

1 HB286
2 136685-1
3 By Representative Love
4 RFD: Ways and Means Education
5 First Read: 09-FEB-12

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8 SYNOPSIS: This bill would modify the definition of
9 gross income for Alabama income tax purposes so
10 that resident individuals, who are either partners
11 or members of partnerships or limited liability
12 companies, shareholders of Alabama S corporations,
13 or beneficiaries of estates or trusts, during all
14 or part of a tax year, must include their
15 proportionate share of income from the pass-through
16 entity, regardless of whether the income is earned
17 within or outside of Alabama. This bill would
18 provide resident individuals who are owners or
19 beneficiaries of these pass-through entities an
20 income tax credit for the income tax or gross
21 profits tax paid by the entity to other states or
22 territories on behalf of the individual owner or
23 beneficiaries because the other state imposes a
24 withholding or composite return obligation or an
25 entity-level tax on the pass-through entity.

26 This bill would also provide an income tax
27 credit to resident individuals who are owners or

1 beneficiaries of these pass-through entities for a
2 portion of the amount of net income-based taxes
3 paid by the pass-through entity to foreign
4 countries.

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6 A BILL
7 TO BE ENTITLED
8 AN ACT
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10 To amend Sections 40-18-14 and 40-18-21, Code of
11 Alabama 1975, relating to the manner in which resident
12 individual owners of Subchapter K entities and Alabama S
13 corporations are taxed on the entity's income earned from
14 sources outside of Alabama, to provide those owners, as well
15 as resident beneficiaries of an estate or trust, with a credit
16 equal to their proportionate share of certain income or gross
17 profits taxes paid or accrued to other states or territories
18 on behalf of the owners and a credit for a portion of income
19 taxes paid or accrued to a foreign country with respect to the
20 trade or business or investment income of such entity; and to
21 require the Department of Revenue to report annually to the
22 Legislative Council.

23 BE IT ENACTED BY THE LEGISLATURE OF ALABAMA:

24 Section 1. Sections 40-18-14 and 40-18-21, Code of
25 Alabama 1975, are amended to read as follows:

26 "§40-18-14.

27 "The term "gross income" as used herein:

1 "(1) Includes gains, profits and income derived from
2 salaries, wages, or compensation for personal services of
3 whatever kind, or in whatever form paid, including the
4 salaries, income, fees, and other compensation of state,
5 county, and municipal officers and employees, or from
6 professions, vocations, trades, business, commerce or sales,
7 or dealings in property whether real or personal, growing out
8 of ownership or use of or interest in such property; also from
9 interest, royalties, rents, dividends, securities, or
10 transactions of any business carried on for gain or profit and
11 the income derived from any source whatever, including any
12 income not exempted under this chapter and against which
13 income there is no provision for a tax. The term "gross
14 income" as used herein also includes alimony and separate
15 maintenance payments to the extent they are includable in
16 gross income for federal income tax purposes under 26 U.S.C. §
17 71 (relating to alimony and separate maintenance payments).
18 The term "gross income" as used herein also includes any
19 amount included in gross income under 26 U.S.C. § 83 at the
20 time it is so included under 26 U.S.C. § 83.

21 "(2) For purposes of this chapter, the reductions in
22 tax attributes required by 26 U.S.C. § 108 shall be applied
23 only to the net operating losses determined under this chapter
24 and the basis of depreciable property. The basis reductions
25 of depreciable property shall not exceed the basis reductions
26 for federal income tax purposes. All other tax attribute

1 reductions required by 26 U.S.C. § 108 shall not be
2 recognized.

3 "(3) Gross income does not include the following
4 items which shall be exempt from income tax under this
5 chapter:

6 "a. Amounts received under life insurance policies
7 and contracts paid by reason of the death of the insured in
8 accordance with 26 U.S.C. § 101;

9 "b. Amounts received, other than amounts paid by
10 reason of the death of the insured, under life insurance,
11 endowment or annuity contracts, determined in accordance with
12 26 U.S.C. § 72;

13 "c. The value of property acquired by gift, bequest,
14 devise, or descent, but the income from such property shall be
15 included in the gross income, in accordance with 26 U.S.C. §
16 102;

17 "d. Interest upon obligations of the United States
18 or its possessions; or securities issued under provisions of
19 the Federal Farm Loan Act of July 18, 1916;

20 "e. Any amounts received by an individual which are
21 excludable from gross income under 26 U.S.C. § 104 (relating
22 to compensation for injuries or sickness) or 26 U.S.C. § 105
23 (relating to amounts received under accident or health plans);

24 "f. Interest on obligations of the State of Alabama
25 and any county, municipality, or other political subdivision
26 thereof;

1 "g. The rental value of a parsonage provided to a
2 minister of the gospel to the extent excludable under 26
3 U.S.C. § 107;

4 "h. Income from discharge of indebtedness to the
5 extent allowed by 26 U.S.C. § 108;

6 "i. For each individual resident taxpayer, or each
7 husband and wife filing a joint income tax return, as the case
8 may be, any gain realized from the sale of a personal
9 residence of the taxpayer shall be excluded to the extent
10 excludable for federal income tax purposes under 26 U.S.C. §
11 121;

12 "j. Contributions made by an employer on behalf of
13 an employee to a trust which is part of a qualified cash or
14 deferred arrangement (as defined in 26 U.S.C. § 401(k)(2), or
15 5 U.S.C. § 8437) under which the employee has an election
16 whether the contribution will be made to the trust or received
17 by the employee in cash and contributions made by an employer
18 for an employee for an annuity contract, which contributions
19 would be excludable from the gross income (for federal income
20 tax purposes) of the employee in accordance with the
21 provisions of 26 U.S.C. § 403(b). The limitations imposed by
22 26 U.S.C. § 402(g) shall apply for purposes of this paragraph;

23 "k. Amounts that an employee is allowed to exclude
24 from gross income for federal income tax purposes pursuant to
25 26 U.S.C. § 125 (relating to cafeteria plans) and 26 U.S.C. §
26 132 (relating to certain fringe benefits); and

1 "1. Amounts paid or incurred by an employer on
2 behalf of an employee if the amounts may be excluded from
3 gross income for federal income tax purposes by an employee
4 pursuant to 26 U.S.C. § 129 (relating to dependent care
5 expenses).

6 "(4) The term "gross income," in the case of a
7 resident individual, includes income from sources within and
8 outside Alabama, ~~and~~ including without limitation, the
9 resident's proportionate share of any income arising from a
10 Subchapter K entity, Alabama S corporation, or estate or
11 trust, regardless of the geographic source of the income. The
12 term gross income, in the case of a nonresident individual,
13 includes only income from property owned or business
14 transacted in Alabama. For purposes of this article,
15 proportionate share shall be defined by reference to (i) the
16 status of the individual owner as a partner or member of a
17 Subchapter K entity, shareholder of an Alabama S corporation,
18 or beneficiary of an estate or trust, and (ii) the allocable
19 interest in that entity owned by the individual.

20 "§40-18-21.

21 "(a) (1) For the purpose of ascertaining the income
22 tax due under the provisions of this chapter by individual
23 residents of Alabama whose gross income, as defined herein, is
24 derived from sources both within and ~~without~~ outside the State
25 of Alabama, there shall be allowed a credit against the amount
26 of tax found to be due by such resident, on account of income
27 derived from ~~without~~ outside the State of Alabama, the amount

1 of income tax actually paid by such resident to any state or
2 territory on account of business transacted or property held
3 without, directly or indirectly, outside the State of Alabama.
4 Resident individual owners of Subchapter K entities, Alabama S
5 corporations, and beneficiaries of estates or trusts who
6 include their proportionate share of the income arising from
7 one or more of these entities in their Alabama gross income
8 shall be allowed a credit for their proportionate share of the
9 income tax actually paid by the entity to any state or
10 territory on account of business transacted or property held
11 outside the State of Alabama, whether the payment was made on
12 behalf of the resident individual owner or because the entity
13 was not recognized by such state or territory as a non-taxable
14 pass-through entity. For purposes of this subsection, income
15 tax shall be defined to include, but not be limited to, any
16 tax based in whole or in part on the entity's net income, net
17 profits, or gross profits; provided, however, that the term
18 income tax shall not include any tax based on the entity's net
19 worth, capital, or asset values, and shall not include any tax
20 for which an exclusion or deduction is claimed in the
21 calculation of taxable income reported on the Alabama income
22 tax return.

23 "(2) In case the amount of income tax actually paid
24 by or on behalf of an individual resident of Alabama, or by
25 one of the entities described in subdivision (a)(1) above, to
26 another state or territory is in excess of the amount of tax
27 that would be due on the same income computed ~~on the~~ using the

1 applicable Alabama income tax ~~rate in Alabama~~ rates, then only
2 such amount as would be due in this state on such taxable
3 income shall be allowed as a credit. In no event shall the
4 credit for income taxes paid to another state exceed the
5 amount of tax that would be due on the same taxable income
6 computed using the applicable Alabama income tax rates.

7 "(3) If the amount of income tax actually paid by or
8 on behalf of an individual resident of ~~this state~~ Alabama to
9 any other state or territory on account of business transacted
10 or property held is less than the amount of tax that would be
11 due, as computed ~~on~~ using the applicable Alabama income tax
12 rates, then the income tax levied herein shall be computed on
13 the entire taxable income from sources from both within and
14 ~~without~~ outside the state as defined herein, and the tax shall
15 be paid less the credit allowed in this section for tax paid
16 on income derived, directly or indirectly, from ~~without~~
17 outside the state.

18 "(4) Before a resident of Alabama may claim the
19 credit allowed under this subsection (a), he or she shall file
20 with his or her Alabama income tax return a certificate
21 showing the amount of gross and net income derived, directly
22 or indirectly, from sources ~~without~~ outside this state,
23 together with the amount of tax paid or to be paid on such
24 income.

25 "(b) Any taxpayer described in Section 40-18-2(1) or
26 Section 40-18-2(6), who, during any year, has been assessed a
27 job development fee as described in Section 41-10-44.8(b),

1 shall be allowed a credit against the amount of income tax due
2 under the provisions of this chapter in such year in an amount
3 equal to the job development fee withheld from the taxpayer's
4 wages during the year.

5 "(c) (1) A resident individual taxpayer, who is
6 either a partner or member of a Subchapter K entity, a
7 shareholder of an Alabama S corporation, or a beneficiary of
8 an estate or trust, during all or part of a year, shall be
9 allowed a credit equal to fifty percent (50%) of his or her
10 proportionate share of the income taxes paid or accrued,
11 including a payment recognized by 26 U.S.C. §901, to a foreign
12 country with respect to the trade or business or investment
13 income of such business, including related operations and
14 affiliates, ~~whose income in the foreign country is all~~
15 ~~principally related to the following 2002 North American~~
16 ~~Industry Classification System Sectors and Subsectors in all~~
17 ~~of the following manners:~~

18 ~~"a. The income must be related to Sector 21.~~

19 ~~"b. The income must be related to at least two of~~
20 ~~the following Subsectors: 324, 325, 482, 483, and 486.~~

21 ~~"c. The income must be attributable to the foreign~~
22 ~~country.~~

23 "(2) Notwithstanding the foregoing, the credit
24 allowed in this subsection shall not exceed the amount of
25 income tax that would otherwise be imposed by Alabama on the
26 individual's income derived from the foreign country."

1 Section 2. The Department of Revenue shall report
2 annually to the Legislative Council the extent to which
3 credits for taxes paid to foreign countries are claimed during
4 the year. The report shall be due on the fifth legislative day
5 of each regular session and shall state the number of
6 taxpayers who claim the credits and the total amount of
7 credits claimed during the year.

8 Section 3. For purposes of Chapter 9 of Title 29 of
9 the Code of Alabama 1975 cited as "The Education Trust Fund
10 Rolling Reserve Act," the funds received by the Education
11 Trust Fund under this act after September 30, 2012 shall be
12 considered "New Recurring Revenue" as defined by Section
13 29-9-2 and be available for appropriation in FY 2013 because
14 they will be deposited into the Education Trust Fund in FY
15 2013 for the first time due to a change in statute rather than
16 by a Department of Revenue rule.

17 Section 4. The provisions of this act are severable.
18 If any part of this act is declared invalid or
19 unconstitutional, that declaration shall not affect the part
20 which remains.

21 Section 5. All laws or parts of laws which conflict
22 with this act are repealed.

23 Section 6. The amendments by this act to Section
24 40-18-14, relating to gross income, and to Section
25 40-18-21(a), relating to credits for taxes paid to other
26 states and territories, shall apply to all tax years beginning
27 after December 31, 2010. The amendments by this act to Section

1 40-18-21(c), relating to credits for taxes paid to foreign
2 countries, shall apply to all tax years beginning after
3 December 31, 2011. Notwithstanding the foregoing, taxpayers
4 otherwise subject to this act may recognize gains from any
5 taxable disposition of all or any portion of assets or
6 Subchapter K interests consistent with pre-act application
7 under Sections 40-18-14 and 40-18-21 where the parties thereto
8 can document that negotiations began prior to January 1, 2011
9 and continued with regularity until the transaction was
10 completed in 2011. No penalty, including any payment otherwise
11 required under Section 40-18-80, Code of Alabama 1975, shall
12 be due or assessed for any underpayment of or failure to pay
13 estimated income tax resulting from any retroactive
14 application of the amendments contained herein.

15 Section 7. This act shall become effective upon its
16 passage and approval by the Governor or its otherwise becoming
17 law.