

# State and Local Tax Bulletin

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Alabama Edition



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## Alabama Tax Developments: 2009 in Review

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

#### December 14-15, 2009

The 28th NYU Institute on State and Local Taxation will be held at The Grand Hyatt, New York. Bruce Ely will serve on a panel providing an in-depth review of significant tax developments from regions across the country, entitled: "What's Happening Everywhere Today?" For more information, please visit [www.scps.nyu.edu/salt](http://www.scps.nyu.edu/salt).

#### January 21-23, 2010

American Bar Association Tax Section Winter Meeting, Grand Hyatt Hotel, San Antonio, Texas. Bruce Ely and Will Thistle will be speakers in a panel presentation on "State Administrative Procedure Acts: Procedural Avenues to Attack Faulty Regulations and Assessments." For more information, please visit the ABA website: [www.abanet.org/tax/meetings](http://www.abanet.org/tax/meetings).

#### January 28-29, 2010

Council On State Taxation 2010 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).

Our final SALT Bulletin of the year summarizes many of the key legislative, judicial and administrative developments affecting Alabama taxpayers during 2009 with respect to income, transaction and property taxes. The 2009 regular and special legislative sessions produced several noteworthy tax bills, including legislation that expanded Alabama's tax incentives for new and expanding industries and filmmakers. The courts decided several cases of importance during the year, including granting a taxpayer's requested franchise tax refund in full while, unfortunately, denying a taxpayer's *certiorari* petition challenging the validity of Alabama's add-back statute.

The final section of the bulletin provides a few predictions regarding legislative tax proposals that we expect to be introduced in the 2010 regular session, which begins on January 12 (earlier start date due to elections). Given the current budgetary concerns and likely absence of federal stimulus funds, some of these measures – including unitary combined reporting – may become prevalent topics in the early months of 2010. The powerful Alabama Education Association recently endorsed several revenue-raising measures, including increasing taxes on soft drinks, legalizing and taxing gambling, and ending unspecified "corporate tax loopholes."

#### Income/Franchise Taxes

**Act 2009-144 - Qualified Investment Partnerships / Film Incentives:** exempts "qualified investment partnerships" or "QIPs" from the current income tax withholding regime and their non-resident investors from Alabama income tax, but requires other partnerships or LLCs to file an annual composite tax return and remit Alabama income tax on behalf of their non-resident owners for tax years beginning after January 1, 2009. The Alabama Department of Revenue ("ADOR") reportedly will not assert penalties against 2009 composite return filers if the underpayment is due to nonresident partners having previously made estimated payments. We expect that the ADOR will issue revised composite return/QIP regulations in January. The Act also provides certain tax incentives to in-state film/entertainment producers and reinstates a "failure to pay" penalty that can equal up to 25% of the amount of tax assessed. For more information, please click [here](#).

**Act 2009-722 – Capital Credit Expanded to "White Collar" Industries:** as an incentive to the growth of the "white collar" service economy in Alabama, this Act makes some of the key incentives (e.g., income tax credits and the abatement of certain property and sales and uses taxes) offered to new and expanding businesses available on an equal basis to corporate headquarters, data processing centers, research and development and renewable energy facilities.

**Franchise Tax Refund Cases Update – Taxpayer's Refund Claim Granted in Full by Trial Court.** On October 19, 2009, the Montgomery County Circuit Court finally granted a full refund of franchise taxes in *Vulcan Lands, Inc. v. Russell*, the test case regarding Alabama's former franchise tax scheme that was held unconstitutional over a decade ago by the U.S. Supreme Court. Dkt. No. CV-2001-1106 (Final Order Oct. 19, 2009). Importantly,

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especially for other taxpayers with pending refund claims, the circuit court held that the taxpayer was entitled to a refund equal to the difference between the tax liability it paid as a foreign corporation and the tax liability it would have paid as a domestic corporation (*i.e.*, \$50). While not involving the franchise tax, the taxpayer's *certiorari* petition to the U.S. Supreme Court in *Henri-Duval Winery, L.L.C. v. Alabama Alcoholic Beverage Control Board* may impact the ADOR's continued refusal to grant taxpayers' requested franchise tax refunds. We are monitoring that case closely on behalf of our many franchise tax clients.

**HealthSouth Corporation v. State Dep't of Revenue**, Admin. Law Div. Dkt. No. BIT.08-1021 (July 16, 2009): Chief Administrative Law Judge ("ALJ") Bill Thompson granted corporate income tax refunds and net operating loss adjustments resulting from HealthSouth Corporation's and its five subsidiaries' federal audit changes. The adjustments included reductions in the taxpayers' taxable income during the tax periods at issue in order to correct the intentional and fraudulent overstatements of income by several of the taxpayers' former officers. The ADOR has appealed.

**Ex parte VFJ Ventures, Inc.**, Case No. 1070718 (Ala. S. Ct. Sept. 19, 2008), *cert. denied* Dkt. No. 08-916 (U.S. S. Ct. Apr. 27, 2009): despite a litany of amicus briefs filed by well-respected business organizations and by the State of Delaware, the U.S. Supreme Court denied the petition for a writ of *certiorari* filed by VFJ Ventures, Inc., thereby allowing the Alabama Supreme Court's controversial decision in *Ex parte VFJ Ventures, Inc.* to stand. That decision affirmed the ruling of the Court of Civil Appeals that Alabama's intangibles and interest expense add-back statute did not violate the Commerce and Due Process Clauses of the U.S. Constitution. Several other cases remain pending.

**ADOR Proposed Regulation Deletes BPT Deduction for Alabama Investments:** The ADOR has proposed a regulation that would eliminate the BPT deduction for equity investments in entities doing business in Alabama for all tax years beginning on or after January 1, 2010. Prop. Ala. Admin. Code r. 810-2-8-.08. Numerous comment letters were filed before the October 6 hearing in opposition to this regulation, including by the authors on behalf of the Alabama Society of CPAs. For more information, please click [here](#). Various business and professional groups are working with the ADOR on a compromise solution and we expect legislation to be introduced in January.

#### **Transaction (Sales and Use) Taxes**

**Washer & Refrigeration Supply Co. v. PRA Government Services, LLC**, Montgomery Co. Cir. Ct. CV 2009-901297 (Nov. 4, 2009): Two Alabama taxpayers have filed a very detailed class action suit against the largest private contract auditing firm in Alabama, PRA Government Services, LLC, which conducts business as "Revenue Discovery Systems" or "AlaTax", and its affiliates. The 81 page complaint alleges several violations by AlaTax or its auditors of the Alabama Taxpayers' Bill of Rights and Uniform Revenue Procedures Act ("TBOR"). Both tax practitioners and business and professional groups are closely monitoring this case. For more information, please click [here](#).

**Capitol Machine & Equip. Co., LLC v. State Dep't of Revenue**, Admin. Law Div. Dkt. No. S.08-619 (April 20, 2009): Chief ALJ Bill Thompson held that the taxpayer's pneumatic blowing machines

and parts qualified for the reduced 1.5% (vs. 4%) machine sales tax rate because the machinery processed and converted the insulation into usable form. *Of a more global significance* was Judge Thompson's preliminary ruling that the ADOR could not seek payment of the sales tax assessment from the LLC's individual members but must, if necessary, pursue them under the responsible person penalty procedure. The Judge withdrew that portion of the opinion, however, based on a joint stipulation of the parties that the assessment was void due to his ruling on the first issue. **Warning:** *The ADOR indicates that it will continue to assert personal (joint and several) liability against LLC members for non-income taxes until a court rules otherwise or the statute is amended.*

**Attorney General Opinion No. 2009-092 (July 9, 2009):** confirms that municipalities may not create their own unique sales and use tax exemptions. Thus, because there is no state-level sales tax exemption for food, a *municipality* may not exempt food from its own sales tax. Alabama is one of the thankfully few states that allow all municipalities and counties to levy and administer their own sales, use and rental taxes. In 1998, the Alabama Legislature passed both the Local Tax Simplification Act and Local Tax Procedures Act to bring a greater degree of uniformity to state and local sales, use, rental and lodging taxes and to regulate contract auditing firms.

#### **Property Taxes**

**Act 2009-508 – Valuation of "Tax Sale" Property:** amends the definition of "residential property" for Class III valuation to include property sold at tax sales where the owner resides on the property and remains in possession of the property after the sale. However, the property will be reclassified and taxed as Class II commercial property for any period following the tax sale during which the property is not used as an owner-occupied residence. The Act also contains several procedural changes to tax sales, including an unlimited redemption period in cases where the original owner retains possession of the land after the tax sale or in cases where the subject land is not occupied. In short, purchasers of property at tax sales need to occupy the land in order to start the three year redemption period against the former owner.

**Attorney General Opinion No. 2009-074 (June 10, 2009):** The TBOR does not authorize a county commission to hire a contract auditing firm to find and collect delinquent property taxes for a contingency fee to be paid out of the taxes collected. This excellent AG Opinion partially revokes a 2005 opinion in favor of contract auditing and collecting firms.

#### **Other Developments of Interest**

**Act 2009-811 – Reinstating Jefferson County's Occupational License Tax ("OLT"):** reenacts Jefferson County's OLT, at a rate not to exceed .0045 of the lesser of compensation (excluding benefits) or net income before taxes, attributable to business activity conducted within the County. The Act also expands the tax base by removing the so-called "licensed professionals exemption," which included doctors, attorneys, accountants, veterinarians, and many other licensed professionals and an assorted number of other business owners who were separately licensed under the Alabama Code. The portion of the Act

reinstating the OLT is retroactive to November 29, 1999; however, the portion of the Act removing the licensed professional exemption and decreasing the tax rate to .0045 is effective January 1, 2010. The Act also provides for a public referendum on whether the OLT should be repealed, to be held along with the June 2010 primary, which if approved by a majority of the voters would phase-out the OLT over a five year period. The Act was passed during the 2009 Special Session, called in response to the County's fiscal problems and the Jefferson County Circuit Court decision in *Alarm One, Inc. v. Jefferson County Commission*, which held the OLT was repealed by the Legislature in 1999. That decision was affirmed by the Alabama Supreme Court.

**Act 2009-561 – New Construction Training Program:** imposes a “fee” on general and sub-contractors performing commercial construction jobs in the state, based on in-state wages paid to their employees (broadly defined). The tax, which was advocated by both the construction industry and organized labor, will be collected by the ADOR and will fund a new program providing for recruitment and training of skilled workers in the state. The tax will be equal to .09% of Alabama wages per quarter for the first five quarters, beginning July 1, and then will be adjusted so that net collections will equal \$1.75 million. For more information, please click [here](#) and [here](#).

**Third Party Auditing Firm Conducting Unclaimed Property Audits in Alabama and Other States:** In recent years, many states have begun to more aggressively pursue unclaimed property collections to mitigate budget shortfalls. Revenue Discovery Systems, Inc. (“RDS”), a Birmingham-based company formerly known as AlaTax that assists states, counties and municipalities as their auditor for various local taxes, has recently begun conducting numerous unclaimed property audits spanning many industries. We understand that RDS is currently conducting unclaimed property audits in Alabama, Arkansas, Florida, Kentucky, Louisiana, Maryland, Montana, Tennessee, Virginia, and West Virginia and that many of these audits are on a contingency fee basis. For more information, please click [here](#).

#### **Anticipated Tax Legislation in 2010 Regular Session**

**The “Alabama Arise” or “John Knight” Bill:** House Bill 1 (pre-filed) proposes a constitutional amendment to eliminate the deduction for federal income taxes from the Alabama individual 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.

**Refundable Food Tax Credit:** would provide for a refundable income tax credit or rebate to certain low-income Alabama taxpayers (those having an AGI of \$22,000 or less, which is the national poverty level for a family of four) to offset the estimated amount of state sales tax they pay on groceries during the year, provided that they file an income tax return or application for the refundable tax credit on forms prescribed by the ADOR. Qualified individuals may also adjust their weekly wage withholdings or quarterly estimated tax liability in order to receive the benefit of the credit earlier than year-end. Limitations on who qualifies

for the credit or rebate include those individuals who are only part-year residents, who are eligible for food stamps, or who are in the United States illegally. In contrast to the Alabama Arise/Knight bill, this proposal does **not** call for the repeal of the federal income tax deduction. The House Republican Caucus endorsed this bill last session.

**Unitary Combined Reporting:** HB 865 introduced last Spring would have required a group of two or more corporations to file a combined report (income tax return) that includes the income and apportionment factors of all corporations that are members of a “unitary” business, and repealed Alabama’s existing consolidated reporting regime. Only one corporation in the group must be doing business in Alabama in order for the new taxing system to apply to the entire unitary group. The bill partially adopts the Multistate Tax Commission’s broad definition of a “unitary” business contained in its model combined reporting act, and provides that “unitary” should be construed to the “broadest extent possible under the U.S. Constitution.” Despite requiring a combined report, however, the bill places several restrictions on the sharing of tax attributes (e.g., NOLs and capital credits) among members of a unitary group. This proposal, backed by the Alabama Education Association, received swift opposition from the 34-member Business Associations’ Tax Coalition (BATC), the Council On State Taxation (COST), and the Organization for International Investment.

**Alabama Taxpayers’ Bill of Rights II:** since the enactment of the TBOR in 1992, 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 Tax Section (including the authors) are working on a draft “TBOR II” to be circulated to interested parties prior to the next legislative session.

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

**Tax Classification of Pass-Through Entities:** would harmonize the classification of various pass-through business entities (e.g., LLCs and LPs) for Alabama state and local tax purposes by limiting conformity with the federal “check the box” regulations to only Alabama income and financial institution excise taxes, while preserving the sales, use and rental tax exclusions for certain transactions and the property, business privilege, and sales and use tax exemptions for disregarded entities that exist under Alabama’s current classification regime. The proposal would also clarify that members of a multi-member LLC are not personally liable for the LLC’s sales, use and other non-income taxes solely because their LLC is classified as a partnership for federal and Alabama tax purposes.

**The Alabama Taxpayer Protection and Assistance Act:** would provide for the registration and regulation of individual tax return preparers, with specific guidelines for registrants to facilitate refund anticipation loans or checks. Certified public accountants and other licensed professionals are exempted from

the Act. This bill quickly passed the Senate last session, but encountered substantial opposition in the House, particularly from the newly-formed National Independent Tax Preparers Association and their lobbyists, and other non-CPA tax preparers who do not want increased regulation of their industry.

**Expansion of Unemployment Benefits:** would extend unemployment benefits to cover employees who have been employed two out of the four most recent quarters, those seeking part-time (e.g., at least 20 hours per week) rather than full-time employment, people in certain job-training programs that have exhausted their normal benefits, and employees who leave their jobs due to domestic violence, in order to qualify Alabama for \$100.5 million in federal stimulus funds that would cover the extended benefits through 2013. In order to receive the full amount of funds from the federal economic stimulus plan, the state must decide whether it will expand its unemployment compensation benefits by September 20, 2011. Governor Riley and many members of the business community opposed the bill last session due to concerns over funding after the federal stimulus lapses in 2013 and ambiguities in the federal legislation.

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