

# State and Local Tax Bulletin

May 6, 2011  
Alabama Edition



## House of Representatives Votes out Two Major Business Tax Bills

By Bruce P. Ely and William T. Thistle

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

#### May 10, 2011

The annual Council On State Taxation (COST) Southeast Regional State Tax Update will be held in Birmingham, Alabama at the Regions Bank headquarters. The seminar presenters, which include representatives from industry, the BABC SALT Practice Team, and key Alabama Department of Revenue officials, will provide an update on significant state tax issues for the Southeast States. With the tax arena constantly changing, this seminar is a must for SALT professionals. For details, visit the COST website at [www.cost.org](http://www.cost.org).

#### May 23, 2011

COST's 2011 Spring Audit Session/Income Tax Conference will be held in Albuquerque, New Mexico. BABC attorneys Chris Grissom and Will Thistle will be speaking on "State Taxation of Owners of Pass-Through Entities". For more information, visit the COST website at [www.cost.org](http://www.cost.org).

#### June 24, 2011

The Tax Executives Institute (TEI) Region VII Annual Conference will be held on Hilton Head Island. Chris Grissom and David Huizenga of Jefferson Wells will be co-presenting "Developing State Tax Audit Management Strategies & Current Trends". For more information, visit the TEI website at [www.tei.org](http://www.tei.org).

#### June 27, 2011

The Institute for Professionals in Taxation's (IPT) Annual Conference will be held in San Antonio, Texas. Chris Grissom and Ben Turner of Aaron's Inc. will be co-presenting "Developing State Tax Audit and Appeals Strategies and Audit Maxims to Live By". For more information, visit the IPT website at [www.ipt.org](http://www.ipt.org).

On a vote of 93-4 on Wednesday, May 4, the Alabama House of Representatives approved House Bill 434, which would amend Article IV of Alabama Code § 40-27-1, *i.e.*, Alabama's version of the Multistate Tax Compact, to double-weight the sales factor in the currently equally-weighted three factor formula used to apportion business income to Alabama. In addition, the bill would amend Alabama's apportionment methodology by converting Alabama from a "cost of performance" state to a "market source" state for certain receipts from intangibles or services. This bill provides that sales of services and other intangible property would be sourced to Alabama if the taxpayer's market for the sales is in Alabama (*e.g.*, the customer is located in Alabama, regardless of where the service is performed). According to officials from the Department of Revenue (the "Department"), the market sourcing rule in this bill closely tracks the MTC's model provision.

The bill has been scored by the Legislative Fiscal Office as raising \$20 million in the first fiscal year and \$20 million in succeeding fiscal years. The authors understand that this bill will likely pass the Legislature and, if so, will be signed by Governor Robert Bentley (R).

By a vote of 90-4 on the same day, the House also voted out what is commonly called the Gross Income Regulation "fix," House Bill 548, which affects pass-through entities doing business in Alabama and at least one other state that have Alabama resident members, partners, or shareholders. By statute, the "gross income" of an Alabama resident includes income from sources within and outside of Alabama. Ala. Code § 40-18-14(4). However, under the Department's so-called "Gross Income Regulation," Ala. Admin. Code r. 810-3-14-.01, income earned by a pass-through entity in another state is apportioned to and taxable only by that state.

In 2006, the Department's Administrative Law Division held that the Gross Income Regulation was invalid and inconsistent with the statute applicable to resident individuals owning interests in pass-through entities. *McNees v. State Dep't of Rev.*, Ala. Admin. Law Div., Dkt. No. INC. 06-523 (Dec. 12, 2006). Since that decision, Alabama residents have faced uncertainty in whether to report their pro rata share of income earned by their pass-through entity outside of Alabama. At the same time the Department has argued that it is getting whipsawed. Individual taxpayers owning an interest in an LLC earning income in another state that does not tax that income (or perhaps has a lower tax rate) will rely on the Gross Income Regulation to exclude that income from their Alabama gross income. Conversely, taxpayers who wish to import losses into Alabama reportedly rely on the *McNees* ruling. Governor Bentley has repeatedly called for this "loophole" to be closed.

HB 548 would modify the definition of "gross income" and override the inconsistent Gross Income Regulation so that resident individuals who own interests in pass-

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through entities must include their proportionate share of income from the pass-through entity in their Alabama gross income—regardless of where the income was earned.

To counter-balance that change, the bill provides that resident individuals who are owners of these pass-through entities would receive an income tax credit for certain income and gross receipts-based taxes paid by the entity to other states on behalf of the individual owners, e.g., through a composite return. The bill also provides resident individuals who are owners of these pass-through entities with an income tax credit for net income and similar taxes paid by the entity to foreign countries. The bill contains a retroactive effective date of January 1, 2011, but requires the Department to waive all penalties attributable to this change in the law.

### U.S. News & World Report Ranking

Bradley Arant Boulton Cummings LLP has received the fourth highest number of top-tier rankings in the country in the inaugural U.S. News & World Report – Best Lawyers list of top U.S. law firms. As it has done for many years for hospitals and colleges, this year U.S. News, working with the attorney ranking company Best Lawyers in America, ranked U.S. law firms based on a number of criteria, including client satisfaction. We are pleased to note that each member of our SALT Practice Group who is a partner in the firm was also included in Best Lawyers in America this year, and in many cases has been included for many years prior as well.



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