

State and Local Tax Bulletin

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Alabama Edition



Controversial Regulation Striking Business Privilege Tax Deduction Reissued by ADOR

By James E. Long, Jr. and William T. Thistle

Upcoming Seminars Involving Members Of Our SALT Practice Group

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.

May 3, 2010

Tax Executives Institute, Houston Chapter. Chris Grissom will be speaking on the "State Taxation of Pass-Through Entities." For more information, please visit the TEI website: www.tei.org.

May 13-14, 2010

ASCPA Business and Industry Conference. Jimmy Long and Will Thistle will be speakers in a presentation on "Recent Alabama Tax Developments." For more information, please visit the ASCPA website: www.ascpa.org.

Alabama's business privilege tax ("BPT"), which is imposed on every business entity doing business or registered to do business in Alabama, provides for a deduction in computing the taxable base equal to the book value of the taxpayer's investments in the equity of any other taxpayer *that is doing business in Alabama*. Ala. Code § 40-14A-23. The Alabama Department of Revenue (the "Department") proposed a controversial regulation last August that would have deleted this statutory deduction for all tax years beginning on or after January 1, 2010. Proposed Admin. Code r. 810-2-8-.08. They also amended their BPT form to delete the line allowing the deduction. While the Department wisely allowed the first proposed regulation to lapse in early January, the same proposed regulation – with an exception applicable only to certain investments by financial institutions – was published in the January 29 *Alabama Administrative Monthly* and a public hearing was held on Wednesday, March 24.

In addition to the approximately 15 comment letters filed in opposition to the proposed regulation, representatives from a number of organizations (including the Alabama Society of CPAs (ASCPA), the 30-member Business Associations' Tax Coalition (BATC), the National Federation of Independent Business (NFIB), and various insurance trade associations) attended Wednesday's hearing to present their views on the new proposed regulation. Many of the attendees commented that by denying the deduction for in-state investments, the regulation, in many instances, will subject taxpayers to multiple taxation on the same property. Others noted that eliminating the deduction is equivalent to levying a tax because it increases revenue – a fact conceded by the Department – even though levying taxes is purely a legislative function. Lastly, some of the comments focused on the Department's inability to issue a valid regulation that directly contradicts the statute under which it is promulgated. Despite this staunch display of opposition to the Department's attempt to revoke a statutorily authorized deduction by regulation, we anticipate that, in the absence of a legislative solution, the Department likely will move forward and finalize the regulation in its current form. If finalized, that may force the Alabama Legislature's administrative agency oversight committee, known as the Legislative Council, to step in and suspend the regulation.

The Department's stated need for this regulation stems from its interpretation of the Court of Civil Appeals' decision in *AT&T Corporation v. Surtees*, 953 So. 2d 1240 (Ala. Civ. App. 2006), a case in which the authors' firm represented the taxpayer. In *AT&T*, both the trial court and appellate court held that because the BPT and the now-repealed corporate shares tax deductions were limited only to entities doing business in Alabama, the deduction scheme facially discriminated against interstate commerce in violation of

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the Commerce Clause of the U.S. Constitution. The Court remanded the case to the trial court in order for the Department to offer a permissible justification for the discriminatory scheme (which it could not) or else provide a remedy for the discrimination. It is very likely the Court thought it best to leave such a decision to the Alabama legislature. The parties thereafter settled AT&T's refund claim.

As mentioned above, the 2010 BPT return and related instructions were revised to reflect the first proposed regulation, which was withdrawn. The ASCPA has objected to this revision. The line on the prior years' BPT return that permitted the deduction for investments in entities doing business or registered to do business in Alabama now reads simply "(Reserved for future use)." As a result of numerous comments filed in opposition to the proposed regulation last Fall, officials from the Department began informal talks with various business groups regarding an alternative legislative proposal, which apparently has now been agreed to by most if not all the parties.

The most recent legislative proposal includes a deduction for equity investments in *all* entities (to comply with the AT&T ruling), but it is coupled with a formulaic add-back of certain liabilities as a result of the deduction. The Department recently indicated that it would not push for an increase to the \$15,000 BPT cap applicable to most taxpayers as part of this process. The status of this proposal or any other possible legislation is uncertain at this time. Although it appears that all parties believe legislation is needed to correct the discriminatory deduction scheme, none has been introduced yet. Taxpayers and their advisers should monitor both the proposed regulation and possible legislation when preparing 2010 BPT returns. The authors' firm serves as counsel to the ASCPA in this matter.

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