

# BOARD BRIEFS

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## Federal Tax Reform Highlights Ambiguities and Compliance Challenges for Alabama Banks

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

Unlike most states, Alabama exempts financial institutions from its corporate income tax, choosing instead to subject these entities to its financial institution excise tax ("FIET"). While it's not uncommon for financial institutions to encounter state income tax laws that vary somewhat from those imposed on other businesses, Alabama's antiquated FIET contains an unusual number of variances from the norm. These variances became particularly evident, and multiplied, as a result of the numerous changes implemented by the landmark Tax Cuts and Jobs Act ("TCJA") that President Trump signed into law in late December 2017.

For the most part, the TCJA changes were automatically incorporated into Alabama's corporate income tax code because the starting point for calculating Alabama corporate taxpayer's taxable base is federal "taxable income." On the other hand, Alabama's FIET is not automatically linked to the definition of federal "taxable income" and instead the FIET tax base is tied to a series of outdated Internal Revenue Code sections and limited to only a few paragraphs that attempt to define "net income" as the starting point for the FIET.

While the Alabama Department of Revenue ("ADOR") and Alabama courts have often relied on federal income tax principles in interpreting the FIET, there are a variety of unique features that must be taken into account when calculating the FIET tax base. The preliminary TCJA impact analysis, published by the ADOR last July, noted that "Alabama has traditionally allowed the items of income reported by the financial institution to be computed similarly to those same items of income addressed in the federal statute, unless there are specific Alabama rules that provide direct guidance on these items. ... Certain items referenced in this document have no direct ties to Alabama law, but for ease of administration Alabama follows the federal provisions."

### TCJA Changes and Impact on the FIET

The ADOR's extensive impact analysis noted several of the key changes included in the TCJA and gave its opinion on how those changes should impact the FIET:

- Bonus depreciation and expanded IRC Section 179 expensing – the FIET will follow these changes due to the ADOR's historical interpretation of the FIET's depreciation deduction for ease of administration.
- Business interest limitation under IRC Section 163(j) – the FIET will not follow this change.
- Limits deduction for employee fringe benefits and meals/entertainment expenses under IRC Section 274 – the FIET includes these changes due to the ADOR's historical interpretation of "ordinary and necessary expenses" as being determined

by the Internal Revenue Code, as amended.

- Limits deduction for FDIC premiums – the FIET includes these changes due to the ADOR’s historical interpretation of “ordinary and necessary expenses” as being determined by the Internal Revenue Code, as amended.

### Other Notable Differences Between FIET and Our Corporate Income Tax

In addition to the above list of items highlighted by the TCJA, the following is a brief summary of likely differences between Alabama’s corporate income tax, as amended, and the FIET:

- Dividends received deduction – unlike Alabama’s corporate income tax, the FIET’s dividends received deduction is generally limited to dividends received from Alabama corporations. A similar provision in Alabama’s business privilege tax was determined to be unconstitutional by the Alabama Court of Civil Appeals in 2006, and with any statutory provision that benefits in-state interests over out-of-state interests, the real dispute is over the appropriate remedy to address the facially discriminatory treatment.
- Deductions for charitable contributions – subject to 5% of net income limitation for FIET purposes while corporate income taxpayers are subject to 10% of taxable income limitation.
- Net operating losses – in contrast to the more favorable federal and Alabama corporate income tax rules, NOLs for FIET purposes are subject to a two year carry-back while the carry-forward is limited to only eight years.
- Federal income tax deduction – must be taken on a cash basis for FIET purposes, regardless of the bank’s method of accounting.
- Return due dates – the due date for the FIET return is not tied to the federal income tax return due dates, which can create many administrative problems for both the ADOR and bankers.

As explained above, the TCJA exacerbated the likely differences and ambiguities between the FIET and both the federal income tax provisions and Alabama’s corporate income tax provisions. Representatives from the ADOR approached the Alabama Bankers

Association last May to solicit input regarding the ADOR’s analysis of the effects of the TCJA and to discuss whether changes to the FIET statutes were warranted in light of the TCJA changes. Under the supervision of ABA Vice President of Governmental and Legal Affairs Jason Isbell a working group of bankers, CPAs, and tax attorneys was formed to meet with the ADOR. This group developed compromise legislation that was introduced in the Alabama Legislature on April 11. The bill would provide needed clarification and federal tax conformity while codifying several of the ADOR’s current administrative policies and procedures. With Isbell’s assistance, we plan to publish a summary of the bill for ABA members and their tax advisers in the very near future.

*Jimmy Long assists clients with state and local tax compliance and controversy matters, including income, franchise and transactional taxes. In addition, Jimmy has an active economic development practice in the area of tax incentives and credits, with particular emphasis on federal and state new markets tax credits and historic rehabilitation credits.*



*Bruce Ely’s more than 30 years of experience have allowed him to handle projects as diverse as serving on the recruiting teams that successfully induced both Mercedes-Benz and Hyundai to locate their first U.S. manufacturing plants in Alabama to representing taxpayers before the Internal Revenue Service, the Alabama Department of Revenue and local taxing authorities. His practice focuses on three concentric areas: representing taxpayers in federal, state and local administrative and judicial forums; advising companies on choosing the proper form of entity through which to conduct business in the southeast and potential tax incentives; and advising companies and various trade and professional organizations regarding state and local tax legislative matters.*



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