

# State and Local Tax Bulletin

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BRADLEY ARANT  
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LLP

## Some Unofficial Prognostications On Proposed Alabama Tax Legislation In the 2009 Regular Session

By Bruce P. Ely and James E. Long, Jr.

### Upcoming Seminars Involving Members Of Our SALT Practice Group

#### January 25 – 30, 2009

COST 2009 SALT Basics School, Georgia Tech Hotel & Conference Center, Atlanta, Georgia. Chris Grissom will be a co-panelist in a presentation on preparing internal research memoranda and the interplay with the attorney-client privilege and work product doctrine. For more information, please visit the COST website: [www.statetax.org](http://www.statetax.org).

#### February 23-25, 2009

COST Annual Sales Tax Conference, Amelia Island, Florida. Bruce Ely will be a co-panelist in a presentation entitled "Who's That Knocking on The Door? It's Not Just the IRS and the States. Local Governments Are Also Pounding To Get In." For more information, please visit the COST website: [www.statetax.org](http://www.statetax.org).

#### March 3, 2009

Bruce Ely and Will Thistle will serve as co-panelists as part of the ABA-IPT's annual Advanced Sales and Use Tax Conference discussing the topic "State Administrative Procedure Acts: How Taxpayers Can Invalidate Faulty Regulations and Assessments." Their presentation will be March 3 at the Ritz-Carlton Hotel in New Orleans. For more information, please visit ABA-IPT's website: <http://meetings.abanet.org/meeting/tax/IPT09/materials.cfm>.

This bulletin provides a few unofficial predictions regarding legislative tax proposals that we expect to be introduced during the 2009 Regular Session of the Alabama Legislature, which convenes Tuesday, February 3. Given the current budgetary concerns, some of these measures – including gambling taxes and grocery tax exemptions – may become prevalent topics in the early months of 2009. Our predictions are based in part on previous filings and our review of the influential Business Council of Alabama's and Birmingham Regional Chamber of Commerce's recently-adopted 2009 legislative agendas.

**Gambling Taxes/Gambling Regulation:** based on numerous reports, this tax proposal stands a better chance of passage than in previous years, even though a constitutional amendment would probably be required. Rep. Richard Lindsey, in discussing his projection of an \$800 million to \$1 billion education budget shortfall for fiscal year 2009-10, stated that taxing Alabama's existing gambling activities (e.g., electronic bingo) may be the only feasible source of revenue: "with the economy like it is, it would be very difficult to put on a consumer tax at this time." Sen. Hank Sanders echoed Rep. Lindsey's comments, stating that "in times of crisis, the impossible becomes probable." Rep. Lindsey is the Chairman of the House Education Finance and Appropriations Committee and Sen. Sanders is Chairman of the Senate Education Finance and Taxation Committee, the committees which oversee the education budget.

**Investment Partnership Exemption and Mandatory Composite Returns for Most Subchapter K Entities:** exempting "qualified investment partnerships" ("QIPs") from the current income tax withholding regime and their non-resident investors from Alabama income tax. A QIP is narrowly defined as a partnership or business trust that derives at least 90% of its income from stocks, bonds, debentures, derivatives, and similar financial securities, and at least 90% of its assets consist of these types of financial instruments. Other partnerships or LLCs would be required to file an annual composite tax return and remit Alabama income tax on the taxable shares of their non-resident partners, unless the entity qualifies under federal law as a publicly-traded limited partnership. The new version of the QIP bill has been merged by Committee Chair, Rep. Richard Lindsey, with legislation creating certain motion picture tax incentives, and has been pre-filed as HB 69, with over 50 co-sponsors.

**Entity Conformity for LPs and LLLPs:** enacting the Revised Alabama Uniform Limited Partnership Act of 2009, including language clarifying that the ADOR follows the IRS' check-the-box entity classification rules – but only for income tax purposes – with respect to LPs and LLLPs.

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**Unitary Combined Reporting:** legislation was drafted and advocated by the powerful Alabama Education Association last Spring (HB 768-Rep. McLaughlin) that would have authorized the ADOR to force unitary combined reporting for certain Alabama taxpayers and their affiliates. The most peculiar feature of the proposed legislation was the trigger authorizing the Commissioner's discretionary power: if "the taxpayer's share of the unitary business' taxable income is less than one half of its share of the unitary business' total property, payroll, and sales" factors, as determined under Alabama's version of the Multistate Tax Compact, then the Commissioner "may require a taxpayer to use a combined report to determine its Alabama taxable income." Essentially, this ratio subjected a unitary group's *total* U.S. income to taxation by Alabama only when less profitable members of the unitary group happened to be Alabama taxpayers – in other words, heads the ADOR wins, tails the taxpayer loses.

HB 768 partially adopted the Multistate Tax Commission's broad definition of a "unitary business" contained in its model combined reporting act, and as a backstop applied to *all* income that could be subject to apportionment by Alabama under the U.S. Constitution. Oddly, the bill did not provide any equity ownership requirement or threshold for inclusion in the Alabama combined group. The combined report would include all members of the unitary group doing business in the United States *or* commercially domiciled in foreign "tax havens." HB 768 passed out of committee but, due to opposition by the Business Associations' Tax Coalition (BATC) and the Council On State Taxation (COST), it died on the floor of the House.

While Governor Riley did not support HB 768, it is anticipated that the ADOR would support some form of study commission, à la Massachusetts, Maryland and Mississippi, to review the pros and cons – especially the projected revenue impact – of implementing unitary combined reporting. Considering the current state fiscal projections, we would not be surprised to see a study commission proposal this session.

**Increase in Business Privilege Tax:** recent legislation proposed increasing the annual "cap" on the business privilege tax to \$30,000, while also doubling the annual cap applicable to REITs and financial institution groups to \$1 million and \$6 million, respectively. With the looming shortfall in the General Fund, this proposal is expected to be re-introduced.

**"Gross Income Regulation" Fix:** legislation was discussed during the 2007 and 2008 regular sessions that would have confirmed, but delayed the effect of, the Administrative Law Division's controversial ruling in *McNees v. ADOR*. Readers may recall that the ruling (which the ADOR--to no one's surprise--did not appeal) invalidated the ADOR's entity-level apportionment regulation and held that an Alabama

resident owner of a multistate pass-through entity must include his or her *entire* distributive share of income or loss of the entity in computing Alabama income. In response to proposed ADOR regulations issued after the *McNees* decision that were opposed and eventually withdrawn, the 2007 and 2008 proposal would have allowed an income tax credit for resident owners of multistate Subchapter K entities and S corporations for their share of income taxes paid on their behalf via composite returns, withholding, etc. to states other than Alabama. We may see a more concerted effort this session, either through yet another proposed regulation or by legislation.

**The "Alabama Arise Bill" or "Grocery Tax Bill":** proposing a constitutional amendment to eliminate the deduction for federal income taxes from Alabama individual and corporate income tax. As a result of the increased revenue, the bill would also propose a constitutional amendment to exempt food from the state 4% sales tax (but not local sales taxes), increase the standard deduction allowed to individual taxpayers equal to the amount allowed under federal law pursuant to I.R.C. § 63, and increase the exemption for each dependent to at least \$2,000. We also expect to see various counter-proposals introduced.

**Alternative Energy Incentives:** numerous committees continue to meet as part of the Permanent Joint Legislative Committee on Energy. It is uncertain at this point what legislation may be introduced this year, however. Given that most of these proposals reduce or expend tax revenues without matching revenue sources, it is unclear whether any of them will advance beyond committee.

**Withholding on Sales of Real Property by Nonresidents:** with little debate (or scrutiny) last Spring, Act 2008-504 passed, requiring withholding on sales of real property by nonresidents. The act was a funding mechanism for Act 2008-377, which created an income tax deduction for certain contributions to "ACES" college savings accounts. Several initial issues raised by members of the Alabama State Bar were tentatively resolved by the ADOR's issuance of forms and helpful guidance on its website. It is uncertain whether the ADOR will also issue interpretive regulations, whether clarifying legislation will be introduced, or whether an attempt will be made to simply repeal the act.

**Intrastate Nexus for Local Sales/Use Taxes:** the ADOR has taken the position in several recent assessments and Administrative Law Division appeals that its own longstanding nexus regulation should be revised to eliminate the physical presence requirement for intrastate (*e.g.*, county to county) transactions with respect to sales and use taxes. That effort may take the form of repealing the regulation or proposing legislation to override the longstanding regulation as well as

rulings such as *Yelverton's, Inc. v. Jefferson County*.

**Independent Tax Tribunal--Finally:** transferring the ADOR's Administrative Law Division to a separate stand-alone state agency that would be headed by Chief Administrative Law Judge Bill Thompson. The latest proposal would have allowed input from both the Alabama State Bar and the Alabama Society of CPAs (ASCPA) regarding the selection of Judge Thompson's eventual successor.

**Alabama Taxpayers' Bill of Rights II:** since the enactment of the Alabama Taxpayers' Bill of Rights and Uniform Revenue Procedures Act in 1992 ("TBOR"), its federal counterpart has been amended several times, and numerous Administrative Law Division and ADOR rulings interpreting the Act have been issued. Several members of the Alabama State Bar's Tax Section are working on a draft "TBOR II" to be circulated to the ADOR, BATC, ASCPA, COST and other interested parties prior to the next session.

**Lodgings Tax:** clarifying that apartments under lease to a "resident" rather than to a "transient" are not subject to state or local lodgings tax, previously filed as HB 483 during the 2008 Regular Session. The qualifying definition focuses on corporate executive apartments and those serving as temporary homes for persons in the process of relocation. On the other hand, the definition of facilities subject to the tax would be expanded to include bed and breakfast inns, resort dwellings and condominiums, recreational vehicle (RV) parks, and boat docking accommodations.

**Restrictions on Annual Property Reappraisals-Redux:** restricting the ADOR from conducting reappraisals of property for purposes of ad valorem property tax more often than every four fiscal years, or capping the annual reappraisal amount based on the inflation rate or increase in gross national product. These proposals are in response to the ADOR's recent efforts to conduct annual reappraisals on behalf of several counties, which generated not only a good bit of additional tax revenue but even more outcry from some large landowners.

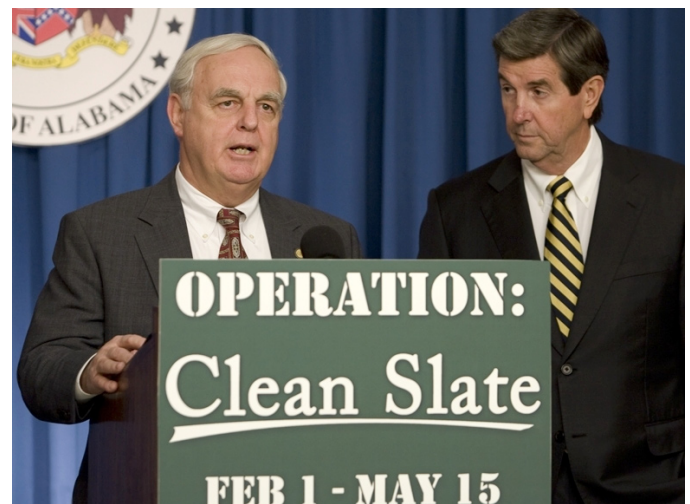
**Prohibition on Increases in Assessed Value of Owner-Occupied Houses:** pre-filed HB 45 proposes a constitutional amendment prohibiting the tax value of Class III residential properties from being increased during the reappraisal process so long as the property is owned by the same person who owned the property at the previous valuation date, there have been no changes to the property that require a building permit, and the property remains owner-occupied residential property.

**Increase in the Homestead Exemption:** several pre-filed bills for the 2009 regular session would increase the homestead exemption, which is currently limited to \$4,000 in assessed value.

**Oil and Gas Severance Tax Increase:** would increase the severance tax on offshore oil and gas producers and repeal a number of deductions now available to offshore producers under the so-called "workback method" of computing the tax base. Governor Riley and the ADOR advocated this bill last regular session, which was introduced in response to the Administrative Law Division's approval of much of Exxon-Mobil's controversial \$41 million refund claim. We understand that the parties recently settled that appeal.

### Recent Judicial and Administrative Developments

**ADOR Announces Amnesty Program – "Operation Clean Slate":** Governor Bob Riley and Commissioner of Revenue Tim Russell announced last Thursday that the ADOR will offer a limited amnesty program beginning February 1 and ending May 15. Under the program, Alabama taxpayers may voluntarily come forward and properly report their tax liabilities – through filing past-due or amended returns – plus interest (which cannot be abated except in very limited circumstances), in exchange for the waiver of penalties and criminal prosecution by the ADOR. The program applies to both corporate and individual income taxes, business privilege taxes, and, if the taxpayer has not previously registered with the ADOR, sales, rental and use taxes. Taxpayers who have been contacted by the ADOR regarding their tax liability are not eligible for the amnesty program, similar to the requirement under the ADOR's voluntary disclosure program. The ADOR informed us that it will generally seek only a three year look-back period for unpaid tax liabilities under the amnesty program. After May 15, the ADOR said that it will bring its new \$26 million computer system online, and that will increase its ability to identify those who are not paying taxes or are understating their liability.



**Jefferson County Occupational License Tax:** in *Alarm One, Inc. v. Jefferson County Commission*, CV-2007-900873 (Cir. Ct. Jefferson County, Jan. 12, 2009), Circuit Court Judge David A. Rains held that Jefferson County's occupational license tax (OLT) was repealed by a 1999 act of the Alabama Legislature because a subsequent 2000 act reinstating the tax was determined to be unconstitutional. Despite holding the tax invalid, Judge Rains determined that no refunds were due to the plaintiffs but ordered the County to hold future OLT collections in escrow pending the eventual outcome of the appeal. The County Commission almost immediately announced that it will appeal Judge Rains' decision. Curative legislation will also be forthcoming.

As of January 1, 2009, Bradley Arant Rose & White LLP and Nashville's well-respected Boulton, Cummings, Conners & Berry PLC merged to form Bradley Arant Boulton Cummings LLP. Our new firm has more than 350 attorneys in seven offices located in Tennessee, Alabama, Mississippi, North Carolina and the District of Columbia. Together, we now offer you or your clients a talented legal team with not only expanded areas of service and enhanced industry knowledge, but also the continued dedication to excellence in client service you have come to expect from our firms. We are especially excited about joining forces with Joe Gibbs' SALT team in Nashville.

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