay Exemption.

(1) DEFINITIONS. The following terms have these meanings for the purposes of this regulation:

(a) Administrative downsizing: A reduction in the employer's workforce or discontinuance or relocation of the operations of the employer in accordance with a business plan. Administrative downsizing does not include:

1. the transfer or exchange of employees between related taxpayers as described in 26 U.S.C. § 267;

2. the transfer or exchange of employees to another legal entity with such employees continuing to perform essentially the same or related duties for the former employer;

(b) Displaced from employment: Termination of the employer/employee relationship due to an employee's job being abolished or relocated.

(c) Employee: A common law or statutory employee as defined by the Internal Revenue Code.

(2) To qualify for the exemption, the payment must be:

(a) received pursuant to a plan of administrative downsizing which has been submitted to and approved by the Department of Revenue, and

(b) received from the employer:

1. as severance pay, unemployment compensation, termination pay, or from a supplemental income plan;

2. by an employee who is terminated, laid off, fired, or displaced from employment;

3. as a result of administrative downsizing.

(3) This exemption is limited to the first twenty-five thousand dollars ($25,000) received in any year for each displaced worker.

(4) The exemption is effective for payments made on or after January 1, 1997.

(5) Alabama income tax withholding requirements for the employer do not apply to payments exempted under this section if the employer has obtained exemption approval from the Department of Revenue.

(6) If all other requirements of this section are met, payments which qualify for this exclusion include but are not limited to the following:

(a) certain union benefits,

(b) certain payments received from voluntary employee's beneficiary associations,

(c) certain payments to laid-off employees from company-financed, supplemental unemployment compensation benefit plans, also known as -"guaranteed annual wage plans," and

(d) incentives or inducements for early retirement.

(7) Payments made to employees which do not qualify for this exemption include but are not limited to the following:

(a) payments made for accumulated sick leave, annual leave, vacation time, or unused benefits unless only offered as an incentive or inducement for early retirement;

(b) cancellation of contract payments made to independent contractors or others not deemed to be employees of the payor;

(c) "parachute payments" or any other payments made due to termination of employment for any reason other than administrative downsizing;

(d) retirement benefits received as a result of a voluntary retirement due to administrative downsizing; or,

(e) payments made by the employer in compensation for services (previous or future), repurchase, redemption, or retirement of stock or similar equity interests, or any interest therein or option thereto, or in consideration of a non-compete agreement, contractual or legal claim.

(8) Exemption of a payment from income taxes is allowed only when the substance of the transaction fairly meets the requirements of this regulation and the statute. The form of the transaction is usually unimportant.

(9) Employers must apply for approval of the exemption by submitting a completed and signed Form ADSPE to the Department of Revenue. In lieu of Form ADSPE, employers may submit a complete description of their plan for administrative downsizing including, but not limited to:

(a) a complete description of the benefits paid to the displaced employee(s),

(b) a complete description of the plan itself, including, but not limited to:

1. the number and description of employees affected,

2. the reasons for administrative downsizing,

(c) the aggregate amount of benefits to be paid to affected employees which will be exempt from Alabama individual income taxation.

(d) the ADSPE must be filed at least annually if the administrative downsizing plan continues into the next year.

(10) Notwithstanding anything to the contrary herein, neither the employer nor the employee is exempted from the income tax withholding requirements if the employee was terminated, fired, or constructively fired through voluntary resignation due to misconduct. Likewise, employees who were terminated, fired, or constructively fired through voluntary resignation due to misconduct shall not be allowed to take the tax exemption on their income tax return.

(11) Severance pay, whether paid as a lump sum or in installments, granted prior to January 1, 1997, is not exempt from Alabama individual income taxation.

Authors: Edward F. Cutter, CPA; Richard H. Henninger, Jr.; Judy A. Robbins, and Ann F. Winborne, CPA.
Authority: §§ 40-2A-7(a)(5) and 40-18-19.1, Code of Alabama 1975.
History: New rule filed February 20, 1998, effective March 27, 1998.
Amended: Filed May 3, 2000, effective June 7, 2000.

ALABAMA DEPARTMENT OF REVENUE
ADMINISTRATIVE CODE

CHAPTER 810-3-15

Deductions for Individuals Generally

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810-3-15-.01 General Provisions.

(1) For tax years beginning after December 31, 1997, no deduction shall be allowed for any losses, expenses, or interest deferred or disallowed pursuant to 26 U.S.C. §267. For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

(2) For tax years beginning after December 31, 1986, no expenses shall be allowed for any cost required to be capitalized in accordance with 26 U.S.C. §263A.

(3) An individual who is a part-year resident of Alabama may deduct expenses allowed by §40-18-15, Code of Alabama 1975, only to the extent that the expenses were paid during the period the taxpayer was a resident of Alabama. If a deduction was paid for the entire year, such as interest or taxes, and the amount actually paid while a resident cannot be determined, the taxpayer may prorate the deductible amount based on the number of months of Alabama residency.

(4) Double deductions are not permitted. Amounts deducted under one provision of this title cannot be deducted under another title.

Author: Ann F. Winborne, CPA, Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§ 40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Rule effective October 1, 1982.
Amended June 19, 1992.
Amended: Filed September 18, 1996, effective October 23, 1996.
Repealed and New: Filed December 14, 1999, effective January 18, 2000.

810-3-15-.02 Business Expenses.

(1) Business expenses deductible from gross income include the ordinary and necessary expenses paid or accrued during the taxable year, directly connected with or pertaining to the taxpayer's trade or business, as determined in accordance with 26 U.S.C. §162.

(2) The provisions and limitations of 26 U.S.C. §274 also apply to expenses for business travel, meals, and entertainment otherwise allowable under 26 U.S.C. §162.

(3) Unreimbursed employee business expenses and certain other miscellaneous itemized deductions are deductible only to the extent that the aggregate of the deductions exceeds 2-percent of adjusted gross income as defined in Code of Alabama 1975, §40-18-14.2.

(4) A farmer who operates a farm for profit is entitled to deduct from gross income as necessary expenses all amounts actually expended in the carrying on of the business of farming in accordance with 26 U.S.C. §162.

(5) Alabama income tax law requires that taxpayers maintain such records as will be sufficient to enable the Department of Revenue to correctly determine tax liability. It is to the advantage of taxpayers who may be called upon to substantiate deductions to maintain as adequate and detailed records as is practical since the burden of proof is on the taxpayer to show that such deductions were not only paid or accrued but also were ordinary and necessary business expenses, as defined in 26 U.S.C. § 162.

(6) For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

(7) The provisions of the federal "Taxpayer Relief Act of 1997" which were adopted by Alabama Act 98-502 have the same effective date for Alabama income tax purposes as they do for federal income tax purposes.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, Betty Knowles, and Ann F. Winborne, CPA
Authority: Sections 40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Effective December 4, 1992.
Amended: Filed September 18, 1996, effective October 23, 1996.
Repealed and New: Filed December 14, 1999, effective January 18, 2000.

810-3-15-.03 Interest Expense.

(1) Effective for all taxable years beginning after December 31, 1997, interest paid or accrued within the taxable year on indebtedness shall be limited to the amount allowable as an interest deduction for federal income tax purposes in the corresponding tax year or period pursuant to the provisions of 26 U.S.C. §§163, 264, and 265. Educational loan interest is not deductible for Alabama income tax purposes. For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

(2) Effective for all taxable years or periods beginning after December 31, 1987, and prior to December 31, 1997, interest paid or accrued within the taxable year on indebtedness shall be limited to the amount allowable as an interest deduction for federal income tax purposes in the corresponding tax year or period pursuant to the provisions of 26 U.S.C. §163.

(3) For taxable years beginning prior to January 1, 1988, all interest paid or accrued within the taxable year on indebtedness was fully deductible.

(4) The provisions of the federal "Taxpayer Relief Act of 1997" which were adopted by Alabama Act 98-502 have the same effective date for Alabama income tax purposes they do for federal income tax purposes.

Author: Roger Frost, Sharon Norman, Hugh Kirkland,
James Lucy, Lee Johnson, and Betty Knowles_
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Adopted September 30, 1982.
Amended June 17, 1988.
Amended: Filed May 16, 1989, effective June 20, 1989.
Repealed and New: Filed December 14, 1999, effective January 18, 2000.

810-3-15-.04 Deductibility of Taxes.

(1) The following taxes imposed by the United States or any possession of the United States are deductible by the taxable entity upon whom the taxes are imposed:

(a) Income taxes

(b) Federal Insurance Contribution Act (FICA) taxes

(c) Self-employment taxes

(d) Estate and gift taxes

1. Estate taxes are imposed on the estate.

2. Gift taxes are imposed on the donor.

(2) State, local, and foreign occupational license taxes and contributions to state unemployment funds are deductible.

(3) The following taxes are deductible to the same extent that the taxes are deductible for federal income tax purposes under 26 U.S.C. §164, in accordance with federal regulations for 26 U.S.C. §164:

(a) State, local, and foreign real property taxes.

(b) State and local personal property taxes.

1. The term "personal property tax" means an ad valorem tax which is imposed on an annual basis in respect to personal property.

(c) The generation-skipping transfer (GST) tax imposed on income distributions by 26 U.S.C. §2601.

(4) There shall be allowed a deduction for state, local, and foreign taxes, and taxes imposed by authority of the United States or any possession of the United States, which are paid or accrued within the taxable year in carrying on a trade or business or an activity described in 26 U.S.C. §212 (relating to expenses for production of income).

(5) Notwithstanding the preceding sentence, any tax which is paid or accrued by the taxpayer in connection with an acquisition or disposition of property shall be treated as part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition. Cross references: Code of Alabama 1975, §§40-18-6, 40-18-15, 40-18-16, and 40-18-17.

(6) See also Rule 810-3-15-20, Federal Income Tax Deduction - Individuals.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles

Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975

History: Effective October 1, 1982.
Amended July 27, 1988.
Amended February 8,1989.
Amended May 15, 1992.
Amended: Filed September 18, 1992, effective October 23,1996.
Repealed and New: Filed December 14, 1999, effective January 18, 2000.

810-3-15-.05 Depreciation, Amortization, and Section 179 Expense.

(1) Effective for all taxable years beginning after December 31, 1997, there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property used in a trade or business, or of property held for the production of income, in accordance with 26 U.S.C. §§167 and 168. For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

(2) Effective for all taxable years beginning after December 31, 1997, intangible assets which are used in a trade or business or held for the production of income may be amortized in accordance with 26 U.S.C. §197. For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

(3) A deduction is allowable for the amortization of start-up expenditures in accordance with 26 U.S.C. §195, but in the case of a nonresident, only if the principal place of business being investigated, created, or acquired is located in the State of Alabama.

(4) For taxable years beginning after December 31, 1989, a taxpayer may elect to treat the cost of any section 179 property as an expense which is not chargeable to a capital account in accordance with 26 U.S.C. §179.

(5) For taxable years beginning before January 1, 1998, Alabama income tax law and regulations were similar to the provisions of the Internal Revenue Code and regulations concerning depreciation and amortization of intangible assets. Applicable federal regulations and determinations pertaining to depreciation and amortization of intangible assets will be followed in administering this rule for those tax periods. See also Rule 810-3-1.1-.01, Operating Rules.

(6) The provisions of the federal "Taxpayer Relief Act of 1997" which were adopted by Alabama Act 98-502 have the same effective date for Alabama income tax purposes as they do for federal income tax purposes.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, Betty Knowles, Ewell Berry, and Ann F. Winborne, CPA
Authority: §§40-2A-7(a)(5) and 40-18-18, Code of Alabama 1975
History: Effective October 1, 1982.
Amended July 27, 1988.
Amended: Filed February 8, 1989, effective March 20, 1989.
Amended: Filed May 15, 1992, effective October 23, 1996.
Repealed and New: Filed December 14, 1999, effective January 18, 2000.

810-3-15-.06. Depletion.

(1) There shall be allowed as a deduction in computing taxable income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion.

(a) Depletion allowance for standing timber shall be computed solely on the adjusted basis of the property.

(b) Depletion allowance for oil and gas may be computed on either the cost depletion method or on a percentage of gross income from the property, see Reg. 810-3-16-.01.

(c) Depletion allowance for other exhaustible natural resources shall be computed on the cost depletion method.

(d) The basis for depletion shall be determined in accordance with §§40-18-16 and 40-18-6, Code of Alabama 1975.

(2) Annual depletion deductions are allowed only to the owner of an economic interest in mineral deposits or standing timber. An economic interest consists of a capital investment in timber or mineral in place together with recovery of the investment through production.

(a) The allowance for depletion should be equitably apportioned between the lessor and lessee. Each should compute cost depletion from his own adjusted basis; each should compute percentage depletion from his own income from the property. One may use percentage depletion while the other may use cost.

(3) Computation of depletion on basis of cost (mines, oil and gas properties). When the adjusted basis applicable to the mineral deposit has been determined under §40-18-16 cost depletion for the taxable year is computed by:

(a) Dividing the adjusted basis of the property by the number of recoverable units to arrive at the rate per unit.

(b) Multiply the rate per unit by the number of units sold in the taxable year if the taxpayer is on the accrual method, or the number of units for which payment is received if the taxpayer is on the cash method.

$$\text{Cost depletion} = \frac{\text{adjusted basis}}{\text{recoverable units}} \times \begin{array}{c}\text{Units sold or paid for}\\ \text{in taxable year}\end{array}$$

1. In the selection of a unit of mineral for depletion, preference shall be given to the customary unit or units paid for the product sold, such as tons of ore, barrels of oil, or thousands of cubic feet of natural gas.

2. The number of recoverable units is the number of units of mineral determined by geological survey to be available for recovery.

(i) After the predetermined number of units have been recovered, no cost depletion is then allowed on any excess recovered.

3. In determining the amount of the adjusted basis of the mineral deposit there shall be excluded:

(i) amounts representing the cost or value of the land for purposes other than mineral production,

(ii) the amount recoverable through depreciation and through deductions other than depletion, and

(iii) the residual value of the property at the end of operations, but there shall be included, in the case of oil and gas wells, those amounts of capitalized drilling and development costs which are recoverable through depletion.

(4) Computation of depletion on basis of cost (timber). Only cost depletion is allowed in computing depletion of timber. The amount of depletion to be deducted during the year is the number of units of timber cut times the depletion unit. The depletion unit is the basis of the timber under §40-18-16 divided by the total depletable units (M board feet, cords, etc.). Depletion is deducted in the same year the cut timber is sold or otherwise disposed of, except that if a taxpayer elects to treat cutting as a sale, depletion is taken in the year of cutting as basis of timber cut:

$$\frac{\text{Basis}}{\text{Total depletable units}} \times \text{units cut} = \text{depletion allowable}$$

(a) A timber account should normally be set up to include all of the timber in one "block", a block being an operational unit which includes all of the taxpayer's timber which logically goes to a single given point of manufacture, or the timber which would logically be removed by a single logging development.

(b) The "total depletable units" shall be determined by a professional cruising of the timber.

(c) After the above determined number of units have been used in computing the depletion allowed, no further depletion is allowed on any excess units removed.

(5) Computation of depletion on basis of percentage of gross income (oil and gas wells). For a description of the calculation of percentage depletion, see Reg. 810-3-16-.01.

(6) Computation of depletion on basis of discovery value (mines, oil and gas properties). With respect to any property for which discovery value is the taxpayer's basis for depletion, the depletion for any taxable year shall be computed by:

(a) Determining the number of units available to be removed and the unmined value of each unit by a professional geological survey.

(b) As each unit is sold depletion is allowable at the above predetermined unmined value.

(c) When the above total predetermined units have been allowed as depletion, no further depletion is allowed on any excess units removed and/or sold.

(7) Determination of fair market value. If the fair market value of the property at a specified date is to be determined for the purpose of ascertaining the basis for depletion and depreciation deductions, such value must be determined, subject to approval or revision by the Department, by the owner of the property in the light of the conditions and circumstances known at that date, regardless of later discoveries or developments in the property or subsequent improvements in methods of extraction and treatment of the mineral product. The value sought should be established assuming a transfer between a willing seller and a willing buyer existed as of that particular date. The Department will give due weight and consideration to any and all factors and evidence having a bearing on the market value, such as cost, actual sales and transfers of similar properties, market value of stock or shares, royalties or rentals, valuation for local taxation, partnership accountings, records of litigation in which the value of the property was in question, the amount at which the property may have been inventoried in a probate court, and, in the absence of better evidence, disinterested appraisals by approved methods.

(8) Depreciation of improvements. A reasonable provision for depreciation shall be allowed with respect to tangible properties, other than land and inventory properties, which are not subject to depletion, as in the case of mines, oil and gas wells, and other natural deposits and timber. It shall be optional with the taxpayer whether the cost or other basis of the plant and equipment plus allowable capital additions and minus salvage value shall be recovered,

(a) by reasonable charges for depreciation (see Reg. 810-3-15-.05) at a rate determined by the physical or economic life of such plant or equipment, or

(b) at a rate established by the exhaustion of the wasting asset, or

(c) according to the particular conditions of the case, by a method satisfactory to the Department.

Authors: Ann F. Winborne, CPA, Jerilyn P. Christian
Authority: §40-18-15, Code of Alabama 1975
History: Effective September 30, 1982.
Amended July 27, 1988.
Amended September 18, 1996, effective October 23, 1996.

810-3-15-.07 Losses.

(1) The following losses sustained during the taxable year and not compensated for by insurance or otherwise are deductible by individuals:

(a) Losses incurred in a trade or business, in accordance with 26 U.S.C. §165(c)(1).

(b) Losses incurred in any transaction entered into for profit, though not connected with a trade or business, in accordance with 26 U.S.C. §165(c)(2), but in the case of a non-resident, only as to those transactions within the state.

(c) Casualty and theft losses sustained during the taxable year of property not connected with the conduct of a trade or business or a transaction entered into for profit as determined in accordance with 26 U.S.C. §165(c)(3) and (h). In the case of a nonresident, the deduction shall be allowed only for the losses arising from property located within the State of Alabama and the limitations in 26 U.S.C. §165 shall be applied only with regard to the taxpayer's Alabama adjusted gross income.

(d) Losses from debts ascertained to be worthless and charged off during the taxable year of ascertainment, if sustained in the conduct of the regular trade or business of the taxpayer. The reserve method for bad debts is not allowed for individuals.

(2) For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

(3) Losses from personal bad debts not incurred in a trade or business, nor in a transaction entered into for profit, are not deductible.

Author: Roger Frost, Sharon Norman, Hugh Kirkland,
James Lucy, Lee Johnson, and Betty Knowles
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975.
History: Adopted October 1, 1982.
Amended July 27, 1988.
Amended May 15, 1992.
Amended: Filed September 18, 1996, effective October 23, 1996.
Repealed and New: Filed December 14, 1999, effective January 18, 2000.

810-3-15-.09 Nontrade or Nonbusiness Expenses.

(1) In accordance with 26 U.S.C. §212, an individual is allowed a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year:

(a) for the production or collection of income;

(b) for the management, conservation, or maintenance of property held for the production of income; or

(c) in connection with the determination, collection, or refund of any tax.

(2) The provisions and limitations of 26 U.S.C. §274 also apply to deductions for travel, entertainment, and meals.

(3) Except as otherwise provided in Alabama law, nontrade or nonbusiness expenses are not deductible.

(4) For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Adopted October 1, 1982.
Amended Filed July 27, 1988.
Amended May 15, 1992.
Repealed and New: Filed December 14, 1999, effective January 18, 2000.

810-3-15-.12 Moving Expenses.

(1) Effective for taxable years beginning January 1, 1990, a deduction is allowed for moving expenses paid or incurred during the taxable year in connection with the commencement of work by the taxpayer as an employee or as a self-employed individual at a new principal place of work in accordance with 26 U.S.C. §217; provided, however, that the "new principal place of work" is located within the State of Alabama. For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Adopted October 1, 1982.
Amended July 27, 1988.
Amended May 15, 1992.
Repealed and New: Filed December 14, 1999, effective January 18, 2000.

810-3-15-.13 Alimony and Separate Maintenance Payments.

(1) Effective for taxable years beginning January 1, 1990, alimony and separate maintenance payments will be deductible in accordance with 26 U.S.C. §215. For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

(2) For taxable years ending after December 31, 1984, and before January 1, 1990, alimony and separate maintenance payments will be deductible as provided in 26 U.S.C. §215 as in effect on January 1, 1985.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§ 40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Adopted October 1, 1982.
Amended filed July 27, 1988.
Amended May 15, 1992.
Amended: Filed September 18, 1996, effective October 23, 1996.
Repealed and New: Filed December 14, 1999, effective January 18, 2000.

810-3-15-.14 Deductions Allowable for Retirement Savings - IRA, SEP, and Keogh Plans.

(1) A deduction is allowed for an individual's qualified retirement contribution in accordance with 26 U.S.C. §219.

(2) A deduction is allowed for contributions of an employer to an employees' trust or annuity plan, or for compensation paid or accrued on account of an employee under a deferred-payment plan, in accordance with 26 U.S.C. §404.

(3) For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Adopted October 1, 1982.
Amended July 27, 1988.
Amended May 15, 1992.
Repealed and New: Filed December 14, 1999, effective January 18, 2000.

810-3-15-.16 Medical and Dental Expenses. A deduction is allowed for expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent, in accordance with 26 U.S.C. §213; provided, however, that the limitation of the deduction to the excess of those expenses over 7.5 percent of adjusted gross income as provided in 26 U.S.C. §213 shall instead be limited to the excess of those expenses over 4.0 percent of adjusted gross income as defined in Code of Alabama 1975, §40-18-14.2. For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Adopted October 1, 1982.
Amended July 27, 1988.
Amended May 15, 1992.
Amended September 18, 1996, effective October 23, 1996.
Repealed and New: Filed December 14, 1999, effective January 18, 2000.

810-3-15-.17 Charitable Contributions. A deduction for charitable contributions is allowable to the extent allowed for federal income tax purposes under 26 U.S.C. §170; provided, however, that the contributions base shall be the adjusted gross income as defined in Code of Alabama 1975, §40-18-14.2, except for any net operating loss carryback deduction allowable by §40-18-15.2. For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Adopted October 1, 1982.
Amended July 27, 1988.
Amended May 15, 1992.
Amended September 18, 1996, effective October 23, 1996.
Repealed and New: Filed December 14, 1999, effective January 18, 2000.

810-3-15-.19 Optional Standard Deduction.

_____(1) A deduction is allowed for resident individual taxpayers filing Form 40 or nonresident individual taxpayers filing Form 40NR who elect to claim an optional standard deduction instead of itemizing their nonbusiness expenses for medical and dental care, taxes (other than federal income taxes), interest, contributions, casualty and theft losses, long-term health care premiums, and miscellaneous deductions allowable by Code of Alabama 1975, §40-18-15. For tax years beginning January 1, 1982, the maximum optional standard deduction:

(a) for a single taxpayer, head of family, or a married taxpayer filing a separate return, is 20% of adjusted gross income, or $2,000, whichever is less.

(b) for married taxpayers filing a joint return, is 20% of adjusted gross income or $4,000, whichever is less.

_____(c) for a nonresident, is the amount determined under subparagraph (1)(a) or (1)(b) above,apportioned by the percentage of Alabama adjusted total income to total income from all sources.

(2) Adjusted gross income is determined in accordance with Code of Alabama 1975, §40-18-14.2.

(3) Federal income taxes paid or accrued during the taxable year may be deducted in addition to the optional standard deduction.

(4) If a husband and wife file separate returns and one spouse itemizes deductions, the other spouse will not be allowed to claim the optional standard deduction but must also itemize deductions.

_____(5) For tax years beginning January 1, 1985, the election to claim the optional standard deduction is revocable. If a taxpayer claims itemized deductions which are less than the allowable optional standard deduction, an amended return may be filed claiming the optional standard deduction. If a taxpayer claims the optional standard deduction which is less than the allowable itemized deductions, an amended return may be filed claiming the itemized deductions.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975.
History: Adopted September 30, 1982.
Amended July 27, 1988.
Amended September 18, 1996, effective date October 23, 1996.
Repealed and New: Filed December 14, 1999, effective January 18, 2000.

810-3-15-.20 Federal Income Tax Deduction - Individuals.

(1) **DEFINITIONS**. For the purpose of this regulation, the following words, phrases and abbreviations have these meanings:

(a) **FIT**: Federal income tax. Deductible federal income tax includes:

1. Federal income tax withheld by employers during the taxable year.

2. Excess social security or Medicare tax (FICA) and railroad retirement tax (RRTA) withheld during the taxable year and claimed as federal income tax on the federal return for the same year. Regular FICA and RRTA tax withheld cannot be claimed as federal income tax since these can only be claimed as itemized deductions.

3. All federal income tax payments made during the year for liabilities of prior years, including the previous year's payment made when the previous year return was filed.

4. All federal income tax estimate payments made during the year. Any overpayments of previous years which are applied to the current year's estimated tax are not deductible unless the overpayment is included in income as a refund of federal income tax.

5. Earned income credit of the previous year which was applied to the previous year's federal income tax liability.

6. Alternative Minimum Tax.

(b) Federal income tax does not include:

1. Federal accumulated earnings tax,

2. Self-employment taxes,

3. Social security and Medicare tax on tip income not reported to employers,

4. Tax on excess contributions to Individual Retirement Arrangements,

5. Tax (10% Additional Tax) on early distributions from a qualified retirement plan (including IRAs),

6. Tax on excess accumulations in qualified retirement plans (including IRAs),

7. Tax on excess distributions from qualified retirement plans (including IRAs),

8. Advance earned income credit payments,

9. Household employment taxes,

10. Penalties and interest.

(c) **FIT Paid**: Payment includes FIT withholdings, FIT paid by the taxpayer, and FIT paid through wage garnishments.

(d) **FIT Accrued**: Imposed FIT payable for the year.

(e) **Paid or Accrued**: Either paid or accrued, but not both.

(f) **Transition Year**: The year in which the method of computing the FIT deduction is changed; i.e., from cash method to accrual method or vice versa. The change in method can be the result of taxpayer's request or a Revenue Department directive.

(g) **To Contest**: To challenge via some objective act of protest, substantiated by some affirmative evidence of denial of liability by the taxpayer.

(2) **FEDERAL INCOME TAX DEDUCTION FOR RESIDENTS**. Net federal income tax may be deducted for the taxable year in which paid or accrued. Taxes are deductible only by the person or entity upon whom they are imposed. A cash basis taxpayer may allocate his federal income tax deduction on the cash basis or accrual basis. Once a method is selected, it shall be consistently applied from year to year, unless approval for a change is obtained from the Department. An accrual basis taxpayer must allocate his federal income tax deduction using the accrual basis.

(a) **FOR RESIDENTS SELECTING THE CASH BASIS**:

1. FIT is deducted in the year paid, regardless of the year for which it is imposed.

2. If the taxpayer received a prior-year tax benefit from the deduction of FIT resulting in a reduction of tax paid to Alabama in the prior year, the amount of the FIT refund must be included in income in the year received. See Reg. 810-3-14-.04.

3. EXAMPLE 1: Taxpayer has $1,200 withheld from his earnings during 19X8 for federal income taxes. In March, 19X8, he paid $100 additional tax on his 19X7 liability and $200 on his declaration of estimated tax for 19X8. He paid an additional assessment of $300 on his 19X5 income in September 19X8, thereby settling a disputed liability for 19X5. The taxpayer reports his income for state

income tax purposes using the cash receipts and disbursements method. He may deduct for the calendar year 19X8 all payments listed above, totaling $1,800.

4. EXAMPLE 2: A taxpayer made the same payments as listed in the preceding example, except that he received a $300 refund of 19X5 taxes, for which he received a tax benefit, in September, 19X8, thereby settling the disputed 19X5 liability. Taxpayer selected the cash basis to compute the federal income tax deduction. He may deduct for the calendar year 19X8 all payments listed above, totaling $1,500, and the $300 refund must be reported as income.

(b) **FOR RESIDENTS SELECTING THE ACCRUAL METHOD**:

1. Uncontested FIT is deducted in the year for which it is imposed.

2. Contested FIT is deducted in the year in which the liability becomes fixed and certain, but in no case later than the year in which the tax was actually paid.

3. Refunded FIT is reported in the year received but only if the taxpayer received a prior-year tax benefit from deduction of the FIT refunded.

4. EXAMPLE 3: A taxpayer using the accrual basis, who had made the same payments listed in Example 1 above, determined early in 19X9 that his federal income tax liability for 19X8 would be $1,700. He had previously paid $1,400 and therefore would have to pay an additional $300. He may deduct $1,700 accrued for 19X8 plus $300 accrued during 19X8 on his contested 19X5 liability, for a total of $2,000. He may not deduct $100 paid in 19X8 on his 19X7 liability, since this amount accrued in 19X7 and should have been deducted in that year.

5. EXAMPLE 4: A taxpayer using the accrual basis, who had made the same payments as those listed in Example 2 above, determined early in 19X9 that his federal income tax liability for 19X8 would be $1,700 and that he had paid $1,400 and would have to pay an additional $300. He may deduct the $1,700 accrued for 19X8. He may not deduct the $100 paid in 19X8 on his 19X7 liability, since this amount accrued in 19x7 and should have been deducted in that year. The $300 refund accrued during 19X8 on his contested 19X5 tax liability should be reported as income on his 19X8 return.

(c) **MARRIED TAXPAYERS**: For spouses who file a joint federal income tax return but separate Alabama income tax returns for the same year, the FIT deduction of each is based on the ratio of Alabama adjusted gross income of each to the total Alabama adjusted gross income of both.

1. EXAMPLE 5: Proration Based on Alabama Adjusted Gross Income

| | Husband | Wife | Total |
|---|---|---|---|
| Income - Salaries, wages, etc. | $7,000 | $4,000 | $11,000 |
| Income - Other | 500 | 500 | 1,000 |
| Totals | $7,500 | $4,500 | $12,000 |
| | | | |
| Ratio of income for each spouse | 62.5% | 37.5% | 100% |
| Total federal income tax | | | $ 2,400 |
| Husband: $2,400 x 62.5% | $1,500 | | |
| Wife: $2,400 x 37.5% | | $ 900 | |

The husband deducts $1,500 on his state return and the wife deducts $900 on her state return for federal income tax. Total federal income tax deducted on both state returns is $2,400, the amount to be prorated.

(3) **NONRESIDENTS**: The FIT deduction for Alabama shall be apportioned according to the ratio of adjusted gross income from Alabama sources to the total adjusted gross income from all sources (as computed under Alabama law, not federal law). Each annual FIT deduction must be computed separately. Cash basis nonresidents may compute the FIT deduction on the cash basis or may elect to compute it on the accrual basis. The election, once made, must be consistently applied from year to year unless prior written approval for a change is obtained from the Department.

(a) **FOR NONRESIDENTS SELECTING THE CASH BASIS**:

1. FIT is deducted in the year paid, regardless of the year for which it is imposed.

2. Refunded FIT is reported in the year received but only if the taxpayer received a prior-year tax benefit from deduction of the FIT refunded.

3. Copies of the federal income tax returns for all years used in the computation of the FIT deduction must be submitted with the return.

4. EXAMPLE 6: A nonresident taxpayer had adjusted gross income in 19X2 from sources within Alabama of $10,000 and adjusted gross income from sources within and without Alabama of $25,000. Data regarding his federal income tax is:

| | |
|---|---|
| Federal income tax liability for 19X2 | $5,500 |
| Withheld in 19X2 | $3,600 |
| Paid in 19X2 on 19X2 federal estimate | $ 800 |
| 19X1 federal tax paid in 19X2 (on estimate, final return, or otherwise) | $ 300 |
| 19X0 federal tax paid in 19X2 | $ 500 |
| 19X1 federal income tax refund received in 19X2 | $ 400 |

| | |
|---|---|
| 19X1 ratio of Alabama AGI to federal AGI | 60% |
| 19X0 ratio of Alabama AGI to federal AGI | 30% |

(19X1 and 19X0 ratios based on 19X1 and 19X0 returns.)

For the 19X2 tax year, the ratio of adjusted gross income from sources within Alabama to adjusted gross income from sources within and without Alabama is 40% ($10,000 divided by $25,000).

| | |
|---|---|
| Total 19X2 payment | $4,400 |
| Deduction for 19X2 tax (40% of $4,400) | $1,760 |
| Deduction for 19X1 tax (60% of $300) | $ 180 |
| Deduction for 19X0 tax (30% of $500) | $ 150 |
| Refund of 19X1 tax (60% of $400) | $ 240 |
| Total 19X2 FIT deduction ($1,760 + $180 + $150 - $240) | $1,850 |

(b) **FOR NONRESIDENTS SELECTING THE ACCRUAL BASIS:**

1. Uncontested FIT is deducted in the year for which it is imposed.

2. Contested FIT is deducted in the year in which the liability becomes fixed and_certain, but in no case later than the year in which the tax was actually paid.

3. Refunded FIT is reported in the year received but only if the taxpayer received a prior-year tax benefit from deduction of the FIT refunded.

4. EXAMPLE 7: Using the information in Example 6 and assuming the taxpayer had consistently used the accrual method, the FIT deduction for 19X2 would be $2,200.00
($5,500.00 x 40%).

(4) **CHANGE IN METHOD USED TO COMPUTE/ALLOCATE FIT DEDUCTION**:

(a) Any change in methods must be effective with the first day of a tax year.

(b) Any tax year in which a change of methods occurs is a transition year.

(c) There are two ways the method can be changed:

1. Taxpayer request.

(i) Taxpayer's request must be in writing and must include the reason(s) for requesting the change.

(ii) The taxpayer will receive written approval if the request is granted.

(iii) A copy of the written request for a change in method and the Department's written approval must be submitted with the return.

(iv) Once a change in computation and/or allocation methods is approved, it must be consistently applied from the year of change forward.

2. Change in method required by the Department of Revenue.

(i) Effective with any tax year beginning after December 31, 1998, the Department may select the method (cash or accrual basis) used to compute the federal income tax deduction on resident and non-resident returns. Taxpayers filing a return for a year in which the Department changes the method will be considered to have been granted approval to change methods.

(5) **TRANSITION YEAR RULES**:

(a) Year of change from cash basis to accrual basis: Any FIT refund received must be reported as income and additional FIT paid must be deducted.

(b) Year of change from accrual basis to cash basis: Any FIT refund received during the transition year for previous tax years shall not be reported as income. Any_additional tax paid during the transition year for previous tax years may not be deducted.

(c) After a change from cash to accrual method in non-transition years, refunds of previously deducted accrued taxes must be reported as income and payments of taxes for an accrual basis year, not previously deducted, may be deducted.

Author: Richard H. Henninger, Jr., Sharon Norman, Judy A. Robbins, Jack W. Stewart, Sr.
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Adopted September 30, 1982.
Amended: Filed February 8, 1989, effective April 24, 1989.
Amended: Filed September 18, 1996, effective October 23, 1996.
Repealed and New: Filed December 14, 1999, effective January 18,

810-3-15-.21 Deductions for Nonresidents

____(1) A nonresident is an individual who is a legal resident of another state.

(2) The phrase "adjusted gross income from all sources" is comprised of income which would be included in gross income if received by a resident of the State of Alabama in accordance with § 40-18-14, Code of Alabama 1975, less the deductions described in § 40-18-14.2.

____(3) Effective for all taxable years beginning after December 31, 1997:

____(a) Business-related Expenses. The following business-related expenses are deductible in computing Alabama adjusted gross income for a nonresident only to the extent that they are paid or incurred in a trade or business within the State of Alabama:

____1. Ordinary and necessary business expenses in accordance with § 40-18-15(a)(1),

2. Interest expense in accordance with § 40-18-15(a)(2),

3. Taxes in accordance with § 40-18-15(a)(3),

4. Losses in accordance with §§ 40-18-15(a)(4) and (5),

5. Losses from debts ascertained to be worthless in accordance with § 40-18-15(a)(7),

6. Depreciation and amortization in accordance with § 40-18-15(a)(8),

7. Depletion in accordance with § 40-18-15(a)(9),

8. Retirement savings contributions and expenses for qualified pension plans, profit sharing plans, stock bonus plans, and annuity plans in accordance with §§ 40-18-15(a)(11) and (12),

9. Expenses incurred in removing barriers to handicapped persons in accordance with § 40-18-15(a)(19),

10. Section 179 expenses in accordance with § 40-18-15(a)(21),

11. Unreimbursed employee business expenses and expenses described at 26 U.S.C. § 212 in accordance with § 40-18-15(a)(23), and

12. Assistance provided to the State Industrial Development Authority in accordance with § 40-18-15(a)(25).

____(b) Net Operating Losses. The deduction allowed by § 40-18-15.2 for net operating losses shall be deductible only to the extent that a loss arose from a trade or business carried on in Alabama. See § 40-18-15.2.

____(c) Property Located in Alabama - Income Subject to Alabama Tax. The following expenses are deductible in computing Alabama adjusted gross income for a nonresident only to the extent arising from property located in Alabama or transactions producing income that is subject to tax in the State of Alabama:

1. Interest expense in accordance with § 40-18-15(a)(2),

2. Taxes in accordance with § 40-18-15(a)(3),

3. Losses in accordance with § 40-18-15(a)(5),

4. Depreciation and amortization in accordance with § 40-18-15(a)(8),

5. Depletion in accordance with § 40-18-15(a)(9),

6. Ordinary and necessary business expenses in accordance with § 40-18-15(a)(14) and 26 U.S.C § 212, and

7. Expenses incurred in removing barriers to handicapped persons in accordance with § 40-18-15(a)(19).

____(d) Casualty and Theft Losses. The deductible amount of casualty and theft losses allowed by § 40-18-15(a)(6), which references 26 U.S.C. § 165, shall be allowed only for losses arising from property located within the State of Alabama. The limitations in 26 U.S.C. § 165 shall be applied only with regard to the taxpayer's Alabama adjusted gross income.

____(e) Alabama Percentage of Adjusted Total Income. Nonresidents must divide the amount of their Alabama adjusted total income by the amount of their adjusted total income from all sources in order to determine the ratio of Alabama income to income from all sources. This percentage, the Alabama percentage of adjusted total income, is used to determine the deductible amount of certain expenses taken below the adjusted total income line. Alimony paid and adoption expenses are not considered in the computation of the Alabama percentage of adjusted total income - the amounts are not subtracted from either the numerator or the denominator of the fraction. See § 40-18-14.2.

____1. Personal Exemption and Dependent Exemption. A nonresident must prorate the personal exemption by multiplying the amount of the personal exemption by the Alabama percentage of adjusted total income. If Alabama total income exceeds the prorated amount, a Form 40NR must be filed. Dependent

exemptions must be prorated in the same manner using the Alabama percentage of adjusted total income. See § 40-18-19.

____2. Federal Income Tax Deduction. The federal income tax deduction must also be prorated using the Alabama percentage of adjusted total income. See Rule 810-3-15-.20.

(i) If the taxpayer is filing separately on the Alabama return, but jointly on the federal return, an intermediate computation is performed before the federal income tax deduction is prorated, and the Alabama percentage of adjusted total income is not used to prorate the federal income tax deduction.

(I) The taxpayer's Alabama adjusted total income is divided by the sum of the spouse's federal adjusted gross income and the taxpayer's adjusted total income from all sources.

____(II) The percentage computed in subparagraph (I) is then applied to the amount of the federal income tax liability as shown on the current federal income tax return. The result of the computation is the allowable federal income tax deduction.

____3. Optional Standard Deduction. If a nonresident taxpayer elects to claim the optional standard deduction in lieu of claiming itemized deductions, the optional standard deduction must be prorated by multiplying the amount of the optional standard deduction by the Alabama percentage of adjusted total income. See Rule 810-3-15-.19.

____4. Other Adjustments and Itemized Deductions. The amount allowed for the following deductions shall be limited to the amount determined by multiplying the total amount of the deduction by the Alabama percentage of adjusted total income.

(i) Interest expense in accordance with § 40-18-15(a)(2),

(ii) Taxes (other than federal income tax)in accordance with § 40-18-15(a)(3),

____(iii) Casualty and theft losses in accordance with § 40-18-15(a)(6),

(iv) Charitable contributions in accordance with § 40-18-15(a)(10),

(v) Medical and dental expenses in accordance with § 40-18-15(a)(13),

(vi) Expenses relating to the construction of a radioactive fallout shelter in accordance with § 40-18-15(a)(15),

(vii) The cost of conversion to wood as the primary energy source in accordance with § 40-18-15(a)(16),

____(viii) Alimony in accordance with § 40-18-15(a)(17),

(ix) Expenses relating to the removal of barriers to handicapped persons in accordance with § 40-18-15(a)(19),

(x) Adoption expenses in accordance with § 40-18-15(a)(24), and

____(xi) Qualified long-term care coverage in accordance with § 40-18-15(a)(26).

____(4) Prior to January 1, 1998. Effective for taxable years beginning before January 1, 1998, the provisions of subparagraphs (3)(a) through (3)(e) of this rule were the same except:

____(a) The deductions for alimony, retirement contributions, and early withdrawal of savings penalties were not deductible from Alabama income;

(b) Qualified long-term care coverage was deducted as an adjustment to income - after January 1, 1998, only the percentage applicable to Alabama income is deductible from Alabama income; and

(c) Adoption expenses were not allowable as a deduction for a nonresident - after January 1, 1998, adoption expenses are deductible according to the Alabama percentage of adjusted total income.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Effective September 30, 1982.
Amended June 17, 1988.
Amended September 18, 1996, effective October 23, 1996.
Repealed and New Rule: Filed July 26, 1999, effective August 30, 1999.

810-3-15-.24. Adoption Expenses.

(1) For tax years beginning on or after January 1, 1991, resident individual taxpayers may include as an adjustment to income, reasonable medical and legal expenses paid or incurred by the taxpayer in connection with the adoption of a minor.

(2) "Medical expenses" shall include any medical and hospital expenses of the adoptee and the adoptee's biological mother which are incidental to the adoptee's birth and subsequent medical care which, in the case of the adoptee, are paid or incurred before the petition for adoption is granted.

(3) Expenses associated with the adoption of a minor that are not properly classified as medical or legal expenses as stipulated in paragraphs (1) and (2) above are not to be considered in computing the adjustment to income.

(4) In cases of adoption petitions which are not granted, no deduction for medical and legal expenses will be allowed.

Author: Anne Simms, Roy Wiggins
Authority: Section 40-18-15, Code of Alabama 1975
History: Effective December 4, 1992.
Amended September 18, 1996, effective October 23, 1996.

810-3-15-.25. Contributions to State Industrial Development Authority.

(1) In computing adjusted gross income under §40-18-15, Code of Alabama 1975, the following shall be allowed as a deduction:

(a) The amount of aid of assistance, whether in the form of property, services or monies, provided to the State Industrial Development Authority pursuant to §41-10-44.8(d), Code of Alabama 1975.

1. The amount of aid or assistance provided shall be deducted in the year contributed.

2. The deduction for property or services shall be the fair and reasonable value of the property or services as determined by the Authority.

3. Any portion of aid or assistance returned pursuant to §41-10-44.8(d), Code of Alabama 1975, shall be included in income in the year in which the refund of the aid or assistance is made.

Author: Tina M. Melancon
Authority: §40-18-15, Code of Alabama 1975
History: Effective date September 30, 1994.
Amended September 18, 1996, effective October 23, 1996.

810-3-15-.26 Qualified Long-Term Care Coverage.

(1) Effective for taxable years beginning after December 31, 1997, the amount of premiums paid for qualified long-term care insurance coverage is deductible as an itemized deduction.

(2) For tax years beginning on or after January 1, 1995, and ending December 31, 1997, individual taxpayers may include as an adjustment to income the amount paid for premiums for qualifying long-term care coverage pursuant to Section 40-18-15.

(3) "Qualified long-term care services" shall include any care for necessary diagnostic, preventive, therapeutic, and rehabilitative services and maintenance or personal care services which are required by a chronically ill individual in a qualified facility or services which are pursuant to a plan of care prescribed by a licensed health care practitioner.

(4) Premiums paid for long-term care insurance contracts are deductible if the contract meets the following requirements:

(a) Offers coverage only for qualified long-term care services and benefits incidental to the coverage.

(b) Guaranteed renewal.

(c) No cash surrender value.

(d) All refunds of premiums and all policyholder dividends or similar amounts under the contract are to be applied as a reduction in future premiums or to increase future benefits, except for a refund of premiums on surrender or cancellation of the policy.

(5) A long-term care insurance contract shall be treated as an accident or health insurance contract. The amount of coverage under the long-term care insurance contract shall be equal to or greater than Medicaid coverage for a period of at least three years.

(6) An insurance contract shall not fail to be treated as a long-term care contract by reason of the payments being made on a per diem or other periodic basis without regard to the expenses incurred during the period to which the payments relate.

(7) A long-term care insurance contract may cover Medicare reimbursable expenses where Medicare is a secondary payor.

(8) In the case of long-term care insurance coverage provided by a rider on a life insurance contract, this regulation shall apply as if the portion of the contract providing long-term care coverage was a separate contract.

(9) The deduction is available only to the person or entity who pays the premiums.

Author: Roger Frost and James Lucy
Authority: §§ 40-2A-7(a)(5), 40-18-15 and 27-47-2, Code of Alabama 1975
History: New rule: Filed May 7, 1996, effective June 11, 1996.
Amended: Filed December 15, 1999, effective January 19, 2000.

810-3-15-.27 Net Operating Loss Carryback or Carryover.

(1) Computation of a Net Operating Loss (NOL).

(a) A net operating loss is the amount by which deductions (after modifications) exceed gross income. A net operating loss may result from losses incurred in a trade or business, from the sale of assets used in a trade or business, or from personal casualties or thefts.

1. For the purpose of computing the amount of an allowable net operating loss, certain items of income, expense or deduction will be classified as "business" or "nonbusiness." The following is a partial list of items regularly classified as business or nonbusiness:

(i) Business. Business income, expense and deductions include, but are not limited to: salary and wages; income or loss from a trade or business; gain or loss from sale of assets used in a trade or business; losses on Internal Revenue Code § 1244 stock (up to the amount of ordinary loss allowed for federal income tax purposes); rental income or loss; income or loss from a partnership; income or loss from an Alabama S corporation; income or loss from farming; employee moving expenses; employee business expenses; and casualty and theft losses.

(ii) Nonbusiness. Nonbusiness income, expense and deductions include, but are not limited to: medical expenses; taxes; interest expense; charitable contributions; miscellaneous deductions other than employee business expenses; gain from the sale of a personal residence to the extent recognized in accordance with § 40-18-14, Code of Alabama 1975; gain or loss from the sale of assets not used in a trade or business (including distributive shares of gains or losses from such assets held by a partnership or an Alabama S corporation); interest and dividend income (including distributive shares of interest and dividend income received by a partnership or an Alabama S corporation); losses on Internal Revenue Code §1244 stock (in excess of the amount of ordinary loss allowed for federal income tax purposes) federal income tax refunds or tax paid; alimony received; taxable pension and annuities; income or loss from a trust or estate; deductible contributions to IRA retirement plans; Keogh retirement plans; employee benefit contributions paid by an employer; penalties for early withdrawal of savings; alimony paid and disability income exclusions.

2. In computing the amount of a net operating loss allowable for a particular taxable year, the following modifications must be made:

(i) no deduction may be taken for any net operating loss carried over from another year,

(ii) no deduction is allowed for the personal exemption or exemption for dependents allowed by § 40-18-19, Code of Alabama 1975,

(iii) nonbusiness deductions, including the federal income tax deduction, may not exceed nonbusiness income, and

(iv) the optional standard deduction, if claimed, is considered a nonbusiness deduction and may not exceed nonbusiness income.

(b) Definitions. As used in this regulation, the following terms have the meanings ascribed to them, unless the context clearly indicates otherwise:

1. "NOL" means "net operating loss."

2. "Carryback" means an NOL applied to a year prior to the year in which the NOL occurred.

3. "Carryover" means the excess NOL after a portion of the NOL has been applied to a carryback or carryforward year.

4. "Carryforward" means an NOL applied to a year subsequent to the year in which the NOL occurred.

5. "Intervening Year" means a year between the earliest year to which an NOL can be carried back and the year in which the NOL occurred.

6. "Loss Year" means the year in which an NOL occurred.

(2) Application of an NOL Carryback.

(a) For loss years beginning after December 31, 1997, an NOL may be carried back and deducted from taxable income in each of the preceding two years or until exhausted.

(b) NOL Carrybacks.

1. When an NOL is carried back to a prior year, taxable income will be recomputed in such prior year as specified in subparagraphs (i), (ii), and (iii) below.

(i) If the NOL being carried back is equal to or greater than taxable income as previously reported or last adjusted (including any deductions for NOLs carried over or carried back to such year from any loss year prior to the current loss year), taxable income will be reduced to zero. See paragraph (5) below for the computation of any remaining NOL for carryover to a subsequent year. See subparagraph 3 for refund procedures.

(ii) If the NOL being carried back is less than taxable income as previously reported or last adjusted (including any deductions for NOLs carried over or carried back to such year from any loss year prior to the current loss year), taxable income for the carryback year is reduced by the amount of the NOL.

(iii) The NOL carryback reduces adjusted gross income, and therefore, will affect those deductions which are based on or limited by a percentage of adjusted gross income.

(I) The limitation on contributions will be reduced.

(II) The amount of medical expenses exceeding 4% of adjusted gross income may increase.

(III) If the optional standard deduction is elected, the amount will be computed by applying the appropriate percentage to adjusted gross income after subtracting the NOL carryback.

2. Recomputation of Tax in a Carryback Year. The appropriate rates for the carryback year will be applied to the amount of taxable income after subtraction of the NOL deduction.

3. Refund Procedures.

(i) To apply an NOL carryback and to request any refund due, complete Form NOL-85A and attach it to Form 40X (Amended Alabama Individual Income Tax Return) for each year to which the carryback is being applied.

(ii) Limitations on Refund Claims. A claim for refund of tax based on an NOL carryback must be filed within three (3) years, including extensions, from the due date of the loss year return.

(I) If the taxpayer has an NOL and fails to claim the NOL carryback within three years, including extensions, from the due date of the loss year return, no refund will be made based on the NOL carryback. The taxpayer will be allowed to carry any available loss forward.

(II) After computing the carryback and reducing the loss available by the taxable income and required modifications for all of the carryback years, a loss may still be available to be carried forward. If so, the remaining available loss may be claimed in the first year following the loss year, providing the loss is claimed when the return is filed for the carryforward year as described in paragraph (4).

4. No deduction will be allowed in any carryback year which has been closed by expiration of the statute of limitations or by final assessment prior to the application of the carryback.

(3) Election to Relinquish the Entire Carryback Period.

(a) A taxpayer may elect to forego the carryback period of an NOL.

(b) If such an election is made, the NOL will then be carried forward to the first available year following the loss year. The carryforward period limitation of fifteen (15) years is not extended if an election is made to forego the carryback period.

(c) For loss years beginning after December 31, 1997, the election to forgo the carryback period can be made in one of two ways. The election can be made on or before the due date (with extensions) for filing the income tax return for the loss year. If no election is made by the due date of the loss year return, then the filing of the next year=s return by the due date, including extensions, and claiming the loss on the return shall be considered the taxpayer's election to forgo the carryback period. The election, once made, is irrevocable.

(d) If a proper election to forego the carryback period is not made, or not timely made, the NOL must be carried back to the earliest year preceding the loss year in which the NOL may be utilized (e.g., a 1998 NOL must be carried back to 1996). Any unused NOL may be carried to the next earliest preceding year, in order.

(4) Application of an NOL Carryforward to a Year After the Loss Year.

(a) Eligible Carryforward Years. An NOL may be carried forward to years subsequent to the loss year in order of time or until exhausted, whichever occurs first; subject to the following limitations:

1. To each of the fifteen tax years following the loss year.

2. No deduction will be allowed in any carryforward year which has been closed by expiration of the statute of limitations or by final assessment prior to the application of the carryforward.

(b) Computation of Taxable Income.

1. If the NOL being carried forward is equal to or greater than taxable income, taxable income will be reduced to zero. Taxable income is computed without considering the current NOL carryover to be applied, but will reflect any prior carryovers which have been applied. See paragraph (5) below for the computation of any remaining NOL for carryover to a subsequent year.

2. If the NOL being carried forward is less than taxable income (computed without considering the NOL deduction to be applied), adjusted gross income will be reduced (but not below zero) by the amount of the NOL carryforward.

(i) The NOL carryforward reduces adjusted gross income, and therefore, will affect those deductions which are based on or limited by a percentage of adjusted gross income.

(I) The limitation on contributions will be reduced.

(II) The amount of medical expenses exceeding 4% of adjusted gross income may increase.

(III) If the optional standard deduction is elected, the amount will be computed by applying the appropriate percentage to adjusted gross income after subtracting the NOL carryforward.

(5) Computation of any Remaining NOL Carryover After Application of an NOL.

(a) In order to determine the amount of an NOL available for carryover, certain adjustments must be made to the taxable income for the year in which the deduction was taken. The amount by which the NOL will be reduced is called "modified taxable income."

(b) The modifications required by law provide that no deduction is allowed for:

1. the personal exemption provided in § 40-18-19(a)(6), and

2. the deduction for dependents provided in § 40-18- 19(a)(7).

(c) These modifications are applied after all prior adjustments or modifications have been made to adjusted gross income and/or taxable income in the year to which the NOL is being applied.

1. If a prior NOL carryback or carryover was fully absorbed in the year, and a subsequent NOL is carried to the year and cannot be fully absorbed, the modifications required in subparagraph (a) above would be computed after taxable income has been recomputed for the year.

2. If the subsequent NOL can be fully absorbed, after taxable income has been recomputed for the prior NOL, taxable income for the year must be recomputed, with adjusted gross income reduced again for the subsequent NOL.

(6) Special Rules.

(a) Joint Returns.

1. In general, in the case of a husband and wife who file a joint income tax return for any taxable year in which an NOL occurs, the loss is to be computed on the basis of the combined income and deductions of both spouses, and the modifications required are to be computed as if the combined income were the income of one individual. However, if separate returns were filed for any of the carryback years, the NOL must be computed as if separate returns were being filed in the joint loss year.

2. Special rules are necessary when there is a change in the status of the spouses due to marriage, divorce or death.

(i) An NOL sustained after or prior to a marriage cannot be used to reduce the taxable income of a former or future spouse, even though a joint return was filed for the carryback and/or carryforward year. The NOL can only be applied to the separate income of the spouse which incurred the loss.

(ii) If there is a change in marital status due to the death of a spouse:

(I) and in a succeeding year the survivor sustains an NOL, the loss may be carried back only to that portion of the income reported on a joint return previously filed with the decedent which is allocated to the survivor.

(II) and a joint return is filed for the year of death of the spouse and an NOL was sustained -

I. the loss may be carried back to a year in which the decedent filed a joint return with the surviving spouse, and/or

II. the loss allocated to the deceased spouse may be carried back to a year in which the decedent filed a separate return.

A. Any NOL allocated to a deceased spouse not utilized in subsentence II, above, may not be carried forward.

(b) Reduction for Allowable NOL, Whether or Not Claimed.

1. An NOL carryback or carryover will be reduced by the amount available for use, whether used or not. For instance, if a taxpayer neglects to claim an NOL carryback within the prescribed time limit, the amount of loss available for carryover to other years will be reduced by the amount that could have been carried back but was not claimed.

2. If the loss was available for use prior to the final assessment, the remaining NOL must be reduced by the amount that was available for use before the final assessment.

(c) NOLs of Nonresidents.

1. In general, nonresidents are allowed the same deduction for NOLs as the deduction allowed to residents, except that the loss must be attributable to sources in Alabama, and is applied to income attributed to Alabama. The computation of the loss, as applied to Alabama source income, is made as provided in paragraph (1) above. The deduction for a carryback is computed as provided in paragraph (2) above. The deduction for a carryover is computed as provided in paragraph (4) above. The computation of any remaining carryover of an NOL that cannot be fully absorbed is computed as provided in paragraph (5) above.

2. A number of deductions allowed nonresidents, including the personal exemption and exemption for dependents, are limited based on the ratio of income from Alabama sources to income from all sources. When an NOL is fully absorbed, these deductions must be recomputed based on the changes to Alabama income and total income after the NOL is applied.

Authors: Ann F. Winborne, CPA; Brenda J. Russ; Jason B. Overby; Harold A. McKinnon; and Ed Cutter, CPA.

Authority: Sections 40-2A-7(a)(5) and 40-18-15.2, Code of Alabama 1975.

History: New rule: Filed February 1, 2001, effective March 8, 2001.

RULES OF THE

DEPARTMENT OF REVENUE

CHAPTER 810-3-16

Basis for Depreciation and Depletion

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810-3-16-.01. Basis for Depreciation and Depletion.

(1) The basis upon which depreciation and depletion shall be computed is the adjusted basis for determining gain on the sale or disposition of the property, (including any taxes required to be capitalized in connection with the acquisition of a capital asset), as determined under Sec. 40-18-6, except that at the option of the taxpayer:

(a) In the case of mines, or oil and gas wells, depletion may be computed based on discovery value, if the conditions of Code Section 40-18-16(b)(2) are met. (See Reg. 810-3-15-.06(6)).

(b) In the case of oil and gas wells only, for taxable years beginning on or after January 1, 1953, a taxpayer may deduct for depletion an amount equal to 27 1/2% of the gross income from the property during the taxable year, computed on the same basis and subject to the same limitations as provided in the Federal Income Tax Act in effect on September 17, 1953, the effective date of Act No. 719 - 1953 General Acts of Alabama. These limitations on the amount of percentage depletion which may be deducted are:

1. the amount may not be more than fifty percent of the net income from the property before the deduction for depletion, and

2. the amount may not be less than the depletion computed under the cost method.

(2) An election once exercised to claim depletion on the discovery basis or on the percentage basis is irrevocable, and the depletion allowance in respect to each property will for all succeeding tax years be computed in accordance with the election so made. The election to use percentage depletion may be made only with respect to oil and gas wells.

(3) Depreciation and depletion must be charged off on the taxpayer's books, or suitable subsidiary records must be kept to show the basis of the depletable property together with capital additions and all other adjustments. After depreciation or depletion to the extent __ 100 percent of the cost or other income tax basis of the depreciable or depletable assets has been allowed, no further deduction will be permitted, except with respect to depletion when the percentage method is used. Land is not subject to a deduction for depreciation.

(Adopted September 30, 1982; amended February 8, 1989, filed with LRS March 20, 1989, effective April 24, 1989)

Authors: George E. Mingledorff, III
Income Tax Division

Auth: § 40-18-16

810-3-16-.02. Allowable Capital Additions, Mines and Oil and Gas Wells.

(1) All expenditure in excess of net receipts from minerals sold shall be charged to capital account recoverable through depletion while the mine is in the development stage. The mine will be considered to have passed from a development to a producing status when the major portion of the mineral production is obtained from workings other than those opened for the purpose of development, or when the principal activity of the mine becomes the production of developed ore rather than the development of additional ores for mining.

(2) Expenditures for plant and equipment and for replacements, not including expenditures for maintenance and for ordinary and necessary repairs, shall ordinarily be charged to capital account recoverable through depreciation. Expenditures for equipment (including its installation and housing) and for replacements thereof, which are necessary to maintain the normal output solely because of the recession of the working faces of the mine, and which

(a) do not increase the value of the mine, or

(b) do not decrease the cost of production of mineral units, or

(c) do not represent an amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made, shall be deducted as ordinary and necessary business expenses.

(3) Intangible drilling and development cost, such as wages, fuel, repairs, supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of oil or gas, may, at the option of the operator, be deducted from gross income as an expense or charged to capital account. If the taxpayer charges such expenditures as fall within the option to capital account, the amounts so capitalized and not deducted as a loss are returnable through depletion insofar as they are not represented by physical property, and if represented by physical property through depreciation. Expenditures for clearing ground, draining, road making, surveying, geological work, excavation, grading, and the drilling, shooting and cleaning of wells are not considered to be represented by physical property; but expenditures incurred in the installation of casing and equipment and in the construction on the property of derricks and other physical structures are represented by physical property.

(a) If the operator has elected to capitalize intangible drilling and development costs, such costs incurred in drilling a nonproductive well may be deducted as a loss at the election of the taxpayer; but such election must be consistently followed.

(b) The option with respect to intangible drilling and development costs does not apply to expenditures by which the taxpayer acquires property ordinarily

considered as having a salvage value. The option does not apply to any expenditure for wages, fuel, repairs, hauling, supplies, etc., in connection with equipment, facilities, or structures, not incident to or necessary for the drilling of wells, such as structures for storing or treating oil or gas. These are capital items and are returnable through depreciation. Expenditures in connection with the operation of the wells and of other facilities on the property for the production of oil or gas must be charged off as expense.

(Adopted September 30, 1982) §40-18-57

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CHAPTER 810-3-17

Items Not Deductible

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810-3-17-.01 Items Not Deductible

810-3-17-.01. Items Not Deductible.

(1) Costs and expenses which are not deductible for income tax purposes include, but are not limited to:

(a) Personal, living, and family expenses such as:

1. Premiums paid for life insurance by the insured.

2. Cost of insuring a dwelling owned and occupied by the taxpayer as a personal residence.

3. Expenses of maintaining a household, including amounts paid for rent, water, utilities, domestic services, etc.

4. Expenses incurred for care of dependent children, even if both spouses work.

5. Losses sustained by the taxpayer upon the sale or other disposition of property held for personal, living, and family purposes.

6. Travel expenses or automobile expenses not deductible under Sec. 40-18-15.

7. Cost of wearing apparel unless such wearing apparel is required as a condition of employment and is not suitable for street wear.

8. Amounts paid as damages, attorneys' fees and other costs of suit to recover such damages. However, damages in settlement of a suit, claim or judgement arising out of a trade or business or transactions entered into for profit are deductible.

9. Attorneys' fees paid in a suit for separation or divorce.

10. Losses sustained and expenses incurred in illegal transactions.

11. Dues to fraternal and social organizations, etc.

12. Gambling losses in excess of gains.

13. Job hunting expenses, other than fees paid to employment agencies.

14. Adoption expenses for tax years prior to January 1, 1991 are not deductible. For tax years subsequent to December 31, 1990, see Reg. 810-3-15-.23.

(b) Capital expenditures. No deduction shall be allowed for:

1. Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate, or

2. Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made in the form of a deduction for depreciation, amortization, or depletion.

(c) Premiums paid on life insurance. Premiums paid on a life insurance policy covering the life of any officer or employee of the taxpayer, or any person (including the taxpayer) who is financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary of the policy.

(d) Organization and financing expenses.

1. For tax years beginning January 1, 1985, Expenses in connection with the organization or reorganization of a business enterprise, such as fees for incorporating, attorneys, accountants, and appraisers, and commissions or other expenses in the issuance or sale of capital stock are properly capitalized when incurred or paid. Such expenses are not deductible from gross income until the business for which the expenses were incurred is abandoned and the business organization itself, or, in the case of a reorganization the successor to the business organization, has been dissolved, or has completely wound up its affairs, whichever is later.

2. For tax years beginning after December 31, 1984, organizational expenditures incurred by a corporation may be amortized over a period of not less than 60 months. See Reg. 810-3-35-.01(7).

3. For tax years beginning after December 31, 1989, certain startup costs may, if the taxpayer so elects, be amortized over a period of not less than 60 months even if the costs do not qualify for amortization as organization fees. See Reg. 810-3-15-23.

(e) Amortization of bond premiums. Premiums paid on bonds purchased by individuals are part of the cost of such bonds, and no portion of such premiums will be allowed as a deduction from gross income until the bonds are sold or redeemed. An exception to this general rule occurs in the case of estates and trusts where the trustee has no alternative other than to protect the corpus of the estate or the trust. In such cases the Department will permit the premium to be amortized over the life of the bond.

(f) Fines and penalties.

1. Fines imposed for violations of law, or penalties imposed for legal infractions, misconduct or failure to adequately or timely comply with laws or regulations are not deductible. Such nondeductible items include:

(i) penalties for late payment or nonpayment of taxes.

(ii) punitive damages imposed by a court for violations of civil or criminal laws (including overweight or speeding fines or penalties).

2. "Penalties" imposed by contract as liquidated damages are deductible. Such items include:

(i) penalties for early withdrawal of savings certificates.

(ii) penalties for failure to complete a construction contract within a specified time.

Author: Mary L. Gifford
Authority: §40-18-17, Code of Alabama 1975
History: Filed with LRS July 22, 1992, certification filed with LRS October 30, 1992, effective December 4, 1992

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CHAPTER 810-3-19

Exemptions - Generally

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810-3-19-.01. Exempt Retirement Allowances.

(1) Income received from retirement systems that is totally exempt from Alabama income tax is as follows:

(a) Retirement allowances, pensions, annuities, or optional allowances paid by Alabama Teachers' Retirement System, the Alabama Judicial Retirement System, and the Alabama Employees' Retirement System and

(b) retirement annuities paid under the United States Retirement System to civil service employees from the United States government civil service retirement and disability fund including income received from the Tennessee Valley Authority's pension system, income received as annuities under the United States foreign service retirement and disability fund or income received from any other United States government retirement and disability fund.

(c) amounts received under the Federal Social Security Acts.

(d) retirement annuities paid under the provisions of the Federal Railroad Retirement Act of 1935, 1937, and 1974.

1. The exclusion from Railroad Retirement Act benefits includes both tier one and tier two benefits.

(e) military retirment (see §40-18-20).

(f) For tax years beginning after December 31, 1990 any retirement compensation, retirement allowances, pensions and annuities, or optional allowances received by any eligible peace officer, as defined in Section 36-21-60(10), or his/her designated beneficiary, from any police retirement system established in the state of Alabama, but only if such retirement compensation, retirement allowances, pensions and annuities, or optional allowances are awarded as a result of police services rendered.

1. An eligible peace officer as defined in Section 36-21-60(10) is:

"A person duly sworn as a peace officer of the state of Alabama possessing powers of arrest and employed by the state, any political subdivision thereof or any municipal corporation therein who is required by the terms of his employment, whether such employment exists by virtue of election or appointment, to give his full time to the preservation of public order and the protection of life or property or the detection of crime in the state. Such terms shall include enforcement officers for conservation laws and full-time coroners, but shall not include any pardon, parole or probation officer, district attorney, assistant district attorney, assistant attorney general, commissioner, deputy commissioner or any municipal inspector, county inspector or state inspector."

(g) For tax years beginning after December 31, 1990, any retirement compensation, retirement allowances, pensions and annuities, or optional allowances, received by any eligible firefighter, as defined in Sections 36-32-1 and 36-32-2, or his/her designated beneficiary, from any firefighting agency established in the state of Alabama, but only if such retirement compensation, retirement allowances, pensions and annuities, or optional allowances are awarded as a result of fire protection services rendered.

(2) Income from retirement systems that is partially exempt from Alabama income tax is as follows:

(a) For tax years beginning after December 31, 1983 and before January 1, 1991, the first $8,000.00 of retirement compensation, retirement allowances, pensions and annuities, or optional alowance received by any eligible peace officer, or his/her designated beneficiary, from any police retirement system established in the State of Alabama, but only if such retirement income was awarded as the result of police services as defined in Sections 36-21-60(10) and 40-18-19 and Regulation 810-3-19-.01(1)(f).

(b) For tax years beginning after December 31, 1986 and before January 1, 1991, the first $8,000.00 of retirement compensation, allowances, pensions and annuities or optional allowances received by an eligible fire fighter (as defined in §§36-32-1 and 36-32-2), or his/her designated beneficiary, from any fire fighting agency established in this state, but only if such amounts are awarded as a result of fire protection services rendered.

(3) Retirement pay annuities received by a retired employee from any retirement system not listed in the preceding paragraphs are subject to tax after recovery of the taxpayer's investment in the system. The taxpayer's investment in the system is the taxpayer's contributions, excluding those allowed as a deduction in determination of Alabama taxable income. Computations, for Alabama purposes, of taxable amounts and the recovery of the taxpayer's investments will be determined in the same manner as used for determining these amounts for federal purposes. Alabama totals will be substituted for federal totals.

Author: Mary L. Gifford, Ann F. Winborne, & Roy Wiggins
Authority: §40-18-19
History: Rule effective October 1, 1982. Amended: Filed July 27, 1988; May 15, 1992.

810-3-19-.02. Personal Exemptions and Credit for Dependents.

(1) (a) General Rule - Resident or Part-year Resident Taxpayers. A single person, or a married person not filing a tax return with their spouse, is entitled to a personal exemption of fifteen hundred dollars ($1,500.00). A head of a family or a married couple filing a joint return is entitled to a personal exemption of three thousand dollars ($3,000.00). If a married couple file separate returns, each must claim a personal exemption of fifteen hundred dollars ($1,500.00).

1. A common law marriage is recognized in Alabama for income tax purposes.

2. Head of Family - years ending before January 1, 1990:

(i) An individual is a head of family within the meaning of §40-18-19 only if he actually supports or maintains in his household one or more dependents (as defined in subparagraph (b)1. below). All of the six factors described below are essential to qualify as head of family:

(I) Taxpayer must be unmarried, and

(II) Taxpayer must provide over fifty percent (50%) of the actual support of the dependent and be entitled to claim the exemption for such dependent on his income tax return, and

(III) The dependent(s) must reside in a household maintained by the taxpayer, and

(IV) The taxpayer must have the right to exercise family control over the dependent(s), and

(V) The taxpayer must be related to the dependent(s) as defined in subpart (b) below and must have a legal or moral obligation to support the dependent(s), and

(VI) The dependent must not have independent means and must be actually dependent upon the taxpayer for support.

(ii) Head of family - years beginning after December 31, 1989. The term "head of family" has the same meaning as "head of household" as described in 26 U.S.C. §2(b) for federal income tax purposes. The judicial and administrative decisions and interpretations of 26 U.S.C. §2(b) will be given due weight in interpreting §40-18-19 as it relates to head of family status.

(I) To be head of family, the taxpayer must be unmarried, or considered unmarried, at the close of the taxable year and not be entitled to claim married filing joint return, as in the year of a spouse's death. The taxpayer is considered not married under 26 U.S.C. §2(b) if --

(A) the taxpayer has been legally separated from his spouse under a decree of divorce or of separate maintenance, or

(B) at any time during the taxable year the taxpayer's spouse was a nonresident alien as recognized for federal income tax purposes.

(II) The taxpayer must maintain as his home a household which also serves as the principal place of abode for any of the following persons--

(A) a son, stepson, daughter, or stepdaughter of the taxpayer, or a descendent of a son or daughter, but only if the son, daughter, stepson, stepdaughter, or descendent is unmarried at the end of the taxable year, except when the taxpayer is entitled to a deduction for the taxable year for the exemption of such son, daughter, stepson, stepdaughter, or descendent, or would be so entitled except that the right to claim such dependent exemption had been relinquished by reason of a signed agreement or court's declaration which provides that the noncustodial parent may claim any deduction allowable for the dependent exemption; or

(B) any other person who is a dependent of the taxpayer, as described in subpart (b), below, if the taxpayer is entitled to a deduction for the taxable year for a dependent exemption for that person, but

(C) if the dependent described in the above provisions would not be a dependent but for --

I. the person has as his principal place of abode the home of the taxpayer and is a member of the taxpayer's household, or

II. the person may be claimed as a dependent under a multiple support agreement as described in 26 U.S.C. §152(c):

then the taxpayer is not entitled to claim the status of head of family.

(III) The father or mother of the taxpayer may qualify the taxpayer as head of family, but only if the taxpayer is entitled to the dependent exemption for the father or mother. The taxpayer must maintain a household which constitutes the principal place of abode of the taxpayer's dependent father or mother, or both, and provide more than one-half of the support of the father or mother. It is not necessary for the taxpayer to reside in the same place of abode as the parent, as is required for other dependents, for the taxpayer to qualify as head of family.

(IV) Maintaining a household for another person is defined as providing more than one-half of the cost of maintaining the home for that person.

(V) Under no circumstances shall the same person be used to qualify more than one taxpayer as the head of family for the same taxable year.

(VI) If, at any time during the taxable year, the taxpayer is a nonresident alien as recognized for federal income tax purposes, the head of family status will not be allowed.

4. Unless otherwise provided (see subparagraph (a)(ii) above), the status of a taxpayer as single, married or head of family will be determined on the last day of the Alabama tax year.

(b) Every taxpayer is entitled to an exemption of three hundred dollars for each person, other than a spouse, who is a dependent of the taxpayer and who received over half of his support from the taxpayer during the calendar year during which the taxpayer's taxable year begins. There is no maximum age limit for a qualifying dependent.

(1) A "dependent" as used in the preceding paragraph is limited to persons having the following relationship to the taxpayer:

(i) son or daughter, or descendant of a son or daughter; or

(ii) stepson or stepdaughter; or

(iii) brother, sister, stepbrother, or stepsister; or

(iv) father or mother or ancestor of either; or

(v) stepfather or stepmother; or

(vi) son or daughter of taxpayer's brother or sister (nephew or niece); or

(vii) a brother or sister of the taxpayer's father or mother (aunt or uncle); or

(viii) son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law.

2. The terms "brother" and "sister" include a brother or sister by the half blood. A legally adopted child of a person shall be considered a child of such person by blood.

3. In the case of the birth or death of a dependent, a full dependency exemption is allowed for the year.

(2) Nonresident Taxpayers,

(a) A nonresident must prorate the personal exemption for dependents listed in paragraph (1) above by the ratio of adjusted gross income from sources within this state to total adjusted gross income from all sources. In such cases, a schedule must be submitted with the return explaining the computation of the personal exemption and the exemption for dependents. See Reg. 810-3-14-.05 for the computation of "total adjusted gross income from all sources."

(b) Married nonresident taxpayers may file a joint return, even if only one had income from Alabama sources. The election to file joint or separate returns is irrevocable after the due date for filing the return. If separate returns are filed each taxpayer must claim his or her own personal exemption.

1. EXAMPLE: Taxpayer is a nonresident having adjusted gross income from sources within the State of Alabama of $5,000.00, and total adjusted gross income (including that from within Alabama) of $30,000.00. He is single and has no dependents. He is entitled to deduct as a personal exemption $250.00 ($1,500.00 x $5,000.00/ $30,000.00 = $250.00).

2. EXAMPLE: Taxpayer and spouse are nonresidents. Taxpayer has income from sources within Alabama of $5,000.00 and total adjusted gross income (including that from within Alabama) of $30,000.00. His spouse has no income. He has two dependents (note that a spouse may not be a dependent).

(i) If a joint return is filed, taxpayer is entitled to a personal exemption of $500.00 ($3,000.00 x $5,000.00/$30,000.00 = $500.00) and exemption for dependents of $100.00 ($600.00 x $5,000.00/$30,000.00 = $100.00).

(ii) If a separate return is filed, taxpayer is entitled to a personal exemption of $250.00 ($1,500.00 x $5,000.00/$30,000 = $250.00) and exemption for dependents of $100.00 ($600.00 x $5,000.00/$30,000.00 = $100.00).

1. EXAMPLE: Taxpayer and spouse are nonresidents. Taxpayer has $5,000.00 adjusted gross income within Alabama and total adjusted gross income of $30,000.00. Spouse has adjusted gross income within Alabama of $10,000.00 and total adjusted gross income of $20,000.00. They have two dependents who must be claimed by the taxpayer if the separate returns are filed, since he had the greater income.

(i) If a joint return is filed, the personal exemption will be $900.00 ($3,000.00 x $15,000.00/$50,000.00 = $900.00). The exemption for dependents will be $180.00 ($600.00 x $15,000.00/$50,000.00 = $180.00).

(ii) If a separate return is filed,

(I) The taxpayer's personal exemption will be $250.00 ($1,500.00 x $5,000.00/$30,000.00 = $250.00). Exemption for dependents will be $100.00 ($600.00 x $5,000.00/$30,000.00 = $100.00).

(II) Spouse's personal exemption will be $750.00 ($1,500.00 x $10,000.00/$20,000.00 = $750.00).

4. EXAMPLE: Taxpayer and spouse are nonresidents. Taxpayer has $5,000.00 adjusted gross income within Alabama, and total adjusted gross income of $30,000.00. Spouse has no adjusted gross income in Alabama and total adjusted gross income of $10,000.00. They have one dependent who is claimed by the taxpayer if he files a separate return.

(i) If a joint return is filed the personal exemption will be $375.00 ($3,000.00 x $5,000.00/$40,000.00 = $375.00). Exemption for dependents will be $37.50 ($300.00 x $5,000.00/$40,000.00 = $37.50).

(ii) If a separate return is filed the personal exemption will be $250.00 ($1,500.00 x $5,000.00/$30,000.00). Exemption for dependents will be $50.00 ($300.00 x $5,000.00/$30,000.00 = $50.00).

(3) Special Rules.

(a) If a taxpayer is a resident for part of the tax year, and also a nonresident for part of the tax year, the personal exemption and/or exemption for dependents will be allowed in full on the return as a part-year resident. In such cases, no deduction will be allowed for the personal exemption and/or exemption for dependents on the nonresident return.

(b) 1. In the event a taxpayer makes a change in the tax year (from calendar year to fiscal year, from fiscal year to calendar year, or from one fiscal year to another fiscal year) as provided in §40-18-30, the deduction for the personal exemption and/or for dependents must be prorated for each year that is less than twelve months by the ratio of the number of months in the tax year divided by twelve. No proration is required if the change in the tax year is caused by the death of the taxpayer.

2. For example, if a taxpayer changes from a calendar year to a fiscal year ending June 30th., the maximum allowable deduction for the personal exemption would be $750.00 for a single person (6/12 x $1,500.00 = $750.00) or $1,500.00 for a married couple or head of family (6/12 x $3,000.00 = $1,500.00), for the 6-month short-period following the change.

(c) In no event may any combination of status as a resident or nonresident, or as single, married, or head of family, result in a deduction for personal exemption of more than $1,500.00 for one individual, $3,000.00 for a married

couple, or $3,000.00 for a head of family in any one tax year; nor more than $300.00 for each individual dependent for any one tax year.

(d) The terms "dependent exemption" and "exemption for dependent": as used in this and other regulations, as well as the forms used for filing Alabama income tax returns, shall mean that deduction referred to as "credit for dependents" in §40-18-19(b), Code of Alabama 1975.

Author: Anne Simms & Ann F. Winborne
Authority: §40-18-19
History: Rule effective October 1, 1982. Filed with LRS October 21, 1991.
Amended: Filed May 15, 1992 effective June 19, 1992.

810-3-19-.03. Income Realized from a Financial Business.

(1) Net income realized in conducting a business subject to the excise tax on financial institutions imposed by Sections 40-16-1, et seq., and where such excise tax is paid, is excluded from gross income under the provisions of Chapter 18 of Title 40.

(2) Salaries paid by businesses subject to the financial institution excise tax, allowed as deductions to such businesses under Sec. 40-16-1(2)(a) are included in gross income of the recipient for income tax purposes under Chapter 18.

(Adopted September 30, 1982; Amended: June 17, 1988; Filed with LRS: July 27, 1988)

Authors: Rebecca S. Whisenant
and John H. Burgess
Income Tax Division

Auth: § 40-18-19

810-3-19-.04 Defined Benefit Plans.

(1) Effective January 1, 1991, payments made on or after such date to a retiree or his designated beneficiary under a "defined benefit plan," as defined by IRC §414(j), as amended from time to time, to the extent such payment would be taxable for federal income tax purposes.

(2) A "defined benefit plan" is any plan that is not a "defined contribution plan." A "defined contribution plan" is a plan that provides an individual account for each participant and for benefits based solely on the amount contributed to the participant's account, and for income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participants' accounts. This includes plans such as profit sharing, stock bonus, and money purchase pension plans. These plans "could" be Keogh, SEP, or IRA plans. In a "defined contribution plan" such as a money purchase plan, contributions will be specified (not based on profits) and the benefits are whatever these contributions will provide. "Defined benefit plans" may include pension and annuity plans, but all plans are to necessarily "defined benefit plans." A "defined benefit plan" is one in which the contributions are based on a computation of what contributions are needed to provide definitely determinable benefits to plan participants. That is, contributions are dependent on promised benefits. Contributions to the plan are actuarially calculated to provide the promised benefits.

(3) (a) A lump-sum distribution, received by a retiree from a defined benefit plan, which is rolled over into another type of retirement plan or account is not taxable and is considered as basis in the new account.

(b) Distributions rolled into an individual retirement account (IRA) are not deductible as an adjustment to income.

(c) Any earnings or income produced by the amount invested in another plan or account represents taxable income. The taxable portion of distributions from the account is computed pro rata, similar to nontaxable IRA distributions.

(4) A lump-sum distribution from a defined benefit plan, received by a person who is not retired, is taxable as an early distribution unless the distribution is rolled over into another plan.

(5) Benefits received from nonqualified excess benefit plans or supplemental employment retirement income plans (SERP's) are taxable. Excess or supplemental benefits which exceed the limits set by the Internal Revenue Code are not considered as tax exempt benefits received from a defined benefit plan.

(6) Where a combination of plans exists requiring the benefits from a defined benefit plan to be reduced, distributions in excess of the amount distributed

from the defined benefit plan are taxable. Even though the recipient could have received more from the plan had a combination of plans not existed, only the amount actually distributed from the defined benefit plan is exempt from tax.

Author: Anne Simms and Ann Winborne, Income Tax Division
Authority: §40-18-19, Code of Alabama 1975
History: Rule effective October 1, 1982. Amended: Filed July 27, 1988; filed May 15, 1992, effective June 19, 1992

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CHAPTER 810-3-21

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810-3-21-.01 Credit for Taxes Paid to Another State or Territory.

(1) For all taxable years beginning after the Multistate Tax Compact became effective in 1977, and taxable years beginning before January 1, 1997, resident taxpayers, including individuals, engaged in multistate business in such a manner as to subject their income to allocation and apportionment provided by the Multistate Tax Compact were not allowed a credit for taxes paid to other states or territories. For tax years beginning after December 31, 1996, resident individuals are not required to allocate and apportion income and the credit for taxes paid to other states and territories, as provided in this section, is allowable for all individuals.

(2) See Reg. 810-3-162-.01 for credit allowed to shareholders of an Alabama S corporation for taxes paid by the shareholders to other states on S corporation earnings.

(3) For all individuals with taxable years beginning after December 31, 1996:

(a) Any Alabama resident individual with gross income from sources outside Alabama which is includible in Alabama gross income and also in another state or a territory of the United States, is entitled to a credit against the income tax due to Alabama, as described below.

I. The amount of credit will be the lesser of the amount of income tax actually paid to another state on the same income, or the tax computed on the same taxable income in the other state using Alabama tax rates.

(i) When income tax is paid to more than one other state, the tax credit must be computed separately for each state.

(ii) When a state allows credits against its tax in lieu of exemptions, the taxable income in that state will be determined after a deduction computed by converting the credit at the lowest rates applicable in that state.

(I) EXAMPLE: Taxpayer, a resident of Alabama, has taxable income in Alabama, in State X and in State Y. Taxpayer is filing a joint return with his spouse.

| | Taxable Income | Tax on Taxable Income | Tax on Taxable Income at Alabama Rates | Credit Allowable |
|---|---|---|---|---|
| State X | $ 9,000 | 500.00 | 373.00 | 373.00 |
| State Y | 4,000 | 60.00 | 142.00 | 60.00 |

| | | | |
|---|---|---|---|
| Alabama | 23,000 | 1,073.00 | |
| Total credit allowable | | | 433.00 |

| | |
|---|---|
| Total Alabama income tax | $1,073.00 |
| Less credit for tax paid to other states | 433.00 |
| Tax due Alabama | $ 640.00 |

(II) EXAMPLE: Taxpayer, a single individual and a resident of Alabama, has gross gambling income of $50,000 and $50,000 gambling losses in State A. State A only allows a deduction for a percentage of gambling losses ($30,000 in this example) but Alabama allows a deduction for gambling losses up to the amount of gambling income ($50,000 in this example). Taxpayer pays tax to State A on $20,000 net gambling income but does not pay tax to Alabama on any gambling income. In this situation, there is no credit for tax paid to State A because the net income from gambling on the Alabama return is zero and, therefore, there is no double taxation.

(III) EXAMPLE: Same situation as (II) above, except gambling losses are $40,000, with a net taxable income from gambling of $10,000 on the Alabama return and $20,000 in State A. In this instance, the credit allowed will be the lesser of tax at the Alabama rate on $10,000 or tax in State A on $10,000. Credit is allowed for tax on $10,000 only because this is the amount of income that otherwise would be subject to double taxation without the credit.

2. Credit for taxes paid other states will be administratively applied as if payment were made on the due date of the applicable return against any liability due Alabama. The amount of any estimated taxes due under § 40-18-82 will be reduced by the amount of any credit allowed under this regulation.

(b) A resident claiming the credit for taxes paid to another state must attach to his Alabama income tax return a copy of each nonresident return filed showing the amount of the tax payment-claimed as credit. The Department may require a certified copy of the return or a certificate showing the amount of tax paid.

(c) The credit is allowed to a taxpayer who reports on the cash basis even though the tax due to another state was not actually paid during the year for which the credit is claimed, as long as the tax is actually paid to the other state. The credit is allowed only on the return for the year in which the income is taxable by the other state. For instance, a credit will be deducted on a 1997 return for tax due on 1997 income which is payable in 1998.

(d) If a resident individual is included in a joint return in another state, the Alabama credit allowable for taxes paid the other state must be apportioned to each individual. The allowable share will be a fraction, the numerator of which is

the tax the individual would have paid the other state on his separate income, and the denominator of which is the total amount that each would have paid the other state; applied to the tax liability due the other state. If either individual has a negative or zero tax liability, no credit will be allowed that individual. The allowable credit in any instance will not be more than the amount due at Alabama rates.

(e) Taxable income of a nonresident includes only income derived from sources within the state, and therefore, no credit is allowable for taxes paid to other states.

Author: Rebecca S. Whisenant.
Authority: §40-18-21, Code of Alabama, 1975.
History: Adopted September 30, 1982.
Amended: Filed October 26, 1988, effective December 2, 1988.
Amended: Filed March 26, 1998, effective April 30, 1998.
Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-21-.02 Credits for Job Development Fees.

(1) Any taxpayers who is subject to the personal income tax imposed by Section 40-18-2 and has had a Job Development Fee withheld from the taxpayer's wages by an Approved Company pursuant to Section 41-10-44.8(b) is allowed a credit against the taxpayer's state personal income tax liability for the year in which the Job Development Fee has been withheld. The credit is allowed to the taxpayer in an amount equal to the Job Development Fee withheld from the taxpayer's wages by the Approved Company during such year.

(a) The Job Development Fee credit allowed pursuant to paragraph (1) above shall be included in computing the taxpayer's total withholding tax liability pursuant to Section 40-18-71.

(b) In the event that the Job Development Fee withheld from a taxpayer's wages during the year by an Approved Company exceeds the taxpayer's state personal income tax liability for such year, the taxpayers shall be entitled to a refund. Such refund shall be issued to the taxpayer by the Department in an amount equal to the difference between the taxpayer's state personal income tax liability and the Job Development Fee withheld from the taxpayer's wages by the Approved Company.

Authors: Tina M. Melancon and Ann F. Winborne
Income Tax Division
Authority: Section 40-18-21 and Act 93-852, Code of Alabama 1975
History: New rule filed: August 26, 1994, effective September 30, 1994.

RULES OF
DEPARTMENT OF REVENUE

CHAPTER 810-3-24

Taxation of Partnerships

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810-3-24-.01 Taxability of Partnership Income.

(1) (a) A partnership is considered to be a "conduit" of income to each partner and not a taxable entity under Alabama income tax law.

(b) The term "partnership" includes a limited partnership as well as a general partnership, and a syndicate, group, pool, or joint venture which is not a corporation, estate, trust or sole proprietorship within the meaning of the Alabama income tax law.

(c) The term "partner" means any person who is a member of a partnership.

(d) The term "person" as used in this regulation includes an individual, corporation, fiduciary or another partnership.

(2) A partnership, once established, continues until:

(a) no part of any business, financial operation or venture of the partnership continues to be carried on by any of its partners as a partnership, or

(b) 50% or more of the total interest in partnership capital and profits is sold or exchanged within a period of twelve consecutive months.

(3) (a) Each partner shall include in gross income from all sources, the distributive share of the income (or loss) of a partnership for any partnership year ending within the partner's taxable year. For an Alabama resident, this amount will also be included in Alabama gross income.

(b) Each nonresident partner shall include in Alabama gross income the distributive share of partnership income (or loss) attributable to Alabama as provided in Reg. 810-3-24-.02(2). For the purpose of apportioning deductions based on the ratio of Alabama adjusted gross income to total adjusted gross income, total adjusted gross income will include the nonresident partner's full share of the partnership income, and not just the portion attributable to Alabama.

(4) The Internal Revenue Code contains provisions similar to those in § 40-18-24. The Department will consider administrative rulings and judicial decisions in respect to the similar provisions of federal law and regulations in interpreting this regulation.

(Adopted September 30, 1982; amended February 8, 1989, filed with LRS March 20, 1989, effective April 24, 1989)

Authors: Ecta Spicer, Roy Wiggins and John H. Burgess

Auth: § 40-18-24

Income Tax Division

810-3-24-.02 Computation of Partnership Income (or Loss).

(1) The net income of a partnership is computed in the same manner as that of an individual, except:

(a) no deduction is allowed for a personal exemption or credit for dependents as provided in § 40-18-19, and

(b) no deduction is allowed for charitable contributions or gifts made in accordance with § 40-18-15(a)(10), and

(c) no deduction is allowed for a net operating loss carryback or carryforward as provided in § 40-18-15(a)(16), and

(d) no deduction is allowed for the additional itemized deductions provided for individuals in § 40-18-15, and

(e) no deduction is allowed for the optional standard deduction provided in § 40-18-15(b).

(2) A partnership doing business in Alabama and at least one other state must compute income attributable to Alabama in the manner provided in Reg. 810-3-31-.02 for foreign corporations.

(Adopted: June 17, 1988; Filed with LRS: July 27, 1988)

Authors: Ecta Spicer, Roy Wiggins and John H. Burgess
Income Tax Division

Auth: § 40-18-24

810-3-24-.03 Partner's Distributive Share of Partnership Income (or Loss).

(1) A partner's distributive share of partnership income, gains, losses and deductions shall be determined in accordance with the partner's interest in the partnership (taking into account all facts and circumstances) unless -

(a) the partnership agreement provides otherwise, and

(b) the allocation to a partner in accordance with the partnership agreement is not substantially for the purpose of avoiding or evading taxation under this regulation.

(2) The character of any item of income, gain, loss or deduction included in the partner's distributive share of partnership net income (or loss) shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

(3) (a) A partner's distributive share of partnership net income (or loss) includes any "Guaranteed Payments to Partner" as defined in Reg. 810-3-24-.04. The distributive share is included in gross income of the partner as provided in Regs. 810-3-14-.01 (for residents) and 810-3-14-.05 (for nonresidents) or 810-3-34-.01 (for corporations).

(b) A partner is also entitled to a proportionate share of any contributions made by the partnership which would be deductible under § 40-18-15(a)(10). See Reg. 810-3-15-.17.

(4) A partner's distributive share of partnership loss shall be allowed only to the extent of the adjusted basis (before reduction by the current year loss) of such partner's interest in the partnership at the end of the partnership taxable year in which such loss occurred. If a partner's distributive loss exceeds the adjusted basis in the partnership interest -

(a) the amount of the loss that exceeds the partner's adjusted basis will not be allowed as a deduction for that year, and

(b) any loss disallowed in subparagraph (a) above shall be allowed as a deduction at the end of the first succeeding partnership taxable year and subsequent partnership taxable years to the extent that the partner's adjusted basis in his partnership interest at the end of such year exceeds zero.

(5) In any case where it is necessary to determine the gross income of a partner, such amount shall include his distributive share of the gross income of the partnership.

(Adopted: June 17, 1988; Filed with LRS: July 27, 1988)

Authors: Ecta Spicer, Roy Wiggins
and John H. Burgess
Income Tax Division

Auth: § 40-18-24

810-3-24-.04 Transactions between Partner and Partnership.

(1) A partner who engages in a transaction with a partnership other than in his capacity as a partner shall be treated as if he were not a member of the partnership with respect to such transaction. In all cases the substance of the transaction will govern and not its form. The relationship between a partner not acting in his capacity as a partner and the partnership may include, but is not limited to, that of creditor-debtor, vendor-vendee and employee-employer.

(2) To the extent determined without regard to the income of the partnership, payments to a partner for services or for the use of capital shall be considered as made to one who is not a member of the partnership. Such guaranteed payments to partners shall be treated as a deductible business expense in the computation of the partnership net income.

(3) (a) Gain or loss will be recognized by a partner on a contribution of property to a partnership in exchange for an interest in the partnership to the extent provided in § 40-18-8.

(b) 1. Gain or loss will be recognized by a partnership on a distribution of property to a partner to the extent provided in § 40-18-8.

2. Gain or loss will be recognized by a partner on a distribution of property from a partnership to the extent provided in § 40-18-8.

(Adopted: June 17, 1988; Filed with LRS: July 27, 1988)

Authors: Ecta Spicer, Roy Wiggins and John H. Burgess
Income Tax Division

Auth: § 40-18-24

810-3-24-.05 Partner's Basis in Partnership Interest.

(1) A partnership interest is personal property held for the production of income. A gain or loss from the sale or other disposition of a partnership interest must be recognized to the extent provided in § 40-18-8.

(2) The adjusted basis of a partner's interest in a partnership shall be the amount of property, including money, contributed to the partnership:

(a) increased by the sum of his distributive share (not including any "Guaranteed Payments to Partners") for the taxable year and prior taxable years of;

1. the taxable income of the partnership,

2. the income of the partnership exempt from tax, and

3. the excess of the deductions for depletion over the basis of the property subject to depletion,

(b) decreased (but not below zero) by distributions by the partnership and the sum of his distributive share for the taxable year and prior taxable years of -

1. losses of the partnership, and

2. expenditures of the partnership not deductible in computing its taxable income and not property chargeable to the capital account.

(3) (a) Any increase in a partner's share of the liabilities of a partnership, or any increase in a partner's individual liabilities by reason of the assumption by such partner of partnership liabilities shall be considered as a contribution of money by such partner to the partnership.

(b) Any decrease in a partner's share of the liabilities of a partnership, or any decrease in a partner's individual liabilities by reason of the assumption by the partnership of such individual liabilities, shall be considered as a distribution of money to the partner by the partnership.

(4) (a) If a partner makes a contribution of property subject to a liability to a partnership, and the partnership assumes the liability, the amount of the liability (not exceeding the fair market value of the property at the time of the contribution) will be considered a contribution to the partnership in the amount of the liability that is not allocated to the other members of the partnership.

(b) If property subject to an indebtedness is distributed by a partnership to a partner, and the liability is assumed by the distributee, the amount of the liability,

(not exceeding the fair market value of the property at the time of the distribution) will be considered to be a contribution to the partnership in the amount of the liability that had been allocated to the other members of the partnership.

(Adopted: June 17, 1988; Filed with LRS: July 27, 1988)

Authors: Ecta Spicer, Roy Wiggins and John H. Burgess

Auth: § 40-18-24

RULES OF THE
DEPARTMENT OF REVENUE

CHAPTER 810-3-25

Estates and Trusts

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810-3-25-.01 Taxable Income of Estates and Trusts.

(1) The tax imposed by Chapter 18, Title 40, Code of Alabama 1975, shall apply to the income of estates or of any kind of property held in trust, including:

(a) Income received by estates of deceased persons during the period of administration or settlement of the estate;

(b) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;

(c) Income accumulated or held for future distribution under the terms of the will or trust; and,

(d) Income which is to be distributed to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct.

(2) The net income, or taxable income, of an estate or trust is computed in the same manner as that of an individual, with the exception that the deduction for amounts paid or permanently put aside for a charitable purpose shall be allowed to the extent specified in 26 U.S.C. § 642(c). For interpretation of federal statutes adopted by the Alabama legislature, see Rule 810-3-1.1-.01, Operating Rules.

(a) Gross income is computed as provided in § 40-18-14.

(b) Deductions (including net operating loss carrybacks or carryforwards) are allowed as provided in §§ 40-18-15 and 40-18-15.2.

1. Federal estate taxes are an allowable deduction on the fiduciary return of an estate.

(c) Taxable income is reduced by any income properly paid to the beneficiary of the estate of a deceased person which is taxable to the beneficiary.

(d) Taxable income is also reduced by the amount of income identified in paragraph (1)(d), above.

(e) The estate or trust is allowed the same exemption as is allowed a single person under § 40-18-19.

(f) In the case of a trust created by a nonresident or the estate of a nonresident, gross income of such trust or estate includes only amounts which

would be included in the gross income of a nonresident individual as provided in § 40-18-14(4).

Author: Ron Bedsole and Ed Cutter, CPA
Authority: §§40-2A-7(a)(5) and 40-18-25, Code of Alabama 1975
History: Adopted September 30, 1982;
Amended: Filed June 17, 1988, effective July 27, 1988.
Amended: Filed July 26, 1999, effective August 30, 1999.

810-3-25-.04 Estates and Trusts Tax Computation.

(1) Estates and trusts are taxed at the same rate as a single individual - see § 40-18-5(1), Code of Alabama 1975. Those rates are two percent of the first $500.00 of taxable income, four percent of the taxable income in excess of $500.00 and not in excess of $3,000.00, and five percent of taxable income in excess of $3,000.00.

(2) A resident estate or trust that has gross income taxable in Alabama and another state will be allowed a credit for net income taxes paid the other state on such income as provided in §40-18-21. See Rule 810-3-21-.01.

Authors: Ron Bedsole and Ed Cutter, CPA
Authority: §§ 40-2A-7(a)(5) and 40-18-25, Code of Alabama 1975
History: Adopted September 30, 1982.
Amended: Filed June 17, 1988, effective July 27, 1988.
Amended: Filed March 31, 2000, effective May 5, 2000.

810-3-25-.05 Estates and Trusts Beneficiary Taxable Income.

(1) (a) Each beneficiary of a trust or estate shall include in gross income the distributive share, whether distributed or not, of the net income of the trust or estate; except that portion of the estate or trust net, or taxable, income which was taxed as provided in Rule 810-3-25-.01. Income which would be exempt if received directly by the beneficiary shall be exempt if received through a fiduciary.

(b) Each nonresident beneficiary of an estate or trust shall include in Alabama gross income the distributive share, whether distributed or not, of the net income of the trust or estate which is attributable to Alabama sources; except that portion of such trust or estate income which was taxed as provided in Rule 810-3-25-.01.

(2) The amounts distributed to an individual from those trusts described in Rule 810-3-25-.06 subparagraphs (1)(a), (1)(b), (1)(c), and (1)(d) shall be taxable to the distributee in accordance with 26 U.S.C. § 72 in the year in which distributed as if it were an annuity the consideration for which is the amount contributed by the employee.

(a) The individual's cost basis, "the amount contributed by the employee", shall include:

1. Amounts contributed before January 1, 1982, by an individual and/or his spouse to an individual retirement account, bond, or annuity for which no deduction was allowed under § 40-18-15, Code of Alabama 1975.

2. Amounts contributed before January 1, 1982, by a taxpayer to a trust described in § 40-15-25(e) for which no deduction was allowed under § 40-18-15.

3. Amounts contributed before January 1, 1985 to an annuity plan qualifying under 26 U.S.C. §§ 401(k)(2) and 403(b), for which no deduction was allowed under § 40-18-15.

4. The amount included in prior years income by the individual or the trust due to failure to qualify for exempt status.

5. The amount included in the individual's gross income because of a prior distribution that failed to qualify for the "rollover provision" or was included in gross income pursuant to 26 U.S.C. § 408(m) (acquisition of works of art, etc., treated as a distribution).

(b) The cost of the annuity to the recipient is the amount contributed by him or her, and not previously deducted.

1. For annuities which started before January 1, 1985, annuity proceeds are first considered to be a recovery of contributions to the extent of such contributions before being included in gross income of the recipient.

2. For annuities which started after December 31, 1984, but before January 1, 1986, annuity proceeds will be included in gross income in the ratio of expected return in excess of contributions to total expected return; provided however, that recipients of an employee annuity as defined in 26 U.S.C. 72(d) (as in effect before January 1, 1986) will continue to recover all costs first as provided in subparagraph 1., above.

3. For annuities which started after December 31, 1985, annuity proceeds will be included in gross income in the ratio of expected return in excess of contributions to total expected return in the same manner as described in 26 U.S.C. § 72 (as in effect after December 31, 1985).

(c) 1. Lump sum distributions will be included in gross income in the year received. There is no provision in Alabama law for the forward averaging of such distributions.

2. No part of a distribution may be excluded from gross income as a capital gain.

(d) Alabama law, unlike the provisions of 26 U.S.C. § 72, does not impose an additional tax on certain early distributions from trusts described in § 40-18-25(e).

(3) Recipients of distributions from charitable remainder unitrusts and charitable remainder annuity trusts shall include in gross income the amounts specified in 26 U.S.C. §§ 664 (b) (1) and (2).

(4) Distributions from or rollovers to individual retirement accounts described in 26 U.S.C. §§ 408A and 530, shall be taxed to the distributee according to 26 U.S.C. §§408A and 530. See also Rule 810-3-25-.09, Reporting of Roth IRA Conversions for Part-Year Residents.

(5) Distributions from a trust that are not included in gross income of the individual for federal purposes due to the "rollover provisions" of 26 U.S.C.§§ 402, 403, 408, and 409 are excluded from Alabama gross income of the individual. These are:

(a) Qualified stock bonus, pension, or profit sharing plans as described in 26 U.S.C. §401(a), which are exempt under 26 U.S.C. § 501(a), and meet the rollover requirements of 26 U.S.C. § 402,

(b) Employee annuities which meet the requirements of 26 U.S.C. § 404(a)(2), and the rollover requirements of 26 U.S.C. § 403,

(c) Individual retirement accounts that qualify under and meet the "rollover provisions" of 26 U.S.C. § 408, and

(d) Retirement bonds that qualify under 26 U.S.C. §§ 409 or 219 and meet the "rollover provisions" of 26 U.S.C. § 409.

(6) If an employer makes a contribution to a nonexempt trust for an employee and the contribution is nonforfeitable to the employee, it shall be included in the gross income of the employee at the time of the contribution.

(7) If contributions in the preceding paragraph are not nonforfeitable when made but later become nonforfeitable, their fair market value shall be included in the gross income of the employee when they become nonforfeitable.

(8) The income from a revocable trust is taxable income to the grantor unless the trust is irrevocable as to the income, then the income is taxable to the trust or the beneficiary as directed in § 40-18-25.

(a) A loss on the final return of a revocable trust is allowed to pass on to the grantor unless the trust is irrevocable as to income, then the loss is allowed to pass on to the beneficiary.

(b) A loss on an irrevocable trust cannot be passed on to the grantor or the beneficiary.

(9) See also § 40-18-14 for inclusion of trust or estate distributions in gross income.

(10) For interpretation of federal statutes adopted by the Alabama legislature, see Rule 810-3-1.1-.01, Operating Rules.

Authors: Ron Bedsole and Ed Cutter, CPA
Authority: §§ 40-2A-7(a)(5) and 40-18-25, Code of Alabama 1975
History: Adopted September 30, 1982;
Amended: Filed October 26, 1988, effective December 2, 1988.
Amended: Filed March 31, 2000, effective May 5, 2000.

810-3-25-.06 Trusts Exempt from Taxation.

(1) Except as provided in paragraphs (2), (3) and (4) below, the following trusts are exempt from taxation under § 40-18-25, Code of Alabama 1975:

(a) Any qualified trust defined in 26 U.S.C. § 401(a) relating to qualified pension, profit sharing, or stock bonus plans.

(b) A custodial account, an annuity contract, or a contract issued by an insurance company that qualifies under 26 U.S.C.§ 401(f).

(c) An individual retirement account, an individual retirement annuity, or any custodial account that qualifies under 26 U.S.C. § 408(e), 26 U.S.C. § 408A, or 26 U.S.C. § 530.

(d) A retirement bond that qualifies under 26 U.S.C. § 409.

(e) Corporations, as described in 26 U.S.C. § 501(c)(2), organized for the exclusive purpose of holding title to property, collecting income therefrom, and remitting the proceeds, less expenses, to an organization which is exempt under § 40-18-25.

(f) Voluntary employees' beneficiary associations as described in 26 U.S.C. § 501(c)(9).

(g) Local teachers' retirement fund associations as described in 26 U.S.C.§ 501(c)(11).

(h) A trust or trusts forming part of a plan providing for the payment of supplemental unemployment compensation benefits as described in 26 U.S.C. § 501(c)(17).

(i) An organization or trust created exclusively to form part of a qualified group legal services plan or plans, as described in 26 U.S.C. § 501(c)(20).

(j) A trust created exclusively to pay liability insurance premiums for, pay administrative and other expenses of, and pay claims for liability for disability or death due to pneumoconiosis (black lung), as described in 26 U.S.C. § 501(c)(21).

(k) A charitable remainder annuity trust or a charitable remainder unitrust, as those terms are defined in 26 U.S.C. § 664, relating to charitable remainder trusts, to the extent provided in 26 U.S.C. § 664.

(l) Corporations and any organization as described in 26 U.S.C. § 501(c)(3).

(2) Feeder organizations, as described by 26 U.S.C. § 502, are not exempt from taxation under § 40-18-25, Code of Alabama 1975.

(3) Organizations not exempt from federal income tax due to the requirements of 26 U.S.C. § 503, relating to requirements for exemption, are not exempt from taxation under § 40-18-25, Code of Alabama 1975.

(4) The unrelated business income of an exempt organization, as defined in 26 U.S.C. § 512, is not exempt from taxation under § 40-18-25, Code of Alabama 1975 . See Reg. 810-3-32-.03.

(5) For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

Authors: J. Ron Bedsole, Nancy Butler, and Ed Cutter, CPA
Authority: §§40-2A-7(a)(5) and 40-18-25, Code of Alabama 1975
History: Adopted September 30, 1982.
Amended: Filed June 17, 1988, effective July 27, 1988.
Amended: Filed March 31, 2000, effective May 5, 2000.

810-3-25-.07 Estates and Trusts, Miscellaneous Information.

(1) Estates and trusts are required to file Alabama Form 41, Fiduciary Income Tax Return, by the 15th day of the fourth month following the close of their calendar or fiscal year.

(2) The fiduciary is required to make and file the return and pay the tax on the taxable income of an estate or trust. If a fiduciary receives income which is to be distributed to a nonresident beneficiary, the fiduciary shall file with his or her return a schedule showing the amount of income distributed to each such beneficiary and the portion thereof which is exempt and the portion which is subject to Alabama tax.

(3) (a) For rules on recognition of gain or loss on transfer of property to or from an estate, trust, or beneficiary, see § 40-18-8, Code of Alabama 1975.

(b) For rules on basis of property transferred to or from an estate, trust or beneficiary, see § 40-18-6.

(4) The Internal Revenue Code contains provisions similar to those of § 40-18-25. Decisions and interpretations of the federal courts and agencies will be given due weight in interpreting this section.

Authors: Ron Bedsole and Ed Cutter, CPA
Authority: §§ 40-2A-7(a)(5) and 40-18-25, Code of Alabama 1975
History: Adopted September 30, 1982;
Amended: June 17, 1988, effective July 27, 1988.
Amended: Filed March 31, 2000, effective May 5, 2000.

810-3-25-.08 Trusts and Estates Net Operating Loss.

(1) A trust or estate may carryover a net operating loss in the same manner as an individual. See Rule 810-3-15-.22.

(a) When a trust or estate has a carryback of a net operating loss that reduces income available for distribution to beneficiaries below the amount that has been distributed, the prior distribution in excess of available income becomes a nontaxable distribution of corpus. If such income was taxed to the beneficiary, an amended Alabama return should be filed.

(b) A trust or estate loss cannot be passed on to the beneficiary except as described in Rule 810-3-25.05(8).

Authors: Ron Bedsole and Ed Cutter, CPA
Authority: §§ 40-2A-7(a)(5) and 40-18-25, Code of Alabama 1975
History: Adopted September 30, 1982.
Amended: Filed June 17, 1988, effective July 27, 1988.
Amended: Filed March 31, 2000, effective May 5, 2000.

810-3-25-.09 Reporting of Roth IRA Conversions for Part-Year Residents.

(1) Taxpayers are allowed to convert an IRA to a Roth IRA in accordance with 26 U.S.C. §408A. Any amount required to be included in gross income as a result of the conversion will be ratably included in gross income over a 4-taxable year period beginning with the taxable year in which the conversion is made.

(2) Part-year residents, reporting in years 1998, 1999, 2000 and 2001, will use the original date of rollover to determine whether the allocated amount will be included as Alabama income.

(a) If an individual becomes an Alabama resident on or before the date of rollover or the anniversary date of the rollover, the allocation for that year will be taxable to Alabama.

(b) If an individual ceases to be an Alabama resident after the date of rollover or the anniversary date of the rollover, the allocation for that year will be taxable to Alabama.

Authors: Nancy Butler, Ronnie Bedsole & Ed Cutter, CPA
Individual and Corporate Tax Division
Authority: Sections 40-2A-7(a)(5) and 40-18-25, Code of Alabama 1975
History: New rule: Filed March 31, 2000, effective May 5, 2000.

RULES OF THE
DEPARTMENT OF REVENUE

CHAPTER 810-3-26

Information from Source of Income

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810-3-26-.01 Information Returns.

(1) All resident payers engaged in a trade or business and making nonwage payments of fifteen hundred dollars ($1,500) or more within a calendar year to any person (whether a resident or nonresident) are required to issue an information return (Alabama Form 99 or federal Form 1099) to the payee and file a copy of such return with the Department. Payments which are required to be reported include all nonwage payments exceeding $1,500 which must be included in the gross income of the recipient under Title 40, Code of Alabama 1975.

(2) Information to be reported. Each Form 99 must include the following information:

(a) The payer's name, address and taxpayer identification (federal employers identification number or social security number),

(b) The payee's name, address and taxpayer identification number,

(c) The amount of payments made during the calendar year, and

(d) The type of payment made during the year.

(3) Forms to be used.

(a) In lieu of Form 99, the following substitutes are acceptable:

1. Form 1099 (copies of any type of federal Form 1099),

2. Computer listings containing all the information required to be included in Form 99, or

3. Magnetic media reports under the Combined Federal/State Information Return Reporting Program. (Under this program, a single magnetic media filing is made with the Internal Revenue Service, and the information required by this Department is extracted by I.R.S. and forwarded to the Department. (No Form 96 summary report is required. Departmental approval to participate in this program is not required. Contact the Internal Revenue Service for approval/instructions.)

(b) Payers who have elected to voluntarily withhold income tax from payments referred to in this section may not participate in the Combined Federal/State Information Return Reporting Program. See Rule 810-3-75-.04 for filing requirements for payers who have voluntarily withheld Alabama income tax.

(4) Filing Dates.

(a) Statement to Payee. On or before January 31 of the year following a nonwage payment, payers shall provide to each payee a completed Form 99 or substitute therefor as described above.

(b) Duplicate to Department. A copy of each Form 99 (or the substitute therefor) and Form 96 or federal Form 1096 (Annual Information Return - Summary Reports of Income Payments of $1,500 or More) must be filed with the Department on or before March 15th of the year following the year in which the payments were made.

(5) Miscellaneous Provisions.

(a) Noncash payments. If payment is made in a form other than cash, the fair market value of the noncash payment is the amount to be reported.

(b) Voluntary withholding. Withholding of Alabama income tax from payments described in this section is not mandatory. Voluntary withholding, however, is permitted. For reporting and remitting amounts voluntarily withheld, see §§40-18-74, 40-18-76, 40-18-77, 40-18-78, and Rule 810-3-75-.04.

(6) Penalties.

(a) Any person who fails to comply with the requirements of this section shall be subject to the penalties provided for in §40-2A-11, Code of Alabama 1975.

(b) In addition to the penalties provided for in §40-2A-11, the $50 civil penalty provided for in §40-29-74, Code of Alabama 1975, shall apply.

Authors: Ewell Berry, Judy A. Robbins, and Ann F. Winborne, CPA
Authority: §§40-2A-7(a)(5) and 40-18-26, Code of Alabama 1975.
History: Adopted September 30, 1982.
Amended: Filed October 26, 1988, effective December 2, 1988.
Amended: Filed March 20, 1989, effective April 24, 1989.
Amended: Filed October 1, 1993, effective November 6, 1993.
Amended: Filed March 31, 2000, effective May 5, 2000.

810-3-26-.02 Voluntary Withholding of Alabama Income Tax from Nonwage Payments.

(1) Alabama income tax is not required to be withheld from distributions from a retirement or pension plan, interest payments or other nonwage payments. However, voluntary withholding of Alabama income tax is permissible. If a payer of nonwage payments voluntarily withholds Alabama income tax, the following procedures must be followed:

(a) Payments of amounts withheld must be remitted to the Department in the same manner and at the same time as described in §40-18-74, Code of Alabama 1975.

(b) On or before January 31 of the year following a nonwage payment from which Alabama income tax was withheld, the payer shall issue the recipient a statement showing the following information:

1. Year of payment.

2. Amount of payment.

3. Amount of Alabama income tax withheld.

4. Amount of federal income tax withheld.

5. Name and address of recipient.

6. Social security number of recipient.

7. Payer's name, address, and Alabama withholding tax account number.

8. Payer's federal employer identification number.

(2) See Rule 810-3-26-.01 for form requirements.

(3) On or before the last day of February of the year following a nonwage payment from which Alabama income tax was withheld, the payer shall file with the Department a copy of the statement described in the above paragraph (1)(b). Such statement must be accompanied by Form A-3, Annual Reconciliation of Alabama Income Tax Withheld. This statement must be filed in the same manner as described in §40-18-75.

Authors: Ewell Berry and Ann F. Winborne, CPA
Authority: §§40-2A-7(a)(5), 40-18-26, and 40-18-75, Code of Alabama 1975

History: New rule filed July 26, 1999, effective August 30, 1999.

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CHAPTER 810-3-27

Individual Taxpayers' Returns

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810-3-27-.01. When an Individual Return is Required.

(1) (a) Each resident shall file a return for each tax year if single or married but not living with husband or wife, and having for the year a net income (as defined in § 40-18-12) of $1,500 or more; or if married and living with husband or wife and having a net income of $3,000 or more for the tax year.

(b) 1. A husband and wife, each having income for the tax year, may file separate returns reporting the income and deductions of each, or they may elect to file a joint return reporting their combined income and deductions. A joint return may only be filed when -

(i) both spouses have the same tax year (except when one spouse dies during the tax year), and

(ii) both spouses were residents of Alabama for the tax year.

2. A joint return must be signed by both husband and wife.

3. The election to file a joint return is irrevocable after the due date of the return for any tax year.

4. (i) If a husband and wife file a joint return, they shall be jointly and severally liable for the tax shown by said return, or as may be determined by the Department to be due by them.

(ii) Innocent Spouse Rule.

(I) General Rule. For tax years beginning after August 10, 1987, if a joint return was made for such tax year and -

I. on such return there is a substantial understatement of tax attributable to grossly erroneous items of one spouse, and

II. the other spouse (innocent spouse) establishes that in signing the return such innocent spouse did not know, and had no reason to know, that there was a substantial understatement, and

III. taking into account all the facts and circumstances, it is inequitable to hold such innocent spouse liable for the deficiency in tax for such tax year attributable to such substantial understatement by the other spouse,

then the innocent spouse shall be relieved of liability for tax (including interest, penalties and other amounts) for such tax year to the extent such liability to attributable to such substantial understatement.

(II) Definitions. For purposes of this subsection (ii):

I. the term "grossly erroneous items" means, with respect to any spouse -

A. any item of gross income attributable to such spouse which is omitted from gross income, and

B. any claim of a deduction, credit, or basis by such spouse in an amount for which there is no basis in fact or law.

II. the term "substantial understatement" of tax means any understatement which exceeds $500. (If the understatement of tax is not more than $500, the innocent spouse is not relieved of joint liability.)

III. the term "understatement" means the excess of the amount of tax required to be shown on the return for the tax year (reduced by any credits allowed by § 40-18-21) over the amount shown on the return as filed by the taxpayer (reduced by any credits allowed by § 40-18-21).

IV. the term "preadjustment year" means the most recent tax year of the innocent spouse ending before the date an assessment is issued pursuant to § 40-18-40. (If the assessment is not issued in the first year following the year of the understatement, the "preadjustment year" will be a year which occurs after the year of the understatement.)

V. the term "inequitable" means the innocent spouse received no benefit, directly or indirectly, from the understatement by the other spouse.

(III) Limitations and Exceptions.

I. This subsection (ii) shall apply only (the innocent spouse will be relieved of joint liability for the understatement by the other spouse) if -

A. the adjusted gross income of the innocent spouse for the preadjustment year is more than $5,000 but not more than $20,000, and the understatement is greater than ten percent (10%) of such adjusted gross income, or

B. the adjusted gross income of the innocent spouse for the preadjustment year is greater than $20,000 and the understatement is greater than twenty-five percent (25%) of such adjusted gross income.

(A) If the innocent spouse is married to another spouse at the close of the preadjustment year, the innocent spouse's adjusted gross income shall include the income of the new spouse, whether or not they file a joint return.

II. The limitation in subsentence I. above shall not apply to any liability attributable to the omission of an item from gross income. (The relief from joint liability for an innocent spouse may be available, regardless of the ratio of the understatement to the innocent spouse's adjusted gross income in the preadjustment year, if the understatement resulted from the omission of an item of gross income by the other spouse.)

(c) If the taxable period is for less than twelve months a return is required if the net income is more than the exemption computed for the fractional part of the year. See Reg. 810-3-19-.02(3) for proration of exemptions.

(d) If the taxpayer is unable to make a return, his duly authorized agent or guardian is required to file the return.

(2) (a) Every nonresident individual, receiving taxable income from property owned or business transacted within Alabama, which is more than his prorated Alabama personal exemption is required to file a return. For income from property owned or business transacted in the state, see Reg. 810-3-14-.05. For deductions allowable to nonresidents, see Reg. 810-3-15-.21. For proration of the exemptions of a nonresident, see Reg. 810-3-19-.02(4). In order to receive the deductions authorized by § 40-18-15, a nonresident shall make a complete return of his gross income both from within and from without Alabama.

(b) 1. A nonresident individual may file a joint return with his spouse as provided in subparagraph (1)(b) above, even if only one spouse has income from sources within Alabama.

2. If both spouses have income from sources within Alabama, each may file a separate return reporting their separate income and deductions, or they may file a joint return if (i) both spouses have the same tax year and (ii) both were nonresidents of Alabama for the entire tax year.

3. The provisions of section (1)(b)4. above (innocent spouse rule) are applicable to joint returns filed by nonresidents.

(Adopted September 30, 1982; Amended: June 17, 1988; Filed with LRS: July 27, 1988)

Authors: Mary L. Gifford
and John H. Burgess
Income Tax Division

Auth: § 40-18-27

810-3-27-.02 Preparation and Filing of Individual Taxpayer's Return.

(1) Every resident individual taxpayer required to file a return should do so using Form 40 or Form 40A, copies of which may be obtained from the Department. Nonresidents should file using Form 40NR. For use of Form 40A, see Rule 810-3-81-.01.

(a) Alabama individual income tax returns can also be filed electronically. See the Electronic Tax Return Filing Act, §§ 40-30-1 through 40-30-6, Code of Alabama 1975. See also Rules 810-3-27-.04 through 810-3-27-.08.

(2) Every person who prepares a tax return for another shall show his name, address, and social security number.

(3) The return must be signed or otherwise validated under penalty of perjury by the taxpayer and the person who prepares the return. A joint return must be signed or otherwise validated by both spouses. Each spouse included in a joint return will be jointly and severally liable for any tax due on such return, or as may be determined to be due by the Department.

(4) (a) Returns of income must be filed on or before the fifteenth day of the fourth month following the close of the taxable year. In the case of a final return of a decedent for a fractional part of a year, the return must be filed on or before the fifteenth day of the fourth month following the close of the twelve month period which began with the first day of such fractional part of the year.

(b) Any return which is postmarked on or before the due date will be deemed timely filed. See Rule 810-1-5-.01.

Author: Patricia L. Wilborn, CPA, Ann F. Winborne, CPA, and Ed Cutter, CPA
Authority: §§ 40-2A-7(a)(5) and 40-18-27, Code of Alabama 1975
History: Adopted September 30, 1982.
Amended: June 17, 1988. Filed with LRS: July 27, 1988.
Amended: Filed July 26, 1999, effective August 30, 1999.

810-3-27-.03 Extension of Time for Filing of Individual Taxpayer's Return.

(1) An individual may request a four month extension of time for filing an individual income tax return.

(a) The request must be made on forms prescribed by the Department.

(b) The request must show the taxpayer's name, address, social security number, and the reason an extension is required.

(c) The request must be filed on or before the due date for filing the return for which the extension is requested.

(2) In exceptional cases, a second extension may be granted for an additional two months.

(a) The request for a second extension must be signed or otherwise validated by the taxpayer or his authorized agent.

(b) The request must be filed on or before the expiration of the first extension request.

(3) Except in the case of taxpayers who are outside the United States, extensions will not be granted for more than six months.

(4) (a) A copy of the extension request must be attached to the return when filed.

(b) No notification will be made by the Department of approved extension requests.

(c) If an extension request is rejected, notification will be mailed to the taxpayer. If the return is filed within ten (10) days from the date the rejection notice is mailed, the return will be timely.

(5) An extension request will be timely filed if postmarked on or before the due date of the return or the expiration of an earlier extension request. See Rule 810-1-5-.01.

(6) Payment of tax may be made at the time of filing the extension request. For extension of time for payment of tax, See Rule 810-3-42-.02.

Authors: Patricia L. Wilborn, CPA, and Ann F. Winborne, CPA, Individual and Corporate Tax Division

Authority: §§ 40-2A-7(a)(5) and 40-18-27, Code of Alabama 1975

History: Adopted September 30, 1982.
Amended: June 17, 1988; Filed with LRS: July 27, 1988.
Amended: Filed May 3, 2000, effective June 7, 2000.
Amended: Filed October 12, 2001, effective November 16, 2001.

810-3-27-.04 Participation in the Federal/State Electronic Filing Program.

(1) The Department will participate with the Internal Revenue Service in the Federal/State Electronic Filing Program for the joint electronic filing of individual income tax returns, effective for tax year 1997.

(2) The requirements of the Alabama Electronic Filing Program for electronic return originators and transmitters are stated in the Alabama Handbook for Electronic Filers of Individual Income Tax Returns, which is issued on an annual basis by the Department.

Author: Ed Cutter
Authority: Sections 40-2A-7(a)(5) and 40-30-4, Code of Alabama 1975
History: New rule: Filed April 23, 1998, effective May 28, 1998.

810-3-27-.05 Requirements for the Alabama Electronic Individual Income Tax Return.

(1) A complete Alabama electronic individual income tax return will consist of data transmitted electronically and supporting paper documents. A complete Alabama electronic return must contain the same information as a comparable Alabama return as if filed entirely on paper.

(2) The transmission date of an Alabama electronic individual income tax return will be used to determine timely filing of an electronic return in the same manner that the postmarked date is used to determine timely filing of a paper Alabama individual income tax return.

Author: Ed Cutter
Authority: Sections 40-2A-7(a)(5) and 40-30-5, Code of Alabama 1975
History: New rule filed April 23, 1998, effective date May 28, 1998.

810-3-27-.06 Requirements for the Individual Income Tax Declaration for Electronic Filing.

(1) The Individual Income Tax Declaration for Electronic Filing requires the following information:

(a) The Declaration Control Number of the electronic return.

(b) The taxpayer's first name, middle initial and last name.

(c) The taxpayer's social security number.

(d) If a joint return, the spouse's first name, middle initial, last name and social security number.

(e) The taxpayer's address.

(f) The Alabama taxable income reported by the electronic return.

(g) The net tax liability reported by the electronic return, which is computed by adding the net tax due Alabama to the voluntary contributions to the Alabama Election Campaign Fund and the Neighbors Helping Neighbors Fund.

(h) The total tax payments reported by the electronic return.

(i) The amount of the refund reported by the electronic return.

(j) The signature of the taxpayer and date of the signature.

(k) If a joint return, the signature of the spouse and date of the signature.

(l) The signature of the electronic return originator and date of the signature.

(m) An indication whether the electronic return originator is self-employed.

(n) The firm name of the electronic return originator.

(o) The address, including the zip code, of the electronic return originator.

(p) The federal employer identification number of the electronic return originator.

(q) If the paid preparer is different from the electronic return originator, the following information is required:

1. The signature of the paid preparer and date of the signature.

2. An indication whether the paid preparer is self-employed.

3. The firm name of the paid preparer.

4. The address, including the zip code, of the paid preparer.

(2) The signatures of the taxpayer(s), the electronic return originator, and the paid preparer (if the paid preparer is different from the electronic return originator) must be affixed to the Alabama Form AL8453 - Individual Income Tax Declaration for Electronic Filing before the return is electronically transmitted.

(a) Members of the firm or designated employees may sign for the electronic return originator.

(b) If the taxpayer is unable to obtain the paid preparer's signature on the Alabama Form AL8453, in lieu of the paid preparer's signature the electronic return originator may attach to the Alabama Form AL8453 a copy of the appropriate pages of the paper return with the paid preparer's signature.

(c) Electronic return originators and electronic return preparers are prohibited from allowing taxpayers to sign blank Alabama Forms AL8453.

(3) The completed and signed Alabama Form AL8453 will serve as the filing declaration for the electronic Alabama individual income tax return.

(4) The completed and signed Alabama Form AL8453, and the state copies of wage and tax statements (Forms W-2, W-2G, and 1099R), must be retained by the electronic return originator for a period of three years from the due date of the return or three years from the date the return was filed, whichever is later.

(5) Electronic transmission of the Alabama individual income tax return by the electronic return originator is an attestation by the electronic return originator that a properly completed and properly signed Alabama Form AL8453 is being retained on file by the electronic return originator.

(6) The electronic return originator will provide the Department with the original Alabama Form AL8453 and the related wage and tax statements within five business days of receiving a written request for the documents from the Department.

(7) In the event that the electronic return originator ceases operations, the electronic return originator is responsible for contacting the Department and transferring to the Department all of the original Alabama Forms AL8453 along with the related wage and tax statements. Responsibility for the Alabama Forms AL8453 can be transferred to another electronic return originator upon receiving written approval from the Department.

(8) Nonprofit, volunteer tax preparation organizations such as Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) can elect, upon receiving written approval from the Department, to transfer all of the organization's original Alabama Forms AL8453 to the Department. The documents must be submitted to the Department in Declaration Control Number order.

Author: Ed Cutter
Authority: Sections 40-2A-7(a)(5) and 40-30-5, Code of Alabama 1975
History: New rule filed April 23, 1998, effective date May 28, 1998.

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Attachment 810-3-27-.06

Authority: Sections 40-2A-7(a)(5) and 40-30-5, Code of Alabama 1975

History: Form AL8453 Individual Income Tax Declaration for Electronic Filing

Filed April 23, 1998, effective date May 28, 1998.

810-3-27-.07 Requirements for Electronic Filing Software.

(1) Record layouts and specifications for a complete Alabama electronic individual income tax return are issued annually by the Department in Electronic Return Record Layouts - Alabama Individual Income Tax Returns.

(2) Software developers are required to obtain prior approval from the Department by submitting for testing sample Alabama electronic individual income tax returns prepared by and transmitted by their software products.

(3) Software developer testing will occur in conjunction with IRS testing in accordance with IRS Publication 1436, Test Package for Electronic Filing of Individual Income Tax Returns.

(4) Alabama electronic individual income tax returns received by the Department which are prepared by software which has not completed the Department's software developer testing and which has not been approved by the Department will be rejected by the Department. Paper Alabama individual income tax returns must then be submitted by the taxpayers.

Author: Ed Cutter
Authority: Sections 40-2A-7(a)(5) and 40-30-5, Code of Alabama 1975
History: New rule filed April 23, 1998, effective date May 28, 1998.

810-3-27-.08 Acceptance into the Alabama Electronic Filing Program, Monitoring, and Revocation of Acceptance into the Program.

(1) Electronic return originators and transmitters accepted by and in good standing with the Federal Electronic Filing Program are automatically accepted into the Alabama Electronic Filing Program.

(2) Electronic return originators and transmitters accepted into the Alabama Electronic Filing Program serve as agents of the Alabama Department of Revenue, and must comply with the requirements of the program as stated in the Alabama Handbook for Electronic Filers of Individual Income Tax Returns.

(3) The Alabama Department of Revenue will conduct random monitoring visits with Electronic Return Originators and Transmitters to verify that the requirements of the Alabama Electronic Filing Program are being met.

(4) The Alabama Department of Revenue reserves the right to revoke the acceptance of an electronic return originator or transmitter for cause. Failure to comply with the guidelines set forth in the Alabama Handbook for Electronic Filers of Individual Income Tax Returns is considered just cause.

(5) Any of the following can result in the revocation of an electronic return originator's or transmitter's acceptance into the program:

(a) Conviction of a criminal offense under the revenue laws of any state or of any offense involving dishonesty, or breach of trust.

(b) Failure to file timely and accurate tax returns, both personal and business.

(c) Failure to pay personal tax liabilities or business tax liabilities.

(d) Failure or refusal to effect corrective action as required by the Alabama Department of Revenue.

(e) Other facts or conduct of a disreputable nature that would reflect adversely on the Alabama Electronic Filing Program.

(f) Unethical practices in return preparation.

(g) Suspension by IRS.

Author: Ed Cutter
Authority: Sections 40-2A-7(a)(5) and 40-30-6, Code of Alabama 1975
History: New rule filed April 23, 1998, effective date May 28, 1998.

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CHAPTER 810-3-28

Partnership Returns

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810-3-28-.01 Partnership Returns

810-3-28-.01. Partnership Returns.

(1) (a) Each subchapter K entity, and every single member limited liability company having income from property owned or business conducted in this state shall file Form 65 "Partnership Return of Income,", on or before the fifteenth day of the fourth month following the close of the taxable year.

(b) An Alabama Schedule K-1 must be prepared for each person who held an interest in the subchapter K entity or single member limited liability company during the taxable year showing each partner's or member's name, address, social security or federal employers identification number, distributive share of the income (or loss) of the partnership and distributive share of charitable contributions made by the partnership.

1. For an Alabama resident partner or member, the K-1 shall include:

(i) For multi-state subchapter K entities doing business within and without the State of Alabama, only that income which is required to be allocated and apportioned to Alabama under the rules of Section 40-18-22. (If the multi-state subchapter K entity is not doing business in Alabama, no income is reportable to Alabama from that subchapter K entity.)

(ii) For a subchapter K entity doing business in only one state, whether the state of Alabama or another state, the distributive share of the entire income from that subchapter K entity.

2. For a non-resident partner or member, the K-1 shall include:

(i) For multi-state subchapter K entities doing business within and without the State of Alabama, only that income which is required to be allocated and apportioned to Alabama under the rules of Section 40-18-22.

(ii) For a subchapter K entity doing business in Alabama exclusively, the distributive share of the entire income from that subchapter K entity.

(c) Form 65 is designed as a "cover sheet" to the federal Form 1065 "U.S. Partnership Return of Income". The computation of Alabama net partnership income on Form 65 begins with the Federal ordinary income as shown on Form 1065. Adjustments must be made to conform federal income to the Alabama law for any items of income or expense, except contributions, which are passed directly through to the partners or members on the federal return and for items which are treated differently under Alabama law than federal law. These adjustments include, but are not limited to, the following:

1. long-term capital gains (or losses) which are passed through directly to partners or members on the federal return are added to federal ordinary income, and

2. additional depreciation is allowed for assets which have a reduced federal basis due to investment tax credits or which have been expensed under I.R.C. § 179, and

3. depletion on oil and gas properties which is passed through directly to the partners or members in the federal return are subtracted from federal ordinary income using the rates allowed by §§ 40-18-16 or 40-18-15, and

4. percentage depletion in excess of cost on minerals other than oil and gas are added to federal ordinary income.

5. interest expense passed through directly to partners or members on Form 1065 is subtracted from federal ordinary income.

6. any other items of income, expense or deduction which are passed directly through to partners or members and not included in federal ordinary income.

(d) Federal Form 1065 and accompanying schedules must be attached to Form 65 when filed.

(e) The return must be signed by one partner or member and the person who prepared the return, and must contain a printed declaration that it is made under the penalties of perjury.

(2) See Reg. 810-3-24-.01, et seq., for computation of distributive income for subchapter K entity or single member limited liability company and the distributive share for each partner or member.

(3) Partnership returns shall be made on or before the fifteenth day of the fourth month following the close of the calendar or fiscal year, whichever taxable year is used by the subchapter K entity or single member limited liability company.

Author: Individual and Corporate Tax Division
Authority: Sections 40-2A-7(a)(5) and 40-18-28
Code of Alabama 1975
History: Adopted September 30, 1982.
Amended April 24, 1989.
Amended March 26, 1998, effective date April 30, 1998.

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CHAPTER 810-3-29

Fiduciary Returns

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810-3-29-.01 Fiduciary Returns

810-3-29-.01. Fiduciary Returns.

(1) Every fiduciary, other than one appointed by authority of law in possession of only a part of the property of a taxpayer, shall file a return for the taxpayer for whom he acts if either of the following conditions are met:

(a) the net income of the taxpayer is $1,500 or over if single or if married and not living with spouse, or combined net income is $3,000 or over if taxpayer is married and living with spouse, or

(b) if the taxpayer is an estate or trust, if the net income thereof is $1,500 or over, or if any beneficiary is a taxpayer other than a resident of Alabama.

(2) The required return should be on Form 41 "Fiduciary Return of Income," and should be made in accordance with the instructions thereto. The fiduciary shall certify that he has knowledge of the affairs of the individual, estate or trust sufficient to enable him to make the return, and that it is to the best of his knowledge and belief true and correct. Fiduciaries are generally subject to the same provisions of law as apply to other taxpayers. For specific treatment of income and deductions of estates and trusts, see Sec. 40-18-25 and regulation thereunder.

(3) A guardian, whether of an infant or other person, is a fiduciary and as such is required to make and file the return for his ward and pay the tax, unless the return is made and the tax is paid by the ward. The return for a ward should be filed on Form 40 "Individual Income Tax Return" rather than Form 41 generally used by fiduciaries.

(4) Returns may be filed on a calendar year or fiscal year basis. Returns are due the fifteenth day of the fourth month following the close of the taxable year.

Auth: § 40-18-57

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CHAPTER 810-3-30

Return when Accounting Period Changes

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810-3-30-.02 Returns on Change of Accounting Period

810-3-30-.01 Permission to Change Accounting Period.

(1) For tax years beginning after December 31, 1989, the change in accounting period for single entity taxpayers will change whenever there is an approved federal accounting period change.

(a) For corporations, filing Alabama returns on a separate entity basis, which become a member of a federal consolidated group, or cease to be a member of a consolidated group, or change from one federal group to another during the taxable year, no change in accounting period is required or permitted if the taxable year after the change in federal group membership will end at the same time as before the change.

(b) Alabama separate entity basis part-year returns are not permitted to be combined with Alabama affiliated group consolidated return.

1. A part-year return is not required following a change of corporate parent, unless the company affected will have a different tax year after the change. If two or more part-year returns are required for federal purposes, these part-year returns should be combined into a single return for Alabama purposes.

(2) For tax years beginning after December 31, 1998, the change in accounting period for a consolidated group will change whenever there is an approved federal accounting period change.

(3) For tax years beginning before January 1, 1990:

(a) In all cases in which a taxpayer desires to change from a calendar year to a fiscal year, from a fiscal year to a calendar year, or from one fiscal year to another fiscal year ending at a different date, permission must be obtained from the Department. The request for permission to make such change may be made by letter.

(b) Except as provided in (1)(a) above, a taxpayer who is required or permitted by federal law or rules to change the accounting period, will automatically receive approval for the same change in accounting period from this Department. Prior approval is not required if a copy of the approved federal change is attached to the first return filed after the accounting period is changed.

Author: Anne Simms, Carmen Mills and Anne Glenn
Authority: §§ 40-2A-7(a)(5), 40-18-57 and 40-18-30, Code of Alabama 1975
History: Adopted September 30, 1982.
Amended: June 17, 1988; Filed with LRS July 27, 1988.
Amended: Filed May 3, 2000, effective June 7, 2000.

810-3-30-.02 Returns on Change of Accounting Period.

(1) If a taxpayer changes his accounting period from a calendar year to a fiscal year or from a fiscal year to a calendar year or from one fiscal year to another fiscal year, such change necessitates the filing of a return for a period of less than twelve months. Under no conditions may the return cover a period of more than twelve months. The following examples will illustrate this point:

(a) EXAMPLE: Taxpayer A has been filing returns for fiscal years ending June 30. The books have been closed for the fiscal year ending June 30, 1998. The return will be filed for this period, but it has been decided that it will be more advantageous to file for the calendar year in the future. In order to do this, a return must be filed for the six months beginning July 1, 1998 and ending December 31, 1998. Thereafter, the taxpayer must file a return each calendar year.

(b) EXAMPLE: Taxpayer B desires to change the taxable year from the calendar year to a fiscal year ending July 31. The taxpayer filed a regular calendar year return for 1997 and desires to file the first fiscal year return in 1998. A return must be filed for the seven month period beginning January 1, 1998 and ending July 31, 1998. A return will be filed for the twelve months ending July 31 in 1999 and each subsequent year.

(c) EXAMPLE: Taxpayer C has filed a return for the fiscal year ending September 30, 1997, but now desires to change to a fiscal year ending April 30 of each year. This can be accomplished by filing a seven month return for the period beginning October 1, 1997 and ending April 30, 1998. The taxpayer will file a return for the twelve months ending April 30 in 1999 and each subsequent year.

(2) In all of the above cases the taxable income shall be computed for each period for which a separate return or a consolidated return (for years beginning after 12/31/98) is made, and the tax shall be paid thereon at the rate applicable to the calendar years in which such period is included. The exemptions allowed shall be one-twelfth of the full annual exemptions multiplied by the number of months in the short taxable period.

(3) In general, the requirements with respect to the filing of returns and the payment of tax for a short period when the taxpayer has not been in existence for the entire taxable year are the same as for the filing of a return and the payment of tax for a taxable year of twelve months ending on the last day of the short period. This applies to a corporation or partnership that has gone out of business and to an individual who is a resident of the State of Alabama for the first part of the year only.

Author: Anne Glenn
Authority: §§40-2A-7(a)(5) and 40-18-57, Code of Alabama 1975
History: Readopted through APA effective October 1, 1982.
Amended: Filed May 3, 2000, effective June 7, 2000.

RULES OF THE
ALABAMA DEPARTMENT OF REVENUE

CHAPTER 810-3-31

Imposition of Income Tax on Corporations

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810-3-31-.02 Determination of Income from Multistate Operations

810-3-31-.01 Tax on Corporations.

(1) Code § 40-18-31 provides that a corporation which is taxable under § 40-18-2 shall pay a tax equal to five percent (5%) of its taxable income, as defined in §§40-18-33 and 40-27-1. An Alabama affiliated group of corporations filing an Alabama consolidated income tax return pursuant to the provisions of § 40-18-39 shall pay a tax equal to five percent (5%) of the consolidated affiliated group taxable income. Any organization listed under subdivisions (1), (2), (3), (4), (5), (6), (7), (11) and (12) of § 40-18-32(a) as otherwise exempt from taxation under this chapter, is not exempt from taxation on any income which constitutes "unrelated business taxable income." Alabama S corporations are not subject to the tax imposed by § 40-18-31; however, Alabama S corporations may file composite returns and make composite income tax payments on behalf of its nonresident shareholders pursuant to the provisions of § 40-18-176.

Authors: Fred H. Pritchard and Chris Sherlock, Individual and Corporate Tax Division
Authority: §§ 40-2A-7(a)(5), 40-18-31 and 40-18-57, Code of Alabama 1975
History: Adopted through APA September 30, 1982.
Amended: June 17, 1988; Filed with LRS July 27, 1988.
Amended: Filed May 3, 2000, effective June 7, 2000.

810-3-31-.02 Determination of Income from Multistate Operations.

(1) Taxpayers having income from business activity which is taxable both within and without this state are required to allocate and apportion their taxable income pursuant to the provisions of the Multistate Tax Compact, Chapter 27, Title 40, Code of Alabama 1975.

Authors: Verlon R. Frost, Jeff Taylor and Chris Sherlock,
Individual and Corporate Tax Division
Authority: §§ 40-2A-7(a)(5) and 40-18-57, Code of Alabama 1975
History: Effective September 30, 1982.
Amended July 27, 1988.
Amended: Filed October 18, 1996, effective November 22, 1996.
Repealed and New: Filed May 3, 2000, effective June 7, 2000.

RULES OF
DEPARTMENT OF REVENUE

CHAPTER 810-3-32

Exemption of Certain Organizations, Associations, Etc.

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810-3-32-.01. Exempt Organizations.

(1) The following organizations are exempt from taxation as provided by § 40-18-32:

(a) Labor, agricultural or horticultural organizations. In order to be exempt, these organizations must have no net earnings inuring to the benefit of any member, and have as their objects the betterment of the conditions of those engaged in such pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective organizations. These organizations, otherwise exempt, are taxable on their unrelated business taxable income.

(b) Fraternal beneficiary societies, orders, or associations. A fraternal beneficiary society is exempt from tax only if operated under the "lodge system" or for the exclusive benefit of the members so operating. "Operating under the lodge system" means carrying on its activities under a form of organization that comprises local branches, chartered by a parent organization and largely self-governing, called lodges, chapters, or the like. In order to be exempt it is also necessary that the society have an established system for the payment to its members or their dependents of life, sick, accident, or other benefits.

1. To be exempt a fraternal beneficiary society must be operated in furtherance of its fraternal purposes and may not engage in business activities of a kind carried on for profit, except that the carrying on of activities which raise revenues from members and their guests, will not deprive the society of its exemption.

(c) Business league, chambers of commerce or boards of trade, not organized for profit, and no part of the net earnings of which inures to the benefit of any private stockholder or individual. A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. These organizations, otherwise exempt, are taxable upon their unrelated business taxable income.

(d) A civic league or organization may be exempt as an organization if it is not organized or operated for profit, and it is operated exclusively for the promotion of social welfare. An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community.

1. Clubs organized and operated exclusively for pleasure, recreation and other nonprofitable purposes, no part of the earnings of which inures to the benefit of any private stockholder or members. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities. A club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate (other than an incidental sale of property), timber, or other products, is not exempt.

(e) Farmers' and other mutual hail, cyclone or fire insurance companies, mutual ditch or irrigation companies, or like organizations of a purely local character, the income of which consists solely of assessments, dues and fees collected from members for the sole purpose of meeting expenses. An organization of a purely local character is one whose business activities are confined to a particular community, place, or district, irrespective, however, of political subdivisions. If the activities of an organization are limited only by the borders of a state, it cannot be considered to be purely local in character.

(f) Cooperative associations engaged in the marketing of farm products for farmers, fruit growers, livestock growers, dairymen, etc., and turning back to the producers the proceeds of the sales of their products less the necessary operating expenses, on the basis of either the quantity or the value of the products furnished by them, are exempt from income tax. If the proceeds of the business are distributed in any other way than on such a proportionate basis, the association does not meet the requirements of the Code and is not exempt. In order to show its cooperative nature and to establish compliance with the requirement of the Code that the proceeds of sales, less necessary expenses, be turned back to all producers on the basis of either the quantity or the value of the products furnished by them, it is necessary for such an association to keep permanent records of the business done both with members and nonmembers.

(g) Federal land banks and national farm loan associations as provided in Section 26 of the Act of Congress approved July 17, 1916, entitled "An act to provide for agricultural development, to create standard forms of investment based upon farm mortgages, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create government depositories and financial agent for the United States, and for other purposes."

(h) All national banks and national banking associations and all corporations engaged in the business of banking and of conducting a financial business employing moneyed capital coming into competition with the business of national banks during and for the periods during which such national banks and corporations are subject to an excise tax imposed by this state on or with respect to their respective incomes.

(I) Building and loan associations, substantially all the business of which is confined to making loans to members.

(j) Insurance companies upon which the statutes of Alabama impose a tax upon their premium income.

(k) Code Section 40-18-25 and regulations thereunder, provide that certain trusts are exempt from taxation under this chapter.

(Adopted September 30, 1982; Amended: June 17, 1988; Filed with LRS: July 27, 1988)

Authors: Fred H. Pritchard
and John H. Burgess
Income Tax Division

Auth: § 40-18-32

810-3-32-.01.01 Political Organizations.

(1) A "Political Committee" as defined in Section 17-22A-1, et seq., Code of Alabama 1975, is "any political committee, club, association, principal campaign committee, political party, or other group of one or more persons which receives or anticipates receiving contributions or makes or anticipates making expenditures to or on behalf of any elected official, proposition, candidate, principal campaign committee or other political committee."

(2) The above defined organizations are taxable for Alabama tax purposes to the same extent and in the same manner as any other entity that exceeds the protection afforded by P.L. 86-272.

(a) This rule is effective for tax periods beginning after June 9, 1999.

Author: Michael E. Mason, CPA, Jack Frost
Authority: Sections 40-2A-7(a)(5) and 17-22A-1, Code of Alabama 1975
History: New rule filed May 5, 1999, effective June 9, 1999.
Amended: Filed August 30, 2000, effective October 4, 2000.

810-3-32-.02. Proof of Exemption.

(1) (a) An organization is not exempt from tax merely because it is not organized and operated for profit. It must establish its exemption by filing an affidavit showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and the disposition of such income, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To the affidavit shall be attached a copy of the articles of incorporation, declaration of trust, or other instrument of similar import, setting forth the permitted powers or activities of the organization, the by-laws or other code or regulations, and the latest financial statement showing the assets, liabilities, receipts, and disbursements of the organization.

(b) In addition to the information specifically called for in the preceding subparagraph, the Department may require additional information necessary for a proper determination of entitlement to an exemption pursuant to § 40-18-32.

(c) The status of a corporation claiming exemption under Sec. 40-18-32 will be determined by the Department on the basis of the facts in each individual case, and the taxpayer will be notified of the findings of the Department. The exemption statute will be strictly construed, and an organization not qualifying under a specific subsection of Sec. 40-18-32 will be held to be subject to tax.

(d) If an organization is exempt under both federal and state law, approved federal forms establishing exemption for federal income tax purposes will be acceptable as proof of exemption for state income tax purposes.

(2) Subject to revocation as a result of changes in the law, regulations, or other good cause, an organization that has once established its exemption may rely upon this determination and need not reestablish its exemption so long as there are no substantial changes in the organization's character, purposes, or methods of operation.

(3) This exemption does not extend to unrelated business taxable income of an exempt organization. See Reg. 810-3-32-.03.

(4) An organization is organized exclusively for one or more exempt purpose only if its articles of organization:

(a) limit the purposes of such organization to one or more exempt purposes; and

(b) do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

(5) An organization will be regarded as "operated exclusively" for one or more exempt purpose only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in Sec. 40-18-32; and no more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

(6) The Federal Internal Revenue Code contains provisions similar to those in this section. Decisions and interpretations of the federal courts and agencies will be given due weight in interpreting this section.

(Adopted September 30, 1982; Amended: June 17, 1988; Filed with LRS: July 27, 1988)

Authors: Fred H. Pritchard
and John H. Burgess
Income Tax Division

Auth: § 40-18-32

810-3-32-.03. Unrelated Business Taxable Income.

(1) Any organization specified in subdivisions (1), (2), (3), (4), (5), (6), (7), (11), and (12) of subparagraph (a) of § 40-18-32 which receives "unrelated business taxable income" (as defined in 26 U.S.C. § 512) is not exempt from taxation on such income. Any organization which receives unrelated business taxable income must comply with the provisions of §§ 40-18-2, and -31, and file the appropriate income tax returns and pay any tax due.

(2) Except for organizations described in § 40-18-32(a)(5), the term "unrelated business taxable income" is defined as follows:

(a) The gross receipts from any "unrelated trade or business" regularly carried on by the organization, reduced by the expenses and deductions directly connected with the unrelated trade or business.

(b) The following amounts are excluded from unrelated business taxable income:

1. All dividends, interest, payments with respect to securities loans (as defined in 26 U.S.C. § 512(a)(5)), and annuities; together with all expenses and deductions directly connected with such income.

2. All royalties (including overriding royalties) whether measured by production or by gross or taxable income from the property; together with all expenses and deductions directly connected with such income.

3. All rents from real property, together with rents from personal property if the rents from such personal property are incidental to the rental of the real property. If more than 50% of the total rents received are attributable to the rental of the personal property or if the amount of rents to be received is dependent in whole or in part upon the income or profits derived by any person from such property (other than a fixed percentage or percentages of sales or receipts); then such rents shall not be excluded from unrelated business taxable income. If any rents are excluded from unrelated business taxable income, then any expenses or deductions directly connected with such income shall also be excluded.

4. In the case of debt-financed property (as defined in 26 U.S.C. § 514), unrelated business taxable income will include the amount ascertained under 26 U.S.C. § 514(a)(1) less the deductions allowed by 26 U.S.C. § 514(a)(2).

5. All gains or losses from the sale, exchange or other disposition of property, other than stock in trade or property held primarily for sale to customers in the ordinary course of the trade or business, together with all expenses and deductions directly connected with such income.

6. The net operating loss deduction allowed by § 40-18-35.1.

7. Income derived from research performed for the United States government, or any of its agencies or instrumentalities, and any state or political subdivision thereof; together with all expenses and deductions directly connected with such income.

8. In the case of a college, university or hospital, all income from research performed for any person, together with all expenses and deductions directly connected with such income.

9. In the case of organizations operated primarily for the purpose of carrying on research, the results of which are freely available to the general public, all income derived from research performed for any person, together with all expenses and deductions directly connected with such income.

10. In the case of any organization subject to tax on its unrelated business taxable income under § 40-18-32, there will be allowed a deduction for charitable contributions as provided in § 40-18-35, but not in excess of 10% of the unrelated business taxable income computed without regard to this subdivision.

11. In the case of a trust described in 26 U.S.C. § 511(b), the deduction allowed for contributions (whether or not directly connected with the carrying on of a trade or business) shall be allowed, and any distribution made to a beneficiary described in 26 U.S.C. § 170 shall be considered to be a contribution. The deduction shall not exceed 10% of the unrelated business taxable income computed without regard to the deduction allowed by this subdivision.

12. Except from the purposes of computing the net operating loss deduction for section 6. above, there shall be allowed a specific deduction of $1,000,00. In the case of a diocese, province of a __ligious order, or a convention or association of churches, there shall also be allowed with respect to each parish, individual church, district or other local unit, a specific deduction of $1,000.00 or the gross income derived from any unrelated trade or business regularly carried on by such local unit, whichever is the lesser.

13. [RESERVED].

14. [RESERVED].

(c) 1. In the case of an organization described in § 40-18-32(a)(5), the term "unrelated business taxable income" means the gross income (excluding any exempt function income) less the deductions and expenses directly

connected with such income and with the deductions specified in sections 6., 10., 11. and 12. of subparagraph (b) above.

2. The term "exempt function income" means the gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing such members or their dependents or guests goods, facilities, or services in furtherance of the purposes constituting the basis of the exemption of the organization to which such income is paid. Exempt function income also includes all income set aside by the organization for the benefit of an organization described in § 40-18-32(a)(2), if such contribution is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

(d) An organization which receives "unrelated business taxable income" from sources within and without Alabama shall determine the amount of such income attributable to Alabama by using the apportionment and allocation rules of Reg. 810-3-31-.02.

(Adopted: June 17, 1988; Filed with LRS: July 27, 1988)

Authors: Fred H. Pritchard
and John H. Burgess
Income Tax Division

Auth: § 40-18-32
and 40-18-57

RULES OF
DEPARTMENT OF REVENUE

CHAPTER 810-3-34

Gross Income of Corporations Defined

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810-3-34-.01 Gross Income of Corporations

810-3-34-.01 Gross Income of Corporations.

(1) The gross income of a corporation which files or is required to file a separate return and is subject to tax in this state and another state is computed pursuant to §40-18-14, Code of Alabama 1975, and classified as either business or nonbusiness income pursuant to §40-27-1. Rules pursuant to these sections should be consulted in determining the gross income of a corporation. For a discussion of corporations subject to the tax, see Rule 810-3-2-.02.

(2) The gross income of a corporation subject to the tax imposed by §40-18-31, and which has elected to file an Alabama consolidated income tax return, is computed pursuant to §40-18-14 and classified as either business or nonbusiness income pursuant to §§40-27-1 and 40-18-39. Rules pursuant to these sections should be consulted in determining the gross income of a corporation.

(3) The gross income of a corporation which files or is required to file a separate return and is subject to tax only in this state is computed pursuant to §40-18-14. For a discussion of corporations subject to the tax, see Rule 810-3-2-.02.

(4) Mutual marine insurance companies shall include in gross income the gross premiums collected less amounts paid for re-insurance.

(5) Gross income does include deemed dividends from a Domestic International Sales Corporation (DISC) in the same manner as required by I.R.C. § 995, except for deemed dividends from an "interest charge DISC" after December 31, 1984.

(a) For shareholders of a DISC prior to and including December 31, 1984, gross income of the shareholder for the tax year which includes December 31, 1984, also includes the amounts of income deferred into the DISC which have not been previously taxed either as deemed dividends or as actual distributions.

1. In the case of a foreign corporation, the amount to be included in Alabama taxable income for the tax year which includes December 31, 1984, will be the sum of the results of:

(i) the amount of income deferred into the DISC each year which was not previously taxed -

(ii) multiplied by the apportionment factor for each such year.

(6) For tax years beginning before January 1, 1985, if a corporation adopts a plan of complete liquidation, and within the 12-month period beginning

on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims, no gain or loss shall be recognized to the corporation from the sale or exchange by it of property within the twelve-month period. The taxable year must end after January 1, 1976.

(a) The 12-month period shall begin on the date of the adoption of the plan and no extension of such period can be granted. The date of adoption of the plan of liquidation is the date on which occurs the first step in the plan, but not later than the date of adoption of the resolution by the shareholders authorizing the distribution of the corporate assets in redemption of all the stock pursuant to which the corporation is liquidated. Unusual sales of property might be a factor in determining the date of adoption of the plan.

(b) All assets (less assets retained to meet claims), both tangible and intangible, must be distributed within the 12-month period. If assets are held to meet claims, they must be specifically set apart and must be reasonable in amount.

(c) For the purposes of this regulation only the term "property" does not include:

1. Inventories, or other property, held by the corporation primarily for sale to customers in the ordinary course of its business. However, if this property is sold to one person in one transaction, the property and any installment obligations acquired in the sale do meet the definition of "property."

2. Installment obligations acquired in the sale of inventories or other property.

3. Installment obligations acquired from the sale of property other than described in subparagraphs 1. and 2. and acquired before the adoption of the plan of liquidation.

(d) Provided the other conditions of this section are met, sales or exchanges which occur on or after the date on which the plan of complete liquidation is adopted and within the 12-month period thereafter are subject to the provisions of such section. The date on which a sale occurs depends primarily upon the intent of the parties to be gathered from the terms of the contract and the surrounding circumstances. In ascertaining whether a sale or exchange occurs on or after the date on which the plan of complete liquidation is adopted, the fact that negotiations for sale may have been commenced, either by the corporation or its shareholders, or both, shall be disregarded. Ordinarily, a sale has not occurred when a contract to sell has been entered into but title and possession of the property have not been transferred and the obligation of the seller to sell or the buyer to buy is conditional.

(e) It is not necessary that only one distribution be made to each stockholder, partial distributions may be made so long as they are made within the twelve-month period and total the complete amount to be distributed.

(7) For tax years beginning after December 31, 1984, gross income does not include gains or losses which are not recognized under the provisions of § 40-18-8.

Author: Verlon R. Frost
Authority: §§ 40-2A-7(a)(5) and 40-18-57, Code of Alabama 1975.
History: Adopted September 30, 1982.
Amended: Filed October 26, 1988, effective December 2, 1988.
Amended: Filed February 1, 2000, effective March 7, 2000.

RULES OF
DEPARTMENT OF REVENUE

CHAPTER 810-3-35

Deductions Allowed Corporations Generally

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810-3-35-.02 Deductions of Foreign Corporations **(REPEALED - Effective March 7, 2000)**

810-3-35-.01. Deductions Allowed Corporations.

(1) The regulations under §§ 40-18-15 and 40-18-16, Code of Alabama 1975, apply to corporations with the same force and effect as they apply to individuals with the following exceptions:

(a) Expenses designated as personal expenses are generally personal expenses only to an individual.

(b) Legislative Act 82-667 revised §40-18-15(a)(3) in relation to taxes allowable as deductions for individuals but no comparable change to §40-18-35 was made, therefore, deductions as now allowed individuals for taxes are not applicable to corporations.

1. Taxes, excluding state and local income taxes, imposed from time to time upon the taxpayer by the United States or any of its possessions, territories, or constituent states, or by any county, school district, municipality, or other taxing subdivision thereof may be deducted for the taxable year in which paid or accrued, according to the method of accounting used in computing taxable income.

(i) Possessions and territories of the United States are: American Samoa, Guam, Puerto Rico, and the Virgin Islands. These do not include the Trust Territory of the Pacific Islands: Mariana Islands, Marshall Islands, Palau, Ponape, Truk, and Yap.

(ii) Taxes levied by or paid to a foreign country are not deductible.

(iii) The windfall profits tax imposed by I.R.C. § 4986 is deductible.

(iv) Accrual basis taxpayers may deduct taxes only in the year in which the tax accrues, while cash basis taxpayers deduct taxes actually paid during the tax year. A penalty for non-payment of a tax may not be deducted.

(v) No deduction is allowed for taxes (such as sales and use taxes) imposed on the acquisition of property required to be capitalized pursuant to §40-18-17. Such taxes may be included in the basis of such property as provided in §40-18-6 and recovered through allowable deductions for depreciation and/or depletion as provided in §§40-18-15 and -16.

2. Net federal income tax may be deducted in the year paid or accrued, according to the method of accounting used in computing taxable income. The federal income tax allowable as a deduction or allocated in paragraph (5) is the net tax liability as accrued and subsequently paid, that is, the amount after subtracting all deductible and/or refundable credits. The federal alternative

minimum tax ("AMT") is a prepayment of federal income tax and is not deductible in computing Alabama taxable income. As a consequence, the AMT credit is not considered in relation to Alabama taxable income.

| | | |
|---|---|---|
| Federal Income Tax | | $55,000.00 |
| Less: Foreign Tax Credit | $15,000.00 | |
| Investment Credit | 7,000.00 | |
| 22,000.00 | | |
| Net Apportionable Federal Income Tax | | |
| $33,000.00 | | |

(i) For a cash basis taxpayer federal income tax should be deducted in the year paid.

(ii) An accrual basis taxpayer should deduct federal income tax:

(I) in the year for which the tax was imposed if the tax is not contested; that is, in the absence of some objective act of protest, affirmative evidence of protest, or affirmative evidence of denial of liability by the taxpayer, or

(II) if the tax is contested it shall be accrued and deducted during the year in which the liability becomes fixed and certain, but in no case later than the date the tax was actually paid.

3. The annual federal income tax deduction for members of an affiliated group filing a consolidated federal income tax return shall be determined according to the method elected under 26 U.S.C. §1552 (without regard to any election under 26 U.S.C. §1502) for the group's consolidatedfederal return filed for such taxable year which corresponds to the following methods:

(i) The federal tax liability shall be apportioned among the members of the group according to the ratio which that portion of the consolidated federal taxable income attributable to each member of the group (after taking into account any applicable consolidating eliminations, allowances, limitations and deductions) having taxable income bears to the consolidated federal taxable income.

(I) If the computation of the federal taxable income of a member results in an excess of deductions over gross income, then for the purposes of this computation such member's federal taxable income shall be zero. If the computation of the separate return tax liability of a member in this computation does not result in a positive federal income tax liability, then for the purposes of this computation such member's separate return federal tax liability shall be zero.

(II) This method corresponds to the method described in 26 U.S.C. § 1552(a)(1).

(ii) The consolidated federal tax liability shall be apportioned among the several members of the group on the basis of the percentage of the total federal tax, which the tax of such member, if computed on a separate return (after taking into account any applicable consolidating eliminations, allowances, limitations and deductions), would bear to the total amount of federal tax for all members of the group so computed.

(I) If the computation of the separate return tax liability of a member in this computation does not result in a positive number, such member's separate return federal tax liability shall be zero.

(II) This method corresponds to the method described in 26 U.S.C. § 1552(a)(2).

(iii) The tax liability of the group (excluding the tax increases arising from the consolidation) shall be apportioned on the basis of the contribution of each member of the group (after taking into account any applicable consolidating eliminations, allowances, limitations and deductions) to the consolidated federal taxable income of the group; provided such amount does not exceed the liability of such member on a separate return basis, in which case the member's deduction is limited to the amount it would have paid on a separate return basis. Any tax increases arising from the consolidation shall be distributed to the several members in direct proportion to the reduction in federal tax liability resulting to such members from the filing of the consolidated return as measured by the difference between their federal tax liabilities determined on a separate return basis and their federal tax liabilities based on their contributions to the consolidated federal taxable income.

(I) If the computation of the federal taxable income of a member results in an excess of deductions over gross income, then for the purposes of this computation such member's federal taxable income shall be zero. If the computation of the separate return tax liability of a member in this computation does not result in a positive federal income tax liability, then for the purposes of this computation such member's separate return federal tax liability shall be zero.

(II) This method corresponds to the method described in 26 U.S.C. §1552(a)(3).

(iv) (I) When no election has been made for any taxable year in which a consolidated federal return is filed, the method described in (i) above shall apply.

(II) Any method other than those described in (i), (ii), or (iii) abovemust be requested from and approved by the Department. If approval has not been

granted by the Department for the use of any method other than those described in (i), (ii) or (iii) above, the method described in (i) shall be used.

(v) If either the numerator, denominator, or both, in the ratios described in (i), (ii), (iii), or (iv) above are zero or less than zero, then no federal income tax will be apportioned to the members involved from the consolidated federal return.

(vi) If a corporation is a member of more than one affiliated group filing aconsolidated federal return during a tax year, such corporation shall compute its share of the consolidated federal tax of each group using a method described in (i), (ii), (iii) or (iv) above which was in effect for each such group during the time the corporation was a member of such group.

4. If an accrual basis taxpayer has a federal carryback that produces a refund, the tax refunded accrues to the year from which the item is carried.

(i) EXAMPLE: A taxpayer has more investment tax credit available in 1979 than can be utilized in 1979 and carries this excess back to 1976 and 1977. The 1976 and 1977 federal income taxes will be reduced and refunded, but the refund is negative federal income tax in 1979. These refunds are accomplished by filing a federal Form 1139 or amended federal returns.

(ii) If the taxpayer is a member of a group filing a consolidated federal return, the refund will be apportioned to each corporation in the same ratio that the tax deduction being refunded was originally apportioned.

(iii) If the taxpayer is a foreign corporation the refund will be apportioned to Alabama income at the same rate the tax deduction was originally apportioned to Alabama income.

(iv) The net refund attributed to Alabama will be used to reduce the current federal income tax deduction, if any. If the refund results in a negative deduction (the refund is larger than the current deduction), the result will increase taxable income.

(c) The provisions of Sec. 40-18-15(a)(13), (15), (16), and 40-18-15(b) and regulations thereunder do not apply to corporations. Medical expenses, to be deductible by a corporation, must be business expenses. No standard deduction is available to corporations.

(d) Under Sec. 40-18-35(2), a corporation is not permitted to deduct interest paid on an indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917), if the interest income from the obligations or securities is exempt from Alabama income tax.

(e) Section 40-18-15(a)(6), which allows a deduction for casualty and theft losses, has no counterpart for corporations. However, such losses to a corporation normally would be business losses.

(f) Mutual insurance companies (other than mutual life or mutual marine insurance companies) and marine insurance companies are entitled to special deductions as provided in Secs. 40-18-35(8) and 40-18-35(9).

(g) Charitable contributions: 1. For taxable years beginning before January 1, 1985, the limitation on contributions, in the case of a corporation, is five percent of the corporation's net income computed without the benefit of the deduction for contributions. Reg. 810-3-15-.17 should be modified to this extent when it is applied to a corporation. Actual payment of the contribution must be made to a recognized charitable institution to be deductible.

2. For taxable years beginning after December 31, 1984, and before January 1, 1990: charitable contributions by corporations are allowed in the same manner and subject to the same limitations as provided by 26 U.S.C. §170 as in effect on January 1, 1985.

3. For taxable years beginning after December 31, 1989, charitable contributions are allowed in the same manner and subject to the same limitations as provided by 26 U.S.C. § 170 as in effect from time to time.

(i) For the purpose of this section the limitation is 10% of total income computed under Alabama law, after taking into account all other allowable deductions (except the net operating loss carryforward), but without the benefit of this deduction.

(ii) For accrual basis taxpayers, actual payment of the contribution must be made not later than the 15th day of the third month following the close of the tax year.

(iii) If the total contributions available for deduction in the year exceed the 10% limitation in subsection (i) above, the excess may be carried over to the next five succeeding years in chronological order . The amount to be carried over in succeeding years is the excess, if any, of the limitation for the succeeding year over the current contributions for that year.

(iv) The amount of any deduction allowable under this section for a contribution of property must be determined by the amount the fair market value of the property exceeds the taxpayer's basis in the property. In the case of a charitable contribution of less than the taxpayer's entire interest in the property contributed, the taxpayer’s adjusted basis in such property shall be apportioned between the interest contributed and any interest not contributed.

(h) For tax years beginning after December 31, 1989, the deduction for expenses of travel, entertainment and meals incurred by corporations shall be determined according to and subject to the same limitations as provided in 26 U.S.C. § 274. See regulation 810-3-15.02.

(i) For tax years beginning after December 31, 1989, if a personal service corporation has in effect an election under 26 U.S.C. § 444 (relating to the use of a taxable year other than the required taxable year) and does not satisfy the minimum distribution requirements as defined in 26 U.S.C. § 280H, the minimum deduction otherwise allowable under this chapter for applicable amounts paid or incurred by such corporation to employee-owners shall not exceed the minimum deductible amount as defined in 26 U.S.C. § 280H.

1. If any amount is not allowed as a deduction for a taxable year under part (i) above, such amount shall be treated as paid or incurred in the succeeding taxable year.

2. For the purposes of this part, the terms "minimum distribution requirements", "maximum deductible amount", "employee-owner", and "applicable amount" shall have the same meaning as defined in 26 U.S.C. § 280H.

(2) Dividends (including liquidating dividends) are deductible if received from a corporation or any subsidiary corporation taxable under this title whether received in cash or property or both, if at the time of the receipt of such dividends the receiving corporation owns stock of the distributing corporation:

(a) possessing at least 50% of the total combined voting power of all classes of stock entitled to vote and

(b) constituting at least 50% of the total number of shares of all classes of stock other than classes of stock which are limited and preferred as to dividends.

NOTE: Ownership of stock under this paragraph must be direct ownership. Alabama law has no provision regarding indirect ownership (attribution rules).

(3) Losses from bad debts (a) For tax years beginning before January 1, 1985, a deduction is allowed for all debts which became worthless during the taxable year if sustained in the conduct of the taxpayer's regular trade or business. Only actual write-offs may be deducted. The reserve method may not be used for these years.

(b) For all taxable years beginning after December 31, 1984, and beginning before January 1, 1990, either actual write-offs of bad debts or a reasonable addition to a reserve for bad debts may be used. Bad debts are

deductible to the extent allowed by 26 U.S.C. §166 as in effect on January 1, 1985.

1. If a taxpayer changes from actual write-offs to a reserve method, or from a reserve method to actual write-offs, proper adjustments must be made so that no deduction is taken more than once for the same bad debt and so that no allowable deduction will not be deducted due to the change in method for deducting bad debts.

2. Any reserve method and the computation thereof allowed by the U.S. Secretary of the Treasury pursuant to 26 U.S.C. §166(c) and U. S. Treasury Regulation §1.166-4, as in effect January 1, 1985, will be allowed by this regulation.

3. The Alabama law has no provision for the establishment of an initial reserve, only for a reasonable addition to a reserve. Therefore, the provisions of 26 U.S.C. §481 and U.S. Treasury Regulation §1.481-1, et seq., are not applicable in computing the allowable addition to the bad debt reserve under Alabama law.

(c) For all taxable years beginning after December 31, 1989, a deduction is allowed in accordance with 26 U.S.C. 166 for all debts which become worthless during the taxable year, if sustained in the conduct of the taxpayer's regular trade or business.

(4) A deduction is allowed for all amounts invested during the taxable year in devices, parts of devices, systems or facilities used or placed in operation in the state of Alabama or to be used or placed in operation in the state of Alabama primarily for the protection of the public and the public interest through the control, reduction, or elimination of air or water pollution; provided, however, that in lieu of deducting such amounts, the corporation may elect to amortize all such amounts over such period (not exceeding the useful life of devices, parts, systems or facilities for which such amounts were expended) as it specifies in its tax return for the taxable year during which such amounts were expended, in which case it shall be entitled to appropriate deductions for the taxable years so specified; and provided further:

(a) that the taking of any deductions authorized by subsection (12) shall be optional with the corporation; and

(b) that if any such deduction is taken with respect to any such devices, parts of devices, systems or facilities, such corporation shall not be permitted any allowance for depreciation or obsolescence thereof otherwise allowable under this Sec. 40-18-35.

(c) The election to expense qualified pollution control capital expenditures must be made in the return for the taxable year in which the expenditures are incurred and the election may not be made, revoked or modified after the return is filed.

(d) Definitions:

1. "Water Pollution" means the discharge or deposit of sewage, industrial wastes, or other wastes in such condition, manner or quantity as may cause ground or surface water to be contaminated, unclean, or impure to such an extent as to make said waters detrimental to the public health or to the health of animals, wildlife, fish, marine life or aquatic life; unsuitable with reasonable treatment for use as present or possible future sources of public water supply; or unsuitable for recreational, commercial, industrial, agricultural, or other reasonable uses.

2. "Air Pollution" means the presence in the outdoor atmosphere of one or more air contaminants or combinations thereof in such quantities and of such characteristics, location and duration which are injurious to human, plant or animal life or to property, or which unreasonably interfere with the comfortable enjoyment of life or property or to the conduct of business within such areas of the state as shall be affected thereby.

3. "Air Contaminant" means dust, fumes, mist, smoke, other particulate matter, vapor, gas, odorous substances, or any combination thereof.

4. "Air Cleaning Device" means any method, process, or equipment which removes, reduces, or renders less noxious air contaminants discharged into the atmosphere.

(e) The Department will recognize as subject to deduction or amortization any devices, parts of devices, systems or facilities used or placed in operation in the state of Alabama and approved for the control, reduction, or elimination of air or water pollution by the Water Improvement Commission, the Air Pollution Control Commission or by the Alabama Department of Environmental Management.

(f) The deduction allowed by this section is for expenditures in the nature of capital items and does not include expenses for maintenance, operation or supplies.

(5) Corporate employers' deduction for contribution to an employees' trust or annuity plan or compensation under a deferred-payment plan and bond purchase plan are allowed as follows:

(a) For tax years beginning before January 1, 1984, corporations may deduct their contributions to stock bonus, pension, profit sharing, annuity, deferred compensation, and bond purchase plans as they qualify and are allowed by I.R.C. 404 and 405, as in effect from time to time.

(b) For tax years beginning after December 31, 1983, and before January 1, 1990, corporations may not deduct their contributions to bond purchase plans since I.R.C. §405 was repealed for all years after January 1, 1984.

(c) For tax years beginning after December 31, 1989, corporations are allowed to continue to deduct their contributions to a qualified employees' stock bonus, pension, profit-sharing or annuity plan, or deferred compensation plan within the same limitations as allowed by I.R.C. § 404.

(6) For qualified expenditures made on or after May 17, 1985, a corporation which incurs expenses during the taxable year for the removal of architectural or transportation barriers to the handicapped may elect to deduct such expenditures, even if the expenditures are capital in nature. The maximum amount of the deduction is $35,000. If the election is made to deduct such expenses, no depreciation may be taken in connection with such expenditures. The election may not be made, changed or revoked after the return is filed.

(7) (a) For taxable years beginning after December 31, 1984, a corporation may amortize organizational expenditures over any period of not less than sixty (60) months. To qualify for amortization, the expenditures must have been:

1. incidental to the creation of the corporation,

2. chargeable to its capital account, and

3. of a character, which if expended incident to the creation of a corporation with a limited life, would be amortizable over such life.

(b) The taxpayer shall elect the amortization period in the return for the first taxable year in which the corporation engages in business. The election may not be made, changed, or modified after the due date (with extensions) for filing the return for such first taxable year.

(8) See Reg. 810-3-35-.02 for apportionment and allocation of allowable deductions of foreign corporations.

(9) The Internal Revenue Code contains provisions similar to those in this section. Decisions and interpretations of the federal courts and agencies will be given due weight in interpreting this section.

Author: Cindy D. Norwood, Verlon R. Frost
Authority: Sections 40-2A-7(a)(5) and 40-18-35, Code of Alabama, 1975
History: Adopted September 30, 1982.
Amended March 20, 1989.
Amended June 19, 1992.
Amended March 26, 1998, effective date April 30, 1998.

RULES OF
DEPARTMENT OF REVENUE

CHAPTER 810-3-35.1

Assessment of Income Taxes - Deduction for a
Limited Net Operating Loss Carryforward
for Corporations

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810-3-35.1-.01 Carryforward of Net Operating Losses for Corporations - General.

(1) In addition to the deductions allowed to corporations by §40-18-35, a deduction is also allowed for net operating losses carried forward from any year which began after December 31, 1983.

(2) The term "net operating loss" means the excess of deductions (other than the net operating loss carryforward) allowed by Chapter 18, Title 40, Code of Alabama 1975, over the gross income.

(3)(a) For any tax year that begins after December 31, 1983, but before January 1, 1985, the loss may be carried forward for a maximum of five (5) years or until exhausted. For all tax years beginning after December 31, 1984, losses may be carried forward for a maximum of fifteen (15) years or until exhausted. A loss must be carried first to the earliest year in which the corporation has net income (determined without taking into account the loss carryforward). The excess, if any, may then be carried forward to the next earliest year, in succession, in which the corporation has net income. Any years in which the corporation had elected to be an Alabama S corporation are included within the maximum carryforward limitation of five or fifteen years, as well as any "year" of less than twelve months (as outlined in subparagraph (b) below).

(b) The term "year" includes a period of less than twelve months (short-year) resulting from a change in accounting period pursuant to §40-18-30. Thus, a short-year loss may be carried to a succeeding full year, or a full year loss may be utilized in a short-year.

(4) The loss for any year is to be computed under the law applicable to that year.

(5) In computing the amount of a net operating loss available for carryforward, certain adjustments must be taken into account.

(a) Due to the limitation on the charitable contributions deduction of §40-18-35(10), contributions may not form part of a net operating loss carryforward. For tax years beginning on or after January 1, 1985, excess contributions may be carried forward for a maximum of five years. See Rule 810-3-35-.01(3)(j).

(b) The net operating loss will be increased by the amount of any federal income tax accrued (or reduced by the amount of any refund) attributed to the corporation for the loss year.

(c) The amount available for carryforward must be reduced by the amount of any loss deduction which was available for use, even if not actually

used. No adjustment will be required under this subparagraph for years in which the corporation had in effect an election to be an Alabama S corporation.

(6) (a) For tax years beginning before January 1, 1990, the maximum amount of net operating loss carryforward which may be utilized in any year is $600,000. The excess, if any, may continue to be carried forward not to exceed the time limitations in paragraph (3) above. The net operating loss deduction utilized cannot create a net operating loss - that is, the result, after subtracting the net operating loss carryforward cannot be less than zero.

(b) For tax years beginning after December 31, 1989, the $600,000 limitation for subparagraph (a) no longer applies.

(7) EXAMPLE:

| | | | |
|---|---|---|---|
| Income | 1,000,000 | 4,000,000 | 3,500,000 |
| Expenses (except contributions) | 2,400,400 | 2,000,000 | 2,400,000 |
| Contributions | 100,000 | 100,000 | 100,000 |
| Totals | (1,500,000) | 1,900,000 | 1,000,000 |
| Contributions adjustment | 100,000 | -0- | -0- |
| Income before Federal Tax Deduction | (1,400,000) | 1,900,000 | 1,000,000 |
| Federal Tax (Deduction/ Refund) | 400,000 | (500,000) | (300,000) |
| Taxable Income/Net Operating Loss) | (1,000,000) | 1,400,000 | 700,000 |
| Net Operating Loss Carryforward | 1,000,000 | (600,000) | (400,000) |
| Net Taxable Income | -0- | 800,000 | 300,000 |

(8) A net operating loss carryforward deduction may only be utilized by the corporation which incurred the loss. A corporation, resulting from a reorganization will be considered to have incurred the losses not utilized by the parties to a reorganization in a transaction described in sections 1., 2., 5. and 6. of Rule 810-3-80-.04(1)(a). The limitations on the maximum carryforward period

and the ordering rules for multiple losses in paragraph (3) above, will be applied to the carryforwards after the reorganization as if the reorganization had not taken place. The limitation on the maximum amount of net operating losses which may be deducted in a taxable year in paragraph (6) above will be applied to the total of all carryforwards resulting from a reorganization.

(9) In the case of an acquiring corporation subject to the rules of 26 U.S.C. §381, or in the case of a new loss corporation within the meaning of 26 U.S.C. §382, or in the case of the recognized built-in gains of a gain corporation within the meaning of U.S.C. §384, only such net operating losses as are allowable in accordance with said U.S.C. §§381, 382, and 384 shall be allowed as a deduction under this section. This paragraph shall be applied before the limitations in this preceding example are applied.

(10) A net operating loss from any year in which the corporation had elected to be an Alabama S corporation may not be carried forward. See Rule 810-3-168-.01.

Author: Voncile Catledge, Individual and Corporate Tax Division
Authority: §§40-2A-7(a)(5) & 40-18-57, Code of Alabama 1975, as amended
History: Rule adopted through APA October 1, 1982.
Amended: Filed May 15,1992, effective June 19, 1992.
Amended: Filed February 1, 2000, effective March 7, 2000.

810-3-35.1-.02 Carryforward of Net Operating Losses for Corporations Apportioning and Allocating Income.

(1) (a) For corporations apportioning and allocating income to Alabama, the amount of a net operating loss to be attributed to Alabama will be computed in the manner provided in §40-18-33, Code of Alabama, 1975, and modified as provided in the Multistate Tax Compact, Chapter 27, Title 40, Code of Alabama 1975.

(b) In other words, a corporation apportioning and allocating income to Alabama will have a net operating loss attributed to Alabama if the sum of the following items is less than zero:

1. the income (or loss) apportioned to Alabama,

2. the income (or loss) allocated to Alabama,

3. any deductions allocated to Alabama (such as pollution control capital expenditures),

4. any federal income tax attributed to the corporation which is apportioned to Alabama income (this usually will be -0- because the federal tax apportionment factor will have -0- as either the numerator, the denominator or both), and

5. any overpayment of federal income tax previously taken as a deduction in Alabama returns for prior periods which is attributable to the taxpayer for the loss year.

(2) For a corporation apportioning and allocating income, the net operating loss attributed to Alabama will be treated as allocated to Alabama in the year utilized. That is, income (including the deduction for charitable contributions and the federal income tax deduction) for the year of utilization will first be computed as provided in §§ 40-18-33 and 40-27-1, and the net operating loss deduction then will be subtracted to determine taxable income.

Author: Voncile Catledge, Individual and Corporate Tax Division
Authority: §§ 40-2A-7(a)(5), 40-18-35.1-.1 and 40-8-57 , Code of Alabama 1975, as amended
History: Adopted January 28, 1987. Amended June 17, 1988; Filed July 27, 1988.
Amended: Filed February 1, 2000, effective March 7, 2000.

810-3-35.1-.03 Carryforward of Net Operating Losses for Corporations Filing Alabama Consolidated Returns.

(1) Corporations filing Alabama Consolidated Income Tax Returns will compute the net operating loss attributed to Alabama in the manner provided in Rules 810-3-31-.01 and 810-3-31-.02.

(2)(a) The deductibility of net operating losses incurred in a tax year before a corporation becomes a member of an Alabama affiliated group and elects to file an Alabama consolidated return is limited in accordance with the separate return limitation year (SRLY) rules contained in 26 U.S.C. §1502.

1. The term "separate return year" means a taxable year of a corporation for which it files a separate return or for which it joins in the filing of a consolidated return by another group.

2. The term separate return limitation year (or SRLY) means any separate return year of a member or of a predecessor of a member.

3. The term separate return limitation year (or SRLY) does not include:

(i) A separate return year of the corporation, which is the common parent for the consolidated return year to which the tax attribute is to be carried,

(ii) A separate return year of any corporation which was a member of the group for each day of such year, or

(iii) A separate return year of a predecessor of any member if such predecessor was a member of the group for each day of such year.

4. The term "group" means an affiliated group of corporations as defined in 26 USC §1504.

5. The term "member" means a corporation (including the common parent) that is included in the group, or as the context may require, a corporation that is included in a subgroup.

6. The term "predecessor" means a transferor or distributor of assets to a member (the successor) in a transaction -

(i) To which section 381(a) applies; or

(ii) That occurs on or after January 1, 1997, in which the successor's basis for the assets is determined, directly or indirectly, in whole or in part, by reference to the basis of the assets of the transferor or distributor, but in the case

of a transaction that occurs before June 25, 1999, only one member may be considered a predecessor to or a successor of one other member.

(b) The aggregate of the net operating loss carryovers of a member arising in SRLYs that are included in the consolidated net operating loss deductions for all consolidated return years of the group under paragraph (1) of this section may not exceed the aggregate consolidated taxable income for all consolidated return years of the group. For this purpose:

1. Consolidated taxable income is computed without regard to consolidated net operating loss deductions;

2. Consolidated taxable income takes into account the member's losses and deductions actually absorbed by the group in consolidated return years;

3. In computing consolidated taxable income, the consolidated return years of the group include only those years, including the year to which the loss is carried, that the member has been continuously included in the group's consolidated return, but exclude any years ending after the year to which the loss is carried.

(c) EXAMPLE: 1. In Year 1, corporation P sustains a $40 net operating loss that is carried forward. P has no income in Year 2. Unrelated corporation T sustains a net operating loss of $50 in year 2 that is carried forward. P buys the stock of T during Year 3, but T is not a member of the P group for each day of the year. P and T file separate returns and sustain net operating losses of $120 and $60, respectively, for Year 3. The P group files consolidated returns beginning in Year 4. During Year 4, the P group has $160 of consolidated taxable income (computed without regard to the consolidated net operating loss deduction). The consolidated taxable income would be $70 if determined by reference to only T's items. These results are summarized as follows:

| | Separate Year 1 | Separate/ Affiliated Year 2 | Consolidated Year 3 | Year 4 | |
|---|---|---|---|---|---|
| P | $(40) | $ 0 | $(120) | $ 90 | |
| T | $ 0 | $(50) | $( 60) | $ 70 | |
| CAI | | | | | $160 |

2. P's Year 1, Year 2, and Year 3 are not SRLYs with respect to the P group. P's $40 net operating loss arising in Year 1 and $120 net operating loss arising in Year 3 are not subject to the SRLY limitation. The loss arising in Year 1 is the first loss that the P group must absorb in Year 4. Absorption of this loss

leaves $120 of the group's consolidated taxable income available for offset by other loss carryovers.

3. T's Year 2 and 3 are SRLYs with respect to the P group. T's $50 net operating loss arising in year 2 and $60 net operating loss arising in Year 3 are subject to the SRLY limitation. Under paragraph (2)(b) of this section, the SRLY limitation for Year 4 is $70. T's $50 loss from year 2 must be included in the P group's consolidated net operating loss deduction for year 4. The absorption of this loss leaves $70 of the group's consolidated taxable income available for offset by other loss carryovers.

4. P and T each carry over net operating losses to Year 4 from a taxable year ending on the same date (Year 3). The losses carried over from Year 3 total $180. Under paragraph (b) of this section, the losses carried over from Year 3 are absorbed on a pro rata basis, even though one arises in a SRLY and the other does not. However, the group cannot absorb more than $20 of T's $60 net operating loss arising in Year 3 because its $70 SRLY limitation for Year 4 is reduced by T's $50 Year 2 SRLY loss already included in the consolidated net operating loss deduction for Year 4. Thus, the absorption of Year 3 losses is as follows:

Amount of P's Year 3 losses absorbed = $120/($120 + $20) x $70 = $60

Amount of T's Year 3 losses absorbed = $ 20/($120 + $20) x $70 = $10.

5. The absorption of $10 of T's Year 3 loss further reduces T's SRLY limitation to $10 ($70 of initial SRLY limitation, reduced by the $60 net operating loss already included in the consolidated net operating loss deductions for Year 4 under paragraph (a) of this section).

6. P carries its remaining $60 Year 3 net operating loss and T carries its remaining $50 Year 3 net operating loss over to Year 5. Assume that, in Year 5, the P group has $90 of consolidated taxable income (computed without regard to the consolidated net operating loss deduction). The group's consolidated taxable income determined by reference to only T's items is a consolidated net operating loss of $4. For Year 5, the consolidated net operating loss deduction includes $60 of P's Year 3 loss but only $6 of T's Year 3 loss (the aggregate consolidated taxable income for Years 4 and 5 determined by reference to T's items, or $66, reduced by T's SRLY losses actually absorbed by the group in Year 4, or $60).

(d) If any consolidated net operating loss that is attributable to a member may be carried to a separate return year of the member, the amount of the consolidated net operating loss that is attributable to the member is apportioned to the member (apportioned loss) and carried to the separate return

year. If carried over to a separate return year, the apportioned loss may not be carried over to an equivalent, or later, consolidated return year of the group.

1. The amount of a consolidated net operating loss that is attributable to a member is determined by a fraction the numerator of which is the separate net operating loss of the member for the year of the loss and the denominator of which is the sum of the separate net operating losses for that year of all members having such losses.

(e) If a corporation ceases to be a member during a consolidated return year, net operating loss carryovers attributable to the corporation are first carried to the consolidated return year, and only the amount so attributable that is not absorbed by the group in that year is carried to the corporation's first separate return year.

(f) In determining net operating loss carryovers for SRLY subgroups where an existing Alabama affiliated group acquires another affiliated group, the limitations on net operating loss carryovers from a SRLY apply to the SRLY subgroup and not to its members. In determining the members of a SRLY subgroup with respect to the carryover of a net operating loss, the SRLY subgroup is composed of the member carrying over the loss (the loss member) and each other member that was a member of the former group that becomes a member of the new group at the same time as the loss member.

(3) The limitation provided in paragraph (2) of this section does not apply to net operating loss carryovers when the application of paragraph 2 of this section results in an overlap with the application of 26 U.S.C. §382.

(a) An overlap of §382 with respect to a net operating loss occurs if a corporation becomes a member of a consolidated group (the SRLY event) within six months of the change date of an ownership change giving rise to a §382 limitation with respect to that carryover (the §382 event).

(b) If an overlap of this section occurs with respect to net operating loss carryovers of a corporation whose SRLY event occurs within the six month period beginning on the date of a §382 event then an overlap is treated as also occurring with respect to that corporation‘s net operating loss carryover that arises within the period beginning with the §382 event and ending with the SRLY event.

Author: Voncile Catledge
Authority: §§40-2A-7(a)(5) & 40-18-57, Code of Alabama 1975, as amended
History: New rule: Filed February 1, 2000, effective March 7, 2000.
Amended: Filed June 6, 2001, effective July 11, 2001.

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CHAPTER 810-3-36

Distribution by Corporations

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810-3-36-.01 Corporate Distributions **(REPEALED, Effective March 7, 2000)**

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CHAPTER 810-3-38

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810-3-38-.01 Additional Deductions Allowed for Corporations.

(1) In computing the amount of tax imposed by Section 40-18-31, there shall be allowed the following deductions:

(a) Interest received which is included in gross income under Section 40-18-34, upon;

1. obligations of the United States, and

2. bonds issued by the war finance corporation.

(b) Dividends received (subject to the limitations in subpart 4. below) from;

1. National banks, or

2. National banking associations, or

3. Corporations which are;

(i) engaged in the business of banking, and

(ii) conducting a financial business employing moneyed capital coming into competition with the business of national banks.

4. The deduction is allowed only during and for the periods during which;

(i) such national banks, corporations, individuals and partnerships are subject to an excise tax imposed by this state, or

(ii) the dividends received are paid by such corporations out of income subject to an excise tax imposed by this state.

(c) The amount of any aid or assistance, whether in the form of property, services or monies, provided to the State Industrial Development Authority (Authority) pursuant to Section 41-10-44.8(d).

1. The amount of aid or assistance provided shall be deducted in the year contributed to the Authority.

2. The deduction for property or services provided shall be the fair and reasonable value of the property or services as determined by the Authority.

3. Any portion of aid or assistance returned pursuant to Section 41-10-44.8(d), shall be included in income in the year in which the refund of the aid or assistance is made.

Author: Jeff Taylor
Income Tax Division
Authority: §40-18-38 and Act 93-852
History: Filed with LRS May 13, 1994. Certification filed with LRS August 26, 1994, effective date September 30, 1994.

810-3-38-.02 Additional Credits Allowed for Corporations. For an Approved Company whose project is financed by the State Industrial Development Authority's Project Obligations, the following shall be allowed as credits against the state corporate income tax imposed by Section 40-18-31:

(1) The credit available to an Approved Company pursuant to Section 41-10-44.8(a); and

(2) The credit available to an Approved Company pursuant to Section 41-10-44.9.

(3) The sum of the credits allowed in (1) and (2) above to an Approved Company in a given year shall not exceed the lesser of:

(a) the Approved Company's state corporate income tax liability for such year on the income generated by or arising out of a Project; or

(b) the total debt service payments made during such year by the Approved Company on the Project Obligations.

(4) Income generated by or arising out of a Project shall be determined by an Approved Company in accordance with the method set forth in a written agreement between the Company and the Department entered into before any Job Development Fees are collected.

(a) Whenever possible, such agreement shall require the Approved Company to separately account for all items of income and expense generated by or arising out of a Project.

(b) If it is impossible or impractical to separately account for such items, such agreement shall require the Approved Company to apportion all items of income and expense generated by or arising out of the Project based on the ratio of the Approved Company's property, payroll and sales attributed to or arising from the Project to the Approved Company's total property, payroll and sales in Alabama.

(c) If the methods set forth in (a) and (b) are impossible or impractical to utilize, such agreement shall require the use of any other method which has been agreed upon by the Approved Company and the Department to determine income generated by or arising out of a Project.

(5) For purposes of the limitations set forth in paragraphs (a) and (b) of (3), excess corporate income tax liability or debt service payments which are unused as a result of the applications of such limitations in a given year may not be carried backward or forward for use by an Approved Company in prior or subsequent years.

(6) For purposes of paragraphs (a) and (b) of (3), the term "Project" shall include the entire industrial, research or distribution facility acquired, constructed, expanded, or installed by an Approved Company at a given location as a result of the inducement available under Act No. 93-851 notwithstanding that only a portion of the cost of such facility may be financed with the proceeds of Project Obligations.

(7) For purposes of the limitations set forth in paragraphs (a) and (b) of (3), the term "Project Obligations" shall have the meaning ascribed to it in Section 41-10-44.2.

(8) Pursuant to Section 41-10-44.8(c), if an Approved Company fails to achieve the level of capital investment or employment anticipated at the time the State Industrial Development Authority agreed to finance the Project, the Department may, after notice and hearing, prospectively reduce or suspend all or part of the credits allowed in (1) and (2) above until such time as the anticipated capital investment and employment levels are met.

(9) A taxpayer claiming either of the credits allowed in (1) and (2) shall attach to its corporate income tax return a certificate executed by the State Industrial Development Authority confirming the taxpayer's status as an Approved Company pursuant to Section 41-10-44.4 together with a copy of the agreement required by paragraph (4) above.

Author: Jeff Taylor and Ann F. Winborne
Authority: §40-18-38 and Act 93-852
History: Filed with LRS May 13, 1994. Certification filed with LRS August 26, 1994, effective date September 30, 1994.

RULES OF
DEPARTMENT OF REVENUE

CHAPTER 810-3-39

Corporation Returns

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810-3-39-.01 Corporation Returns.

(1) (a) Each corporation, joint stock company, or association, except as provided in (b), subject to Alabama income tax shall file a separate return for each tax year, including organizations subject to taxation on unrelated business taxable income as provided in § 40-18-32, Code of Alabama 1975. The return (Form 20C for corporations–and organizations with unrelated business taxable income, and Form 20S for an Alabama S corporation) shall be filled out completely and in accordance with the instructions. The return must be signed by one of the following officers: the president, vice-president, treasurer, assistant treasurer, secretary, assistant secretary, chief accounting or financial officer. The individual preparing the return, if not an officer or employee of the corporation or organization making the return, must also sign the return, and his address should be shown.

(b) An Alabama affiliated group may elect to file an Alabama consolidated return, in lieu of separate returns for the taxable year. The election is made on Form 20C-CRE (Consolidated Return Election) which shall be filed by the common parent on or before the due date, including extensions, of the Alabama consolidated return for the first taxable year for which the election is made. The Alabama consolidated return must be signed by one of the officers of the common parent listed in (1)(a) on behalf of the Alabama affiliated group. All pertinent and necessary data needed to compute the tax must be attached to the return. Form 20C-AS (Alabama Affiliations Schedule) should be attached to the Alabama consolidated return for each year the election is in effect.

(2) If the property or business of a corporation is operated by a receiver, trustee, or assignee, such person shall make a return for the corporation in the same manner as the corporation would otherwise make the return. Any tax due on the basis of such return shall be collected in the same manner as if collected from the corporation.

(3) All corporation returns shall be made on or before the fifteenth day of the third month following the close of the tax year of the corporation. The return of a corporation, or an Alabama affiliated group reporting for a calendar year is due the fifteenth day of March of the following year.

(4) Nexus. If an Alabama affiliated group elects to file an Alabama consolidated return, each and every member of the Alabama affiliated group has voluntarily agreed to nexus with the State of Alabama for income tax purposes. The election, once made, is conclusively binding on each and every member of the Alabama affiliated group as to nexus with the State of Alabama for income tax purposes - as long as the election is in effect.

(5) Extension of time for filing the return of a corporation may be granted under authority of § 40-18-39. See Rule 810-3-39-.02.

(6) Consolidated corporate returns were not permitted by the laws of Alabama for tax years beginning prior to January 1, 1999.

Author: Verlon Frost, C. McCary and M. Moncrief
Authority: §§ 40-18-39 and 40-2A-7(a)(5) Code of Alabama 1975
History: Adopted September 30, 1982.
Amended: June 17, 1988. Filed with LRS July 27, 1988.
Amended: Filed May 3, 2000, effective June 7, 2000.

810-3-39-.02 Extension of Time for Filing a Corporation Return.

(1) Automatic Extension. When a corporation or an Alabama affiliated group has been granted an extension, up to a maximum of six months, by the Internal Revenue Service, an automatic extension for the same period will be granted to file the Alabama corporation income tax return. To qualify for this automatic extension, the Alabama return, filed within the extended period, shall include a copy of the approved Federal extension. If a copy of the Federal approved form is not properly attached to the return when filed, the return will be considered delinquent and a penalty shall be assessed. Any tax due, not paid on or before the unextended due date, will be subject to interest until paid at the rate provided in § 40-1-44, Code of Alabama 1975, and all applicable penalties.

(2) Additional Extensions.

(a) Any extension beyond that granted by the Internal Revenue Service must be requested in writing to be individually approved. A copy of the Federal Form 7004 must be included with a request for such an extension. An Alabama affiliated group must attach a copy of the Federal Form 851. A copy of such granted extension shall be included with the Alabama return when filed. No extension can be granted for more than six months.

(b) A corporation or an Alabama affiliated group may request an extension of time to file its Alabama income tax return, without regard to whether or not an extension of time to file the federal return has been requested, by filing Alabama Form 20-E. The Alabama affiliated group must attach a copy of Alabama Form 20C-AS.

(3) Estimated Payments. Those corporations with liabilities in excess of estimated payments or credits (even if an extension of time to file has been requested or granted) should file Alabama Form 20-E with the Department on or before the due date of the return, together with remittance covering the liability. Members of an Alabama affiliated group which have carryover payments from a prior year's filing of a separate return shall treat such carryover as a payment of estimated taxes on the Alabama consolidated return for the following year. Interest and penalties are due on all taxes not paid on or before the unextended due date. See Rule 810-3-42-.01.

(4) Termination of Extension.

(a) The Department may terminate an extension at any time by mailing a notice of termination to the corporation or to the person who requested the extension for the corporation. The notice shall be mailed at least ten days prior to the termination date designated in the notice.

(b) Termination by the Internal Revenue Service of an extension granted on Form 7004 also terminates the automatic extension granted by the Department.

(c) If the Department rejects a request for an extension, the return must be filed within 10 days after the date the Department mails the notice of rejection.

Author: Verlon Frost, C. McCary and M. Moncrief
Authority: Sections 40-18-39 and 40-2A-7(a)(5), Code of Alabama 1975
History: Adopted September 30, 1982.
Amended: June 17, 1988. Filed with LRS July 27, 1988.
Amended: Filed May 3, 2000, effective June 7, 2000.

810-3-39-.03 Consolidated Filing.

(1) Making the Election. The election is made by the common parent of the Alabama affiliated group properly completing and filing Form 20C-CRE (Election to File Consolidated Corporate Income Tax Return), Form 20C-AS (Affiliations Schedule), and the Alabama consolidated return, Form 20C, with the annual fee by the due date (including extensions). If the election is not filed timely with payment of the annual fee, the election is invalid.

(2) Liability. Each corporation included in the Alabama consolidated return will be jointly and severally liable for the Alabama income tax liability of the Alabama affiliated group. If a corporation is a member of the Alabama affiliated group for only part of the tax year, then the corporation will be liable for only the portion of the Alabama consolidated tax liability attributed to that portion of the year that the corporation was a member of the Alabama affiliated group prorated on a daily basis. The tax liability of the Alabama affiliated group will be the Alabama tax rate specified in § 40-18-31 applied to the taxable income of the Alabama affiliated group.

(a) Part-year members. If an eligible corporation becomes a member of an Alabama affiliated group after the beginning of the Alabama consolidated return year or ceases to be a member of the Alabama affiliated group during the consolidated return year, two tax returns will be due for that taxable year. The Alabama consolidated return shall include amounts attributable to such corporation for the part of the year in which it was a member of the Alabama affiliated group. A separate return shall be filed and include (or if a member of a different Alabama affiliated group, such group's Alabama consolidated return shall include) amounts attributable to such corporation for the remainder of the taxable year. The method used to determine the federal taxable income of that member will be used to attribute amounts of taxable income or loss, modifications, business income or loss, apportionment factors, nonbusiness or partnership income or loss, and credits to the different portions of the taxable year.

(b) Ineligible members. If a part-year member is a taxpayer that is ineligible to be a member of an Alabama affiliated group it shall file a separate tax return for the respective period(s) using the accounting method used in determining federal taxable income of such member.

(c) Liability of corporation after withdrawal. If a corporation has ceased to be a member of an Alabama affiliated group and if such cessation resulted from a bona fide sale or exchange of its stock for fair value and occurred prior to the date upon which any deficiency is assessed, the Commissioner may, if the Department determines that the assessment or collection of the balance of the deficiency will not be jeopardized, make assessment and collection of such deficiency from such former member in an amount not exceeding the portion of

such deficiency which the Commissioner may determine to be allocable to it. If the Commissioner makes assessment and collection of any part of a deficiency from such former member, then for purposes of any credit or refund of the amount collected from such former member, the agency of the common parent will not apply.

(d) Effect of intercompany agreements. No agreement entered into by one or more members of the Alabama affiliated group with any other member of the group or with any other person will in any case have the effect of reducing the liability prescribed pursuant to § 40-18-39.

(3) Computation of consolidated income. The business income of the members of the Alabama affiliated group is combined and apportioned to the state in the ratio that the Alabama property, payroll and sales numerator of the Alabama affiliated group bears to the Alabama affiliated group's property, payroll, and sales denominator everywhere.

(a) All intercompany transactions between and among members of an Alabama affiliated group will be eliminated in computing taxable income or loss and in determining the Alabama apportionment factor.

1. An intercompany transaction is a transaction between corporations that are members of the same Alabama affiliated group immediately after the transaction.

2. Treasury regulations §1.1502 et seq. and interpretations thereof regarding intercompany transactions apply in determining the taxable income or loss of an Alabama affiliated group.

(b) The federal income tax deduction for the Alabama affiliated group is the consolidated federal income tax liability per federal return determined for a single taxpayer in accordance with Rule 810-3-35-.01.

(c) The nonbusiness income, loss, or interest expense will be computed separately for each member of the Alabama affiliated group and then the amounts will be combined.

(d) The property factor, payroll factor, and sales factor as determined in accordance with § 40-27-1 Article IV, and regulations promulgated thereunder, will be adjusted to eliminate intercompany transactions.

(4) Consolidated estimated tax.

(a) Generally. If an Alabama affiliated group files an Alabama consolidated return for two consecutive taxable years, it must make payments of estimated tax on a consolidated basis for each subsequent taxable year, until such time as separate returns

are properly filed. Until such time, the Alabama affiliated group is treated as a single corporation for purposes of § 40-18-82 (relating to payment of estimated tax by corporations). If separate returns are filed by the members of an Alabama affiliated group for a taxable year, the amount of any estimated tax payments made with respect to a consolidated payment of estimated tax for such year will be credited against the separate tax liabilities of the members in any manner designated by the common parent which is reasonably satisfactory to the Department. For example, the manner of allocation will be satisfactory to the Department if it does not jeopardize the collection of any income tax liability.

(b) First two consolidated return years. For the first two years for which an Alabama affiliated group files a federal and a Alabama consolidated return, it may make payments of estimated tax on either a consolidated or separate basis. If a consolidated return is filed for such year, the amount of any estimated tax payments made for such year by any member will be credited against the tax liability of the Alabama affiliated group. The amount of any separate estimated tax payments made for such year will be credited against the combined income tax liability for the Alabama affiliated group.

(c) Example. Corporations P and S-1 file a federal and an Alabama consolidated return for the first time for calendar year 1999. Corporations P and S-1 also file Alabama consolidated returns for calendar years 2000 and 2001. For calendar years 1999 and 2000, Corporations P and S-1 may make payments of estimated Alabama income tax on either a separate or consolidated basis. For calendar year 2001, however, the Alabama affiliated group must pay its estimated tax on a consolidated basis.

(5) Records. In accordance with § 40-2A-7, taxpayers must maintain records to allow the Department to determine the correct amount of tax including support for deviations from federal to Alabama income, gain computations, elimination entries, etc.

(6) Federal statutes. For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

(7) Effective date. This rule is effective for tax periods beginning after December 31, 1998.

Author: Cathy McCary, Melody Moncrief, and Michael Mason, CPA
Authority: §§ 40-2A-7(a)(5)and 40-18-39, Code of Alabama 1975.
History: New rule: Filed December 15, 1999, effective January 19, 2000.

810-3-39-.04 Incentives Rules for Alabama Affiliated Groups Filing Consolidated Alabama Income Tax Returns.

(1) **Scope:** Alabama provides various business incentives in the form of tax credits and exemptions to specific taxpayers who register and qualify for specific programs. The rules and examples presented herein are to facilitate the computation of incentives for an Alabama affiliated group filing a consolidated Alabama income tax return.

(2)(a) **Consolidated Filing Fee:** Incentives in the form of credits may not be used to reduce the Alabama affiliated group's consolidated filing fee, however, estimated tax payments exceeding the current year's net tax liability may be applied to the yearly consolidated filing fee.

(b) EXAMPLE: The consolidated income tax return indicates a tax liability of $50,000 after accounting for any net operating loss (NOL). The separate filing fee is $2,500. The available incentives from various programs total $55,000. Because the available tax credit exceeds the tax liability, the usable tax credit is limited to $50,000. The taxpayer must remit the $2,500 filing fee when the return is filed.

(3) **Separation from the Affiliated Group:** An incentive for which a member has qualified continues exclusively with such member upon separation from an Alabama affiliated group.

(4) **Applicability of Incentives:** Several members in an Alabama affiliated group may qualify for one or more of the various incentives provided by the state. Each qualifying member within the Alabama affiliated group must compute its incentives separately each year.

(a) Generally. The various usable incentives, as computed separately by each eligible member of the group, shall be added and that total shall be made available to reduce the consolidated income tax liability reflected on the consolidated income tax return. The use of incentives to reduce consolidated income of an Alabama affiliated group is limited by both the availability of allowable incentives to the qualifying member of the Alabama affiliated group and the consolidated income of the Alabama affiliated group.

(b) Records Retention. For each tax period for which a member qualifies for an incentive, the member must first compute its separate Alabama income tax liability as if it were filing a separate return using the format of Form 20C. Each member's separate income tax liability and incentives computations shall be retained by both the member and Common Parent corporation for a period of seven years. These records shall be made available to the Department in their entirety (including details pertaining to any tax credit, job development fees, or other incentives for each tax period) upon written request

by the Department. The Department will disallow incentives for failure to retain the required detailed documentation.

(c) Carryovers. No incentive shall be available for carryover by the member to the following tax period of that member unless permitted by the code section providing the credit or incentive.

(d) Incentives Non-Refundable. No incentive may produce a refund of tax not paid by the member nor be carried over unless specifically permitted by the section of the Code of Alabama 1975 which grants the incentive. An NOL will therefore reduce the amount of available tax credit which each member computes. The resulting credit will be the usable credit.

(e) Net Operating Losses. The total amount of usable incentives from each member's calculation will be available for use on the consolidated return. The usability of such amount shall be further restricted by all NOLs used to reduce the consolidated income tax liability.

(5) **EXAMPLE:** Consolidated Group A has elected to file an Alabama consolidated income tax return for tax period ending December 31, 1999. Group A has Common Parent Y and Subsidiary Z. Common Parent Y is a coal producer and has qualified for the coal income tax credit pursuant to § 40-18-220, Code of Alabama 1975. Subsidiary Z is a manufacturer and has qualified for an income tax credit and job development fees under the State Industrial Development Authority program pursuant to §§ 41-10-44.8 and 40-18-200.

(a) Common Parent Y will compute its Alabama income tax liability and available coal credit as if filing a separate income tax return. In this instance Common Parent Y has computed its Alabama taxable income as $10,000 before any NOL and its available coal credit as $5,000. Common Parent Y has an NOL of $9,000 attributable to Alabama operations. Common Parent Y's usable coal credit is computed as ($10,000 less $9,000 NOL) x 5% = $50. The credit may not exceed the liability of the Alabama affiliated group.

(b) Subsidiary Z will compute its Alabama income tax liability and available income tax credit as if filing a separate income tax return. Subsidiary Z has computed its Alabama taxable income as $10,000,000 and income attributable to the project as $5,000,000 (under a written agreement with the Department). Subsidiary Z withheld $200,000 in job development fees (JDF) during this tax period. Subsidiary Z made principal and interest payments during this tax period of $2,000,000 to satisfy its project obligations. Subsidiary Z has an available income tax credit of $250,000 ($5,000,000 income from project x 5% tax rate =$250,000). Note: § 41-10-44.8(a)(1) provides that the income tax credit shall be the lesser of the income tax due from project income or the payments made to satisfy project obligations and § 41-10-44.8(a)(2) provides for JDF retention only to the extent that payments made to satisfy project obligations

exceed the income tax credit permitted in § 41-10-44.8(a)(1) ($2,000,000 debt payments - $250,000 income tax credit = 1,750,000 maximum job development fees, limited to Subsidiary Z's $200,000 actual job development fees withheld.) The credit for the Alabama affiliated group would be limited to $200,000 for the incentive relating to Subsidiary Z and the ability of the Alabama affiliated group to utilize this incentive is further limited by the consolidated tax liability of the Alabama affiliated group.

(c) Group A has consolidated taxable income attributable to Alabama of $15,000,000 before any NOLs. Group A has a consolidated NOL of $9,000 attributable to Alabama. Group A has an adjusted Alabama consolidated taxable income of $14,991,000 ($15,000,000 less $9,000 NOL). Group A has an Alabama consolidated income tax liability of $749,550 ($14,991,000 consolidated taxable income x 5% tax rate). Group A has a credit available of $250,050 ($50 coal credit from Common Parent Y plus $250,000 income tax credit from Subsidiary Z). Group A's net Alabama income tax liability is $499,500 ($749,550 income tax liability less $250,050 usable credits).

(6) **EXAMPLE:** Consolidated Group G has Common Parent P and Subsidiaries A, B, C and D. Consolidated Group G has elected to file an Alabama consolidated income tax return for tax period ending December 31, 1999. Common Parent P and Subsidiary D do not qualify for any incentives in this state. Subsidiary A is a small business located in an Enterprise Zone and has qualified for certain tax incentives pursuant to § 41-23-30. Subsidiary B is a manufacturer and has qualified for the capital credit pursuant to § 40-18-194. Subsidiary C is qualified for the Basic Skills Education Program (BSEP) credit pursuant to § 40-18-136, and is also located in an Enterprise Zone and has qualified for tax credits pursuant to § 41-23-22.

(a) Subsidiary A computes its Alabama taxable income as $100,000. Subsidiary A has a 50% income tax exemption (per agreement with the Alabama Department of Economic and Community Affairs). The income tax exemption is $2,500 ($100,000 taxable income x 5% = $5,000 income tax x 50% exemption). The tax exemption is available as a $2,500 credit.

(b) Subsidiary B computes its Alabama taxable income as $10,000,000. Income from the project is computed at $1,000,000 (per written agreement with Alabama Department of Revenue). Subsidiary B's available capital credit is $75,000 (determined by total investment of project x 5% as computed on Form INT-2). Subsidiary B's tax liability generated from the project is $50,000 ($1,000,000 project income x 5% tax rate). The credit may not exceed the subsidiary's separately calculated Alabama tax liability; therefore, the credit is limited to $50,000.

(c) Subsidiary C computes its Alabama taxable income as $150,000. Subsidiary C computes its BSEP credit as $800 and its Enterprise Zone Credit as

$3,000. Subsidiary C uses $2,000 of the Enterprise Zone Credit to satisfy its Alabama franchise tax liability. Subsidiary C has available a potential income tax credit of $1,800 ($3,000 Enterprise Zone credit less $2,000 used for franchise tax plus $800 BSEP credit).

(d) Group G computes its consolidated Alabama taxable income as $25,000,000. The group has no NOL available. Group G has an income tax liability of $1,250,000 (taxable income x 5% tax rate). Group G has income tax credits available of $54,300 ($2,500 from Subsidiary A, $50,000 from Subsidiary B, and $1,800 from Subsidiary C). Group G utilizes these income tax credits and has an adjusted Alabama income tax liability of $1,195,700 ($1,250,000 less income tax credits of $54,300). Group G has made estimated income tax payments of $1,200,000 using Form 20CD. Group G has an overpayment of $4,300 (estimated payments of $1,200,000 less adjusted income tax liability of $1,195,600). Group G has a consolidated filing fee due of $5,000. Group G may apply the overpayment of $4,300 to the consolidated filing fee and remit $700 at the time the return is filed.

(7) This rule is effective for all tax periods beginning after December 31, 1998.

Authors: Michael E. Mason, Commissioner's Office; Verlon Frost and Melody Moncrief, Individual and Corporate Tax Division.
Authority: §§ 40-2A-7(a)(5), 40-18-39 and 40-18-57, Code of Alabama 1975.
History: New rule: Filed May 3, 2000, effective June 7, 2000.

810-3-39-.05 Taxable Years Following an Election Period for an Alabama Affiliated Group.

(1) Except as provided in paragraph (2), for any taxable year beginning after the expiration of the election period set forth in § 40-18-39(c)(6), Code of Alabama 1975, each member of the Alabama affiliated group subject to Alabama income tax shall file a separate return unless the Alabama affiliated group elects to file an Alabama consolidated return and is not otherwise prohibited from doing so.

(2) The election to file an Alabama consolidated return on or before the date prescribed by Rule 810-3-39-.01 for filing the return or as extended pursuant to Rule 810-3-39-.01 for the first taxable year after the expiration of the 96 month election period, shall:

(a) Constitute a new election to file an Alabama consolidated return; and

(b) Establish a new election period under § 40-18-39(c)(6).

Authors: Michael E. Mason, Commissioner's Office; Verlon Frost, Individual and Corporate Tax Division.
Authority: §§40-2A-7(a)(5), 40-18-39, and 40-18-57, Code of Alabama 1975.
History: New rule: Filed May 3, 2000, effective June 7, 2000.

810-3-39-.06 Mechanics of Consolidated Filing.

(1) In General. This rule is established in respect to the apportionment of income and loss from an Alabama Affiliated Group (AAG) that is taxable both in this state and in one or more other states.

(a) When an AAG has elected to file an Alabama consolidated return in lieu of separate returns and has income from sources both within and without this state, the taxable income or loss of the AAG and the business and nonbusiness income of each member shall be determined pursuant to Title 40, Chapter 18 and § 40-27-1, Article IV, Code of Alabama 1975, and regulations issued thereunder by the Alabama Department of Revenue (ADOR), except as modified by this regulation. The AAG shall be treated as a single corporation and all transactions between and among members of the AAG shall be eliminated in computing taxable income, loss, and in determining the Alabama property, payroll, and sales apportionment factors. See § 40-18-39(c)(3), Code of Alabama 1975.

(2) Business and Nonbusiness Income. The classification of business and nonbusiness income or loss shall be determined pursuant to § 40-27-1, Article IV, Code of Alabama 1975, and the regulations issued thereunder by the ADOR. For definitions, regulations, and examples for determining whether income shall be classified as "business" or "nonbusiness" income, see Rule 810-27-1-4-.01.

(a) The business and nonbusiness income or loss of each member is determined in accordance with Title 40, Chapter 18 and with the rules of allocation and apportionment under § 40-27-1, Article IV.

(3) Apportionment of Business Income.

(a) In General. The property factor shall be determined in accordance with Rules 810-27-1-4-.10, 810-27-1-4-.11, and 810-27-1-4-.12; the payroll factor in accordance with Rules 810-27-1-4-.13 and 810-27-1-4-.14; and the sales factor in accordance with Rules 810-27-1-4-.15, and 810-27-1-4-.16. The special rules stated in Rule 810-27-1-4-.18 apply to AAGs. The total AAG's combined business income is multiplied by the Alabama apportionment factor average percentage (commonly referred to as the Alabama apportionment factors - See Alabama Form 20C) which is the sum of the AAG's Alabama property factor, payroll factor, and sales factor, divided by three pursuant to § 40-27-1, Article IV.9.

(b) Alabama Property Factor.

1. In General. The AAG's Alabama property factor is a fraction, the numerator of which is the average value of the AAG's real and tangible personal

property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the AAG's real and tangible personal property owned or rented and used during the tax period everywhere.

2. Property Factor Denominator. All real and tangible personal property of the AAG (the sum of the group's property everywhere), whether owned or rented and used everywhere during the tax period, shall be included in the denominator of the property factor as described in Rule 810-27-1-4-.10.

3. Property Factor Numerator. All real and tangible personal property owned or rented by the AAG and used in this state (the sum of each member's property employed in this state) during the tax period shall be included in the numerator of the property factor as provided in Rule 810-27-1-4-.10(d).

(c) Alabama Payroll Factor.

1. In General. The AAG's Alabama payroll factor is a fraction, the numerator of which is the total amount paid in this state during the tax period by the AAG and the denominator of which is the total paid everywhere by the AAG during the tax period.

2. Payroll Factor Denominator. The denominator of the payroll factor shall include all compensation paid to employees for the production of business income during the tax period for the AAG everywhere as provided in Rule 810-27-1-4-.13(b).

3. Payroll Factor Numerator. The numerator of the payroll factor shall include all compensation paid to employees within this state by the AAG for the production of business income (the sum of each member's payroll within this state during the tax period) as may be determined by the application of the provisions of Rules 810-27-1-4-.13(c) and 810-27-1-4-.14.

(d) Alabama Sales Factor.

1. In General. The AAG's Alabama sales factor is a fraction, the numerator of which is the total sales of the AAG in this state during the tax period, and the denominator of which is the total sales of the AAG everywhere.

2. Sales Factor Denominator. The denominator of the sales factor is the total sales derived by the AAG from transactions and activity in the regular course of its trade or business everywhere as provided in Rule 810-27-1-4-.15(b).

3. Sales Factor Numerator. The numerator of the sales factor is the total sales of the AAG in this state (the sum of each member's sales within this state) during the tax period as provided in Rule 810-27-1-4-15(c).

(e) Application of Attributional Nexus. In determining activities within and without Alabama beyond the protection of P.L. 86-272, activities that are conducted by one or more members of the AAG shall be considered attributable to the AAG. See § 40-18-39(c)(3).

1. **EXAMPLE:** If a member of the AAG sells goods shipped to a purchaser in Alabama, and that member is not taxable in the state of shipment, the sale is assigned to Alabama, provided that no other member of the AAG is taxable in the state of shipment. Conversely, if a member sells goods to a purchaser in another state which are shipped from Alabama, and that member is not taxable in the state of destination, the sale is not assigned to Alabama, provided that another member of the AAG is taxable in the state of destination.

(4) Liability.

(a) In General.

1. Full-year members. Each full-year member of the AAG is jointly and severally liable for all of the Alabama consolidated income tax liability.

2. Part-year members. A corporation, not a member of the AAG for the entire taxable year, is jointly and severally liable only for the portion of the Alabama Consolidated Income Tax Liability attributable to that portion of the year during which the corporation was a member of the AAG prorated on a daily basis.

3. Liability for the Annual Fee. Each member, whether a full-year member or a part-year member, is jointly and severally liability for the full amount of the annual fee assessed in § 40-18-39(c)(7).

(b) **EXAMPLE:** Corporate Group X elected to become an AAG effective January 1, 1999. The Alabama Consolidated Income Tax Liability for AAG X for the calendar year 1999 is $365,000. AAG X, which was in business during the entire calendar year, has three members, A, B, and C, as follows:

| | **Number of Days a Member of AAG X During Tax Year** |
|---|---|
| **Member A** | 90 |
| **Member B** | 365 |
| **Member C** | 365 |

The Total Prorated Alabama Consolidated Income Tax Liability for each member is computed as follows:

**Member A**

(90 days / 365 days) multiplied by $365,000 = $90,000

**Member B**

(365 days / 365 days) multiplied by $365,000 = $365,000

**Member C**

(365 days / 365 days) multiplied by $365,000 = $365,000

(c) The Common Parent has the responsibility of constructing and maintaining records to substantiate a member's liability.

Authors: Michael E. Mason, Commissioner's Office; Verlon Frost, Individual and Corporate Tax Division.
Authority: §§40-2A-7(a)(5), 40-18-57, Code of Alabama 1975.
History: New rule: Filed May 3, 2000, effective June 7, 2000.

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810-3-40-.01 Tax to be Reported on Prescribed Forms.

(1) All tax shall be reported on forms prescribed by the Department. Each taxpayer shall file a return or returns with the Department for each tax year on forms prescribed for taxpayers of the class within which the taxpayer falls. Should the Department not furnish copies of the appropriate form to the taxpayer, the taxpayer may obtain them upon request.

(2) The amount shown to be due on the return or returns filed by the taxpayer with the Department shall constitute the prima facie liability of the taxpayer. If the Department finds no error in a return, it shall be entered on the tax rolls. The taxpayer will receive no notification of this action unless the tax as shown to be due by the return has not been paid.

(3) The Department may assess additional tax, penalty, and/or interest pursuant to Chapter 2A, Title 40, Code of Alabama 1975, and the rules promulgated thereunder.

(4) For the purposes of reporting, paying, and notifying the Department of changes made by the Internal Revenue Service, changes due to a federal amended return, or other changes to the federal return which result in an increase or decrease of income or estate tax due the state or the taxpayer, the following rules shall be followed:

(a) The taxpayer shall file a completed amended return for each year indicating the additional tax owed the state or refund requested.

(b) If the amended return is filed as a result of changes made by the Internal Revenue Service a copy of the federal revenue agent's report or any other itemized explanation of the federal changes furnished to the taxpayer shall be attached to each amended return filed.

(c) Forms authorized by the department must be used to report such changes.

1. Individuals shall file a Form 40X.

2. Partnership's, fiduciary's, "C" corporations and "S" corporations shall check the "Amended Return" box.

(d) Example: A taxpayer has a 1988 tax year audit finalized with the Internal Revenue Service which has resulted in additional tax due this state. The taxpayer intends to notify the state of such changes but does not have available a 1988 Alabama corporation income tax form. The taxpayer shall contact the Department and request a 1988 form or the taxpayer may use a similar version of the 1988 form. In this case the taxpayer has a 1993 Form 20C. The taxpayer

strikes through “1993" and writes “1988.” The taxpayer checks the “amended return” box and completes the form. The taxpayer mails or delivers to the department the amended return, a check for the additional tax and applicable interest, and a copy of the Internal Revenue Service changes.

(5) A taxpayer failing to substantially comply with the rules and example outlined in subsection (4) above shall be subject to the five percent negligence penalty pursuant to §40-2A-11(c), Code of Alabama, 1975. See *Nellie F. Crumb v. State*, Inc. 96-497 (Admin. Law Div. 4/10/1997).

Authors: Anne Simms, Carmen Mills and Verlon R. Frost
Authority: §§40-2A-7(a)(5) & 40-18-57, Code of Alabama 1975
History: New rule: Filed May 3, 2000, effective June 7, 2000.

810-3-40-.02 Whole Dollar Reporting.

(1) Whole Dollar Reporting Mandatory. Effective December 31, 1998, all tax forms, declarations, statements or other documents submitted to the Individual and Corporate Tax Division shall be completed using whole dollar amounts only.

(2) Rounding to Nearest Whole Dollar Amount. Amounts of 49 cents or less shall be rounded down to the nearest whole dollar amount. Amounts of 50 to 99 cents shall be rounded up to the nearest whole dollar amount.

Author: Judy A. Robbins
Authority: §§40-2A-7(a)(5) and 40-18-40, Code of Alabama 1975
History: New rule: Filed May 3, 2000, effective June 7, 2000.

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810-3-42-.01 Time of Payment of Tax.

(1) Individuals. The income tax return for an individual is due on April 15th following the close of the calendar year or the fifteenth day of the fourth month following the close of a fiscal year. Any balance due, as shown on the return when filed, after applicable credits for taxes paid through withholding and through declarations of estimated tax, must be paid on or before the due date for filing the return.

(2) Fiduciaries. The income tax returns for fiduciaries are due on April 15th following the close of a calendar year or the fifteenth day of the fourth month following the close of the tax year. The tax shown due on the return must be paid on or before the due date for filing the return.

(3) Corporations. The income tax returns for corporations are due on March 15th following the close of the calendar year or on the fifteenth day of the third month following the close of the fiscal year. The tax due on the return, after applicable credits, must be paid on or before the due date for filing the return.

(4) Organizations with Unrelated Business Taxable Income. The income tax returns for organizations with unrelated business taxable income are due at the same time as returns for corporations as specified in paragraph (3) above.

(5) Interest on all past due and unpaid taxes will be collected at the current interest rate prescribed by § 40-1-44.

(6) Advance Payments. Any taxpayer may pay any portion or all of his tax prior to the dates stated above. However, the Department has no authority to discharge a liability for income tax before the end of the taxable year, as the liability cannot be determined until the year is ended.

(7) For tax years ending after December 31, 1984, any payment which is postmarked on or before the last date for timely payment will be considered to be timely paid. See Reg. 810-1-5-.01.

Authors: Carmen Mills and Anne Simms
Authority: §§ 40-2A-7(a)(5) and 40-18-42, Code of Alabama 1975
History: Adopted September 30, 1982.
Amended: June 17, 1988; Filed with LRS July 27, 1988.
Amended: Filed May 3, 2000, effective June 7, 2000.

810-3-42-.02 Extension of Time for Payment.

(1) The Department is authorized to grant extensions for the payment of tax for a period not to exceed three months. Applications for extension should be made in writing in time for consideration by the Department before the date on which the payment is due. The application should be signed by the taxpayer or his duly authorized agent.

(2) If an extension of time to make payment is granted, no penalty for late payment will be incurred, if payment is made within the extended period, but interest will accrue at the rate provided in § 40-1-44 from the unextended due date for payment until payment is made.

(3) For extension of time for filing returns, see Sec. 40-18-27.

Authors: Anne Simms, Carmen Mills
Authority: §40-2A-7(a)(5) and 40-18-42, Code of Alabama 1975
History: Adopted September 30, 1982.
Amended: June 17, 1988; Filed with LRS July 27, 1988.
Amended: Filed May 3, 2000, effective June 7, 2000.

810-3-42-.03. Deferment of Tax in Hardship Cases under Soldiers' and Sailors' Civil Relief Act.

(1) Public Law No. 861 of the United States, known as the Soldiers' and Sailors' Civil Relief Act, provides that persons in the military service of the United States who can show their inability to pay income tax by reason of such service be granted deferment of income tax, without interest, during the period of military service and for a period extending not more than six months after termination of the military service.

(2) Military personnel claiming the benefit of this relief will be required to file with the Department of Revenue requests for deferment stating their financial condition and affirming that their ability to pay the state income tax has been materially impaired by reason of their military service.

§ 40-18-57

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810-3-44-.01. Installment Basis Sales - Sales of Real Estate and Casual Sales of Personal Property.

(1) (a) For transactions prior to January 1, 1985 - With three important exceptions, Sec. 40-18-44 (as in effect before January 1, 1985) is with regard to the sale of real estate and the casual sale of personal property for a price exceeding $1,000, essentially the same as provisions of the United States Internal Revenue Code as in effect prior to January 1, 1985. The Department will therefore consider the rules and decisions of the Internal Revenue Service and the Federal courts with respect to this section. The basic differences in the two laws are:

(1) In Sec. 40-18-44(b)(ii), (as in effect prior to January 1, 1985) in order to qualify for the use of the installment method, the Alabama law requires that the principal payments received in the year of sale not exceed forty percent of the selling price.

(2) Alabama law requires that the election to use the installment basis must be made in the return for the year of the sale.

(3) The provision of the Federal Tax Reform Act of 1984 (P. L. 98-369) requiring that depreciation previously expensed be recognized in the year of sale whether or not any payments were received, does not apply.

(b) Installment Sales - Dealers in Personal Property - Prior to January 1, 1985.

1. A taxpayer who regularly sells personal property on the installment plan, may report the income from such sales on the installment basis. The seller may treat as income that proportion of the total payments received in the taxable year from installment sales that the gross profit realized or to be realized on the total installment sales made during each year bears to the total contract price of all such sales made during that respective year.

(i) "Gross profit" means sales less cost of goods sold.

(ii) "Total contract price" includes carrying charges and interest ascertainable at the time of sale, but excludes sales tax.

(I) If state, county and city sales taxes are imposed on the consumer, and collected by the seller and remitted to the taxing agency, such sales taxes must not be included in the total contract price for purposes of computing taxable income from installment sales. Payments received are treated as applying first against the sales taxes.

(II) If carrying charges or interest are not determinable at the time of sale and not included in the total contract price, payments received will be treated as applying to such charges before the gross profit percentage is applied against the balance of the total contract price.

2. The installment method described in section 1. above applies only to dealers and to sales of inventoriable personal property.

(2) Installment Method - Transactions occurring after December 31, 1984 and before January 1, 1987.

(a) Notwithstanding the provisions of Reg. 810-3-13-.03 (Method of Accounting), and subject to the requirements and restrictions of this rule, a taxpayer may elect to report income from installment sales under the installment method.

(b) The election to report income from installment sales on the installment method must be made on or before the due date (with extensions) of the income tax return for the taxable year in which the installment sales occur. The election to report income from installment sales on the installment method may not be made, changed or revoked after the due date (with extensions) for the taxable year in which the installment sales occur.

1. The election to report on the installment method is made by including a statement with the income tax return for the taxable year in sufficient form to indicate the taxpayer is electing to report installment sales on the installment method, and containing details of the amounts of such installment sales, the amounts collected and included in income for the taxable year, and the amounts to be deferred to future taxable years.

2. For purposes of this paragraph (2), the following terms have the meanings ascribed to them:

(i) The term "installment sale" means a disposition of property (other than property of a kind which is required to be included in the inventory of the taxpayer if on hand at the close of the taxable year) where at least one (1) payment is to be received after the close of the taxable year in which the disposition occurs.

(I) The requirements of non-inventoriable property and at least one payment in a subsequent taxable year in section 1. above do not apply if the seller is a person who regularly sells or otherwise disposes of personal property on the installment plan.

(ii) The term "installment method" means a method under which the income recognized for any taxable year from a disposition is that proportion of the

payments received in that year which the gross profit (realized or to be realized when payment is completed) bears to the total contract price.

(I) As used in subsection (ii) above, the total contract price of all sales of personal property on the installment plan includes the amount of carrying charges or interest and sales taxes which are determined with respect to such sales and which are added on the books of account of the seller to the established cash selling price of such property. This subsection (I) does not apply with respect to sales of personal property under a revolving credit plan.

(II) If the carrying charges or interest and sales taxes with respect to sales of personal property, the income from which is reported on the installment method, are not included in the total contract price, payments received with respect to such sales shall be treated as first applying against such carrying charges or interest and sales taxes.

(3) For transactions after December 31, 1986 -

(a) Unless otherwise provided an installment sale must be reported under the installment method. An installment sale means a disposition of property where at least one payment is received after the close of the taxable year in which the disposition occurs.

1. Exceptions to (a) include dealer dispositions. A dealer in real and/or personal property may not use the installment method to report the gain from "dealer dispositions." This includes:

(i) any disposition of personal property by a person who regularly sells such property on the installment plan and

(ii) any disposition of real property that is held by a taxpayer for sale to customers in the ordinary course of the taxpayer's trade or business.

2. A taxpayer may elect to not have an installment sale be reported as an installment disposition. An election not to report an installment sale on the installment method shall be made on or before the due date prescribed by law (including extensions) for filing the taxpayer's return. Such an election shall be the same for Alabama purposes as for Federal purposes. Once the election has been made, it may only be revoked if the IRS allows the election to be revoked for Federal purposes.

(b) Second dispositions by related persons - When a person makes an installment sale of property to a related person (first disposition) who in turn, sells the property before the installment payments are made in full (second disposition), the amount realized by the related party from the second disposition is treated as received by the initial seller at the time of the second disposition. Except in the

case of marketable securities the related party rule will not apply if the second disposition took place more than two years after the first disposition. Further exceptions are:

1. Reacquisitions of stock by the issuing company.

2. A compulsory or involuntary conversion and any transfer thereafter shall be treated as a second disposition if the first disposition occurred before the threat or imminence of the conversion.

3. Second dispositions occurring after the death of the installment seller or the related purchaser.

(c) Depreciable Property Sales. The installment method does not apply to installment sales of depreciable property between related persons. Therefore, all payments are deemed received in the year of disposition unless the disposition did not have as one of its principal purposes the avoidance of tax. For this purpose the term "related person" is as defined in I.R.C. §1239(b) and includes partnerships that are more than 50% owned, either directly or indirectly, by the same person.

(d) Use of Installment Method by Shareholders in Certain Liquidations. If in a liquidation to which I.R.C. §331 applies the shareholder received (in exchange for the shareholder's stock) an installment obligation then the shareholder may report the gain when received. Gain on the transfer of an installment obligation to a shareholder during a liquidation is not immediately taxed to the shareholder. [See I.R.C. §453(h)(1) for restrictions for use of this rule.]

(e) Exceptions to Dealer Dispositions in (a) that may be reported using the installment method include:

1. The disposition of any property used or produced in the trade or business of farming.

2. The disposition of any residential lot, provided the dealer or any related person is not obligated to make any improvements to the lot.

3. The disposition of time-share rights to use or own residential real property for not more than six weeks per year or a right to use specific campgrounds for recreational purposes.

(i) In order to use the installment method for the disposition of residential lots and timeshares, the taxpayer must pay interest (at the applicable state rate) on the amount of tax that is attributable to the installment payments received during the year (See I.R.C. §453(1)(3)(B)).

(f) As this section adopts by reference I.R.C. §453 as in effect from time to time, decisions and interpretations of federal courts and agencies will be given due weight in interpreting this section.

Author: Royce Lader
Authority: §40-18-44, Code of Alabama 1975
History: Rule effective October 1, 1982. Amended filed July 27, 1988; May 15, 1992.

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CHAPTER 810-3-45

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810-3-53-.01 ***REPEALED, Effective November 16, 2001***

ALABAMA DEPARTMENT OF REVENUE
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CHAPTER 810-3-70

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810-3-70-.01 Definitions.

(1) (a) Amendments to § 40-18-71 have defined the terms "employer", "employee" and "wages" to have the same meaning as under the laws of the United States in effect July 1, 1982, or as amended from time to time. These amendments supersede the provisions of Section 40-18-70.

(b) Act 88-952 added additional definitions in connection with the requirement for withholding of income tax on certain winnings from wagering transactions.

(2) The current definition of the terms in paragraph (1) above are:

(a) Employer - Any person for whom an individual performs or performed any service, of whatever nature, as an employee of such person. An employer may be an individual, corporation, partnership, trust, estate, joint-stock company, association, or a group, pool, joint venture, or other unincorporated organization, group or entity. A trust or estate, rather than the fiduciary acting for or on behalf of the trust or estate, is generally the employer.

1. For the purpose of administering the withholding of income tax on gambling winnings as provided in Act 88-952, the term "employer" includes any person (as defined in § 1(5) of Act 88-952) who pays winnings subject to withholding.

(b) Employee - Any individual performing a service if the relationship between him and the person for whom he performs such service is the legal relationship of employer and employee. Generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the results to be accomplished by the work but also as to the details and means by which the result is accomplished. An employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing the right is an employer.

1. For the purpose of administering the withholding of income tax on gambling winnings as provided in Act 88-952, the term "employee" includes any person (as defined in § 1(5) of Act 88-952) who receives winnings subject to withholding.

(c) 1. Wages - All remuneration for services performed by an employee for his employer. The name by which the remuneration for services is designated is immaterial. Thus, salaries, fees, bonuses, commissions, etc., are wages. The basis on which the remuneration is paid is immaterial. It may be paid on the basis of piecework, or a percentage of profits; and may be paid hourly, daily, weekly, monthly, or annually. The medium in which remuneration is paid is immaterial. It may be paid in cash or in

something other than cash. If services are paid for in a medium other than cash, the fair market value of the thing taken in payment is the amount to be included as wages.

2. Wages for Withholding Tax Purposes - Generally wages for withholding tax purposes are the same as defined in I.R.C. § 3401, except when the Alabama law is in conflict with the Federal law. "Wages" for Alabama withholding tax purposes, shall include those wages exempt from Federal withholding if the wages represent taxable income under Alabama income tax law, or if there is no provision under the Alabama law for a deduction corresponding to the allowable Federal deduction.

(d) Person - For the purpose of withholding income tax on proceeds from a wagering transaction, the term "person" means all individuals, firms, partnerships, companies, corporations, associations, trustees, receivers, the State of Alabama and any of its agencies, authorities, boards, bureaus, commissions, departments and instrumentalities, each incorporated municipality and any agencies, authorities, boards, bureaus, commissions, and departments of such municipalities, and the several counties of the State of Alabama and any agencies, authorities, boards, bureaus, commissions, and departments of such counties, and any other political subdivisions of the State of Alabama by whatever name or description.

(e) Winnings Subject to Withholding - means any payment from a wagering transaction, but only if the proceeds from a wager -

1. exceed one thousand dollars ($1,000.00), and

2. are at least three hundred (300) times as large as the amount of the wager.

(f) Proceeds from a Wager - has the same meaning as that defined in U. S. Treasury Department regulation 31.3402(q)-1(c)(1).

(g) Wagering Transaction - has the same meaning as that defined in U.S. Treasury Department regulation 31.3402(q)-1(c)(3).

(Adopted June 17, 1988; amended February 8, 1989, filed with LRS March 20, 1989, effective April 24, 1989)

Authors: Ecta B. Spicer, Ewell Berry and John H. Burgess
Income Tax Division

Auth: § 40-18-70 and Act 88-952

810-3-70-.02 Retention of Payroll Records.

(1) Every employer or withholding tax agent required to withhold income tax or who voluntarily withholds income tax is required to maintain withholding tax records for a period of three years from the due date of the return or three years from the date the return is filed with the Department, whichever is later. See also §40-2A-7, Code of Alabama 1975, and Rule 810-14-1-.07, Maintenance of Records.

(2) Withholding tax records maintained in an electronic format shall be maintained in accordance with Rule 810-14-1-.07.01, Model Recordkeeping and Retention Regulation in an Electronic Environment.

Author: Ewell Berry & Ann F. Winborne, CPA
Authority: §§ 40-2A-7(a)(5) and 40-18-70, Code of Alabama 1975
History: New rule filed July 26, 1999, effective August 30, 1999.

ALABAMA DEPARTMENT OF REVENUE
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CHAPTER 810-3-71

Withholding Tax

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810-3-71-.01 Employers Required to Withhold Tax from Wages.

(1) Each calendar quarter every withholding agent shall deduct, withhold, and pay over to the Department of Revenue on or before the last day of the month following the close of each quarterly period a tax, computed as indicated in Rule 810-3-71-.02. on the compensation paid within each quarter for personal services of covered employees. For employers required to submit payment monthly see Rule 810-3-74-.01.

(2) All employers or withholding tax agents are required to register with the Alabama Department of Revenue prior to withholding Alabama income tax. Forms for registering with the Department as a withholding tax agent may be obtained from the Department.

(3) Similar to the provisions of 26 U.S.C § 3504, the Alabama Department of Revenue also allows common-pay agents to register with the Department and withhold Alabama income tax on behalf of employers or other withholding tax agents. Common-pay agents are required by 26 U.S.C § 3504 to make written request to the Internal Revenue Service for permission to act as a common-pay agent. A copy of the forms filed with the Internal Revenue Service must be submitted with the agent's withholding tax application when applying for an Alabama withholding tax account.

(4) Beginning August 25, 1993, employers approved by the State Industrial Development Authority (SIDA) to collect a job development fee will be allowed a credit for such job development fee against the amount deducted and withheld under Paragraph (1) above. The credit shall be allowed in an amount equal to the aggregate job development fees withheld from employees wages during each calendar quarter pursuant to §§ 41-10-44.8(a)(2) and 41-10-44.8(b), Code of Alabama 1975.

(5) Alabama income tax must be withheld on the total wages subject to Alabama income tax.

(6) An employer who is a resident of Alabama is required to withhold tax from the wages of his or her employees who are residents of Alabama, regardless of whether the wages are earned in Alabama or outside the State; except that if the employer is withholding tax for the state in which the employee is working, the employer is not required to withhold tax for Alabama.

(7) An employer who is a resident of Alabama is required to withhold tax from the wages of employees who are not residents of Alabama only to the extent that the wages are earned in Alabama. In other words, a nonresident employee of an Alabama employer should have Alabama income tax withheld only on wages earned in Alabama.

(8) An employer who is not a resident of Alabama is required to withhold tax from the wages of employees to the extent that such wages are earned in Alabama, whether the employee is a resident or a nonresident of the State. A nonresident employer is not required to withhold Alabama income tax on wages paid for services performed outside of Alabama, whether such wages are paid to a resident or to a nonresident of Alabama.

(9) Public Law 91-569 provides an exemption from Alabama withholding tax for employees of water and air carriers if either of the following conditions are met:

(a) The employee is not a resident of Alabama, or

(b) The employee did not earn over 50% of his or her income in Alabama the previous year.

(c) This public law does not affect the taxability of the income.

(10) Beginning July 6, 1990, the Amtrack Reauthorization and Improvement Act (P.L. 101-322) provides that no part of the compensation paid to an employee of an interstate railroad subject to the jurisdiction of the Interstate Commerce Commission (ICC) may be subject to the income tax laws of any state except the state of the employee's residence when such employee performs regularly assigned duties in more than one state. The bill also precludes the taxation of compensation paid by an interstate motor carrier subject to the jurisdiction of the ICC or to an employee of a motor private carrier performing services in two or more states except by the state of the employee's residence. For purposes of the motor carrier, "employee" is as defined in §204 of the Motor Carrier Act of 1984 (40 U.S.C. 2503).

(11) The burden and duty is placed upon the employer to determine the place of residence of each employee, and to determine the exact part of each employee's earnings which is attributable to the services performed within Alabama and to apportion such earnings accordingly for the purpose of withholding the tax.

(12) An employer and employee may agree to the withholding of Alabama income tax in addition to the amounts specified in this regulation. The employee may request such withholding by proper indication on Form A-4, or any other means acceptable to the employer. If the employer withholds such additional amounts from the employee's wages, such action constitutes agreement to withhold the additional amounts, and to submit such additional amounts at the same time and in the same manner that other withholding is submitted. An agreement for additional withholding continues in effect until canceled or modified by the employer and/or employee.

(13) Any person paying winnings subject to withholding is required to withhold income tax from such winnings in the same manner as if the person receiving such winnings was an employee and the payer was an employer.

Authors: Ewell Berry, Ann F. Winborne, CPA
and Neal Hearn, CPA

Authority: §§ 40-2A-7(a)(5), 40-18-70, 40-18-91, 41-10-44.8(a)(2), 41-10-44.8(b), Code of Alabama 1975

History: Adopted September 30, 1982.
Amended September 7, 1988; amended February 8, 1989, filed with LRS March 20, 1989, effective April 24, 1989.
Amended: Filed August 26, 1994, effective September 30, 1994.
Amended: Filed May 3, 2000, effective June 7, 2000.

810-3-71-.02 Computing Tax Withheld.

(1) Employers may elect to compute the amount of Alabama income tax to be withheld from the wages of employees in one of two ways.

(a) The withholding amounts can be computed from withholding tax tables, which may be obtained from the Department. The tables show amounts to be withheld for weekly, biweekly, semimonthly, monthly, and quarterly payroll periods.

(b) Alabama withholding tax may also be computed using the following formula, based on information provided by the employee on the Alabama Form A-4, Employee's Withholding Exemption Certificate:

1. The employee will select a withholding exemption, and indicate the selected exemption on the Form A-4.

(i) A withholding exemption of "0" indicates that no personal exemption is selected.

(ii) A withholding exemption of "S" indicates that a full personal exemption is selected.

(iii) A withholding exemption of "M" indicates that personal exemptions for both spouses are being selected or that the employee is claiming head of family.

2. Compute the Employee's Gross Wages. Multiply the employee's gross wages for the current payroll period by the number of payroll periods in the year.

3. Compute the Standard Deduction. Multiply the amount computed in subparagraph 2, above, by 20% not to exceed $2,000 if employee claims the "0", "S", or "Head of Family" withholding exemptions on the Alabama Form A-4, or; not more than $4,000 if the employee claims the "M" withholding exemption.

4. Compute the Federal Withholding Tax. Multiply the employee's actual federal withholding tax for the payroll period by the number of payroll periods in the year.

5. Determine the Personal Exemption. If the employee claims the "O" withholding exemption, the personal exemption is zero. If the employee claims the "S" withholding exemption, the personal exemption is $1,500. If the employee claims the "M" or the "Head of Family" withholding exemption, the personal exemption is $3,000.

6. Compute the Dependency Exemption. Multiply the number of dependents the employee claims by $300. Do not include the employee's spouse as a dependent.

7. Add the amounts determined in subparagraphs 3 through 6, above.

8. Compute the taxable amount by subtracting the amount determined in subparagraph 7 from the amount determined in subparagraph 2.

9. Compute the tax for the taxable amount computed in subparagraph 8, as follows:

(i) If the employee is claiming the "O", "S", or “Head of Family” withholding exemption, the tax will be equal to the sum of:

(I) 2% of the first $500,
(II) 4% of the next $2,500, and
(III) 5% of the amount over $3,000.

(ii) If the employee is claiming the "M" withholding exemption, the tax will be equal to the sum of:

(I) 2% of the first $1,000,
(II) 4% of the next $5,000, and
(III) 5% of the amount over $6,000.

10. Compute the Alabama withholding tax by dividing the amount determined in subparagraph 8, above, by the number of payroll periods in the year.

(c) The withholding tax to be remitted to the Department may be rounded to the nearest dollar.

(2) Tax to be withheld from supplemental wage payments such as bonuses, commissions and overtime pay shall be computed by one of the following methods:

(a) If paid at the same time as regular wages, the tax to be withheld shall be determined as if the aggregate of the supplemental and regular wages were a single wage payment for the regular payroll period.

(b) If paid at a time different from the regular payroll period, the tax to be withheld may be determined by aggregating the supplemental wage either with the regular wages for the current payroll period or with the regular wages for the last preceding payroll period within the same calendar year.

1. Example: An employee receives a regular paycheck of $500 biweekly, and the next week receives a bonus of $1,000. Withholding for the bonus payment is computed as follows:

| | |
|---|---|
| Withholding on $1,500 (bonus plus regular pay - exemption status - "S") | $44.09 |
| Amount withheld previously on | |

| | |
|---|---|
| biweekly salary of $500 | 14.28 |
| Amount to withhold from bonus | $29.81 |

(c) Tax for supplemental wage payments may be withheld using a rate of 5% without allowance for exemptions or dependents.

(3) Withholding on vacation pay shall be computed as follows:

(a) If the employee receives vacation pay in lieu of regular wages, tax shall be withheld as though it were regular wage payments.

(b) If the employee receives vacation pay in addition to regular wages, such payments shall be treated as supplemental payments and the tax shall be withheld in accordance with paragraph (2).

(4) When wages are paid in a form other than cash (such as certain fringe benefits required to be treated as wages) tax shall be collected and paid to the Department in the same manner as tax withheld on other supplemental wages. See paragraph (2).

(a) The employer must make the necessary arrangements to insure that the amount of tax required to be collected is available for payment in cash.

(5) If a payment of wages is made to an employee by an employer through an agent, fiduciary or other person who also has the control, receipt, custody, or disposal of, or pays the wages payable by another employer, the amount of the tax required to be withheld shall, whether the wages are paid separately on behalf of each employer or paid in a lump sum on behalf of all such employers, be determined upon the aggregate amount of such wage payment or payments in the same manner as if such aggregate amount had been paid by one employer.

(a) In all such cases, each employer shall be liable for the return and payment of a pro rata portion of the tax so determined, such portion to be determined in the ratio which the amount contributed by the particular employer bears to the aggregate of such wages.

(6) For payments of all winnings subject to withholding, income tax shall be withheld at the rate of five percent (5%) of the amount of proceeds from a wager.

Author: Ewell Berry
Authority: §§ 40-2A-7(a)(5), 40-18-71, 40-18-91, Code of Alabama 1975
History: Adopted September 30, 1982; amended June 17, 1988; amended February 8, 1989.
Amended: Filed March 20, 1989, effective April 24, 1989.
Amended: Filed May 3, 2000, effective June 7, 2000.

810-3-71-.03 Job Development Fee. Upon the issuance by the Authority of its Project Obligations for the purpose of financing a Project for an Approved Company:

(1) The Approved Company may impose a Job Development Fee only on the new employees hired by the Approved Company for a Project. The term "new employees" includes only those individuals who (i) have not previously been employed by the Approved Company in Alabama; (ii) will be employed at the project site; and (iii) will be subject to the personal income tax imposed by Section 40-18-2 of the Code upon commencement of employment at the site. An Approved Company may assess and withhold a Job Development Fee from a new employee only during the time such employee is employed at the project site. Accordingly, an Approved Company may not continue to assess and withhold a Job Development Fee from an employee who is no longer employed at the project site.

(2) The Job Development Fee assessed by an Approved Company and withheld from the gross wages of new employees shall be based solely on the wages paid to such employees by the Approved Company. The Job Development Fee withheld from a new employee's wages shall be limited to an amount no greater than the tax that would otherwise be withheld from such employee's wages pursuant to the provisions of subsections (a) through (d) of Section 40-18-71 of the Code but for the imposition of the Job Development Fee. Any tax withheld pursuant to subsection (e) of Section 40-18-71 of the Code is not a Job Development Fee within the meaning of Section 41-10-44.8(b) of the Code and must be remitted by the Approved Company in accordance with the provisions of Section 40-18-74 of the Code.

(3) Pursuant to Section 41-10-44.8(a), the aggregate Job Development Fee withheld in a given year by an Approved Company from the wages paid to employees at a Project shall not exceed the difference between (1) the sum of the debt service payments made during such year by the Approved Company pursuant to the terms of a Financing Agreement (as that item is defined in Section 41-10-44.2); and (2) the sum of the corporate income tax credits claimed by the Approved Company on its state corporate income tax return for such year pursuant to Section 41-10-44.8(a)(1) and 41-10-44.9.

(4) In determining the aggregate Job Development Fee which may be withheld from an employee's wages in a given year, an Approved Company:

(a) shall apply the limitation in section (3) above on a calendar year basis. Accordingly, if an Approved Company's tax year does not correspond to the calendar year, both the corporate income tax credit and the debt service payments will be prorated to the calendar year;

(b) shall base its computation of the aggregate Job Development Fee which it may withhold from employees wages on an estimate of its state corporate income tax liability for such year;

(c) shall determine the actual amount of the aggregate Job Development Fee which it was entitled to withhold within 90 days of the close of the most recent tax year in which a corporate income tax credit was claimed pursuant to Section 41-10-44.8 or 41-10-44.9.

(d) shall, if the aggregate Job Development Fee withheld exceeds the maximum allowable pursuant to the limitation of section (3) above, remit the excess Job Development Fee, plus appropriate interest in accordance with Section 40-1-44, to the Department by the due date of the company's next corporate income tax return (without regard to extensions).

(e) shall not be entitled to any adjustment of its aggregate Job Development Fee if the amount of such fee is less than the maximum allowable pursuant to the limitation of section (3) above. Taxes withheld and remitted to the Department by an Approved Company pursuant to Section 40-18-74 may not be later claimed as Job Development Fees.

(5) Upon notification by the State Industrial Development Authority that an employer has been authorized to withhold a Job Development Fee, the Department shall issue such employer a withholding tax coupon booklet containing forms and instructions for reporting the Job Development Fee and Alabama income tax withheld. This booklet shall also contain instructions for reconciling an employer's yearly withholding amount when a Job Development Fee and/or Alabama income tax has been withheld.

(6) Employers who are authorized to withhold a Job Development Fee are subject to the same filing requirements as employers described in Section 40-18-74. All monthly, quarterly and annual returns must be filed by appropriate due dates. In addition to the requirements described in Section 40-18-74, employers who withhold a Job Development Fee will submit with each monthly, quarterly and annual return a listing of employees from whose wages a Job Development Fee was withheld. This listing shall include the following information:

(a) Employer's name;
(b) Employer's Alabama withholding tax account number;
(c) Employee's name;
(d) Employee's Social Security number; and
(e) Amount withheld from employee's wages as a Job Development Fee.

(7) Pursuant to Section 41-10-44.8(c), if an Approved Company fails to achieve the level of capital investment or employment anticipated at the time the State Industrial Development Authority agreed to finance the Project, the Department may, after notice and hearing, prospectively reduce or suspend all or part of the Job

Development Fee inducement allowed in (1) above until such time as the anticipated capital investment and employment levels are met.

Authors: Ewell Berry, Ann F. Winborne and Neal Hearn
Authority: §40-18-71 and Act 93-852
History: Filed with LRS May 13, 1994. Certification filed with LRS August 26, 1994, effective date September 30, 1994.

810-3-71-.04 Information Submitted to the Department by the State Industrial Development Authority.

(1) The State Industrial Development Authority or its appointed delegate shall provide the Department with the following information:

(a) The names of employers who are authorized to withhold job development fees from their employees;

(b) Sufficient information for the Department to determine the time frame in which an employer may withhold a job development fee; and

(c) The amount of debt service payments paid each year under the financing agreement.

Authors: Ewell Berry, Ann F. Winborne, CPA and Neal Hearn, CPA
Authority: §§40-18-71, 41-10-44.8(a)(2), 41-10-44.8(b), Code of Alabama 1975
History: New rule: Filed LRS August 26, 1994, effective date September 30, 1994.
Amended: Filed May 3, 2000, effective June 7, 2000.

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CHAPTER 810-3-72

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810-3-72-.01. Included and Excluded Wages.

(1) Class exemptions from Alabama withholding are the same as those under Federal law. The chief classes of employees exempt from withholding are agricultural, domestic and merchant seamen. Alabama will not follow the federal requirement to withhold income tax on cash payments made after 1989 to agricultural employees where the payments are considered wages for social security purposes and FICA withholding is required.

(2) If an employee's earnings are partly from exempt work and partly from work subject to withholding, tax should be withheld either from all or from none of his earnings. Tax should be withheld from all of his earnings if one-half or more of his time is spent in nonexempt work; there should be no withholding if over one-half of his time is spent in exempt work.

(3) Where an employer establishes a deferred compensation plan under I.R.C. §§ 401(k)(2) or 403(b), the amounts properly deferred are not wages for withholding tax purposes.

(4) Amounts paid to or on behalf of an employee as reimbursement for moving expenses incurred relative to a new job location in Alabama, or advance payments of such expenses, are not wages for withholding tax purposes to the extent that there is reason to believe that the employee will have a corresponding deduction under §40-18-15(a)(19).

(5) Amounts paid to or on behalf of an employee for traveling or other bona fide ordinary and necessary expenses incurred, or advance payments of such expenses, to the extent that there is reason to believe that the employee will have a corresponding deduction under §40-18-15(a)(1).

(6) For tax years or periods beginning after December 31, 1990 - Where an employer participates in a cafeteria plan as described in I.R.C. §125, contributions made by an employer on behalf of an employee are not included in the employee's gross income and therefore are not subject to Alabama withholding tax.

(7) For tax years or periods beginning after December 31, 1990 - Where an employer incurs dependent care expenses on behalf of an employee, such amount is excluded from wages as defined in I.R.C. §129.

Authors: Ewell Berry
Ann F. Winborne
Authority: §40-18-72, Code of Alabama 1975
History: Filed with LRS November 19, 1991, filed May 15, 1992, effective date June 19, 1992

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CHAPTER 810-3-73

Withholding Certificates

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810-3-73-.01 Withholding Exemption Certificates

810-3-73-.01 Withholding Exemption Certificates.

(1) Every employee is required to furnish his or her employer a withholding exemption certificate (Form A-4) showing the number of exemptions claimed. The number of exemptions claimed may not exceed the number of exemptions to which the employee is entitled to claim under § 40-18-19, Code of Alabama 1975.

(2) The values of Alabama and federal exemptions differ, therefore, federal Form W-4 is not a satisfactory substitute for the required Alabama Form A-4.

(3) If an employee fails to furnish his or her employer with a signed withholding exemption certificate on Form A-4, the employer must withhold on such employee's wages using zero (-0-) exemptions.

(4) Full-time students in temporary employment expecting to earn less than $1,875 during the taxable year and expecting to owe no Alabama income tax for the taxable year may be exempt from Alabama withholding tax. In order to establish this exemption, they must file withholding exemption certificate Form A-4E with their employer. A full-time student means an individual who during each of five calendar months during the taxable year is enrolled at an educational institution for the number of hours or courses which is considered to be full-time attendance.

(5) Employers must furnish the Department with a copy of each Form A-4 in which:

(a) An employee claims 12 or more dependents, or

(b) The total exemptions claimed are known by the employer to exceed the number to which the employee is entitled.

(6) Penalties.

_____(a) Any person who fails to comply with the requirements of this section shall be subject to the penalties provided in §40-2A-11, Code of Alabama 1975.

_____(b) In addition to the penalties provided for in §40-2A-11, the $500 civil penalty provided for in §40-29-75, Code of Alabama 1975, shall also apply.

Author: Ewell Berry
Authority: _§§40-2A-7(a)(5) and 40-18-73, Code of Alabama 1975
History: Adopted September 30, 1982; amended June 17, 1988;
Amended: Filed March 20, 1989, effective April 24, 1989.
Amended: Filed May 3, 2000, effective June 7, 2000.

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810-3-74-.01. Withholding Returns and Payments.

(1) Every employer required to deduct and withhold tax from the wages of employees under Sec. 40-18-71, and those persons required to withhold income tax on proceeds of a wager by Act 88-952, shall remit such withheld taxes to the Department as follows:

(a) Form A-6 must be filed by every employer if the amount withheld in either the first or second month of any calendar quarter exceeds one thousand dollars ($1,000.00). Form A-6 should cover only one month and is required only for those months in which the tax withheld in that month exceeds one thousand dollars ($1,000.00).

(b) Form A-1 "Employer's Quarterly Return of Income Tax Withheld" must be filed by every employer and payment of the total amount of tax withheld from employees and/or any tax withheld on proceeds from a wager, less any tax previously remitted on Form A-6, on or before the last day of the month following the end of the calendar quarter.

1. EXAMPLE: Employer withholds $900.00 in the first month, $1,100.00 in the second month and $1,200.00 in the third month. Employer is not required to file a Form A-6 for the first month, Form A-6 should be filed for the second month and payment in the amount of $1,100.00 should be submitted with the A-6. This form should be filed and payment made on or before the 15th day of the 3rd month. The quarterly return, Form A-1 should be filed on or before the last day of the month following the end of the quarter and payment in the amount of $2,100.00 ($3,200.00 - $1,100.00) should be submitted with the quarterly return.

(2) Under no circumstances may a return on Form A-1 be for more than one calendar quarter of the year, nor may a portion of one calendar quarter be included with a portion of another calendar quarter in a single return, even though the entire period does not exceed three months.

(3) An employer who temporarily ceased to pay wages, including an employer engaged in seasonal activities, shall continue to file returns. A quarterly return shall be filed by the employer for each quarter even though no tax has been withheld.

(4) (a) If an employer goes out of business or otherwise permanently ceases to pay wages, the last Form A-1 filed by the employer should be clearly marked "Final Return". The final return must be filed not later than thirty days after the date on which the final payment of wages was made, along with Form A-7, "Request for Transfer of Withholding Tax Account to Inactive Status."

(b) If the final Form A-1 is submitted before the end of the calendar year, Forms A-2 and A-3 must accompany the final return.

(Adopted September 30, 1982; amended June 17, 1988; amended February 8, 1989, filed with LRS March 20, 1989, effective April 24, 1989.

Authors: Ecta B. Spicer, Ewell Berry
and John H. Burgess
Income Tax Division

Auth: § 40-18-74
and Act 88-952

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CHAPTER 810-3-75

Statement to be Furnished Employee

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810-3-75-.01 Withholding Statement Furnished Employees.

(1) (a) Each employer, on or before January 31 of each year or within thirty days after termination of the employment, shall furnish each employee a withholding statement (Form W-2) for the preceding year, in duplicate, showing:

1. The total wages paid,

2. The amount of Alabama income tax withheld,

3. The amount of job development fee (JDF) withheld, which must be shown separately from the amount of Alabama income tax withheld,

4. The amount of federal income tax withheld,

5. The name and address of the employee,

6. The social security number of the employee, and

7. The employer's name, address, and Alabama withholding tax account number.

8. Qualifying severance payments exempt from Alabama income tax pursuant to §40-18-19.1, Code of Alabama 1975, must be not be shown on the Form W-2 as Alabama wages, but must be disclosed on the form as "Exempt Severance Payments," which can be abbreviated as "ESP."

(b) Each person paying proceeds from a wagering transaction subject to withholding as described in §40-18-91, shall furnish the recipient a statement of the amount of winnings subject to withholding and the amount of tax withheld in the same manner and at the same time as required by U.S. Treasury Department Regulation 31.3402(q)-1(f). A true and correct copy of such statement required to be furnished by said Treasury regulation, together with a statement of the amount of Alabama income tax withheld pursuant to §40-18-91, shall be sufficient.

(2) The statement required by paragraph (1)(a) above, may be prepared on Form A-2, copies of which are available on request from the Department.

(a) In lieu of Forms A-2 furnished by the Department, combination state and federal employee wage and tax statements may be used. Employers may print their own forms; however, the employer must obtain permission from the Department to print such forms.

(b) Any substitute form used must be identified as an Alabama withholding statement and must contain all the information required by this section.

(c) The following forms should be prepared:

1. A copy to be filed with the employer's annual return, as indicated in Rule 810-3-75-.03.

2. Copies to be furnished the employee to file with his individual income tax returns and to retain for his records.

3. A copy to be retained by the employer.

(3) If it becomes necessary to correct a Form W-2 after it has been delivered to an employee, the new statement should be marked "Corrected by Employer." IRS Form W-2C may be used for this purpose. If the withholding statement is lost or destroyed, the employer is authorized to furnish substitute copies to the employee; however, each substitute must be marked "Reissued by Employer." A copy of each corrected statement must be filed promptly with the Department. A copy of reissued statements should not be filed with the Department.

Authors: Ewell Berry, Ann F. Winborne, CPA and Neal Hearn, CPA
Authority: §§ 40-2A-7(a)(5), 40-18-74, 40-18-91, 41-10-44.8(a)(2), 41-10-44.8(b) Code of Alabama 1975
History: Adopted September 30, 1982; amended June 17, 1988.
Amended: Filed March 20, 1989, effective April 24, 1989.
Amended: Filed August 26, 1994, effective September 30, 1994.
Amended: Filed May 3, 2000, effective June 7, 2000.

810-3-75-.02 Extensions of Time for Filing Reports under Withholding Laws. On written application by the taxpayer, extensions of thirty days may be granted with respect to required reports under §40-18-75, Code of Alabama 1975. Requests for extension should state the reason the extension is needed, and should be mailed in time to receive consideration by the Department prior to the due date for the report.

Author: ___Ewell Berry
Authority: §§40-2A-7(a)(5), and 40-18-75, Code of Alabama 1975
History: Amended: Filed May 3, 2000, effective June 7, 2000.

810-3-75-.03 Annual Returns of Withholding Tax Information.

(1) On or before the last day of February of each year, there shall be filed by each withholding tax agent required to file quarterly returns, a summary of amounts of income tax withheld during the previous calendar year. This summary consists of two parts:

(a) Form A-3, Reconciliation of Monthly and Quarterly Withholding Returns, and

(b) A copy of Form W-2 for each employee (see Rule 810-3-75-.01), and/or a copy of each statement required by Rule 810-3-75-.01 to be furnished to a recipient of proceeds from a wager subject to withholding pursuant to §40-18-91, Code of Alabama 1975. If tax has been withheld from a non-wage payment, a copy of the Form 99 or Form 1099 used to report this payment must be submitted. See Rule 810-3-75-.04. See also paragraphs (2) and (3) below for allowable substitute filings.

1. An adding machine tape or other tabulation of amounts withheld, as shown on Forms W-2, must be included.

(2) Forms W-2 may be filed with the Department via magnetic media. This magnetic media information must be produced and submitted in accordance with Departmental specifications. Contact the Department to obtain procedures and specifications for filing wage and tax information (Form W-2) by means of magnetic media.

(3) Forms W-2 may be filed with the Department via a listing containing all the information required by Regulation 810-3-75-.01 in columnar format, with each column totaled.

(4) Penalties.

(a) Any person who fails to comply with the requirements of this section shall be subject to the penalties provided for in §40-2A-11, Code of Alabama 1975.

(b) In addition to the penalties provided for in §40-2A-11, the $50 civil penalty provided for in §40-29-74, Code of Alabama 1975, shall also apply.

Author: Ewell Berry
Authority: §§40-2A-7(a)(5), 40-2A-11, 40-18-75, 40-18-91, and 40-29-74, Code of Alabama 1975
History: Filed with LRS December 1, 1987.
Amended: Filed March 20, 1989, effective April 24, 1989.
Amended: Filed May 3, 2000, effective June 7, 2000.

810-3-75-.04 Voluntary Withholding.

(1) Alabama income tax is not required to be withheld from retirement distributions, pensions, interest payments or other payments which are not wage payments. However, voluntary withholding of Alabama income tax from such payments is permissible. If the election to voluntarily withhold Alabama income tax is made, procedures outlined in this regulation must be followed.

(2) Remitting Tax Withheld. Tax withheld voluntarily must be remitted to the Department in the same manner and at the same time as described in §40-18-74, Code of Alabama 1975.

(3) Statement To Be Furnished Recipient. On or before January 31 of the year following a non-wage payment from which Alabama income tax was voluntarily withheld, the payer shall issue the recipient a statement showing the following information:

(a) Amount of payment.

(b) Amount of Alabama income tax withheld.

(c) Amount of federal income tax withheld.

(d) Name, address and social security number of recipient.

(e) Payer's name, address, Alabama withholding tax account number and social security number or federal identification number.

(4) (a) The statement required in paragraph (3) above, may be prepared on Form 99, copies of which are available on request from the Department.

(b) In lieu of Form 99, the combination state and federal Form 1099 may be used. If federal forms are used, such forms must contain the same information as described above in paragraph (3).

(c) Payers of non-wage payments may elect to produce their own forms. In such cases prior approval from the Department must be obtained. Specifications and instructions for producing such forms may be obtained from the Department.

(5) Statement To Be Furnished Department.

(a) On or before the last day of February of the year following a non-wage payment from which Alabama income tax was voluntarily withheld, the payer shall file with the Department a copy of the statement described above in paragraph (3). Such statement must be accompanied by Form A-3, Annual Reconciliation of Alabama Income Tax Withheld. This statement must be filed in the same manner and at the same time as described in §40-18-75.

(b) If Alabama income tax has been withheld from wages and reported on Form W-2 and also withheld from non-wage payments and reported on Form 99 or Form 1099, such statements must be submitted in a combined report with the Form A-3.

Author: Ewell F. Berry, Ann F. Winborne, CPA
Authority: §§ 40-2A-5(a)(5) and 40-18-75, Code of Alabama 1975
History: Filed April 21, 1993, effective November 6, 1993.
Amended: Filed July 26, 1999, effective August 30, 1999.

810-3-75-.05 Third-Party Reporting Requirements.

(1) Third-party payers are generally insurance companies who have made a wage payment (i.e., sick pay) to an employee on behalf of the employer. The third-party payer remits the tax withheld under the third-party payer's withholding tax account number.

(2) If the third-party payer has remitted tax on behalf of an employer, the payer must submit a listing to the Department of appropriate accounts to be credited for withholding tax payments. After receiving this list, the Department will transfer tax withheld from the third-party payer's withholding tax account to the appropriate employer's withholding tax account. The listing submitted by the third-party payer must include the following information for each employer's withholding tax account to be credited:

(a) Name of employer,

(b) Federal employer identification number,

(c) Alabama withholding tax account number,

(d) Amount to be transferred, and

(e) Year to which payment should be transferred.

(3) The information required by paragraph (2), above, must be filed by the last day of February of the year following the calendar year in which the tax was withheld.

(4) If a third-party payer has paid wages and withheld tax on behalf of an employer and has notified the Department as described in paragraph (2), above, the employer must include such wages and tax withheld on W-2 forms issued by the employer.

(5) Third-party payers who have paid wages and withheld tax on behalf of an employer and have properly notified the Department, as described in the above paragraphs, are not required to submit W-2 forms to the Department.

Author: Ewell Berry
Authority: §§ 40-2A-7(a)(5) and 40-18-75 Code of Alabama 1975
History: New rule: Filed May 3, 2000, effective June 7, 2000.

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CHAPTER 810-3-76

LIABILITY FOR TAX WITHHELD

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810-3-76-.01 Liability for Tax Withheld

810-3-76-.01 Liability for Tax Withheld.

(1) Any person required under §40-18-71, Code of Alabama 1975, and/or § 40-18-91 to withhold, account for, and pay over income tax shall be liable for the tax required to be withheld.

(a) "Person" as used herein includes an officer of a corporation or a member of a partnership or other entity whose duty it is to withhold, account for, and pay over the tax required under § 40-18-71.

(b) Any income tax withheld shall be deemed to be held in trust for the State of Alabama. See § 40-18-74(c).

(c) An employer or withholding tax agent is liable for any additional income tax withheld pursuant to an agreement as provided in § 40-18-71(e).

(2) Penalties for failure to withhold, account for, and/or pay over the tax required under§§ 40-18-71, Code of Alabama 1975, 40-18-75, and 40-18-91 are provided in§ 40-2A-11, Code of Alabama 1975, § 40-29-70, Code of Alabama 1975, in addition to §§ 40-29-73, 40-29-74, and 40-29-75.

Author: Ewell Berry
Authority: §§ 40-2A-7(a)(5), 40-18-71, 40-18-75, 40-18-76, 40-2A-11, 40-18-91, 40-29-70, 40-29-73, and 40-29-74 Code of Alabama 1975
History: Adopted June 17, 1988.
Amended: Filed March 20, 1989, effective April 24, 1989.
Amended: Filed May 3, 2000, effective June 7, 2000.

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REVENUE DEPARTMENT

CHAPTER 810-3-77

Refund to Employer

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810-3-77-.01 Withholding Tax Refunds to Employers

810-3-77-.01 Withholding Tax Refunds to Employers.

(1) If an employer withholds from an employee's wages an amount of tax which exceeds the amount required to be withheld pursuant to §40-18-71, Code of Alabama 1975, and remits the amount withheld to the Department, no refund will be made to the employer. The employee should claim credit for the full amount withheld on his or her Alabama income tax return filed for that year. See Rule 810-3-78-.01.

(2) If an employer remits to the Department an amount in excess of that which is due, the employer must make application for refund or claim credit within three years from the date the return was filed, or two years from the date of payment of the tax, whichever is later. Unless a claim is made within this period, no credit or refund may be allowed.

(3) An employer who erroneously withholds Alabama income tax and remits such amount to the Department for an employee whose services are performed in another state and who is not required under § 40-18-27 to file an Alabama income tax return, may make application for refund or credit.

(4) When computing the amount of a withholding tax refund or credit, the amount of withholding remitted for a particular period shall include only amounts remitted to the Department. Employers shall not receive refunds or credits for amounts withheld as Job Development Fees.

Authors: Ewell Berry, Ann F. Winborne, CPA and Neal Hearn, CPA
Authority: §§40-2A-7(a)(5), 40-18-57, 41-10-44.8(a)(2), and 41-10-44.8(b), Code of Alabama 1975
History: Filed with LRS May 13, 1994, effective date September 30, 1994.
Amended: Filed May 3, 2000, effective June 7, 2000.

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DEPARTMENT OF REVENUE

CHAPTER 810-3-78

Credit for Tax Withheld

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810-3-78-.01 Credit for Tax Withheld

810-3-78-.01 Credit for Tax Withheld.

(1) (a) An employee or other payee from whose wages or other remuneration income tax is withheld, and/or a recipient of proceeds from a wager from which income tax was withheld pursuant to §40-18-91, Code of Alabama 1975, is allowed a credit for the amount withheld on his or her income tax return for the tax year during which the tax was withheld.

(b) An employee from whose wages a job development fee (JDF) is withheld pursuant to §41-10-44.8b., Code of Alabama 1975, is allowed a credit for the amount withheld on his or her income tax return for the tax year during which the JDF was withheld.

(2) (a) Credit will be allowed only if a copy of the withholding statement, Form A-2 or Form W-2, is attached to the return.

(b) In the case of withholding from proceeds of a wager, credit will only be allowed if a copy of the statement required to be furnished the recipient under Rule 810-3-75-.01, is attached to the return of the claimant of the credit.

(c) In the case of withholding from a nonwage payment, credit will only be allowed if a copy of the Form 99, Form 1099, or other information return is attached to the return of the claimant of the credit.

(3) A fiscal year taxpayer is allowed a credit on the fiscal year return for income taxes withheld during the calendar year which ends within the fiscal year. For example, a taxpayer having a fiscal year ending July 31, 1997, is entitled to credit for tax withheld during calendar year 1996.

Authors: Ewell Berry, Ann F. Winborne, CPA and Neal Hearn, CPA
Authority: §§40-2A-7(a)(5), 40-18-78, 40-18-91, 41-10-44.8(a)(2), 41-10-44.8(b), Code of Alabama 1975
History: Adopted September 30, 1982.
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Amended: Filed May 13, 1994, effective September 30, 1994.
Amended: Filed May 3, 2000, effective June 7, 2000.

CHAPTER 810-3-79

Overpayment of Tax

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810-3-79-.01 Overpayment of Tax

810-3-79-.01. Overpayment of Tax.

(1) (a) If the income tax return of a taxpayer shows an overpayment of tax because of withholding from his wages and/or payments of declarations of estimated tax, the overpayment will first be applied against any income tax of earlier years owed by the taxpayer. The balance, at the election of the taxpayer, will be refunded to him or credited as a first payment on his declaration of estimated tax for the following year. See Reg. 810-3-82-.01 as to the irrevocability of the election.

(b) Refunds of less than one dollar are made only on written request of the taxpayer who has made the overpayment. Filing a declaration of estimated tax for the following year together with a request or election that the overpayment be credited thereon will be treated as such a written request. Alternatively, a refund claim may be filed on Form 40X.

(2) Through May 31, 1981, interest on overpayment of taxes was at the annual rate of 6%. Act 81-258, now codified at § 40-1-44, provided that effective June 1, 1981, interest would be equal to the rate set by the United States Secretary of the Treasury pursuant to Internal Revenue Code Section 6621.

(3) Interest on overpayment of tax shall not begin to accrue until 90 days after the due date for filing the return or the date the return is filed, whichever is later.

(Adopted September 30, 1982; amended February 8, 1989, filed with LRS March 20, 1989, effective April 24, 1989)

Authors: George E. Mingledorff, III,
Ecta B. Spicer, Anne Simms
and Carmen Mills
Income Tax Division

Auth: § 40-18-79

(f) "Person" as used in this regulation includes an officer of a corporation or a member of a partnership whose duty it is to perform the act(s) required. See § 40-29-72(b).

Author: Ewell Berry
Authority: §§40-2A-7(a)(5), 40-18-80, 40-29-70, 40-29-72 and 40-29-73, Code of Alabama 1975
History: Adopted September 30, 1982.
Amended June 17, 1988.
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Amended: Filed May 3, 2000, effective June 7, 2000.

ALABAMA DEPARTMENT OF REVENUE
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CHAPTER 810-3-80

Penalties

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810-3-80-.01 Penalties
810-3-80-.02 ***(Repealed, Effective June 7, 2000)***

810-3-80-.01 Penalties.

(1) Penalties are provided for failure to file declarations of estimated tax, failure to pay installments of estimated tax, and for certain substantial underestimations of tax on declarations.

(a) Any person, required under the provisions of § 40-18-82, Code of Alabama 1975, to file a declaration of estimated tax and pay the amount estimated in installments, who fails to file such declaration at the time and in the manner prescribed shall be subject to a penalty. For the purpose of this penalty, the amount and due date of each installment shall be the same as if a declaration had been filed within the time prescribed, showing an estimated tax equal to the correct tax reduced by the credits allowed by §§ 40-18-78 and 40-18-21. The penalty shall be five (5) percent of each installment due but unpaid for one (1) month, or any fraction thereof, plus one (1) percent of the installment due but unpaid for each month thereafter. In no event shall the penalty exceed ten (10) percent of the unpaid portion of any installment due but unpaid.

(b) Any person, required under the provisions of § 40-18-82 to file a declaration of estimated tax and pay the amount estimated in installments, who files the required declaration but fails to pay the installments timely shall be subject to a penalty. The penalty shall be five (5) percent of each installment due but unpaid for one month, or any fraction thereof, plus one (1) percent of the installment due but unpaid for each month thereafter. In no event shall the penalty exceed ten (10) percent of the unpaid portion of any installment due but unpaid.

(c) Any individual, required under the provisions of § 40-18-82 to file a declaration of estimated tax and pay the amount estimated in installments, who substantially under-estimates his tax shall be subject to a penalty. The penalty shall be the lesser of:

1. In the case of an individual other than a farmer, the amount by which ninety (90) percent of the correct tax (after credits allowed by § 40-18-21, if any) exceeds the amount prepaid by estimated tax payments and/or withholding, or

2. In the case of an individual farmer, the amount by which sixty-six and two-thirds (66 2/3) percent of the correct tax (after credits allowed by § 40-18-21, if any) exceeds the amount prepaid by estimated tax payments and/or withholding, or

3. Six (6) percent of the correct tax (after credits allowed by § 40-18-21, if any) reduced by the amount of tax prepaid by estimated tax payment and/or withholding.

(i) The underestimation penalty shall not apply to the taxable year in which:

(I) falls the death of the taxpayer, or

(II) the taxpayer files an estimate and makes timely payments of an amount equal to or greater than the tax for the prior year.

I. If the liability for the previous year was zero (-0-) (except for a net operating loss carryback to such year), it will not be necessary to file a declaration of zero (or to make payments) to qualify for the exception to the penalty in sentence (II) above.

(d) 1. Any corporation, required under the provisions of § 40-18-82 to file a declaration of estimated tax and pay the amount estimated in installments, who substantially under-estimates its tax shall be subject to a penalty. The penalty shall be the lesser of:

(i) The amount by which ninety (90) percent of the correct tax (after credits allowed by § 40-18-21, if any) exceeds the estimated tax, or

(ii) Six (6) percent of the correct tax (after credits allowed by § 40-18-21, if any) reduced by the amount of the estimated tax payments.

2. The underestimation penalty shall not apply to the taxable year in which the corporation files an estimate and makes timely payments of an amount equal to or greater than the tax for the prior year.

(i) If the liability for the previous year was zero (-0-), it will not be necessary to file a declaration of zero (or to make payments) to qualify for the exception to the penalty in section 2. above.

(e) 1. Any person who issues the Department a bad check will, in addition to any other penalties provided by law, pay a penalty equal to:

(i) 10% of the amount of the bad check, if the bad check is for $500 or more, or

(ii) $10.00 or the amount of the bad check, whichever is lesser, if the bad check is less than $500.

2. This penalty shall not apply if settlement is made by the payee within 10 days after notification by the Department. See § 40-29-70, Code of Alabama 1975.

(f) "Person" as used in this regulation includes an officer of a corporation or a member of a partnership whose duty it is to perform the act(s) required. See § 40-29-72(b).

Author: Ewell Berry
Authority: §§40-2A-7(a)(5), 40-18-80, 40-29-70, 40-29-72 and 40-29-73, Code of Alabama 1975
History: Adopted September 30, 1982.

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ALABAMA DEPARTMENT OF REVENUE
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CHAPTER 810-3-81

Optional Short Form Tax

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810-3-81-.01 Optional Short Form Tax

810-3-81-.01. Optional Short Form Returns.

(1) An individual who has been a resident of Alabama for a full tax year of 12 months, may elect to file short form 40-A and use the tax tables provided by the Department if,

(a) Total adjusted gross income is not more than,

1. $20,000.00 if single, head of family or married and filing a separate return, or

2. $40,000.00 if married and filing a joint return with spouse; and

(b) Income from sources other than salaries and wages is not more than $1,500.00.

(2) The election to use the short form, or not to use it, is irrevocable after the due date for filing the return - April 15 in case of a calendar year return. The election to use the short form return includes an election to use the optional standard deduction. See Sec. 40-18-15(b) and Reg. 810-3-15-.19.

(3) A husband and wife may elect to file a joint short form return. If this election is made, it is irrevocable after the due date for filing the return. See also Reg. 810-3-27-.01(1)(b).

(4) A short form return may not be used to establish a net operating loss. See Reg. 810-3-15-.22.

Authors: Ewell Berry, Ann Fondren and John H. Burgess
Income Tax Division
Authority: § 40-18-81
History: Adopted September 30, 1982; Amended: June 17, 1988; Filed with LRS: July 27, 1988

ALABAMA DEPARTMENT OF REVENUE
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CHAPTER 810-3-82

Declaration of Estimated Tax

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810-3-82-.01 Declarations of Estimated Tax for Individuals
810-3-82-.02 Declaration of Estimated Tax for Corporations

810-3-82-.01. Declarations of Estimated Tax for for Individuals.

(1) (a) Every individual is required to file Form 40-ES "Declaration of Estimated Tax" if reasonably expected to have net income from sources other than wages in excess of:

1. $1,500 if single or married filing a separate return, or

2. $3,000 if married filing a joint return.

(i) No substitute for Form 40-ES will be accepted unless prior approval has been obtained from the Department.

(ii) Payments must be accompanied by a properly completed Form 40-ES or 40-ES voucher in over to be properly credited.

(b) If the amount of estimated tax due under subparagraph (a) above is less than one hundred dollars ($100), no declaration of estimated tax is required to be filed.

(c) Amounts included in composite returns filed under the provisions of S 40-18-176 shall not be included in income in computing the amount of estimated tax due under subparagraph (a) above.

(2) The declaration (Form 40-ES) required under paragraph (1) above shall be filed on or before April 15th of the taxable year, except:

(a) if the requirements of paragraph (1) are first met after April 1st and before June 2nd, Form 40-ES shall be filed on or before June 15th of the taxable year;

(b) if the requirements of paragraph (1) are first met after June 1st and before September 2nd, Form 40-ES shall be filed on or before September 15th of the taxable year;

(c) if the requirements of paragraph (1) are met after September 1st of the taxable year, Form 40-ES shall be filed on or before January 15th of the succeeding taxable year.

(3) A Taxpayer may elect to have all or part of an overpayment shown on the income tax return credited to a declaration of estimated tax. The amount indicated will be credited to the earliest installment of the declaration due on or after the date the return is filed. The election to credit an overpayment to estimated tax is irrevocable after the return is filed.

(4) Amounts paid on declarations of estimated tax, including overpayments credited from prior years, must be claimed as credits on the return for the tax year of the declaration, and will not otherwise be refunded or credited.

(5) (a) If, at the time a declaration of estimated tax is required to be filed, a taxpayer is eligible to file a joint income tax return for the year of the declaration, a joint declaration may be made.

(b) The election to file a joint declaration does not require that a joint income tax return subsequently be filed for the year of the declaration.

(c) 1. If a joint declaration is filed, and separate returns are subsequently filed, the amount of estimated tax paid on the joint declarations may be divided between the spouses in any manner they choose. If no division is made by the spouses, the amounts paid on the declarations will be divided equally between the spouses.

2. In the event separate returns are filed, any applicable penalties for underestimation will be computed on each return after crediting the estimated payments as provided in section 1. above.

(6) (a) If, after a declaration of estimated tax is filed, the estimated liability changes, an amended declaration should be filed. An amended declaration may be made by filing Form 40-ES marked "Amended."

(b) 1. If the amended declaration indicates an increase in the estimated liability, payment should be submitted with the amended declaration in an amount equal to all payments that would have been due to date had the amount of the amended estimate been estimated originally.

(i) EXAMPLE: On April 15th, taxpayer filed a declaration of estimated tax in the amount of $1,000. Payments of $250 were made on April 15th and June 15th. On August 20th the taxpayer sold 100 acres of land. As a result of the gain on this sale, the taxpayer should reasonably expect his tax liability to be $2,000 for the current taxable year. The taxpayer should file an amended declaration of estimated tax on or before September 15th and pay $1,000 with the amended estimate ($1,500 the amount of payments that would have been due, if the amended estimate had been originally estimated, less $500 previously paid). He should pay $500 on or before January 15th of the following year.

2. If the amended declaration results in a decrease in the estimated liability, the subsequent payments should be reduced accordingly.

(7) If a taxpayer files his income tax return for a taxable year on or before the fifteenth 15th day of the month following the close of the year, and pays in full the amount of tax shown by the return to be due, the return will be considered an amended declaration or original declaration which otherwise would have been due on that date.

(8) No declaration of estimated tax is required for estates, trusts, or partnerships. However, a partner or beneficiary of an estate or trust must take into account the

distributive share of such income in determining the requirements for filing a declaration and paying estimated tax.

(9) (a) An individual must file Form 40-ES for a period of less than one year, but four (4) or more months, if required to file an income tax return for such period, and can reasonably expect to have income during such period from sources other than wages, prorated by the ratio which the number of months in the taxable year bears to twelve (12), in excess of:

1. $1,500 if single or married filing a separate return, or

2. $3,000 if married filing a joint return.

(i) EXAMPLE: A single taxpayer is changing his taxable year, with the permission of the Department, from a fiscal year ending July 31 to a calendar year. A tax return would be required for the period August 1 through December 31. If the taxpayer can reasonably expect to have income from sources other than wages in excess of $625 (5/12 of $1,500) he is required to file Form 40-ES and pay the amount estimated in installments.

(b) If the requirements of subparagraph (a) are met on or before the 1st day of the 4th month, Form 40-ES must be filed on or before the 15th day of the 4th month of the taxable period. Payments on the declaration will be made in equal installments on the 15th day of the 4th, 6th, and 9th month of the taxable period (or as many of those dates as falls within the taxable period.) and the 15th day of the 1st month after the end of the taxable period.

1. EXAMPLE: For a taxable period January 1 through May 31, a Form 40-ES must be filed on or before April 15th and the amount estimated paid in two (2) equal installments on April 15th and June 15th.

2. EXAMPLE: For a taxable period January 1 through June 30, Form 40-ES must be filed on or before April 15th and the amount estimated paid in three (3) equal installments on April 15th, June 15th, and July 15th.

3. EXAMPLE: For a taxable period January 1 through October 31, Form 40-ES must be filed on or before April 15th and the amount estimated paid in four (4) equal installments on April 15th, June 15th, September 15th, and November 15th.

(c) If the requirements of subparagraph (a) above are met after the 1st day of the 4th month but before the 2nd day of the 6th month, Form 40-ES must be filed on or before the 15th day of the 6th month and the amount estimated paid in equal installments on the 15th day of the 6th and 9th month of the taxable period (or on as many of those dates as falls within the taxpayer period) and the 15th day of the 1st months after the end of the taxable period.

1. EXAMPLE: For a taxable period January 1 through July 31, the requirement to file a declaration was first met on May 1st. Form 40-ES must be filed on or before June 15th and the amount estimated paid in two (2) equal installments on June 15th and August 15.

2. EXAMPLE: For a taxable period January 1 through November 30, the requirement to file a declaration was first met on May 15th. Form 40-ES must be filed on or before June 15th and the amount estimated paid in three (3) equal installments on June 15th, September 15th, and December 15th.

(d) If the requirements of subparagraph (a) are first met after the 1st day of the 6th month but before the 2nd day of the 9th month, Form 40-ES must be filed on or before the 15th day of the 9th month and the amount estimated paid in equal installments on the 15th day of the 9th month of the taxable period and the 15th day of the 1st month after the end of the taxable period.

1. EXAMPLE: For a taxable period January 1 through September 30, the requirement to file a declaration was met on July 30th. Form 40-ES must be filed on or before September 15th and the amount estimated paid in two (2) equal installments on September 15th and October 15th.

(e) If the requirements of subparagraph (a) are met after the 1st day of the 9th month of the taxable period, Form 40-ES must be filed on or before the 15th day of the 1st month after the end of the taxable period together with payment of the amount estimated.

(f) All declarations of estimated tax for a period of less than twelve (12) months should be clearly marked "Short Tax Period". The taxable period should be clearly indicated.

Author: Ewell Berry
Authority: §40-18-82, Code of Alabama 1975
History: Filed with LRS November 19, 1991, filed May 15, 1992, effective June 19, 1992

810-3-82-.02. Declaration of Estimated Tax for Corporations.

(1) Every corporation whose income tax liability for the taxable year can reasonably be expected to exceed $5,000 must file Form 20-CD "Declaration of Estimated Tax". This includes new corporations filing their first return, foreign corporations previously not required to file returns in Alabama, and corporations which had in effect an election to be an Alabama S corporation for the prior year.

(a) No substitute for Form 20-CD will be accepted unless prior approval has been obtained from the Department.

(2) A corporation, filing on a calendar year basis, required to file a declaration of estimated tax under paragraph (1) shall file Form 20-CD on or before April 15th of the taxable year, except:

(a) if the requirement of paragraph (1) is first met after April 1st and before June 2nd, Form 20-CD shall be filed on or before June 15th of the taxable year;

(b) If the requirement of paragraph (1) is first met after June 1st and before September 2nd, Form 20-CD shall be filed on or before September 15th of the taxable year;

(c) if the requirement of paragraph (1) is first met after September 1st, Form 20-CD shall be filed on or before December 15th of the taxable year.

(d) For fiscal year taxpayers, substitute the 15th of the fourth, sixth, ninth or twelfth months of the fiscal year in place of April, June, September and December respectively of subparagraphs (a), (b) and (c) above.

(3) No refund will be made of any amount paid on a declaration of estimated tax except when such amount is taken as a credit on an income tax return for the taxable year. Amounts paid on declarations include overpayments from prior years credited to the declaration.

(4) (a) A corporation should file an amended declaration of estimated tax if there is reason to believe that the tax liability for the taxable year will be different than the amount originally estimated. Form 20-CD, marked "Amended Estimate," should be used to amend a declaration of estimated tax.

(b) If the amended declaration indicates an increase in the estimated liability, payment should be submitted with the amended declaration in an amount equal to all payments that would have been due to date had the amount of the amended estimate been estimated originally.

(c) If the amended declaration results in a decrease in the estimated liability, the subsequent payments should be reduced accordingly.

(5) (a) A corporation must file Form 20-CD "Declaration of Estimated Tax" for a period of less than one year, but four or more months, if the corporation will be required to file an income tax return for the period and can reasonably expect to have a tax liability of more than $5,000 prorated by the ratio which the number of months in the taxable period bears to twelve (12).

1. EXAMPLE: A corporation receives permission to change its taxable year from a fiscal year ending July 31 to a calendar year. A tax return would be required for the period August 1 through December 31. If the corporation can reasonably expect to have a tax liability of at least $2,083 (5/12 of $5,000), Form 20-CD must be filed and the estimated amount paid in installments.

(b) If the requirement of paragraph (1) is met on or before the 1st day of the 4th month, Form 20-CD must be filed on or before the 15th day of the 4th month of the taxable period. Payments on the declaration must be made in equal installments on the 15th day of the 4th, 6th, 9th, and last month of the taxable period, or on as many of those dates as falls within the taxable period.

1. EXAMPLE: For a taxable period January 1 through May 31, Form 20-CD must be filed on or before April 15th and the amount estimated paid in two (2) equal installments on April 15th and May 15th.

(c) All declarations of estimated tax for a period of less than twelve (12) months should be clearly marked "Short Tax Period", and the taxable period clearly indicated.

Author: John H. Burgess
Income Tax Division
Authority: § 40-18-82
History: Adopted: June 17, 1988; Filed with LRS: July 27, 1988.

ALABAMA DEPARTMENT OF REVENUE
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CHAPTER 810-3-83

Payment of Estimated Tax

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810-3-83-.01 Payment on Declaration of Estimated Tax
810-3-83-.02 Declarations for Periods Less than a Year

810-3-83-.01. Payment on Declaration of Estimated Tax for Individuals.

(1) (a) An individual required to file Form 40-ES on or before April 15th of the taxable year must make payments in four equal installments on or before April 15th, June 15th, and September 15th of the taxable year and January 15th of the succeeding year.

(b) An individual required to file Form 40-ES on or before June 15th of the taxable year must make payments in three equal installments on or before June 15th and September 15th of the taxable year and January 15th of the succeeding year.

(c) An individual required to file Form 40-ES on or before September 15th of the taxable year must make payments in two equal installments on or before September 15th of the taxable year and January 15th of the succeeding year.

(d) An individual required to file Form 40-ES after September 15th of the taxable year must pay the total amount estimated on or before January 15th of the succeeding year.

(2) When filing an amended declaration, all payments that would have been due if the amended amount had been originally estimated, less any prior payments, must be paid when the amended declaration is filed.

(a) EXAMPLE: A taxpayer filed a declaration of April 15 with an estimated tax liability of $400. Installments of $100 were paid on April 15 and June 15. On September 15, an amended declaration was filed with a revised estimated liability of $1,000. The amount to be paid with the amended declaration is $550 ($1,000/4 = $250 per installment = $500 for April and June less $200 paid = $300 balance plus $250 current installment).

(3) (a) For taxpayer utilizing a fiscal year, payments must be made on the 15th day of the 4th, 6th, and 9th months of the fiscal year, and the 15th day of the 1st month of the succeeding year.

(b) For taxpayers with taxable years of at least four (4) months, but less than twelve (12) ("short-period" estimates), payments will be due on the dates specified above which fall within the short-period. See Reg. 810-3-82-.01.

(4) A prior year overpayment of tax which is claimed as a credit against the declaration of estimated tax will be applied against the earliest quarterly (or other periodic) installments due on or after the date the return is filed.

(5) At the election of the taxpayer, any installment of estimated tax may be paid prior to the date prescribed for its payment.

Authors: Ecta B. Spicer, Ewell Berry and John H. Burgess
Income Tax Division
Authority: § 40-18-83
History: Adopted September 30, 1982; amended February 8, 1989, filed with LRS March 20, 1989, effective April 24, 1989.

810-3-83-.02. Payment on Declaration of Estimated Tax for Corporations.

(1) A corporation required to file Form 20-CD "Declaration of Estimated Tax," shall pay the estimated tax due in the following manner. For a calendar year taxpayer, if the requirement to file Form 20-CD is met -

(a) on or before April 15th; in four equal installments on or before April 15th, June 15th, September 15th, and December 15th.

(b) on or before June 15th; in three equal installments on or before June 15th, September 15th, and December 15th.

(c) on or before September 15th; in two equal installments on or before September 15th and December 15th.

(d) after September 15th; in a single payment on or before December 15th.

(2) (a) For fiscal year taxpayers, substitute the appropriate dates of the fourth, sixth, ninth and twelfth months of the fiscal year for April, June, September and December respectively in paragraph (1) above.

(b) For taxpayers with taxable years of at least four (4) months, but less than twelve (12) ("short-period" estimates), payments will be due on the dates specified above which fall within the short-period. See Reg. 810-3-82-.02.

(3) When filing an amended declaration of estimated tax under the provisions of § 40-18-82, all amounts that would have been due if the amended amount had been originally estimated, less any prior payments, must be paid with the amended declaration.

(a) EXAMPLE: On April 15th, a corporation filed a declaration of estimated tax in the amount of $6,000. Payments of $1,500 were made on April 15th and June 15th. In August there was reason to believe that the current year's tax liability would be $10,000. The corporation should file an amended declaration of estimated tax on or before September 15th and pay $4,000 ($7,500 the amount of payments that would have been due, if the amended estimate had been originally estimated, less $3,000 previously paid). $2,500 should be paid on or before December 15th of the current year.

(4) A corporation may elect, on its return as filed, to have all or part of an overpayment shown on the return, credited to the declaration for the following year. The election may not be changed or revoked after the return is filed. Such overpayment will be credited as of the date filed of the return for the prior year to any installment then due. If no installment is due at that time, or if the credit is in excess of the installment due, the overpayment will be considered a voluntary advance payment for installments due after that date.

(5) At the election of the taxpayer, any installment of the estimated tax may be paid prior to the date prescribed for its payment.

Authors: George E. Mingledorff, III,
John H. Burgess
Income Tax Division
Authority: § 40-18-83
History:

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INCOME TAX CREDITS


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810-3-135-.01 - Income Tax Credit for Qualifying Workplace Education Costs in the Basic Skills EducationProgram

(1) SCOPE. This regulation sets forth definitions of terms used in regulation 810-3-135-.02 which establishes the computation and limitation of the credit and procedures to be followed.

(2) DEFINITIONS. The following terms have the meaning ascribed to them for the purposes of implementing ***Code of Alabama 1975, §40-18-135*** and associated regulations, unless the context clearly indicates otherwise.

(a) Approved basic skills education program. A basic skills education program that has received written approval from the Alabama Department of Education pursuant to this article.

(b) Basic skills education program. An approved employer provided or employer sponsored education program that enhances basic skills of employees up to and including the twelfth grade functional level.

(c) Costs of education. Direct instructional expenses incurred for or relating to instructors, materials, or equipment used in the qualifying program, or for supplies, textbooks, or salaries, including compensation paid to employees while participating in an approved basic skills education program.

(d) Employee. An individual resident of Alabama who is employed for at least 24 hours per week by the employer seeking the income tax credit and who has been continuously employed for at least 16 weeks.

(e) Employer. A resident or nonresident individual or corporate business, including but not limited to, a subchapter "S" corporation, that is subject to the state income tax.

(f) Employer provided. An approved basic skills education program offered by the employer on the premises of the employer or on premises approved by the Alabama Department of Education.

(g) Employer sponsored. A contractual arrangement with a school, college, university, adult basic skills education program, or other approved provider that offers an approved basic skills education program that is paid for by the employer.

Authors: Jeff Taylor and V.R. Frost
Authority: ***Code of Alabama 1975, §40-18-135 et seq***

History: Filed with LRS October 24, 1995. Certification filed with LRS January 4, 1996, effective date February 8, 1996.

810-3-135-.02 - Reporting and Calculating Credit for Approved Basic Skills Education Program.

(1) SCOPE. This regulation applies to the computation and limitation of the credit available in the Basic Skills Educational Program.

(2) DEFINITIONS. Terms defined in regulation 810-3-135-.01 are incorporated herein by reference for purposes of this regulation, unless the context clearly indicates otherwise.

(3) PROCEDURE. For tax periods beginning on or after January 1, 1993, an income tax credit equal to 20 percent of the actual costs of education of a qualified employee shall be provided to an employer who provides or sponsors a basic skills education program approved by and in compliance with the rules and regulations established by the Alabama Department of Education.

(4) At the time of filing any tax return with the Department in which the education credit is claimed, the person signing the tax return shall file with the Department a statement indicating:

(a) The actual costs of education of qualified employee(s), and,

(b) A copy of the current year's "Workplace Education Tax Credit Certificate" and Certificate number issued by the Alabama Department of Education.

(5) The income tax credit available shall be limited to the amount of the employer's income tax liability for the taxable year as computed without regard to this regulation.

(a) In no event may the credit be carried forward or back to a prior or subsequent year.

(6) No income tax credit shall be granted pursuant to this article to any employer of an employee participating in a basic skills education program if the employer receives or requires reimbursement or any form of remuneration for any cost of the education.

Author: Jeff Taylor and V.R. Frost
Authority: ***Code of Alabama 1975, §40-18-135 et seq***
History: Filed with LRS October 24, 1995. Certification filed with LRS January 4, 1996, effective date February 8, 1996.

810-3-135-.03 Corporate Income Tax Credit for Alabama Coal Producer.

(1) SCOPE. The department promulgates these rules to implement Act 95-239 and clarify the procedures used by a corporation to establish:

(a) the definitions of terms and procedures used to calculate the credit; and,

(b) the determination of when the credit is available; and,

(c) the calculation of the annual credit available; and,

(d) the information required to be reported to the department in order to utilize the credit.

(2) DEFINITIONS. The following terms have the meaning ascribed to them for purposes of the regulations to implement Act 95-239, unless the context clearly indicates otherwise.

(a) Alabama Coal. Coal produced from a location within Alabama.

(b) Base Year. The calendar year 1994, or if the corporation did not produce coal in Alabama during 1994, a twelve-month consecutive period, subsequent to 1994, during which a corporation produces Alabama coal in each of the twelve consecutive months.

(c) Base Year Production. The number of tons of Alabama coal produced during the base year.

(d) Calendar Year. A period of twelve-months ending on December 31.

(e) Corporation. Includes, but is not limited to, an association or joint stock company as defined in § 40-18-1(2), or an Alabama S corporation as defined in § 40-18-160(a).

(f) Producer of Coal. A corporation that ultimately owns the right to extract coal which is subject to the Coal Severance Tax imposed by § 40-13-2, Code of Alabama 1975.

(3) PURPOSE. The purpose of this regulation is to provide the guidelines necessary to determine when a corporation is qualified for the coal credit and to calculate the credit available.

(4) PROCEDURE.

(a) Credit allowed. For tax periods beginning on or after January 1, 1995, every corporation that is doing business as a producer of coal in Alabama will be allowed a credit against the income tax imposed by § 40-18-2, Code of Alabama 1975.

(b) Amount of credit. The credit allowed shall be an amount equal to one dollar ($1) per ton of coal produced during the tax period in excess of the coal produced during the base year of production.

(c) Carry back or carry forward of credit. There is no provision in Act 95-239 for the carry forward or carry back of any unutilized coal credit. Any credit in excess of the current year tax liability cannot be applied to a prior or subsequent year corporate income tax liability.

1. Example: Corporation ABC produced 75,000 tons of coal during calendar year 1994. In calendar year 1995 ABC produced 100,000 tons of coal. ABC is entitled to a income tax credit of one dollar ($1) for every ton of coal produced in excess of the base year production or $25,000. ABC's calendar year 1995 Alabama income tax liability after application of all other credits is $15,000. The amount of credit in excess of the current year liability cannot be applied to a prior or subsequent tax year liability.

(d) Establishment of base year. The credit will not be allowed unless a base year has been established prior to the beginning of the current tax year.

1. Example: Corporation PLM, a calendar year taxpayer, began doing business in Alabama on January 1, 1996. PLM began producing Alabama coal on September 1, 1996, and produced 5,000 tons of coal per month during the next consecutive twelve-month period. PLM's base year is the twelve-month consecutive period from September 1, 1996, to August 31, 1997. The base year production is 60,000 tons. During calendar year 1997 PLM produced 75,000 tons of Alabama coal. PLM is not entitled to the coal credit for the 1997 tax year since the tax year is comprised of a portion of the base year. PLM will be entitled to the coal credit for the 1998 tax year for each ton of coal produced in excess of the base year production.

(e) Tax period of less than twelve-months. There is no provision in Act 95-239 for the proration of the income tax coal credit. The credit is based on the number of tons of coal produced during the short tax period in excess of the base year production.

1. Example: JKL Corporation base year production is 120,000 tons. JKL files a short tax year return for the period beginning January 1, 1996, and ending June 30, 1996. JKL produced 120,000 tons of Alabama coal during this six month period. JKL is not entitled to the coal credit since the number of tons of coal produced during the tax period did not exceed the base year production of 120,000 tons.

2. Example: Assume the same facts as in the preceding example except Corporation JKL produced 150,000 tons of Alabama coal during the short tax period. JKL is entitled to a credit of $30,000.

(f) Statement required to be attached to return. At the time of filing any tax return with the Department in which the coal credit is claimed, the person signing the tax return shall file with the Department a statement certifying the:

1. base year; and,

2. number of tons of coal produced in Alabama during the base year; and,

3. number of tons of coal produced in Alabama during the current tax period.

(g) In the event two or more corporations are merged.

1. The following procedures will determine the base year and amount of credit available. In the event of a merger/acquisition between corporations with and without established base years, the surviving corporation or new corporation shall have as its base year the sum of the previous base years of participants. Upon filing the first tax return of the new or surviving corporation, the amount of credit available shall be the excess of coal produced during the first tax period over the base year.

2. In the event of a merger/acquisition between corporations having no established base years, the surviving or new corporation must establish a base year as provided within this regulation.

3. In the event that one or more of the corporations have filed a short period return and computed a credit as provided in subsection (4)(e) of this regulation, the surviving or new corporation may only compute the credit based only on Alabama coal produced which was not included in a short year return in which such production was used to calculate a coal credit. The excess of Alabama coal (as adjusted) produced over the base year will be allowed as a credit.

4. Example: Corporation BNM and Corporation GHJ are producers of coal as defined in subsection (2)(f) of this regulation and file calendar year returns. BNM and GHJ base year production amounts are 500,000 and 100,000 tons of Alabama coal respectively. On July 17, 1996, BNM and GHJ are consolidated into a new corporation, ZAZ Corporation. BNM and GHJ each file corporate income tax returns for the short tax period ending July 17, 1996. BNM and GHJ produced 600,000 and 125,000 tons of Alabama coal, respectively, during the short tax period ending July 17, 1996. Corporation BNM is entitled to a maximum credit of $100,000 and corporation GHJ is entitled to a maximum credit of $25,000 for the short period ending July 17, 1996. For the period beginning July 18, 1996, and ending December 31, 1996, ZAZ Corporation produced 1,000,000 tons of Alabama coal. ZAZ Corporation is entitled to a maximum credit of $400,000.

Author: Jeffrey Taylor and Verlon R. Frost
Authority: Sections 40-2A-7(a)(5) and 40-18-57, Code of Alabama 1975
History: Filed with LRS November 7, 1995. Certification filed with LRS January 30, 1996, effective March 5, 1996.

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CHAPTER 810-3-160

Requirements for Qualification as an Alabama S Corporation

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810-3-160-.01 Qualification Requirements for S Corporations

810-3-160-.01 Qualification Requirements for S Corporations.

(1) (a) For tax years beginning before January 1, 1990, to qualify as an Alabama S corporation, the criteria to be met for each year of the election are -

1. a valid election must be in effect under I.R.C. §1362, and

2. all non-resident shareholders who held any stock interest in the electing corporation during any part of the tax year of the corporation must execute a consent agreement to report their share of the Alabama S corporation Alabama income to this State and pay any tax due thereon.

(2) (a) The election will be made by filing Form 20S, together with the required consent agreements of all non-resident shareholders (if any), and any other required attachments; not later than the due date (with extensions) of the corporation return.

(b) Once made, the election to be an Alabama S corporation for a taxable year may not be revoked or cancelled.

(c) An "Alabama C corporation" means any corporation other than an Alabama S corporation.

(3) (a) If the corporation ceases to qualify under I.R.C. §1362, part-year S and C returns will be required as provided in I.R.C. §1362(e). Such returns will be due not later than the fifteenth day of the third month after the close of the corporation's tax year, plus any extensions of time to file that may be granted.

(b) An "S return" means Form 20S to be filed by qualified Alabama S corporations. A "C return" means Form 20C for domestic and foreign corporations.

(4) (a) The consent agreement (Schedule NRA) to be executed by all non-resident shareholders shall contain the following information:

1. the name, address and social security number of the shareholder, and

2. a recitation of the agreement to report and pay tax to Alabama on the shareholder's share of the Alabama S corporation income in exchange for the benefits of allowing the corporation to file an Alabama S Corporation return, and

3. an agreement appointing the Alabama resident agent of the corporation and any agent or officer of the corporation present in Alabama as agent of the shareholder for service of process in any matter before the Department relating to the income tax returns of the shareholder and/or the corporation, and

4. be notarized or otherwise authenticated before some officer authorized to administer oaths.

(b) If the stock is held by multiple owners (such as joint owners), each owner must execute a separate consent agreement.

(c) Each non-resident shareholder may designate any other person or firm present in Alabama as agent for service of process, in addition to the agents required to be appointed in subparagraph (a) 3. above.

(d) Any non-resident shareholder may, by power-of-attorney, authorize anyone to execute the required consent agreement on behalf of the shareholder. Such power-of-attorney, to be effective, must be filed with the Department on or before the due date (with extensions) of the first return in which a consent agreement is being executed under the power-of-attorney. The power-of-attorney need be filed only once and remains valid until the expiration date specified therein or until notice of revocation, cancellation or modification is received by the Department. Such power-of-attorney may be in any form sufficient to indicate the intent of the parties, and must be authenticated in the manner prescribed in subparagraph (a)4. above.

(e) 1. A non-resident is any person who is a legal resident of any state other than Alabama, or of any territory, possession, district or foreign country.

2. The status as a resident or non-resident will be determined as of the date of any distribution or deemed distribution.

(5) (a) During all years (beginning on or after January 1, 1985 and before January 1, 1990) for which the corporation qualifies as an Alabama S corporation, the corporation will not be subject to income tax as a corporation under §40-18-31. There are no provisions of Alabama law similar to Federal law (such as I.R.C. § 1374) imposing an income tax on the corporation for certain types of non-qualifying income or for excess investment income.

(b) The corporation will file a return on Form 20S for each year it qualifies as an Alabama S corporation. The S return will be due at the same time as other Alabama corporation income tax returns are due. An Alabama Schedule K-1 must be attached for each shareholder who held any stock interest in the Alabama S corporation during the taxable year, showing the shareholder's legal place of residence, and detailing the shareholder's pro-rata share of the corporation's separately stated and non-separately stated income and deductions attributed to Alabama (see Reg. 810-3-31-.02. for attribution of income to Alabama). The provisions of Reg. 810-3-39-.02 relating to extensions of time to file corporation returns are equally applicable to an Alabama S corporation.

(6) For tax years beginning after December 31, 1989 and before January 1, 1997, an "Alabama S corporation" means any corporation doing business or qualified to do business in Alabama which has in effect a valid election under I.R.C. §1362. (For tax years beginning after December 31, 1989 see Reg. 810-3-176-.01 regarding composite returns for non-residents).

(7) (a) For tax years beginning after December 31, 1996, an Alabama S corporation means:

1. any corporation which has a valid election under I.R.C. §1362 and the income, loss, deductions or credits or items of income, loss, deductions or credits of which affect the liability of any shareholder of the corporation for the income tax imposed by this chapter, either by reason of business done in Alabama by the corporation or the ownership of shares by an Alabama resident; or,

2. any corporation which has a valid election under I.R.C. §1361(b)(3) to be treated as a qualified subchapter S subsidiary and all of its stock is owned by an Alabama S corporation.

Author: Verlon Frost and Catherine McCary
Authority: Sections 40-2A-7(a)(5) and 40-18-160
Code of Alabama 1975
History: Adopted November 13, 1985.
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Amended December 4, 1992.
Amended March 26, 1998, effective date April 30, 1998.

ALABAMA DEPARTMENT OF REVENUE
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CHAPTER 810-3-161

Computing Taxable Income of an Alabama S Corporation

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810-3-161-.01 Computation of Taxable Income.

(1) Nonseparately Stated Income. Nonseparately stated income for Alabama S corporations will be computed in the same manner as for individuals, except for those deductions and exemptions which are not applicable to nonindividuals, such as:

(a) The personal exemption and credit for dependents allowed by § 40-18-19, Code of Alabama 1975,

(b) Charitable contributions allowed by § 40-18-15,

(c) The net operating loss deduction allowed by § 40-18-15.2,

(d) Medical expenses allowed by § 40-18-15,

(e) Moving expenses allowed by § 40-18-15,

(f) Alimony allowed by § 40-18-15,

(g) Contributions to an Individual Retirement Account (IRA) allowed by § 40-18-15,

(h) The deduction for certain expenses of producing income and determining taxes, allowed by § 40-18-15, and

(i) Depletion on oil and gas wells allowed by § 40-18-15.

(2) Separately Stated Income. Certain items of income, loss and deductions are to be passed through to the individual returns of the shareholders, rather than being deducted in computing the nonseparately stated income of the S corporation on the Alabama S corporation return. Separately stated items are those the separate treatment of which could affect the liability for tax of any shareholder. These items include:

(a) Income taxes paid to the United States,

(b) Charitable contributions,

(c) Depletion on oil and gas wells, and

(d) All items of income, loss, expense or deduction, which for the purpose of computing a net operating loss deduction for an individual would be classified as "nonbusiness" as defined in Rule 810-3-15-.22. These items classified as "nonbusiness" for Alabama net operating loss deduction purposes

are usually classified as "portfolio income and expense" on the federal S corporation return and supporting schedules.

(3) Net Operating Losses. The net operating loss carryback/carryforward provision for individuals and the net operating loss carryforward provision for corporations are not applicable to Alabama S corporations. The yearly losses, if any, of the S corporation are passed through to the shareholders, and thus are not available at the corporate level for carryforward. Any losses incurred by a corporation in any years in which the corporation was not an Alabama S corporation, may not be carried forward to any years in which the corporation is an Alabama S corporation.

(4) Multistate Operations.

(a) For tax years beginning before January 1, 1990, Alabama S corporations which conducted business in more than one state were required to compute the income and deductions attributed to Alabama by allocating and apportioning the income and deductions to Alabama in accordance with the rules and regulations applicable to foreign corporations at that time. This includes Alabama S corporations which were created under Alabama law (domestic corporations).

(b) For tax years beginning after December 31, 1989 and before January 1, 1997, the following rules applied for Alabama S corporations which conducted business in more than one state:

1. The Alabama S corporation was required to compute each resident shareholder's pro rata share of the entire income and deductions of the Alabama S corporation.

(i) In computing taxable income under subparagraph 1., the Alabama S corporation was allowed a deduction for income taxes paid to states in which it was not treated as an S corporation.

2. The Alabama S corporation was required to compute each nonresident shareholder's pro rata share of income and deductions apportioned and allocated to Alabama in accordance with the rules and regulations applicable to foreign corporations at that time. For simplicity, compliance with the requirements of the Multistate Tax Compact, Chapter 27, Title 40, Code of Alabama 1975, will satisfy the requirement of this subparagraph.

(c) For tax years beginning after December 31, 1996, Alabama S corporations which conduct business in more than one state shall compute the income, loss, deductions and credits to be attributed to Alabama in the same manner as provided in accordance with the Multistate Tax Compact, Chapter 27, Title 40, Code of Alabama 1975.

(d) An Alabama S corporation is conducting business in more than one state if it meets the provisions for being taxable in more than one state set out in Rule 810-27-1-4-.03.

(e) Allocation and Apportionment Reporting Requirements.

1. For tax years beginning before January 1, 1990, an Alabama S corporation which did business in more than one state was required to complete the necessary schedules of Form 20S to compute the apportionment ratios and to apportion and allocate income, loss, deductions and credits among the states in which the corporation did business.

2. For tax years beginning on or after January 1, 1990 and before January 1,1997, an Alabama S corporation which did business in more than one state and which had one or more nonresident shareholders was required to complete the necessary schedules of Form 20S to compute the apportionment ratios and to apportion and allocate income, loss, deductions and credits among the states in which the corporation did business.

3. For tax years beginning on or after January 1, 1997, an Alabama S corporation doing business in more than one state shall complete the necessary schedules of Form 20S to compute the apportionment ratios and to apportion and allocate income, loss, deductions and credits among the states in which the corporation does business.

(5) Elections. Any election required or permitted to be made with respect to the computation of income, deductions, credits or allowances shall be made by the Alabama S corporation.

Author: Verlon R. Frost, Jeff Taylor, Catherine McCary, Ann Winborne, CPA, Charlotte Jordan, and Ed Cutter, CPA
Authority: Sections 40-2A-7(a)(5) and 40-18-161, Code of Alabama 1975.
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Amended: Filed March 26, 1998, effective April 30, 1998.
Amended: Filed March 31, 2000, effective May 5, 2000.

810-3-161-.02 LIFO Recapture.

(1) Definitions. For purposes of this regulation, the following definitions shall apply:

(a) "LIFO recapture amount" means the excess of the inventory's value using the FIFO method over its value using the LIFO method.

1. For purposes of subparagraph (a), the inventory value means the aggregate amount of the inventory assets determined as of the end of the last tax year before the corporation converts to S status.

2. For purposes of subparagraph (a), the FIFO amount shall be determined by using the retail method if the corporation uses the retail method to determine the LIFO amount. If the corporation does not use the retail method to determine the LIFO amount, then the lower of cost or market method must be used to determine the FIFO amount.

(b) "LIFO method" means the method authorized by 26 U.S.C. § 472. For interpretation of federal statutes adopted by the Alabama legislature, see Rule 810-3-1.1-.01, Operating Rules.

(c) "Inventory assets" means property which would normally be included in inventory of the corporation at the close of the taxable year.

(2) LIFO Recapture Amount.

(a) Any C corporation which converts to S corporation status, and which used the LIFO inventory method for its last C corporation tax year, must include the LIFO recapture amount in gross income for the last taxable year for which it was a C corporation.

(b) Any amount included in gross income under paragraph (a) shall be included in the value of inventory by making the appropriate adjustments to basis.

(3) Payment of Tax. The tax attributable to the inclusion in income of the LIFO recapture amount is payable in four equal installments.

(a) The first installment must be paid on or before the unextended due date for filing the C corporation return for the last tax year before conversion to S corporation status.

(b) The three remaining installments are due on or before the unextended due dates of the corporation's tax returns for the three succeeding tax years.

(c) No interest will be charged if the installments are paid on or before their respective due dates.

Author: Ed Cutter, CPA
Authority: §§40-2A-7(a)(5) and 40-18-161, Code of Alabama 1975
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Amended: Filed March 31, 2000, effective May 5, 2000.

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CHAPTER 810-3-162

Shareholder's Computation of Taxable Income

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810-3-162-.01 Income to be Reported by Shareholders

810-3-162-.01 Income to be Reported by Shareholders.

(1) (a) For taxpayers who are shareholders of an Alabama S corporation with a tax year which began before January 1, 1990,each shareholder of an Alabama S corporation shall include in his individual Alabama income tax return each year his pro rata share of the:

1. separately stated items of income, loss, deduction or credit attributed to Alabama by the Alabama S corporation for the corporation's taxable year which ends with or during the individual's tax year; and

2. nonseparately stated items of income, loss, deduction or credit attributed to Alabama by the Alabama S corporation for the corporation's taxable year which ends with or during the individual's tax year.

(b) For taxpayers who are shareholders of an Alabama S corporation with a tax year which began after December 31, 1989 and before January 1, 1997-

1. Each resident shareholder shall include in his individual Alabama income tax return each year his pro rata share of the:

(i) separately stated items of income, loss, deduction or credit of the Alabama S corporation for the corporation's taxable year which ends with or during the individual's tax year; and

(ii) nonseparately stated items of income, loss, deduction or credit of the Alabama S corporation for the corporation's taxable year which ends with or during the individual's tax year.

2. Each nonresident shareholder shall include in his individual Alabama income tax return each year his pro rata share of the:

(i) separately stated items of income, loss, deduction or credit attributed to Alabama by the Alabama S corporation for the corporation's taxable year which ends with or during the individual's tax year.

(ii) nonseparately stated items of income, loss, deduction or credit attributed to Alabama by the Alabama S corporation for the corporation's taxable year which ends with or during the individual's tax year.

(c) For taxpayers who are shareholders of an Alabama S corporation with a tax year which began after December 31, 1996, each shareholder of an Alabama S corporation shall include in his individual Alabama income tax return each year his pro rata share of the:

1. separately stated items of income, loss, deduction or credit attributed to Alabama by the Alabama S corporation for the corporation's taxable year which ends with or during the individual's tax year; and

2. nonseparately stated items of income, loss, deduction or credit attributed to Alabama by the Alabama S corporation for the corporation's taxable year which ends with or during the individual's tax year.

(2) Any item included in the shareholder's pro rata share shall retain the same character as if received directly by the shareholder from the source. For example, the shareholder's pro rata share of interest income earned by the Alabama S corporation from United States government obligations would be exempt to the shareholder as if received directly by that shareholder from the U.S. Government.

(3) If the sum of the separately stated and nonseparately stated items of income, loss and deduction is a net loss attributed to Alabama, that loss may be deducted on the individual return of the shareholder to the extent permitted below.

(a) The net loss to be deducted on the return may not exceed the shareholder's Alabama adjusted basis in the stock of the Alabama S corporation, plus the shareholder's Alabama adjusted basis in any indebtedness of the Alabama S corporation to the shareholder.

1. For each year, the limitation is the Alabama adjusted basis of the shareholder's stock as determined under Reg. 810-3-164-.01(1), plus the Alabama adjusted basis of any indebtedness due the shareholder as determined under Reg. 810-3-164-.01(2).

2. Any loss in excess of the Alabama adjusted basis of the stock and indebtedness may be carried forward to the next succeeding year.

3. The Alabama adjusted basis of the stock and/or any indebtedness due the taxpayer will not be less than zero.

(4) (a) For taxpayers who are shareholders of an Alabama S corporation with a tax year which began before January 1, 1990, no credit for income taxes paid other states provided in §40-18-21 is allowable with respect to a shareholder's pro rata share of an Alabama S corporation's separately stated and nonseparately stated income, as an Alabama S corporation reports only income apportioned and/or allocated to Alabama and therefore includes no income derived from sources without Alabama. See also Reg. 810-3-21-.01. It should also be noted that no deduction is allowable to either the Alabama S corporation or the shareholders for net income taxes paid other state, local and/or foreign governments. See §40-18-15(3)(h) and Reg. 810-3-15-.04(4)(a).

(b) For taxpayers who are shareholders of an Alabama S corporation with a tax year which began after December 31, 1989 and before January 1, 1997-

1. resident shareholders include in gross income their deemed distributive share of the entire income or loss of the Alabama S corporation. Therefore, resident shareholders are allowed a credit for income taxes paid by the shareholder to any other state in which the corporation is treated as an S corporation.

2. nonresident shareholders include in gross income their deemed distributive share of the income or loss of the Alabama S corporation apportioned and allocated to Alabama. Therefore, no income from sources without Alabama is included and no credit is allowable to the nonresident shareholder for income taxes paid by the shareholder to any other state in connection with such income.

(c) For taxpayers who are shareholders of an Alabama S corporation with a tax year which began after December 31, 1996, each shareholder shall include in gross income their deemed distributive share of the income or loss of the Alabama S corporation apportioned and allocated to Alabama. Therefore, no income from sources without Alabama is included and no credit or deduction is allowable to the shareholder or the Alabama S corporation for income taxes paid by the shareholder or the corporation to any other state, local or foreign government in connection with such income.

Authors: Verlon Frost, Catherine McCary
Authority: Sections 40-2A-7(a)(5) and 40-18-162, Code of Alabama 1975
History: Filed November 20, 1985.
Filed with LRS November 19, 1991,
Amended June 19, 1992.
Amended March 26, 1998, effective date April 30, 1998.

ALABAMA DEPARTMENT OF REVENUE
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CHAPTER 810-3-163

Taxation of Transactions Involving Individuals Related
to Shareholders of an Alabama S Corporation

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810-3-163-.01 Transactions Involving Related Individuals

810-3-163-.01 Transactions Involving Related Individuals.

(1) A related individual (as defined in subsection (2) below) who furnishes capital and/or provides services for an Alabama S corporation without receiving reasonable compensation for the capital and/or services, will be deemed to have received income from the Alabama S corporation equal to the value of reasonable compensation less the value of any compensation actually paid. A deduction will be allowed to the Alabama S corporation in an amount equal to the amount of income the related individual is deemed to have received from the corporation. No deduction is allowable to the related individual.

(2) Definitions. For the purposes of this section, the following definitions apply:

(a) Related Individual - Any person (or persons) who is the spouse, ancestor, or lineal descendent (or any trust for the primary benefit of such persons) related to a shareholder (or shareholders) of an Alabama S corporation or to any beneficiary (or beneficiaries) of a trust (or trusts) that is a shareholder of an Alabama S corporation.

(b) Reasonable Compensation - The fair market value of capital furnished, or the fair market value of property, services, wages, fees or other compensation for services performed. The fair market value of capital furnished will be presumed to be equal to the rate of interest on delinquent taxes provided by § 40-1-44, Code of Alabama 1975.

Author: Ed Cutter, CPA
Authority: §§ 40-2A-7(a)(5) and 40-18-163, Code of Alabama 1975
History: Adopted November 13, 1985.
Amended: Filed March 31, 2000, effective May 5, 2000.

ALABAMA DEPARTMENT OF REVENUE
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# CHAPTER 810-3-164

## Computation of Adjustments to a Shareholder's Basis in the Stock and Indebtedness of an Alabama S Corporation

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810-3-164-.01 Adjustments to Basis of Stock and Indebtedness

810-3-164-.01 Adjustments to Basis of Stock and Indebtedness.

(1) Basis Adjustments - Shareholder's Stock in an Alabama S Corporation.

(a) The shareholder's basis in the Alabama S Corporation stock is increased by:

1. Any separately stated income attributed to Alabama as computed under § 40-18-162(a)(1), Code of Alabama 1975, to the extent included in the shareholder's return, as amended or adjusted.

2. Any nonseparately stated income attributed to Alabama as computed under §40-18-162(a)(2), to the extent included in the shareholder's return, as amended or adjusted.

3. Any oil and gas depletion deduction attributed to Alabama in excess of the basis of the wells being depleted.

(b) The shareholder's basis in the Alabama S Corporation stock is decreased by:

1. Any distributions which constitute a return of capital under §40-18-165.

2. Any separately stated loss and deductions attributed to Alabama computed under §40-18-162(a)(1); such as charitable contributions.

3. Any nonseparately stated loss and deductions attributed to Alabama computed under §40-18-162(a)(2).

4. Any losses or expenses attributed to Alabama not deductible by the corporation or chargeable to its capital account.

5. Any depletion deduction attributed to Alabama on oil and gas property to the extent such deduction does not exceed the proportionate share of the adjusted basis of such property allocated to the shareholder.

(c) Basis Not Reduced Below Zero. The basis of the stock, as adjusted in the manner provided in paragraph (1) above, will not be reduced below zero. Any amount that would reduce the basis of the stock below zero will be used to adjust the shareholder's basis (but not below zero) in any indebtedness due to the shareholder from the corporation, as provided in paragraph (2) below.

(d) Multistate Operations. For tax years beginning after December 31, 1996:

1. The increases under subparagraph (a) and the decreases under subparagraph (b) will include the entire amount, without allocation and apportionment under Chapter 27, Title 40, Code of Alabama 1975, of the shareholder's pro rata share of such increases and decreases during the taxable year.

2. If an item of income is subject to allocation and apportionment, the basis increases under subparagraphs (1)(a)1, (1)(a)2 and (1)(d)1 will be allowed only in proportion to the income reported on the taxpayer's return that bears to the amount of income allocated and apportioned to Alabama and required to be included in the shareholder's return.

(2) Basis of Shareholder Loans to the Corporation. The shareholder's basis in any indebtedness due to the shareholder from the corporation will be:

(a) The basis (determined as provided in §40-18-6) of the debt, less

(b) Any excess basis adjustments to the shareholder's stock as provided in subparagraph (1)(c) above, but

(c) Not less than zero.

(3) See Rule 810-3-162-.01 for carryover of excess amounts which would reduce the basis of debt or stock below zero except for the provisions of this regulation.

(4) Restoration of the Shareholder's Basis in Indebtedness and Stock. Positive adjustments to the shareholder's basis in future years will be first applied to increase the shareholder's basis in any indebtedness due to the shareholder from the corporation, and then applied to increase the shareholder's stock basis.

(5) If the stock of the Alabama S corporation becomes worthless, the amount of loss to be deducted by the shareholder will be determined after making the basis adjustments set out in paragraph (1) above.

(6) For nonresident shareholders, the investment in Alabama S corporation stock and debt will be considered to be attributed to the shareholder's state of domicile. For resident shareholders, the investment in Alabama S corporation stock and debt will be considered to be attributed to Alabama in full.

(7) Examples. The following examples will serve to illustrate the operation of this regulation:

(a) Able, an Alabama resident, is the 100% owner of Sussex Corporation, an Alabama S corporation with all its activities attributed to Alabama. Able's basis for his Sussex Corporation stock at the beginning of 1985 is $1,000. In addition, Able has a basis of $500 in a loan from him to the corporation.

1. On its tax return for the year ended December 31, 1985, Sussex reports the following:

| | |
|---|---|
| Non-separately stated loss | $1,200 |
| Charitable contributions | 100 |

2. Able's basis in his Sussex stock and in the debt of the corporation at December 31, 1985 is computed as follows:

| | Basis in Stock | Basis in Debt |
|---|---|---|
| Basis at January 1, 1985 | $1,000 | $ 500 |
| Non-separately stated loss and charitable contributions reduce stock basis (but not below zero) | (1,000) | (300) |
| Basis at December 31, 1985 | $ -0- | $ 200 |

(b) In the year ended December 31, 1986, Sussex Corporation reports the following:

| | |
|---|---|
| Net income | $2,500 |
| Charitable contributions | 300 |

1. Able's basis in his Sussex Corporation stock and the debt owed to him from the corporation at December 31, 1986 is computed as follows:

| | Basis in Stock | Basis in Debt |
|---|---|---|
| Basis at January 1, 1986 (see above) | -0- | $ 200 |
| Net income increases basis of debt to extent of prior reduction | | 300 |
| Balance of net income and separately stated items increases | | |

| | | |
|---|---|---|
| basis in stock | 1,900 | |
| Basis at December 31, 1986 | $1,900 | $ 500 |

(c) The situation is the same as in (a) and (b) above except (1) the tax periods are 1997 and 1998 and (2) the corporation has only 50% of its activities attributed to Alabama.

1. Able reports his 100% share of the income attributed to Alabama.

2. Able's basis in his Sussex Corporation stock and in the debt to him from the corporation will be the same as computed in (a) and (b) above. For tax periods beginning after December 31, 1996, the shareholder's basis is adjusted by his share of the total Alabama S corporation income (loss).

(d) The situation is the same as in (c) above except Able (100% shareholder) reports on his 1998 tax return only 95% of the nonseparately computed income attributed to Alabama. Able's basis should increase by only 95 % of the nonseparately computed income.

1. Able's basis in his Sussex Corporation stock and in debt to him from the corporation at December 31, 1998 is computed as follows:

| | Basis in Stock | Basis in Debt |
|---|---|---|
| Basis at January 1, 1998 (see above) | $-0- | $200 |
| Net income increases basis of debt to extent of prior reduction | | 300 |
| Balance of net income (2375-300) and separately stated items (-300) increases basis in stock | 1775 | |
| Basis at December 31, 1998 | $1775 | $500 |

(8) Inherited Stock of an Alabama S Corporation.

(a) If any person acquires stock in an Alabama S corporation by reason of the death of a decedent or by bequest, devise, or inheritance, then the treatment of any item of income of the S corporation shall be determined in accordance with 26 U.S.C. § 691, concerning recipients of income in respect of a decedents, which shall be applied as if the decedent had held directly his or her pro rata share of such item. For interpretation of federal statutes adopted by the Alabama legislature, see Rule 810-3-1.1-.01, Operating Rules.

(b) The basis of any stock in an Alabama S corporation which is determined under § 40-18-6 shall be reduced by the portion of the value of the stock that is attributable to items constituting income in respect of a decedent.

Authors: Verlon Frost, Catherine McCary, Ann Winborne, CPA, Charlotte Jordan, and Ed Cutter, CPA

Authority: §§40-2A-7(a)(5), 40-18-164 and 40-18-57 Code of Alabama 1975

History: Adopted November 13, 1985.
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Amended: Filed March 31, 2000, effective May 5, 2000.

ALABAMA DEPARTMENT OF REVENUE
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CHAPTER 810-3-165

Taxation of Actual Distributions Received by a Shareholder from an Alabama S Corporation

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810-3-165-.01 Taxation of Actual Distributions by an Alabama S Corporation

810-3-165-.01 Taxation of Actual Distributions By An Alabama S Corporation.

(1) Treatment of Property Distributions. An actual distribution of property (not the prorata share taken into account under §40-18-162, Code of Alabama 1975) by an Alabama S Corporation in accordance with the provisions of § 40-18-36, will be treated in the following manner:

(a) If the Alabama S corporation has no accumulated earnings and profits (from any year in which an Alabama S election was not in effect or from a merger), the distribution will not be included in the shareholder's gross income to the extent the distribution does not exceed the adjusted basis of the stock.

1. To the extent the distribution exceeds the shareholder's adjusted basis in the stock of the Alabama S corporation, the excess will be treated as a gain from the sale or exchange of property.

(b) If the Alabama S corporation has accumulated earnings and profits (from any year in which an Alabama S election was not in effect or from a merger), and the distribution does not exceed the Alabama Accumulated Adjustments Account, the distribution will not be included in the shareholder's gross income to the extent of the shareholder's adjusted basis of the stock.

1. To the extent the distribution exceeds the shareholder's adjusted basis of the stock, the distribution will be included in the shareholder's gross income as a dividend to the extent that it does not exceed the corporation's Alabama accumulated earnings and profits.

2. To the extent the distribution exceeds the corporation's Alabama accumulated earnings and profits, but not the Alabama Accumulated Adjustments Account (after application of subparagraph (b) above), the excess will not be included in the shareholder's gross income.

3. To the extent the distribution exceeds the corporation's Alabama accumulated earnings and profits and the Alabama Accumulated Adjustments Account, the excess will be treated as a gain from the sale or exchange of property.

(2) In applying the rules of this section, the shareholder's basis in his or her stock will first be adjusted as provided in Rule 810-3-164-.01 and the Alabama Accumulated Adjustments Account adjusted as provided in Rule 810-3-166-.01.

(3) Special Election. As provided in § 40-18-166(b), the Alabama S corporation may elect, with the consent of all the affected shareholders, to treat all distributions made during the taxable year as distributions first from

accumulated earnings and profits rather than from the Alabama Accumulated Adjustments Account. See Rule 810-3-166.01.

(4) Nonresident Shareholders. Nonresident shareholders who receive distributions under the provisions of this regulation are not required to include such amounts in their Alabama nonresident income tax returns, except when paragraph (3) above applies.

(5) Examples. The following examples will serve to illustrate the operation of this regulation:

(a) 1. Jones is the 100% shareholder of Acme, Inc., an Alabama S corporation which has its first year of existence in 1985, and therefore has no accumulated earnings and profits. All its income and deductions are attributed to Alabama. Jones' basis in his Acme stock at January 1, 1985 is $1,000.

2. Acme reports the following on its tax return for the year ended December 31, 1985:

| | |
|---|---|
| Non-separately stated income | $1,500 |
| Distribution to Jones on 10/31/85 | 2,000 |

3. Jones' adjusted basis in his Acme stock at December 31, 1985, before giving effect to the distribution, is computed as follows:

| | |
|---|---|
| Basis at January 1, 1985 | $1,000 |
| Non-separately stated income for 1985 | 1,500 |
| Basis on December 31, 1985 | $2,500 |

4. The entire distribution to Jones on 10/31/85 is a non-taxable return of his basis. After giving effect to the distribution, Jones' basis is his Acme stock at December 31, 1985 is $500.

(b) The facts are the same as in example (a) above, except that the distribution to Jones on October 31, 1985, is $3,000.

1. The distribution to Jones is characterized as a non-taxable return of his basis to the extent of his adjusted basis before giving effect to the distribution. The excess of this distribution over his basis is taxed as a gain from the sale or exchange of his Acme stock. His adjusted basis on December 31, 1985 is $2,500 before recognizing the distribution (see example (a)3, above). Therefore, Jones has a non-taxable return of basis of $2,500 and a gain from the exchange of his stock of $500.

(c) The facts are the same as in the example (b) above, except that Acme has accumulated earnings and profits from prior C corporation years in the amount of $3,000.

1. Acme's accumulated adjustments account at December 31, 1985, before giving effect to the distribution is $1,500, the amount of the non-separately stated income. The $3,000 distribution to Jones on October 31, 1985, is characterized as follows:

| | |
|---|---|
| Non-taxable restoration of basis to the extent of the Alabama Accumulated Adjustments Account | $1,500 |
| Taxable dividend paid from accumulated earnings and profits | $1,500 |
| Total Distribution | $3,000 |

2. Jones' basis in his Acme stock at December 31, 1985, after giving effect to the distribution is $1,000. The balance in Acme's accumulated earnings and profits account at December 31, 1985, after giving effect to the distribution, is $1,500.

(d) The facts are the same as in example (c) above, except that Acme, with Jones' consent, has elected under Rule 810-3-166-.01 to treat all distributions in the taxable year as coming first from accumulated earnings and profits.

1. The entire distribution is characterized as a taxable dividend paid from accumulated earnings and profits. Jones' basis in his Acme stock at December 31, 1985 is $2,500, and the balance in Acme's accumulated adjustments account at December 31, 1985 is $1,500. Acme has no accumulated earnings and profits at December 31, 1985, after giving effect to the distribution.

(6) For tax years beginning after December 31, 1996, adjustments for distributions are made before applying the loss limitation. The stock basis is adjusted by the positive adjustments under Rule 810-3-164-.01 but is not decreased by any of the negative adjustments before taking into account any distributions.

Authors: Verlon Frost, Catherine McCary, Ann Winborne, CPA, Charlotte
Authority: Sections 40-2A-7(a)(5) and 40-18-165, Code of Alabama, 1975
History: Adopted November 13, 1985.
Amended: Filed October 30, 1992, effective December 4, 1992.
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CHAPTER 810-3-166

Computation of the Alabama Accumulated
Adjustments Account

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810-3-166-.01 Alabama Accumulated Adjustments Account

810-3-166-.01 Alabama Accumulated Adjustments Account.

(1) The Alabama Accumulated Adjustments Account.

(a) The Alabama Accumulated Adjustments Account (AAAA) is an account maintained for an Alabama S corporation which details the amounts of earnings, profits, losses, gains and deductions which have been previously included by the individual shareholders on their respective income tax returns. It is used to compute the tax effect of distributions made by Alabama S corporations which have accumulated earnings and profits.

(b) For tax years beginning after December 31, 1990, and before January 1, 1997, the adjustments to the Alabama Accumulated Adjustments Account included:

1. The amounts of earnings, profits, losses, gains and deductions attributed to Alabama and includible by the nonresident shareholders on their respective returns, and

2. The entire amounts of earnings, profits, losses, gains and deductions includible by the Alabama resident shareholders on their respective returns.

(c) For tax years beginning on or after January 1, 1997, the adjustments to the Alabama Accumulated Adjustments Account include the entire earnings, profits, losses, gains and deductions of the S corporation to the extent includible by the individual shareholders on their respective returns.

1. If an item of income is subject to allocation and apportionment, the adjustment is an amount that is in proportion to the amount of the income reportable on the shareholder's return bears to the amount of income allocated and apportioned to Alabama and required to be included in the shareholder's return.

(2) Adjustments to the Alabama Accumulated Adjustments Account. The AAAA is equal to zero on the first day of the first year the corporation is an Alabama S corporation.

(a) The balance of the account is increased by the following amounts:

1. Any separately stated income, except exempt income (as defined in §40-18-14, Code of Alabama 1975), as computed under §40-18-162(a)(1), Code of Alabama 1975,

2. Any nonseparately stated income, except exempt income as defined in §40-18-14, as computed under §40-18-162(a)(2), and

3. Any oil and gas depletion deduction in excess of the basis of the wells being depleted.

(b) The balance of the account is decreased by the following amounts:

1. Any separately stated loss and deductions, as computed under §40-18-162(a)(1),

2. Any nonseparately stated loss and deductions, as computed under §40-18-162(a)(2),

3. Any deduction for oil and gas depletion to the extent such deduction does not exceed the proportionate share of the adjusted basis of such property allocated to the shareholder, and

4. Any distribution of the type described in Rule 810-3-165-.01, subdivisions (1)(a)or (1)(b).

(c) For tax years beginning after December 31, 1996, in applying the rules of §40-18-166 to distributions, the AAAA for the end of the taxable year will be determined without regard to the net loss for the taxable year.

(3) AAAA Adjustment Upon Redemption of Stock. If the Alabama S corporation redeems parts of its stock, the AAAA will be decreased by an amount which bears the same ratio to the balance in such account as the number of shares redeemed in such redemption bears to the total number of shares of the S corporation issued and outstanding immediately before the redemption. For example, if the S corporation should redeem one-half of its stock, the AAAA would be reduced by one-half.

(4) Election Concerning Distribution Treatment. An Alabama S corporation may, with the consent of all affected shareholders, elect to have all distributions treated as distributions first from the accumulated earnings and profits, rather than as distributions of amounts from the AAAA. See Rule 810-3-165-.01(3).

(a) The term "affected shareholder" means any shareholder who receives a distribution from the Alabama S corporation during the taxable year of the corporation.

(b) The consent may be in any form which clearly reflects the shareholder's election under §40- 18-166(b) to treat actual distributions as being first from accumulated earnings and profits, rather than a tax-free distribution from the Alabama Accumulated Adjustments Account, and must be notarized or otherwise authenticated before some officer authorized to administer oaths.

(c) The consent must be attached to the return (Form 20S) of the Alabama S corporation for the taxable year.

(d) This election and consent will not affect the requirement under §40-18-162 for the shareholder to include his or her prorata share of the corporation's income, gains, losses and deductions attributed to Alabama in his or her Alabama individual income tax return.

(5) In administering and interpreting this regulation, the Department will consider administrative rulings and judicial decisions in respect to the similar provisions of the Internal Revenue Code and Regulations thereunder.

Authors: Jeffrey Taylor, Verlon Frost, Catherine McCary, Ann Winborne, CPA, Charlotte Jordan, and Ed Cutter, CPA
Authority: §§40-2A-7(a)(5) and 40-18-166, Code of Alabama 1975
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CHAPTER 810-3-167

Applicability of Income Tax Rules and Regulations to
Alabama S Corporations and Shareholders

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810-3-167-.01 Applicability of Income Tax Rules and Regulations

810-3-167-.01 Applicability of Income Tax Rules & Regulations.

(1) Except to the extent inconsistent with these rules, the rules and regulations adopted by the Alabama Department of Revenue under the provisions of §§40-18-1, et seq., Code of Alabama 1975, are equally applicable to Alabama S corporations and their shareholders. This includes regulations relating to the time and manner of filing returns, record keeping requirements, procedures for extensions of time for filing and/or paying taxes, and procedures and time limits for applying for refunds of taxes paid in error.

(2) Any distributions received by an Alabama S corporation will be included in non-separately stated income to the same extent as an individual, including liquidating distributions.

Authors: Verlon Frost, Catherine McCary
Authority: §§40-2A-7(a)(5), 40-18-167 and 40-18-57, Code of Alabama 1975
History: Adopted November 13, 1985.
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ALABAMA DEPARTMENT OF REVENUE
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CHAPTER 810-3-168

Net Operating Loss Deduction not Applicable to an
Alabama S Corporation

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810-3-168-.01 Net Operating Loss Deduction for S Corporations

810-3-168-.01 Net Operating Loss Deduction for S Corporations.

(1) No net operating loss carryback or carryforward deduction is allowable for an Alabama S corporation. See Rule 810-3-161-.01 and 810-3-35.1-.01.

(2) No carryforward and no carryback shall arise at the corporate level for a taxable year for which a corporation is an Alabama S corporation.

(3) The taxable year that a corporation is an Alabama S corporation may be considered in determining the number of taxable years which a net operating loss item can be carried back or carried forward.

(4) See also Rule 810-3-174-.02, Built-in Gains Tax.

Author: Ed Cutter, CPA and Ann Winborne, CPA
Authority: §§ 40-2A-7(a)(5) and 40-18-168, Code of Alabama 1975
History: Adopted November 13, 1985.
Amended: Filed March 31, 2000, effective May 5, 2000.

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CHAPTER 810-3-169

Adjustments to the Earnings and Profits Account of an Alabama S Corporation

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810-3-169-.01 Adjustments to Earnings and Profits

810-3-169-.01 Adjustments to Earnings and Profits.

(1) Except as provided below, no adjustments will be made to the earnings and profits account of an Alabama S corporation. An Alabama S corporation will have no earnings and profits accruing during any period in which such an election is in effect.

(2) In the case of a redemption, liquidation, or reorganization (including a divisive reorganization) of an Alabama S corporation, the accumulated earnings and profits account (if any) shall be increased or decreased accordingly. For example, if 50% of the fair market value of the assets of the Alabama S corporation are transferred to a new corporation, then 50% of the Alabama accumulated earnings and profits account will also be transferred to the new corporation. In the case of a merger, the accumulated earnings and profits will be increased or decreased by the accumulated earnings and profits of the merged corporation.

(3) If an Alabama S corporation makes a distribution which is in excess of the Alabama Accumulated Adjustments Account, but not in excess of the accumulated earnings and profits account, the earnings and profits account will be decreased by the amount of the excess distribution. See Rule 810-3-165-.01.

(4) If a corporation makes a distribution of money with respect to its stock during a post-termination transition period, the basis of the stock will be reduced by the amount of the distribution which does not exceed the Alabama Accumulated Adjustments Account. An Alabama S corporation may elect to have the preceding sentence of this paragraph not apply to all distributions made during a post-termination transaction period described in §40-18-172, Code of Alabama 1975, but only if all the shareholders of the Alabama S corporation to whom distributions are made by the Alabama S corporation during such post-termination transition period consent to such election.

Authors: Jeffery Taylor
Authority: §§ 40-2A-7(a)(5) and 40-18-169, Code of Alabama 1975
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810-3-170-.01 Two-percent Rule **(REPEALED, effective May 5, 2000)**

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CHAPTER 810-3-171

Computation of Each Shareholder's Share of the Income,
Loss, Deduction & Credit from an Alabama S Corporation

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810-3-171-.01 Determination of Shareholder's Prorata Share.

(1) Except as provided in paragraph (2) below, each shareholder's prorata share of the income, losses, deductions and credits of the Alabama S corporation which are attributable to Alabama for each taxable year will be the sum of the following items:

(a) Each item of separately stated income, loss, deduction and credit attributed to Alabama will be divided by the number of days in the taxable year and the result will be divided by the number of shares outstanding each day.

(b) The net non-separately stated income (or loss) attributed to Alabama will be divided by the number of days in the taxable year and the result will be divided by the number of shares outstanding each day.

(c) The total for each shareholder will be the sum of the amounts in subparagraphs (a) and (b), above, for each share held by the shareholder and for each day the shares were held.

1. For example, if a shareholder held one-half of the outstanding shares of stock of the corporation for one-half of the year, that shareholder would be credited with 25% of the items of income, loss and deductions of the corporation attributed to Alabama for the year.

(d) Other than the items of income, loss, deduction and credit to be separately stated as provided by §40-18-162(a)(1), Code of Alabama 1975, other items of income and deductions are not to be separately allocated or apportioned to individual shareholders.

(2) (a) If a shareholder terminates his or her stock interest in an Alabama S corporation during the taxable year, and all persons who are or were shareholders during the taxable year agree, the computation of the prorata income and losses as outlined in paragraph (1) above will be applied as if the corporation had two short taxable years, the first of which ended on the date of termination of the terminating shareholder's interest.

(b) The consent of the affected shareholders may be in any form which clearly reflects the shareholder's agreement to the election provided by §40-18-171(b), and must be notarized or otherwise authenticated before some officer authorized to administer oaths.

(c) The corporation will not file two returns, but will prepare schedules showing the separately stated and nonseparately stated income, losses, deductions and credits attributed to Alabama for each such part of the taxable year. These schedules, along with the consent agreements of all the shareholders, must be attached to the Alabama S corporation return as filed.

Authors: Cathy McCary and Charlotte Jordan
Authority: §§ 40-2A-7(a)(5), 40-18-57 and 40-18-171, Code of Alabama 1975
History: Adopted November 13, 1985.
Amended: Filed March 31, 2000, effective May 5, 2000.

ALABAMA DEPARTMENT OF REVENUE
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CHAPTER 810-3-172

Computation of the Transistion Period after Termination
of Status as an Alabama S Corporation

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810-3-172-.01 Post-Termination Transition Period.

(1) The "post-termination transition period" is:

(a) The period that begins on the day following the last day of the last S year, and ending on the later of:

1. One year from the last day of the S year, or

2. The due date, including extensions, for filing the return for the last S year.

(b) The 120-day period beginning on the date of a determination pursuant to an audit of the taxpayer which follows the termination of the corporation's election to be treated as a federal S corporation and which adjusts a subchapter S item of income, loss, or deduction of the corporation.

(c) The 120-day period beginning on the date of a determination that the S corporation's election under 26 U.S.C. §1362 for a previous tax year had been terminated.

(d) 1. For example, if (a) above applies, the return, with extensions, will be due not later than 8 ½ months after the year end, and the post-termination transition period would always end one year from the last day of the S year. For instance, if the S year ends on December 31, 1985, the post-termination transition period begins on January 1, 1986, and ends on December 31, 1986.

2. If (c) above applies, and a determination is made on July 1, 1986, that the S election was invalid for the year ended December 31, 1985, the post-termination transition period begins on July 1, 1986, and ends on October 28, 1986.

(2) The term "determination", as used herein, means:

(a) A determination as defined in U.S.C. §1313(a); or

(b) An agreement between the corporation and the U.S. Secretary of the Treasury that the corporation failed to qualify as an S corporation.

(3) The term "S year" means a taxable year for which a corporation is an Alabama S corporation.

Authors: Verlon Frost, Catherine McCary, and Ed Cutter, CPA
Authority: Sections 40-2A-7(a)(5), 40-18-172 and 40-18-57, Code of Alabama, 1975

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ALABAMA DEPARTMENT OF REVENUE
ADMINISTRATIVE CODE

CHAPTER 810-3-173

Application of Internal Revenue Service Rules and
Regulations to Alabama S Corporations
and their Shareholders

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810-3-173-.01 Applicability of Federal Rules and Regulations

810-3-173-.01 Applicability of Federal Rules & Regulations. Alabama law regarding S corporations is substantially similar to federal law regarding S corporations. Therefore, rules and regulations of the Internal Revenue Service interpreting federal S corporation law will be given due consideration in interpreting Alabama S corporation law to the extent the federal law is not inconsistent with Alabama law. See also Rule 810-3-1.1-.01, Operating Rules.

Author: Ed Cutter, CPA
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ALABAMA DEPARTMENT OF REVENUE
ADMINISTRATIVE CODE

CHAPTER 810-3-174

Tax Imposed on Certain Built-in Gains

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810-3-174-.01 Effective Date, **(REPEALED, EFFECTIVE MAY 5, 2000)**
810-3-174-.02 Built-in Gains Tax

810-3-174-.02 Built-in Gains Tax.

(1) For purposes of this regulation, the following definitions shall apply:

(a) "Net unrealized built-in gain" means the excess of the fair market value of the S corporation's assets when it first became an S corporation over the aggregate adjusted basis of those assets at the same time.

(b) 1. "Net recognized built-in gain" means, with respect to any taxable year, the lesser of:

(i) The amount which would be taxable income of the Alabama S corporation if only recognized built-in gains and losses were taken into account, or

(ii) The S corporation's taxable income determined without regard to the dividends received deduction under §40-18-35(a)(14) , Code of Alabama 1975 and the net operating loss deduction under §40-18-35.1.

2. For any taxable year, any excess of the amount in paragraph (b)(I) over the amount in (b)(ii) is carried forward to the next taxable year.

(c) "Recognized built-in gain" means any gain recognized during the recognition period on the disposition of any asset except for assets not held by the S corporation on the first day of the first S year and for assets on which the gain is attributable to appreciation that occurred after the corporation became an S corporation.

(d) "Recognized built-in loss" means any loss during the recognition period on the disposition of any asset except for assets not held on the first day of the first S year and for assets on which the loss is attributable to depreciation that occurred after the corporation became an S corporation.

(e) "Recognition period" means a ten-year period beginning with the first day of the S corporation's first tax year.

(f) The "first taxable year for which the corporation was an Alabama S corporation" means the first taxable year for which the corporation most recently became an Alabama S corporation.

(2) The tax is imposed upon any Alabama S corporation which has a net recognized built-in gain for any taxable year beginning in the recognition period.

(a) The tax shall not apply to any Alabama S corporation which has always been an Alabama S corporation.

(b) The amount of any net recognized built-in gain taken into account for any taxable year shall not exceed the amount of the net unrealized built-in gain less any net recognized built-in gain for prior taxable years beginning in the recognition period.

1. For example, if an Alabama S corporation has a net unrealized built-in gain of $100,000, and during the first 5 years of the recognition period reports net recognized built-in gain of $70,000, then the maximum amount which can be reported as net recognized built-in gain during the final 5 years of the recognition period is $30,000.

(c) The tax is computed by multiplying five percent times the net recognized built-in gain for the taxable year.

(d) Any net operating loss carryforward arising in a tax year in which the corporation was a C corporation and which would be deductible except for §40-18-168 may be used to offset the net recognized built-in gain for the taxable year. For purposes of this paragraph, the net recognized built-in gain shall be treated as taxable income. For tax years beginning prior to January 1, 1990, the maximum amount of net operating loss carryforward deductible in any tax year is $600,000.

(e) Section 40-18-174(d)(5) specifies that any items of income or deduction properly taken into account for any tax year in the recognition period but which are attributable to periods before the first taxable year for which the corporation was an Alabama S corporation shall be treated as recognized built-in gains or losses for the tax year in which they are properly taken into account. Therefore, "disposition of any asset" referred to in the definitions of "recognized built-in gain" and "recognized built-in loss" includes not only sales or exchanges but also any income recognition event which effectively relinquishes a taxpayer's right to claim or receive income.

1. For example, the term "disposition of any asset" includes the collection of account receivable by a cash basis taxpayer or the completion of a long-term contract by a taxpayer using the completed contract method of accounting.

2. The amount of net unrealized built-in gain shall be adjusted for amounts treated as recognized built-in gains or losses under this paragraph.

(f) If an asset with a built-in gain or loss is exchanged for another asset and the new asset's basis is determined in whole or in part by reference to the basis of the old asset, the net asset will be treated as having been held by the S corporation as of the first day of the first taxable year of the S corporation and as having the same built-in gain or loss as the old asset.

(g) If an Alabama S corporation acquires any asset from a C corporation and the basis of the asset in the hands of the S corporation is determined in whole or in part by reference to its basis in the hands of the C corporation, then a tax is imposed on any net recognized built-in gain attributable to any such asset for any tax year beginning in the recognition period.

1. For purposes of subparagraph (g), in computing the amount of the net recognized gain or loss, the day on which the S corporation acquired the asset shall be substituted for the beginning of the first tax year in which the corporation is an S corporation.

2. For purposes of subparagraph (g), the tax shall apply to all Alabama S corporations, including those that have always been Alabama S corporations.

(3) Those companies subject to the tax should complete the appropriate schedules of Alabama S corporation Form 20S, which is due on the fifteenth day of the third month following the end of the tax year (See Rule 810-3-42-.01). The tax is due at the same time as the return.

(a) Those companies which have liabilities and which want extensions of time for filing form 20S should file form 20-E on or before the due date of form 20S, together with remittance covering the liability. Interest and penalties are due on all taxes not paid on or before the unextended due date. See Rules 810-3-42-.01 and 810-3-39-.02.

Author: Cathy McCary and Charlotte Jordan
Authority: §§ 40-2A-7(a)(5) and 40-18-174, Code of Alabama 1975
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ALABAMA DEPARTMENT OF REVENUE
ADMINISTRATIVE CODE

CHAPTER 810-3-175

Passive Investment Income

TABLE OF CONTENTS

810-3-175-.01 Passive Investment Income Tax

810-3-175-.01 Passive Investment Income Tax.

(1) Definitions-

(a) "Passive investment income" means gross receipts from royalties, rents, dividends, interest (excluding installment sales to customers and income of lending and financing companies), annuities, and sales or exchanges of stock or securities to the extent of any gains therefrom.

1. For any tax year in the recognition period, passive investment income shall not include any recognized built-in gain or loss. See §40-18-174, Code of Alabama 1975.

(b) "Net passive income" means passive investment income less deductions directly connected with the production of such income.

(c) "Excess net passive income" means an amount which bears the same ratio to the net passive income as the amount by which the passive investment income exceeds 25 percent of the gross receipts bears to the passive investment income. Therefore,

$$\text{Excess npi} = \frac{\text{pii} - 25\%(\text{GR}) \times \text{npi}}{\text{pii}}$$

pii = passive investment income for the tax year
npi = net passive income for the tax year
GR = total gross receipts for the tax year

1. The amount of excess net passive income shall not exceed the S corporation's taxable income for the tax year as determined under §40-18-161.

(2) The tax is imposed upon S corporations which have Alabama accumulated C corporation earnings and profits. If, for the taxable year, such S corporations have passive investment income which constitutes more than 25 percent of gross receipts, then a tax is imposed on the income of the S corporation for that taxable year.

(3) The tax is computed by multiplying 5 percent times the Alabama excess net passive income.

(4) Those corporations subject to the tax should complete the appropriate schedules of Form 20S, which is due on the fifteenth day of the third month following the end of the tax year. See Rule 810-3-42-.01. The tax is due at the same time as the return.

(a) Those corporations which have liabilities and which want an extension for filing form 20S should file form 20-E on or before the due date of the return, together with remittance covering the liability. Interest and penalties are due on all taxes not paid on or before the unextended due date. See Rules 810-3-39-.02 and 810-3-42-.01.

(5) The department may waive the excess net passive income tax if the S corporation establishes that it made a good-faith determination at the close of the tax year that it had no C corporation earnings and profits and that it distributed such earnings and profits within a reasonable time after determining that they existed.

(a) A request for waiver of the passive investment income tax shall be made in writing to the department. The request must contain a description of how and on what date the S corporation determined that it had no C corporation earnings and profits at the end of the tax year, a description of how and on what date it was determined that the S corporation had C corporation earnings and profits at the end of the tax year, and a description (including dates) of any steps taken to distribute such earnings and profits.

(b) If the earnings and profits have not been distributed, the request must contain a timetable for distribution and an explanation of why such timetable is reasonable. Before the waiver may be granted, all subchapter C earnings and profits must have been distributed.

(6) In administering and interpreting this regulation, the Department will consider administrative rulings and decisions in respect to the similar provisions of the Internal Revenue Code and Regulations thereunder.

Authors: Verlon Frost, Catherine McCary
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ALABAMA DEPARTMENT OF REVENUE
ADMINISTRATIVE CODE

CHAPTER 810-3-176

Composite Returns

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810-3-176-.01 Composite Returns

810-3-176-.01 Composite Returns.

(1) Definitions:

(a) A "composite return" means an information return similar to the federal Schedule K-1 which contains information concerning one or more nonresident shareholder's distributive share of income, deductions and losses.

(b) A "composite payment" means a payment of estimated individual income tax by the Alabama S corporation on behalf of the nonresident shareholders described in the accompanying composite return. The payment shall be considered a loan from the corporation to the shareholder, payable on demand, bearing interest from the date of the loan to the date of its payment, at the minimum applicable federal rate with respect to demand instruments, as provided under 26 U.S.C. § 7872.

(2) An Alabama S corporation may file a composite return and make composite payments on behalf of nonresident shareholders if there are one or more nonresident shareholders at any time during the taxable year.

(a) The composite return may be filed on behalf of some or all nonresident shareholders and must be filed on behalf of nonresident shareholders for whom a Schedule NRA consent agreement has not been filed.

(b) Resident shareholders may not be included in a composite return, and composite payments may not be made on behalf of resident shareholders.

(c) S corporations which choose to file composite returns or which are required to file composite returns must do so on Form 20SC. Composite payments must be made on Form 20SC.

(d) In computing the amount of the composite payment, the Alabama S corporation shall multiply each nonresident shareholder's distributive share of income attributed to Alabama by 5%.

1. Each nonresident shareholder's distributive share of income is the sum of the shareholder's deemed distributive share of the Alabama portion of:

(i) Separately stated income, loss, deduction or expense of the Alabama S corporation; provided that no deduction will be allowed for items of loss, deduction or expense which are subject to other limitations on the Alabama individual income tax return Form 40NR - including federal income tax, contributions, investment interest expense, and casualty losses; and

(ii) Nonseparately stated income, loss, deduction or expense of the Alabama S corporation.

2. In computing the amount of the composite payment, a loss for one nonresident shareholder may not be used to offset income or gain of any other nonresident shareholder.

3. In computing the amount of the composite payment, a net operating loss carryforward may not be used to offset income or gain.

(3) Composite returns and composite payments are due on the fifteenth day of the third month following the close of the Alabama S corporation's taxable year.

(a) Amended composite returns for refund or additional tax due for a taxable year will be accepted up to the extended due date for filing the Alabama S corporation return for the same taxable year.

(b) Refund requests or additional payments made after the extended due date for filing the Alabama S corporation return must be made on Alabama individual income tax Form 40NR by the nonresident shareholder(s).

(4) The S corporation is required to file a Schedule NRA consent agreement for each nonresident shareholder.

(a) A Schedule NRA for each nonresident shareholder shall be due at the same time as the first S corporation return is due.

(b) If, during any subsequent taxable year, the Alabama S corporation has any nonresident shareholders for whom a Schedule NRA has not previously been filed, then a Schedule NRA is due for those nonresident shareholders at the same time as the annual return is due for that taxable year.

(c) The Alabama S corporation shall include each shareholder for whom a Schedule NRA is <u>not</u> timely filed in a composite return and make a composite payment as specified in paragraphs (2) & (3) above.

(d) The consent agreement must be notarized or otherwise authenticated before some officer authorized to administer oaths and must contain the following information:

1. The name, address and social security number of the shareholder,

2. A recitation of the agreement to report and pay tax to Alabama on the shareholder's share of the Alabama S corporation income in exchange for the benefits of allowing the corporation to file an Alabama S Corporation return, and

3. An agreement appointing the Alabama resident agent of the corporation and any agent or officer of the corporation present in Alabama as

agent of the shareholder for service of process in any matter before the Department relating to the income tax returns of the shareholder and/or the corporation.

(e) If the stock is held by multiple owners (such as joint owners), each owner must execute a separate consent agreement.

(f) Each nonresident shareholder may designate any other person or firm present in Alabama as agent for service of process, in addition to the agents required to be appointed in subparagraph (d) 3, above.

(g) Any nonresident shareholder may, by power-of-attorney, authorize anyone to execute the required consent agreement on behalf of the shareholder. Such power-of-attorney, to be effective, must be filed with the Department on or before the due date (with extensions) of the first return in which a consent agreement is being executed under the power-of-attorney. The power-of-attorney need be filed only once and remains valid until the expiration date specified therein or until notice of revocation, cancellation or modification is received by the Department. Such power-of-attorney may be in any form sufficient to indicate the intent of the parties, and must be notarized or otherwise authenticated before some officer authorized to administer oaths .

(h)1. A nonresident is any person who is a legal resident of any state other than Alabama, or of any territory, possession, district or foreign country.

2. The status as a resident or nonresident will be determined as of the date of any distribution or deemed distribution.

Authors: Verlon Frost, Catherine McCary, and Ed Cutter, CPA
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## J

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## K

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## M

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## N

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## O

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## P

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## R

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Corporate Income Tax See Income Tax.
Estate Tax See Income Tax.
Financial Institutions Excise Tax See Financial Institutions Excise Tax.
Individual Income Tax See Income Tax.

## S

Sales and Use Tax - See Also 810-3-15-.04.
Schools See Income Tax
Share Tax See 810-2-4-.01 - 810-2-4-.08.
Sick Pay 810-3-14-.15.
Social Security 810-3-15-.04. 810-3-19-.01.
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Subchapter "S" Corporations 810-3-160-.01 through 810-3-174-.01.

## T

Taxable Year 810-3-13-.01. 810-3-24-.01.

## U

Unclaimed Property See Abandoned Property.
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## V

Veterans 810-3-14-.01 810-3-20-.01.

## W

Wages & Salaries 810-3-15--.02 810-3-72-.01. 810-3-14-.01.
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810-3-74-.02. (Return) 810-3-77-.01 (Refunds) 810-3-75-.01.
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**Y**

Year (Tax Defined)  810-3-13-.01.