ALABAMA DEPARTMENT OF REVENUE
ADMINISTRATIVE CODE

CHAPTER 810-3-24.2
PASS THROUGH ENTITY COMPOSITE RETURNS AND QUALIFIED INVESTMENT PARTNERSHIP (QIP) REQUIREMENTS

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(1) Definitions. The following terms shall have the following meanings for purpose of these rules.

(a) Subchapter K Entity. An entity meeting the definition contained in Section 40-18-1, Code of Ala. 1975, which does not include a single member limited liability company.

(b) Composite Return. A return on a form prescribed by the Department which contains information concerning the distributive share of income for each of the nonresident members and which reports the amount of composite payment made on behalf of each nonresident member.

(c) Composite Payment. A payment of Alabama income tax made by the pass-through entity on behalf of its nonresident members; calculated on the nonresident member's distributive share of the pass-through entity's income, computed in accordance with Section 40-18-24, Code of Ala. 1975, and paid in the manner prescribed by the Department.

(d) Pass-through Entity. A partnership or other entity classified as a Subchapter K entity under Section 40-18-1, Code of Ala. 1975. Neither estates nor trusts, including business trusts, are included in this definition or are subject to Section 40-18-24.2, Code of Ala. 1975, except in their capacity as a nonresident member of a pass-through entity or lower-tier pass-through entity.

(e) Affordable Rental Housing Development. A housing development operated in the form of a Subchapter K entity which has rents restricted pursuant to a federal, state or local government agency requirement, and includes without limitation one or more commonly-managed residential units, generally treated by the owner as comprising a single development, subject to a declaration of land use restrictive covenants or similar recorded written agreement, enforceable against the owner of such development or the property within the development by an agency or instrumentality of the United States, the State of Alabama, or a political subdivision of the State of Alabama, which restricts the rental rates of at least 20% of the residential units in such development or imposes income limits on a portion of the residents.

(2) Requirements for a Composite Return and a Composite Payment.

(a) Effective for taxable years beginning after December 31, 2008, a pass-through entity is required to file a composite return and make composite payments on behalf of its nonresident members if there are one or more nonresident members at any time during the taxable year.

1. Transition Rule. For tax years beginning after December 31, 2008 through December 31, 2009, a pass-through entity may elect, at the time of filing the composite return, to reduce the required composite payment by the amount due on behalf of a nonresident member which makes its required Alabama income tax payments and which files its required Alabama income tax return for the tax year. If a nonresident member fails to make its required Alabama income tax payments or fails to file its Alabama income tax return for the tax year, the pass-through entity shall be liable for the portion of the composite payment due on the non-compliant member's distributive share of the pass-through entity's income. A pass-through entity electing to reduce the composite payment under this transition rule shall indicate "Composite Payment Reduction" in bold lettering, on the front of the tax return.

2. Documentation of any composite payment reduction, elected in accordance with 1 above, must be provided as an attachment to the applicable composite return. The required documentation for each such nonresident member shall include the name, federal tax identification number, distributive share of applicable income items, and any other information needed to reconcile the actual composite payment to the amount otherwise required to be made.

(b) The allocation and apportionment requirements established by the Multistate Tax Compact, codified in Chapter 27, Title 40, Code of Ala. 1975, and all rules pertaining to the Multistate Tax Compact are applicable to composite returns required to be filed by pass-through entities.

(c) In computing the amount of the composite payment, the pass-through entity shall apply the maximum tax rate provided in Section 40-18-5, Code of Ala. 1975, to each nonresident member's distributive share of income, to include both separately stated income and nonseparately stated income (loss). The nonresident member's distributive share of separately stated expenses, deductions, and losses should not be considered in computing the amount of the composite payment. The nonresident member's distributive share of income shall be computed in accordance with Section 40-18-24, Code of Ala. 1975.

(d) Tax-exempt Entities. A pass-through entity is not generally required to remit a composite payment on behalf of a nonresident member that is an entity exempt from Alabama income taxation, in accordance with Section 40-18-32, Code of Ala. 1975. The pass-through entity is required to disclose the tax-exempt entity's name, taxpayer identification number and distributive share of income items on the composite return filed for the taxable year, as is required for all nonresident members. The amount of the composite payment due with respect to the tax-exempt entity would be zero, unless the income is considered unrelated business taxable income in accordance with 26 U.S.C. §512 or the income is otherwise specifically subject to the composite payment requirement of Section 40-18-24.2, Code of Ala. 1975.

1. A tax-exempt entity may be excluded from the composite payment requirement by completion of Form NRC-EXEMPT. Form NRC-EXEMPT must be attached to the entity's return in which the exemption is being claimed.

(e) Certain Affordable Rental Housing Developments. Pass-through entities that are engaged solely in the business of operating one or more affordable rental housing developments are exempt from the composite payment requirements of Section 40-18-24.2, Code of Ala. 1975, if making the composite payment would cause the pass-through entity to be in violation of a Federal or Alabama law, or a regulation, requirement, regulatory agreement or directive concerning the disbursement of funds, issued by the U.S. Department of Housing and Urban Development (HUD) or any other governmental agency having regulatory authority over the development; provided the pass-through entity files and maintains consent agreements signed by each of its nonresident owners, subjecting them to Alabama jurisdiction for income tax purposes, in a manner prescribed by the Department. Pass-through entities that wish to take advantage of this exemption must initially file a complete explanation as to why the exemption applies to the pass-through entity, and must annually certify, in a manner prescribed by the Department, that the exemption continues to apply. If any nonresident member fails to make its required Alabama income tax payments or fails to file its Alabama income tax return for a tax year, the Affordable Rental Housing Development will be liable for the portion of the composite payment due on the non-compliant member’s distributive share of the entity’s income. The Department may then notify the entity that it will no longer be exempt from the composite payment requirements, and if so notified, the Affordable Rental Housing Development must file composite returns and make composite payments for future periods.

(f) In computing the amount of the composite payment, a pass-through entity may not offset the income or gain of a nonresident member with the loss of another member.

(g) In computing the amount of the composite payment, a net operating loss carryforward may not be used to offset income or gain.

(h) Composite returns and composite payments are due on the fifteenth day of the third month following the close of the pass-through entity’s taxable year.

1. The entity is granted an automatic six month extension of time for filing the composite return.

2. An extension of time granted to file the composite return is not an extension of time for payment of the tax. The amount of tax due must be paid on or before the original due date of the return without regard to the extension to file the composite return.

(i) Payment of the tax shall be made in accordance with the payment procedures established by the Alabama Department of Revenue, which requires the use of electronic funds transfer for payments in excess of certain amounts.

(j) Penalties for underpayment of tax and applicable interest will be imposed as provided by Alabama income tax law.

(k) An amended composite return reporting an overpayment of tax or an additional tax due for a taxable year may be filed by the extended due date for filing the Alabama partnership income tax return for the same taxable year.

(l) No refund may be requested by a pass through entity after the extended due date for filing the composite return. Any refund after the extended due date must be requested on the Alabama income tax return of the nonresident member. Any additional composite payment determined to be due after the filing of the initial composite return shall be made by the pass-through entity.

(m) Every pass-through entity that is a member of another pass-through entity and is credited with a composite payment on a composite return must also file a composite return to properly report the composite payment.

(n) An annual composite return is due for a Qualified Investment Partnership (QIP), only if the QIP is required to remit a composite payment for one or more nonresident members.

(o) A publicly traded partnership as defined by 26 U.S.C. §7704(b) doing business in Alabama that is treated as a partnership for federal income tax purposes shall provide the Department with a list of the names of each of its owners or unitholders together with their addresses, taxpayer identification numbers, and each owner or unitholder's distributive share of Alabama source income during the tax year. The information shall be provided in lieu of the composite return in an electronic format that can be sorted and that is approved by the Department. A publicly traded partnership that fails to file a report timely with the Department is presumed to have established reasonable cause for the waiver of the failure to timely file penalty to the extent that the penalty assessed exceeds or would exceed $500 per day of delinquency up to a maximum of $25,000.

(p) Special situations and circumstances such as short years; changes in ownership; and, unforeseen taxpayer-specific complications resulting from the first year of implementing the new composite payment requirements may be addressed on a case-by-case basis. Requests for relief should be submitted to the Department describing the circumstances and type of relief sought on Form PTE-R. All requests for relief on the Form PTE-R must be received at least 30 days before the original filing date for the composite return.

1. Tiered Structure Indirect Owner Exception: A pass through entity may claim a composite payment exemption for an indirect owner (an owner of another pass through entity that is itself an owner of the pass through entity subject to the composite payment requirement) but only with the pre-approval of the Department. To request approval the pass through entity must submit a Form NRC-Exempt executed by the indirect owner along with Form PTE-R and documentation adequate to show the portion of the pass through entity's income flowing through to the indirect owner.

(q) Certain situations may provide additional exemptions from the composite payment without requiring pre-approval.

1. A pass though entity generally subject to the composite payment requirement may claim an exemption for the portion of the composite payment attributable to the following nonresident owners:

(i) Real Estate Investment Trusts that are not captive REITS as defined by Section 40-18-1(5), Code of Ala. 1975, and that has no Alabama sourced income as a result of the dividends paid deduction;

(ii) Nonresidents whose only Alabama sourced income is derived from a capital credit project and the nonresident's capital credit is expected to fully offset any potential tax liability pursuant to Section 810-2-7-.04(4)(f), Code of Ala. 1975.

(iii) Insurance companies that are subject to the Alabama premiums tax and are exempt from income tax as outlined in Section 40-18-32(5), Code of Ala. 1975.

(iv) A C-Corporation that has been in a loss position for the three most recent tax years and expects to be in a loss position for the current year.

2. To claim such exemption, the pass through entity shall include with its return Form NRC-EXEMPT executed by the nonresident owner.

3. Failure to attach form NRC-EXEMPT to the return shall cause the pass through entity to remit payment due as originally required.

4. All other exemption requests must be requested by utilizing Form PTE-R.

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810-3-24.2-.02 Qualified Investment Partnerships.

(1) Definitions.

(a) Qualified Investment Partnership (QIP). A partnership or other entity classified as a subchapter K entity, or a business trust as defined in §40-18-1, Code of Alabama 1975, that for a tax period which begins on or after January 1, 2009, meets the gross income and asset tests for a Qualified Investment Partnership as prescribed by §40-18-24.2, Code of Ala. 1975; and, for which an authorized officer, partner, member or manager of the entity has certified for the tax period that the entity meets the gross income and asset tests. The proper form of the QIP certification and the due date for filing the certification are explained in this regulation.

1. The following restrictions apply concerning entities eligible to be a QIP:

(i) There is a rebuttable presumption that an entity is disqualified as a QIP as abusive when fifty percent (50%) or more of the ownership interest or voting interest of an entity is owned or controlled, directly or indirectly, by a corporation, as defined in §40-18-1, Code of Ala. 1975, or a controlled group of corporations, as defined in 26 U.S.C. §1563, at any time during the tax period. For purposes of this definition, own or control means to own or control directly, indirectly, beneficially, or constructively fifty percent (50%) or more of the voting power or value of an entity. The Department will review written applications or requests to the Commissioner that this presumption not be applied to a particular entity's situation on a case-by-case basis. If the entity establishes that the distributive shares of the income attributed to and owned by the corporate partner are being reported to Alabama for income tax purposes by each of the owners having such interests, the presumption of abuse in this section will have been rebutted.

(ii) An entity that is classified as a dealer in qualifying investment security at any time during a tax period, shall not qualify as a QIP for that tax period. An entity is a dealer in qualifying investment securities if it regularly purchases qualifying investment securities from or sells qualifying investment securities to customers in the ordinary course of a trade or business or regularly offers to enter into, assume, offset, assign or otherwise terminate positions in qualifying investment securities with customers in the ordinary course of a trade or business. The definition provided in 26 U.S.C. §475(c) can also be relied upon to determine if an entity shall be classified as a dealer in qualifying investment securities.

(iii) An entity that is a publicly-traded partnership that is taxed as a corporation for Alabama income tax purposes at any time during the tax period cannot be a QIP for that tax period.

(iv) A common trust fund, as defined in 26 U.S.C. §584, cannot be a QIP.

(v) An unincorporated entity that has elected out of the provisions of Subchapter K in accordance with 26 U.S.C. §761, at any time during a tax period, cannot be a QIP for that tax period.

(vi) Any entity meeting the definition of a Financial Institution under Section 40-16-1, Code of Ala. 1975, cannot be a QIP.

(b) Qualifying Investment Securities (QIS). Financial investments as defined by §40-18-24.2, Code of Ala. 1975, that must be owned by an entity; and must make up a specified percentage of the entity's total assets; in order for the entity to qualify as a QIP, in accordance with §40-18-24.2, Code of Ala. 1975.

1. The term "qualifying investment securities" does not include:

(i) An investment in a captive REIT, as defined by §40-18-1, Code of Ala. 1975.

(ii) An interest in a partnership unless the partnership is a Qualified Investment Partnership, as defined in §40-18-24.2, Code of Ala. 1975.

(iii) Loans that are not debt securities.

(iv) Deposits with a bank or other financial institution that is not regulated by the United States government, a state, a governmental agency or by any political subdivision thereof.

(c) Tax Period. Same definition as "taxable year" as defined in §40-18-1.

(2) QIP Requirements.

(a) All of the following requirements must be met for a tax period in order for an entity to qualify as a QIP for the tax period:

1. Asset Test. No less than 90% of the cost of the total assets owned by the entity consists of qualifying assets: qualifying investment securities (QIS); office facilities; and, tangible personal property reasonably necessary to carry on the activities of the entity as an investment partnership in the State of Alabama.

2. Gross Income Test. No less than 90% of the gross income of the entity consists of qualifying gross income: interest; dividends; distributions; management fees paid by owners of the entity; and gains or losses

from the sale or exchange of qualifying investment securities (QIS).

3. Certification. An authorized officer, partner, member, or manager of the entity certifies that for the tax period the entity meets the Asset Test and the Gross Income Test, in the proper form and by the time specified in this regulation. The certification must be filed as part of the annual Alabama partnership income tax return for the entity, on Alabama Schedule QIP-C, by the due date (including extensions) of the Alabama partnership income tax return for the entity. Filing a certification with a composite return for an entity is not a proper filing of the QIP certification.

(i) If the QIP holds an investment in another Subchapter K entity or business trust which is not subject to tax by the State of Alabama, but which qualifies as a QIP under both the Asset Test and the Gross Income Test, the annual certification as to its qualification as a QIP may instead be filed by an authorized officer, partner, member or manager of the QIP, in a manner prescribed by the Department.

(b) Required QIP Filings.

1. A QIP must file an annual Alabama partnership income tax return, properly reporting the required Schedule K-1 information for each resident member and each nonresident member, that held an interest in the QIP, at any time during the tax period.

2. A QIP must file an annual composite income tax return, as required by §40-18-24.2, Code of Ala. 1975, if the QIP is required to make a composite payment for one or more nonresident members.

(c) Application of the Asset Test.

1. For purposes of applying the Asset Test, the cost of an asset will generally be the entity's basis, computed in accordance with Alabama income tax law (See §§40-18-24 and 40-18-6, Code of Ala. 1975). For office facilities, other tangible personal property, any assets subject to amortization and any assets subject to depletion; the cost to be used will be the entity's basis before any reductions for depreciation, amortization or depletion. The cost of qualifying investment securities shall include any accrued interest or discount and shall be reduced by any premium amortization, that has been recognized in the computation of Alabama taxable income of the entity and

that is included on the entity's balance sheet as of the date the asset's cost was determined.

2. The Asset Test is applied for each tax period, and is computed using the ratio of the entity's cost of its qualifying assets to the entity's cost of its total assets, expressed as a percentage; as of the beginning of the tax period and as of the end of the tax period. The average of the percentages is then computed. The average is referred to as the Average Qualifying Asset Percentage for the Tax Period.

(d) Application of the Gross Income Test.

1. The Gross Income Test is applied for each tax period, and is computed using the ratio of the entity's qualifying gross income to its total gross income, expressed as a percentage. The ratio is referred to as the Qualifying Gross Income Percentage.

2. Calculations for the Gross Income Test are to be based on information from the Alabama partnership income tax return filed by the entity for the tax period.

3. Gross income means income minus costs of sales or basis in an asset sold or traded, but without reduction for any other expenses or deductions.

4. Gross income does not include any item of income that is excluded in computing the Alabama taxable income of the entity.

5. The Gross Income Test is calculated using the method of accounting used for Alabama income tax purposes for the tax

6. Gross income derived from an investment in a qualifying investment partnership, subchapter S corporation, trust or estate shall be characterized as if the entity received the income directly.

7. Gross income derived from a qualifying investment partnership, subchapter S corporation, trust or estate for purposes of the Gross Income Test shall be reduced by related expenses and computed in accordance with Alabama income tax law.

Author: Dennice Hillard
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810-3-24.2-.03 Other Qualified Investment Partnership Matters.

(1) Every nonresident member of a Qualified Investment Partnership (QIP) that has Alabama source income must file an Alabama income tax return and report the Alabama source income even if the income earned in Alabama is included on a composite return filed by the QIP, unless the member is a nonresident individual who has no other Alabama source income. For a nonresident individual to claim the benefit of any net operating losses generated by a QIP, the nonresident individual must establish those losses by filing an Alabama individual income tax return.

(2) The QIP Alabama income tax reporting requirements do not change the Alabama income tax return filing requirements for business entities.

(3) In accordance with §40-18-24.3, Code of Ala. 1975, a nonresident member of a QIP will be exempt from Alabama income tax on its distributive share of QIP income unless the nonresident member actively participates in the day-to-day management of the QIP or the QIP invests in the qualifying investment securities of an entity that is majority owned by the nonresident member.

(a) The term "majority owned" is defined in §40-18-24.3, Code of Ala. 1975, and includes the attribution rules of 26 U.S.C. §318.

(b) Income from a QIP is taxable to a nonresident member of the QIP if the income is from investment activity that is interrelated with an Alabama trade or business in which the nonresident member owns an interest even if the primary activities of the trade or business are separate and distinct from the acts of acquiring, managing, or disposing of qualified investment securities.

(c) Income from a QIP is taxable to a nonresident member of the QIP if any part of the qualifying investment securities of the QIP are acquired with the working capital of an Alabama trade or business in which the nonresident member owns an interest.

(d) A financial institution, as defined in §40-16-1, Code of Ala. 1975, if a nonresident member of a QIP, is taxed on its distributive share of income from the QIP if it participates in the management of the investment activities of the QIP; if it is engaged in a unitary business with another taxpayer that participates in managing the investment activities of the QIP; or, if the financial institution has income from Alabama sources.

(e) A corporation, as defined in §40-18-1, Code of Ala. 1975, if a nonresident member of a QIP, is taxed on its distributive share of income from a QIP if it participates in the management of the investment activities of the QIP; if it is engaged in a unitary business with another taxpayer that participates in managing the investment activities of the QIP; or, if the corporation has income from Alabama sources.

(4) The allocation and apportionment requirements set out in the Multistate Tax Compact, codified in Chapter 27, Title 40, Code of Ala. 1975, and all rules pertaining to such laws are applicable to Alabama income tax returns and composite returns required to be filed by pass-through entities, including those required to be filed by Qualified Investment Partnerships.

(5) Business Trust. The term "business trust" is defined in §40-18-1, Code of Ala. 1975.

(a) For federal income tax purposes, a business trust is classified as a business entity, not as a business trust. A business trust may only be classified as a disregarded entity, a partnership, or a corporation.

1. A business trust that has made a federal election to be treated as a corporation, at any time during the tax period, cannot qualify as a QIP for the tax period.

2. A business trust that is treated as a disregarded entity for federal income tax purposes, at any time during the tax period, cannot qualify as a QIP for the tax period.

3. A business trust that is treated as a partnership for federal income tax purposes can qualify as a QIP, if the entity satisfies the requirements of Section 40-18-24.2, Code of Ala. 1975, and the rules promulgated thereunder.

(6) In order to correct the effect and result of a tax-avoidance or a tax abusive arrangement, or series of transactions, the Commissioner of Revenue shall have the authority to distribute, apportion, or allocate the gross income of any pass-through entity, QIP, or pass-through entity member in order to clearly, fairly, and equitably reflect the income of any entity, pass-through entity, QIP, or QIP member, whose income may have been significantly distorted by the application of the tax-avoidance or tax abusive arrangement, or series of transactions. The Commissioner of Revenue may recast QIP transactions if it is determined the transactions do not have a substantial business purpose or it is determined that the form of the transactions yield results that have the substance of tax-avoidance or tax abuse.

(7) The Commissioner of Revenue may revoke an entity's QIP status for one or more tax periods if it is determined that the entity did not meet the QIP requirements for that or those tax periods.

Author: Ed Cutter, CPA, Ann Winborne, CPA
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