HB9

171503-1

By Representative Beckman

RFD: Ways and Means General Fund

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SYNOPSIS: In determining the amount of income that is subject to tax under current law, taxpayers are allowed to deduct, from income, the full amount of Federal Insurance Contribution Act (FICA) taxes withheld from wages and the full amount of taxes paid on self-employment income. FICA and self-employment taxes are composed of two components, Medicare taxes and Social Security taxes.

This bill would amend Section 40-18-15 to limit the amount of FICA and self-employment taxes that can be claimed as a deduction against income.

A BILL

TO BE ENTITLED

AN ACT

To amend Section 40-18-15, Code of Alabama 1975, relating to income tax, to limit the amount of FICA and self-employment taxes that can be claimed as a deduction in the determination of taxable income.

BE IT ENACTED BY THE LEGISLATURE OF ALABAMA:

Section 1. Section 40-18-15, Code of Alabama 1975, is hereby amended to read as follows:

"§40-18-15.

(a) No deduction shall be allowed for any losses, expenses, or interest deferred or disallowed pursuant to 26 U.S.C. § 267 or for any cost required to be capitalized in accordance with 26 U.S.C. § 263A; otherwise, there shall be allowed as deductions:

(1) All ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, as determined in accordance with 26 U.S.C. § 162.

(2) Interest paid or accrued within the taxable year on indebtedness, limited to the amount allowable as an interest deduction for federal income tax purposes in the corresponding tax year or period pursuant to the provisions of 26 U.S.C. §§ 163, 264, and 265.

(3) The following taxes paid or accrued within the taxable year:

a. Income taxes, ~~Federal Insurance Contribution Act taxes, taxes on self-employment income and~~ estate and gift taxes imposed by authority of the United States or any possession of the United States.

b. State and local, and foreign, occupational license taxes, and contributions to state unemployment funds.

c. State and local, and foreign, real property taxes.

d. State and local personal property taxes.

e. The generation-skipping transfer (GST) tax imposed on income distributions by 26 U.S.C. § 2601.

f. The taxes described in paragraphs c., d., and e. shall be deductible only to the extent that the taxes are deductible for federal income tax purposes under 26 U.S.C. § 164 (relating to taxes).

g. In addition, there shall be allowed as a deduction, state and local, and foreign taxes, except income taxes, and taxes imposed by authority of the United States or any possession of the United States, which are paid or accrued within the taxable year in carrying on a trade or business or an activity described in 26 U.S.C. § 212 (relating to expenses for the production of income).

h. Notwithstanding paragraph g., any tax described in any paragraph preceding paragraph g. that is paid or accrued in connection with an acquisition or disposition of property shall be treated as part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition of that property.

<u>i. The hospital insurance taxes (also known as Medicare taxes) imposed under the Federal Insurance Contribution Act and the Self-Employment Contributions Act, plus one-half of the old-age, survivors, and disability insurance taxes (also known as Social Security taxes) imposed</u>

<u>on self-employment income under the Self-Employment Contributions Act.</u>

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise if incurred in a trade or business, in accordance with 26 U.S.C. § 165(c)(1).

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business in accordance with 26 U.S.C. § 165(c)(2); but, in the case of a taxpayer other than a resident of the state, only as to those transactions within the state.

(6) Casualty and theft losses sustained during the taxable year of property not connected with the conduct of a trade or business or a transaction entered into for profit as determined in accordance with subsections (c)(3) and (h) of 26 U.S.C. § 165. In the case of a nonresident, the deduction shall be allowed only for the losses arising from property located within the State of Alabama and the limitations in 26 U.S.C. § 165 shall be applied with regard only to the taxpayer's Alabama adjusted gross income. No loss shall be allowed if at the time of filing the return, the loss has been claimed on a federal estate tax return.

(7) Losses from debts ascertained to be worthless and charged off during the taxable year of ascertainment, if sustained in the conduct of the regular trade or business of the taxpayer.

(8) A reasonable allowance for the exhaustion, wear and tear of property from which any income is derived, including a reasonable allowance for obsolescence, in accordance with 26 U.S.C. §§ 167 and 168, and an allowance for the amortization of intangibles determined in accordance with 26 U.S.C. § 197.

(9) In the case of mines, oil, and gas wells, other natural deposits and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar condition in each case based upon the cost, including the cost of development not otherwise deducted, such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Department of Revenue; and, in the case of leasehold interests, the deduction allowed by this section shall be equitably apportioned between the lessor and the lessee.

(10) Charitable contributions to the extent allowed for federal income tax purposes under 26 U.S.C. § 170 (relating to charitable contributions and gifts).

(11) The deduction allowed to the individual for federal income tax purposes by 26 U.S.C. § 219 (relating to retirement savings).

(12) The deduction allowed for federal income tax purposes by 26 U.S.C. § 404 (relating to qualified pension, profit sharing, stock bonus, and annuity plans).

(13) For each individual income taxpayer, medical and dental expenses, including amounts paid for medicine and

drugs and amounts paid for accident and health insurance, as determined in accordance with 26 U.S.C. § 213; provided, however, that the limitation of the deduction to the excess of those expenses over 7.5 percent of adjusted gross income as provided in 26 U.S.C. § 213 shall instead be limited to the excess of those expenses over 4.0 percent of adjusted gross income.

(14) For each individual income taxpayer, the deduction determined in accordance with 26 U.S.C. § 212 for all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income, or in connection with the determination, collection, or refund of any tax.

(15) Any expense not exceeding $1,000 actually incurred during the taxable year in constructing on his or her property a family radioactive fallout shelter, as approved and certified by the State Department of Emergency Management, and any amount not exceeding $1,000 which he or she contributed during the taxable year toward the construction of a community radioactive fallout shelter.

(16) A deduction from the taxpayer's adjusted gross income for state income tax purposes of the total cost of installation for conversion from gas or electricity to wood as the primary energy source for heating their individual domestic homes for the taxable year during which a conversion was completed.

(17) Alimony and separate maintenance payments, the amount deductible to be the same as the amount deductible for federal income tax purposes under 26 U.S.C. § 215 (relating to alimony payments).

(18) Moving expenses paid or incurred during the taxable year as allowed under 26 U.S.C. § 217 (relating to moving expenses). However, in applying 26 U.S.C. § 217, the term "new principal place of work" means only places of work located within the State of Alabama.

(19) Any expense not exceeding $35,000 actually incurred during the taxable year in removing from his or her property any architectural or transportation barriers to handicapped persons with nonambulatory and semiambulatory disabilities; provided, however, that any improvements resulting from that expense shall not be eligible to be capitalized for depreciation.

(20) Notwithstanding subdivision (1), the deduction for expenses of travel, entertainment, and meals shall be determined in accordance with 26 U.S.C. § 274.

(21) The deduction allowed by 26 U.S.C. § 179 (relating to expensing certain depreciable property), provided that no deduction shall be allowed under subdivision (8) for any amount allowed as a deduction under this subdivision.

(22) The deduction allowed by 26 U.S.C. § 195 (relating to amortization of start-up expenditures), but in the case of a nonresident, only if the principal place of

business of the business investigated, created, or acquired is located in the State of Alabama.

(23) The deduction allowed by subdivision (1), to the extent that it consists of unreimbursed employee business expenses, and the deduction allowed by subdivision (14) shall be allowed only to the extent that the aggregate of the deductions exceeds 2 percent of adjusted gross income.

(24) The reasonable medical and legal expenses paid or incurred by the taxpayer in connection with the adoption of a minor. For purposes of this subdivision, medical expenses shall include any medical and hospital expenses of the adoptee and the adoptee's biological mother which are incident to the adoptee's birth and subsequent medical care and which, in the case of the adoptee, are paid or incurred before the petition is granted.

(25) The amount of any aid or assistance, whether in the form of property, services, or monies, provided to the State Industrial Development Authority pursuant to Section 41-10-44.8(d) in order to induce an approved company to undertake a major project within the state.

(26) The amount of premiums paid pursuant to a qualifying insurance contract for qualified long-term care coverage.

(27) The amount deductible by the taxpayer in accordance with 26 U.S.C. § 162(h).

(28) The amount, up to five thousand dollars ($5,000) per annum, contributed subsequent to December 31,

2007, to the Alabama Prepaid Affordable College Tuition Program or the Alabama College Education Savings Program as defined in Chapter 33C of Title 16. If the taxpayer makes a nonqualified withdrawal as defined by Section 529 of the Internal Revenue Code (26 U.S.C. 529), the amount of the nonqualified withdrawal, plus 10 percent of the amount withdrawn, shall be added back to the income of the contributing taxpayer in the year the nonqualified withdrawal was distributed.

(b)(1) In lieu of the deductions allowable to individual taxpayers, as provided in subdivision (1) of subsection (a) to the extent of unreimbursed employee business expenses, and as provided in subdivisions (2), (3), (5), (6), (10), (13), (14), (15), (16), (19), (22), and (26) of subsection (a), the taxpayer may elect to take the optional standard deduction of 20 percent of the adjusted gross income or $2,000, whichever is the lesser. Taxpayers filing jointly as defined in Section 40-18-27 may elect to take the optional standard deduction of 20 percent of the adjusted gross income or $4,000, whichever is the lesser.

(2) For tax years beginning after December 31, 2006, the optional standard deduction shall be determined as follows:

a. The standard deduction for married taxpayers filing jointly with adjusted gross income of $20,000 or less shall be $7,500. For married taxpayers filing jointly with adjusted gross income of greater than $20,000, the standard deduction shall be reduced by $175 for each $500 of adjusted gross income in excess of $20,000. Notwithstanding the preceding sentence, the standard deduction shall not be less that $4,000 for married taxpayers filing jointly.

b. The standard deduction for married taxpayers filing separate returns with adjusted gross income of $10,000 or less shall be $3,750. For married taxpayers filing separate returns with adjusted gross income of greater than $10,000, the standard deduction shall be reduced by $88 for each $250 of adjusted gross income in excess of $10,000. Notwithstanding the preceding sentence, the standard deduction shall not be less than $2,000 for married taxpayers filing separate returns.

c. The standard deduction for head of family taxpayers with adjusted gross income of $20,000 or less shall be $4,700. For head of family taxpayers with adjusted gross income of greater than $20,000, the standard deduction shall be reduced by $135 for each $500 of adjusted gross income in excess of $20,000. Notwithstanding the preceding sentence, the standard deduction shall not be less than $2,000 for head of family taxpayers.

d. The standard deduction for single taxpayers with adjusted gross income of $20,000 or less shall be $2,500. For single taxpayers with adjusted gross income of greater than $20,000, the standard deduction shall be reduced by $25 for each $500 of adjusted gross income in excess of $20,000.

Notwithstanding the preceding sentence, the standard deduction shall not be less than $2,000 for single taxpayers.

(c) A deduction is allowable for the amount of federal income tax paid or accrued within the taxable year. In the case of a nonresident taxpayer, the amount of federal income tax deductible to Alabama shall be determined by the ratio that the amount of adjusted gross income received from sources within the State of Alabama bears to the amount of adjusted gross income received from sources within and outside the State of Alabama.

(d) If separate returns are filed by husband and wife and one spouse elects to claim the optional standard deduction, the other spouse must also claim the optional standard deduction, unless, for the tax returns filed for the 2014 and subsequent tax years, the spouses have lived apart for the entire year. In this case, each spouse may claim either the optional standard deduction or itemized deductions. Neither spouse may claim a deduction for expenses paid by the other spouse.

(e) In the case of a nonresident individual:

(1) The deductions allowed in subdivisions (1), (2), (3), (4), (5), (7), (8), (9), (11), (12), (19), (21), (23), and (25) of subsection (a) shall be allowed only to the extent that they are paid or incurred in carrying on a trade or business within the State of Alabama and the deduction allowed by Section 40-18-15.2 shall be allowed only to the extent it arose from a trade or business carried on in Alabama.

(2) The deductions allowed by subdivisions (2), (3), (5), (8), (9), (14), and (19) of subsection (a) shall be allowed only to the extent arising from property located in Alabama or transactions producing income that is subject to tax in the State of Alabama.

(3) The amount of the deductions allowed by subdivisions (2), (3), (6), (10), (13), (15), (16), (17), (19), (24), and (26) of subsection (a) (and not allowed by subdivisions (1) or (2) of this subsection), or by subsection (b) if the taxpayer elects the standard deduction, shall be limited to the amount determined by multiplying the total of such deductions by a fraction, the numerator of which is the taxpayer's adjusted gross income determined using the rules provided in subdivisions (1) and (2) of this subsection and the denominator of which is the taxpayer's adjusted gross income determined under Section 40-18-14.2. The deduction allowed in subdivision (17) of subsection (a) shall not be subtracted in calculating either the numerator or denominator in the previous sentence.

(f) Nothing in this section shall allow any item to be deducted more than once."

Section 2. The provisions of this act are severable. If any part of this act is declared invalid or unconstitutional, that declaration shall not affect the part which remains.

Section 3. All laws or parts of laws which conflict with this act are hereby repealed.

Section 4. This act shall become effective immediately following its passage and approval by the Governor, or upon its otherwise becoming law , and shall apply to the full tax year beginning January 1, 2015 and to all tax years thereafter.