State and Local Tax Bulletin

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Alabama Edition

Bradley Arant Boult Cummings LLP

Composite Return Transition Relief Offered by New Proposed Regulations

By Bruce P. Ely & William T. Thistle

Upcoming Seminars Involving Members Of Our SALT Practice Group

March 22-23, 2010
2010 ABA/IPT Advanced Income Tax Seminar. Chris Grissom will be a co-speaker with Erica Horn of Stites & Harbison PLLC and David Shipley of McCarter & English, LLP. Their topic will be "Add-Back Statutes: The Construction of Exemptions, the Disappointing Decision in the VFJ Ventures Case, Other Pending Litigation and Similarly Annoying Issues." For more information, please visit the ABA website: https://meetings.abanet.org/ meeting/tax/ipt10.

March 22, 2010
Bruce Ely and Will Thistle will be speaking to Accounting students at the University of Alabama Business School in Tuscaloosa on the interaction between attorneys and auditors in the context of tax accrual workpapers, FIN 48, and the work product doctrine. For more information concerning the topic or for a copy of their outline, please contact the speakers or the Practice Group assistant, Sherry Barber.

April 25 – 29, 2010
Council On State Taxation – 2010 Intermediate/Advanced State Income Tax School, Atlanta, Georgia. Chris Grissom will be a co-speaker with Kent Clay of Deloitte Tax on the State Taxation of Pass-Through Entities and Their Corporate Owners. For more information, please visit the COST website: www.statetax.org.

As many of our readers are aware, for tax years after December 31, 2008, Subchapter K entities doing business in Alabama, with one or more nonresident members/partners, are required to file an annual composite income tax return and make composite tax payments on behalf of their nonresident members/partners, subject to certain exceptions for "qualified investment partnerships," publicly-traded partnerships, affordable rental housing developments, and tax-exempt entities. Note that S corporations are *not* included in this new compliance regime, although they are required to follow a similar procedure if one or more of their nonresident shareholders fails or refuses to timely file Schedule NRA, the nonresident jurisdictional consent. Since the first set of proposed regulations associated with the new composite return requirement was issued last October, taxpayers and tax practitioners alike have clamored for transitional relief because this requirement was made retroactive to January 1, 2009, even though it was not enacted until late March 2009.

After numerous pleas, correspondence, and conference calls, the Alabama Department of Revenue wisely granted partnerships and LLCs one year of relief from the otherwise mandatory composite return payment rules. Although this transitional relief is only in the form of a proposed rule, key Department officials announced recently that the transition rule is "Department policy" and that the "Department is bound by the transition rule." As April 15th draws near, and many taxpayers' initial Alabama composite income tax returns become due, we wanted to provide some additional information on the application of the transition rule.

For tax years ending on or before December 31, 2009, a Subchapter K entity may elect, at the time of filing its 2009 composite return, to reduce the amount of its otherwise required composite payment by the amount due on behalf of a nonresident member that makes its required Alabama estimated income tax payments **and** that files its required Alabama income tax return for the 2009 tax year. Therefore, if a nonresident member made its quarterly estimated payments (if due) to the Department and files its 2009 Alabama income tax return, paying the proper amount due thereon, no composite payment is due from the Subchapter K entity with respect to that nonresident member. On the other hand, if the nonresident member either (i) fails to make quarterly estimates (if due) or (ii) fails to file an annual nonresident Alabama income tax return and pay any remaining tax due, then the Subchapter K entity is liable for any tax and interest due with respect to that nonresident member.

To make the election to exclude the compliant nonresident member from the composite return based on the transition rule, the Subchapter K entity must write "**COMPOSITE PAYMENT REDUCTION**" in bold lettering on page 1 of its composite return (new Form PTE-C). If the composite return is filed electronically, the Subchapter K entity should attach the composite payment reduction election to the electronic return in .pdf format, and the file should be named "ALCPRE.pdf." In addition, the Subchapter K entity must also provide the name, federal tax identification number, entity type, ownership

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percentage, and distributive share of applicable income items (including guaranteed payments) for each nonresident member for which it is making the election.

If no composite payment is due as a result of making this transition year election, the Subchapter K entity should prepare and file its 2009 Form PTE-C so that "zero" is shown on Line 1 as the amount of income tax due. Even if an election is made, but Line 1 shows an amount due, an assessment may result for any amount shown due, but not remitted. For more details regarding how to make this election, as well as instructions to and attachments associated with Form PTE-C, please visit the Department's website.

Preparing this initial composite return should remind CPAs and their clients to review their (or their clients') LLC and partnership agreements to determine if amendments are necessary to conform with the new composite return and payment requirements. Many agreements do not provide a funding and withholding mechanism that allows the Subchapter K entity to make the composite payment out of distributions otherwise due to the nonresident members. Even those agreements that *do* authorize withholding often only allow this when the nonresident member refused or otherwise failed to file a nonresident consent form. Remember, under the new composite return rules, the fact that a nonresident member long ago filed a consent agreement with the Department of Revenue to pay income tax on his or her distributive share of Alabama-source income is now *irrelevant*. Therefore, many LLC and partnership agreements may need to be amended to clearly authorize the Subchapter K entity to withhold, especially since the entity is now directly liable for the income tax attributable to its nonresident members.

If you have any questions regarding how the new regulations may affect your company or clients or if you would like for us to review your partnership or LLC agreements, please contact Bruce Ely (205-521-8366), Stuart Frentz (205-521-8216), or Will Thistle (205-521-8985).

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