

# Alabama Tax Developments: 2009 in Review; What's on the Horizon

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

Bruce Ely and James Long summarize many of the key Alabama legislative, judicial and administrative tax developments during 2009 with respect to income, transaction and property taxes and make some legislative predictions for 2010

**T**his article summarizes many of the key Alabama legislative, judicial and administrative tax developments during 2009 with respect to income, transaction and property taxes. The 2009 Alabama 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 past 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 article concludes by offering a few predictions regarding legislative tax proposals that we expect to be introduced in the 2010 regular session, which began on January 12 (earlier start than normal 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 teachers union recently endorsed several revenue raising measures, including increasing taxes on soft drinks, legalizing and

taxing gambling, and ending unspecified "corporate tax loopholes." In early December, State School Superintendent Dr. Joe Morton announced that K-12 schools alone (not counting higher education) would need \$245 million in additional funding next fiscal year just to break even.

## **Income/Franchise Taxes**

### **Act 2009-144—Qualified Investment Partnerships/Film Incentives**

**Act 2009-144** exempts "qualified investment partnerships" or "QIPs" from the income tax withholding regime and their non-resident investors from Alabama income tax, but requires most other partnerships and LLCs to file an annual composite tax return and remit Alabama income tax on behalf of their non-resident owners for tax years beginning on or after January 1, 2009. Due in large part to the retroactive effective date of the act, the Alabama Department of Revenue (ADOR) advises us that they will allow 2009 composite return filers to exclude from the return all nonresident partners who made their estimated tax payments during 2009. The ADOR issued proposed regulations in August and issued final regulations in January that were a marked improvement, but we expect them to issue substantially revised regulations in February. 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.

**Bruce P. Ely** is a Partner with the law firm of Bradley Arant Boulton Cummings LLP. He can be reached at 205-521-8366 or [bely@bab.com](mailto:bely@bab.com).

**James E. Long, Jr.** is an Associate with the law firm of Bradley Arant Boulton Cummings LLP. He can be reached at 205-521-8626 or [jelong@bab.com](mailto:jelong@bab.com).

## **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 (plus interest) 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 in *South Central Bell Tel. Co. v. Alabama*.<sup>1</sup> 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). The ADOR did not appeal this ruling so it is now final, but despite both parties’ characterization of this case as the “test case,” the ADOR argues that it can still attempt to prove that each of the remaining 150 or so refund claimants passed-on the tax to their customers or clients and therefore risk the loss of their refund claims. The Montgomery County Circuit Court has appointed several special masters to handle the remaining refund claims so perhaps another round of litigation will not be necessary.

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* could have impacted the ADOR’s continued refusal to grant taxpayers’ requested franchise

tax refunds. Unfortunately, the taxpayer’s petition was denied on January 25, 2010.

## ***HealthSouth Corporation et al. v. State Dep’t of Revenue*<sup>2</sup>**

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’ IRS 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 to Jefferson County Circuit Court.

## ***Ex parte VFJ Ventures, Inc.*<sup>3</sup>**

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 opinion 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 before the Administrative Law Division on non-constitutional issues.

## ***Tate & Lyle Ingredients Americas, Inc. v. State Dep’t of Revenue*<sup>4</sup>**

Chief ALJ Bill Thompson held that the taxpayer’s gain from the sale of its one-third interest in a European company, Amylum, could not be apportioned to Alabama because the two companies were not involved in a unitary business in Alabama, noting that the relationship and transactions between the taxpayer and Amylum were “almost identical to the facts” in *Allied-Signal*, where the absence of a unitary relationship was “a forgone conclusion.” The ADOR appealed this decision to the Montgomery County

On October 19, 2009, the Montgomery County Circuit Court finally granted a full refund of franchise taxes (plus interest) 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 in *South Central Bell Tel. Co. v. Alabama*.

Circuit Court, which recently affirmed Judge Thompson's decision. The ADOR did not appeal.

## **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.<sup>5</sup> Numerous comments were filed before the initial hearing in opposition to this regulation, including by the authors on behalf of the Alabama Society of CPAs. The ADOR allowed the first proposed regulation to lapse, but then reissued the current proposed regulation in January, with a public hearing scheduled for March 24. Various business and professional groups are working with the agency on a compromise solution and we expect legislation to be introduced this Spring.

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

### ***Washer & Refrigeration Supply Co. v. PRA Government Services, LLC***

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," "RDS" or "AlaTax," and its affiliates. The company handles the sales, use, rental and business license tax audit and collection function for over 250 municipalities and counties in the state. The 81 page complaint alleges several violations by the company or its auditors of the Alabama Taxpayers' Bill of Rights and Uniform Revenue Procedures Act ("TBOR"). Oddly, the defendants have attempted to remove the case to federal district court in Montgomery. Both tax practitioners and business and professional groups are closely monitoring this case.

### ***Capitol Machine & Equip. Co., LLC v. State Dep't of Revenue***

Chief ALJ Bill Thompson held that the taxpayer's pneumatic blowing machines and parts qualified for the reduced 1.5% (vs. 4%) machine state sales tax rate because the machinery processed and converted the insulation into usable form. *Of a more global signifi-*

*cance* 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. The ADOR has indicated several times recently 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<sup>6</sup>**

Attorney General Opinion No. 2009-092 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 their 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**

Act 2009-508 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<sup>9</sup>**

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 Occupational License Tax (OLT)**

Act 2009-811 reenacts Jefferson County's OLT, at a rate not to exceed .0045 of the lesser of compensation (excluding employee 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 was made 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 back in 1999. That decision was affirmed by the Alabama Supreme Court.

### **Act 2009-561—New Construction Training Program**

Act 2009-561 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. We expect proposed regulations from the ADOR any day now.

### **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" (see above) 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.

## **Anticipated and Pending TAX Legislation in 2010 Regular Session**

### **The "Alabama Arise" or "John Knight" Bill**

House Bill 1 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 Code §63, and increase the exemption for each dependent to at least \$2,000.

### **Refundable Food Tax Credit**

The 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

*Continued on page 66*

- Taxpayers should regularly check the Texas Register for proposed rules dealing with those statutes.
- After identifying proposed rules, taxpayers should consult with counsel immediately to develop a set of comprehensive and well-reasoned comments to ensure that their interests are fully considered before the Comptroller issues a final order.

By employing these methods, taxpayers will ensure that their interests are fully represented before the agency that construes and enforces Texas's tax laws. They may also avail themselves of additional options to challenge such rules if the agency fails to sufficiently address the particular taxpayer's comments.

#### ENDNOTES

\* The views set forth in this article are the personal views of the authors and do not necessarily reflect the opinions of Jones Day, its clients, or any other organizations with which the authors are associated.

<sup>1</sup> *Combs v. Entertainment Publications, Inc.*, 292 S.W.3d 712, 721 (Tex. App.—Austin 2009, pet. denied).

<sup>2</sup> *Id.* at 715.

<sup>3</sup> *Id.*

<sup>4</sup> *Id.* at 720.

<sup>5</sup> TEX. GOV'T CODE § 2001.038.

<sup>6</sup> *Entertainment Publications*, 292 S.W.3d at 720-21.

<sup>7</sup> TEX. GOV'T CODE § 2001.003(6).

<sup>8</sup> *Entertainment Publications*, 292 S.W.3d at 721.

<sup>9</sup> See TEX. GOV'T CODE § 2001.033(1).

<sup>10</sup> See *Hammerman & Gainer, Inc. v. Bullock*, 791 S.W.2d 330, 333 (Tex. App.—Austin 1990, no pet.).

<sup>11</sup> *Bullock v. Hewlett-Packard Co.*, 628 S.W.2d 754, 756 (Tex. 1982).

<sup>12</sup> TEX. GOV'T CODE § 2001.23.

<sup>13</sup> *Id.* § 2001.024(a)(7).

<sup>14</sup> *Id.* §§ 2001.033(1)(A)–(C), 2001.035(c).

<sup>15</sup> See, e.g., *Tex. Workers' Comp. Comm'n v. Patient Advocates of Tex.*, 136 S.W.3d 643, 649 (Tex. 2004).

<sup>16</sup> TEX. GOV'T CODE § 2001.035(a).

<sup>17</sup> *Methodist Hospitals of Dallas v. Texas Industrial Accident Board*, 798 S.W.2d 651, 659 (Tex. App.—Austin 1990, writ dismissed w.o.j.).

<sup>18</sup> *Nat'l Assoc. of Indep. Ins. v. Tex. Dep't of Ins.*, 925 S.W.2d 667, 670 (Tex. 1996).

## Unemployment Tax

Continued from page 44

These claims, on average, account for more than 60% of the cost of unemployment. Though not contestable, costs can be reduced for these claims by controlling the duration of unemployment and therefore, the number of weeks these individuals receive benefits.

An employer can impact the duration a former employee receives unemployment benefits by providing the tools and assistance needed to successfully find subsequent employment. The key is to provide a program that incorporates one-on-one job coaching by a qualified job coach, along with a structured learning program that is tailored to the job seeker's needs and will help keep them on track and engaged.

Having an effective reemployment plan for separated employees can reduce the duration of unemployment by as much as third. The best part is that, in addition to implementing a program that often pays for itself in the form of reduced unemployment costs, you can have a positive impact on the lives of your former employees by assisting them in remaining gainfully employed.

## Closing

As you can see, crafting a successful unemployment cost control program involves a "full circle" approach that begins with effectively hiring the right individuals for each job and closes with providing reemployment assistance to those who have become unemployed through no fault of their own. In addition, companies need to have clearly defined personnel rules and poli-

cies that are consistently followed and enforced. Detailed documentation of all infractions will enable companies to present the best case possible when defending against unwarranted unemployment claims and will also establish a reputation as an employer to be taken seriously by the various state agencies.

By following the recommendations in this article and incorporating them into every day processes, companies should be able to increase their success in winning protestable claims and reducing overall unemployment costs. At the end of the day though, it is essential to remember it is the experience and expertise of the individuals involved in the process that will lead to positive results.

## Alabama Developments

Continued from page 48

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, which the authors prepared for the Caucus.

## Unitary Combined Reporting

H.B. 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 Multi-state 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 investment capital credits) among members of a unitary group. This proposal, backed by the powerful 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 Alabama Taxpayers’ Bill of Rights (ATBOR) 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 its introduction during the 2010 session.

## Independent Tax Tribunal—Finally?

This proposal would transfer the ADOR’s Administrative Law Division to a separate, stand-alone state agency that would be headed by Chief ALJ Bill 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. The proposal has received the support of the 5,000 member Business Council of Alabama, the Alabama Retail Association, and COST.

## Tax Classification of Passthrough Entities

At the request of the ADOR, this legislation would harmonize the classification of various passthrough 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

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 has encountered substantial opposition in the House, particularly from the newly-formed National Independent Tax Preparers Association and their lobbyists, and perhaps other non-CPA tax preparers who do not want increased regulation of their industry.

## Expansion of Unemployment Benefits and Increased Tax

Senate Bill 11 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. Gov. Bob Riley (R) and many members of the business community opposed the bill last session and continue to oppose it due to concerns over funding after the federal stimulus money lapses in 2013 and ambiguities in the federal legislation.

## ENDNOTES

- <sup>1</sup> *South Central Bell Tel. Co. v. Alabama*, Dkt. No. CV-2001-1106 (U.S. S. Ct., Final Order Oct. 19, 2009).
- <sup>2</sup> *HealthSouth Corporation et al. v. State Dep't of Revenue*, Admin. Law Div., Dkt. No. BIT. 08-1021 (July 16, 2009).
- <sup>3</sup> *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).
- <sup>4</sup> *Tate & Lyle Ingredients Americas, Inc. v. State Dep't of Revenue*, Admin. Law Div Dkt. No. CORP. 07-162 (Final Order Den. ADOR's Appl. for Reh'g June 23, 2008), *aff'd*, Montgomery County Circuit Ct. Case No. CV-2008-900755 (Aug. 4, 2009).
- <sup>5</sup> Proposed Ala. Admin. Code r. 810-2-8-.08.
- <sup>6</sup> *Washer & Refrigeration Supply Co. v. PRA Government Services, LLC*, Montgomery Co. Cir. Ct. CV 2009-901297 (Nov. 4, 2009).
- <sup>7</sup> *Capitol Machine & Equip. Co., LLC v. State Dep't of Revenue*, Admin. Law Div., Dkt. No. S.08-619 (April 20, 2009).
- <sup>8</sup> Attorney General Opinion No. 2009-092 (July 9, 2009).
- <sup>9</sup> Attorney General Opinion No. 2009-074 (June 10, 2009).

## Announcing ... SOX 404 for Small, Publicly Held Companies

SOX 404 FOR SMALL, PUBLICLY HELD COMPANIES assists the management of small publicly held companies in complying with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002.

It is likely that with no more deferrals in the offing from the SEC, starting December 15, 2009, even smaller public companies will have to comply with SOX section 404(b), that requires an independent auditor's attestation on managements reports on internal controls over financial reporting.

This guide helps management in assessing the effectiveness of its company's internal control structure and procedures for financial reporting. In making internal control assessments, management often identifies situations where internal controls can be improved; this book helps management achieve these improvements cost effectively.

SOX 404 FOR SMALL, PUBLICLY HELD COMPANIES addresses every aspect of performing assessments of internal controls over financial reporting, as well as assessments of disclosure controls. Practice pointers and practical considerations are provided throughout the text so that management can focus on the most critical areas. The book explains the Securities and Exchange Commission rules for assessments of internal controls and analyses the latest requirements of the Public Company Accounting Oversight Board for independent auditors.

The checklists, questionnaires, workpapers and other practice aids for small and very small public companies provided throughout the book are included on the accompanying CD-ROM for auditors to adapt for their own needs. The CD also includes authoritative guidance from the PCAOB and the SEC.

SOX 404 FOR SMALL, PUBLICLY HELD COMPANIES is available from CCH INCORPORATED, 4025 W. Peterson Avenue, Chicago, Illinois 60646-6085. To order by phone, call 1-800-248-3248, book #0-6261-400, or visit the Web at [tax.cchgroup.com](http://tax.cchgroup.com).