RECENT ALABAMA TAX DEVELOPMENTS: LEGISLATIVE, JUDICIAL, AND ADMINISTRATIVE

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I. INCOME/BUSINESS PRIVILEGE TAXES

A. LEGISLATIVE DEVELOPMENTS

Extension of Jobs Act Incentives to December 31, 2020 – Act 2017-314 (H.B. 574): This act extended the sunset date of the Jobs Act incentives (investment credit and jobs credit) from December 31, 2019 to December 31, 2020, unless further extended by the Legislature. The act also revised the cap on the outstanding balance of these incentives to $300 million on an annual basis (as opposed to an aggregate limit). Finally, the act further provides that the Jobs Act incentives will only be available if at least 80% of the new jobs created by the project are full-time.

Reinstatement of Alabama Historic Tax Credit ("HTC") – Act 2017-380 (H.B. 345): This act reinstates Alabama's HTC program by authorizing $20 million in refundable income tax credits per year for five years, beginning January 1, 2018. Like the original program, this act provides a tax credit of up to 25 percent of qualified rehabilitation expenditures for certain historic commercial or residential structures and retains many other aspects of the original program (such as the per project caps of $5 million for commercial and $50,000 for residential projects).

The tax credits available under the act must be claimed in the year in which the rehabilitation is placed in service. Unlike the original program, the tax credits are now refundable if the amount of the credit certified by the Alabama Historical Commission (the "Commission") exceeds the owner's state income tax liability. Unlike the original program, credits under the New Act cannot be used by banks against the Financial Institutions Excise Tax. However, the refundable structure may create the need and opportunity for bridge lending to project owners by banks, especially in light of the minimum pricing requirements if the credits are transferred. While the one-time transferability feature remains, the act requires credits to be sold for at least

 Note that the authors and other members of the Firm were involved in drafting or reviewing many of the bills, and serve as counsel to the taxpayer in several of the cases, discussed herein.

$.85 per dollar of credit and prohibits the allocation of credits by a pass-through entity to its owners. Thus for a project owned by a pass-through entity, which is very common and needed in most instances for federal tax purposes, the credit and likely refund will have to be claimed on the entity's Alabama income tax return. In many instances, this will require the owner entity to obtain a bridge loan to finance rehabilitation costs until the refund is received from the Alabama Department of Revenue. In addition, most historic properties must now be at least 60 years old (as opposed to 50 years for federal purposes) to qualify for the credit (unless located within the boundaries of a national monument or park).

The act also changes the manner in which projects can receive an allocation of credit by establishing a nine-member evaluating committee, four of whom are legislators, to review qualifying projects and rank the application based on criteria to be established by the Commission. Another noteworthy change to the reservation process is that 40 percent of the available credits each year are initially set aside for projects in non-metropolitan counties (less than 175,000 in population), but after six months can be awarded to other qualifying projects. The Commission recently finalized regulations implementing the new program and will begin accepting applications on November 1, 2017. The application must contain both Parts A and B to be considered complete.

Finally, the Department recently proposed new rules to implement the program and clarified that the existing rules only apply to the original program. The proposed rules essentially mimic the old rules, the one exception is that changes were made to implement the refundability feature of the new program. A public hearing is scheduled for November 14, 2017.

Increased Standard Deduction – Act 2017-405 (H.B. 346): This bill would create a new tax return form, Form 40EZ, through which certain Alabama filers would be able to voluntarily claim a greater standard deduction against Alabama income tax in exchange for foregoing deductions and credits based on federal taxes paid, including the federal income tax deduction, as currently provided in Ala. Code §40-18-15. To qualify for the optional increased deduction, an Alabama resident must have less than $100,000 in Alabama gross income, with none of the income accruing from non-wage sources. Also, the option is only available to filers claiming no deductions or expenses based on dependents, nor claiming itemized deductions. The increased standard deduction for single filers would be at minimum $2,250, with a minimum standard deduction for married taxpayers filing jointly of $4,500. In each case, the personal exemption as provided in Ala. Code §40-18-19 is preserved

Apportionment Formula for Financial Institution Excise Tax - Act 2017-165 (H.B. 263): This act reinstates the inclusion of loans and credit card receivables in calculating the property factor for the financial institution excise tax, which would not have been included under the proposed Department rule that takes effect later this year. However, this bill simplifies the sourcing of such loans by adopting the same sourcing methods as used to allocate and apportion the interest receipts from loans and credit card receivables to the state. Governor Ivey signed the bill into law on April 20, 2017. The act is retroactively applicable for all tax years beginning on or after January 1, 2017. The Department recently proposed amendments to the FIET apportionment rule to incorporate the changes required by this Act. A public hearing on the proposed rule was held on October 10, 2017 and a few technical corrections are expected to be made before the rule is finalized.

Expanded Agricultural Irrigation Systems Tax Credit – Act 2017-66 (S.B. 257): For tax years beginning after December 31, 2017 and through December 31, 2022, this act increases the income tax credit for the cost of the purchase and installation related to irrigation systems or the development of irrigation reservoirs and water wells, as well as certain conversion costs, to the greater of 20% of the qualifying costs not to exceed $10,000 or 10% of the qualifying costs not to exceed $50,000, whichever is greater. The increased cap of $50,000 will sunset on December 31, 2022 unless extended by the Legislature.

B. JUDICIAL DEVELOPMENTS

Alabama Department of Revenue v. Coca-Cola Refreshments U.S.A., Inc., Case No. 2160412 (Ala. Civ. App. Sept. 8, 2017): The Alabama Court of Civil Appeals affirmed the circuit court's (and special master's) ruling in favor of the taxpayer, and thus the long-running saga regarding the application of the Alabama separate return limitation year ("SRLY") rule to the first year in which the Alabama affiliated group ("AAG") elects to file consolidated is finally resolved. The Court of Civil Appeals held that "[i]t is counterintuitive to think that the legislature intended to assess a fee to grant AAGs 'the privilege of filing an Alabama consolidated return' but then not allow them to have the benefits of making such an election. Here, each member of the AAG had been part of the AAG since at least 1999. Therefore, we conclude that the [Alabama SRLY rule] did not bar the other members of the AAG from deducting CCE's [net operating losses ("NOLs")] from the years 1999 through 2002 and 2004 from the group's income on its 2007 Alabama consolidated return."

CCE initially appealed its denied refund to the Administrative Law Division (now known as the Alabama Tax Tribunal ("ATT")), and Judge Thompson held that an Alabama consolidated group was entitled to carryforward separate company NOLs incurred before the group's election to file an Alabama consolidated return. However, Judge Thompson also held that the group could not deduct any NOLs incurred before 1999 based on Alabama's SRLY rule. Importantly, Judge Thompson partially overruled his prior decision in *Weyerhaeuser USA Subsidiaries v. Alabama Department of Revenue*, Admin. L. Div., Dkt. No. CORP. 04-511 (Mar. 11, 2005), concluding that an "Alabama affiliated group" could not exist before the term was defined by the original consolidated filing statute in 1999.

The ADOR filed an application for rehearing with Judge Thompson, arguing that the Taxpayer's pre-2007 NOLs were subject to the Ala. Code § 40-18-39(h) limitation (the "Alabama SRLY rule") because the group did not elect to file an Alabama consolidated return until 2007. Specifically, the definition of an "Alabama affiliated group" provides several requirements, including that each member "[c]ombines and reports taxable income or loss … on a single return for the Alabama affiliated group." Ala. Code § 40-18-39(b)(1)f. Citing this requirement, the ADOR argued that the filing of an Alabama consolidated return is a prerequisite to the existence of an Alabama affiliated group. Because the Taxpayer did not file an Alabama consolidated return until 2007, the ADOR contended that the Taxpayer's pre-2007 separate company NOLs were not incurred while it was a member of an Alabama affiliated group, and were thus limited by the Alabama SRLY rule.

The Administrative Law Division rejected the ADOR's argument: "[b]y itself, §40-18-39(b)(1)f. can arguably be construed as supporting the ADOR's position. But various other provisions in §40-18-39, when read together, show that the actual filing of an Alabama consolidated return is not a prerequisite to the existence of an Alabama affiliated group." Judge Thompson also noted that Alabama's provision that allows an affiliated group the option to elect a consolidated return was consistent with the federal consolidated return regime. *See* I.R.C. § 1501 (providing that "[a]n affiliated group of corporations shall . . . have the privilege of making a consolidated return . . . in lieu of separate returns").

Judge Thompson held that "[t]he purpose for the SRLY rule limitation is to prevent an affiliated group of corporations from purchasing another corporation that has amassed large NOLs in prior years, and then using those NOLs to offset the income of the other group members in subsequent years. That is, the SRLY rules prevent an affiliated group from 'buying' tax losses by limiting an acquired corporation's pre-acquisition NOLs to only offset the current year and future income of the acquired corporation. The SRLY rules do not apply, however, to NOLs incurred by a corporation that filed separate returns in the loss years but was also a member of the same affiliated group during the loss years … Allowing the affiliated group to deduct the NOLs incurred by the Taxpayer since 1999 is clearly authorized under Alabama law."

Both parties filed notices of appeal with the Montgomery County Circuit Court. A special master was appointed and issued Findings and Conclusions on February 17, 2016, essentially affirming Judge Thompson's opinion that granted CCE a partial refund. While the Alabama Department of Revenue ("ADOR" or "Department") filed objections to the special master's recommendation, the Judge Truman Hobbs recently entered a final order adopting the special master's recommended decision and ordering the Department to recalculate the Taxpayer's refund claim. The Department appealed to the Alabama Court of Civil Appeals, which affirmed the circuit court; the Department elected not to seek certiorari review so the ruling is at long last final.

Chadhary v. Alabama Department of Revenue, Ala. Tax Trib. Dkt. No. INC. 16-349 (Mar. 28, 2017): The ATT affirmed an assessment of income tax against husband and wife taxpayers working overseas after determining that the couple had remained domiciled in Alabama for the tax year at issue. The taxpayers left their home in Alabama in 2012 to go live and work in Pakistan. In their pleadings, however, the couple admitted their intent to return to Alabama when their work was completed. Consequently, the ATT ruled that the taxpayers failed to establish Pakistan as their new domicile because they did not intended to remain there permanently—or at least indefinitely.

Best Deal Manufactured Homes, Inc. v. Alabama Department of Revenue, Ala. Tax Trib. Dkt. No. BPT. 17-479-CE (Aug. 3, 2017): The ATT upheld the Department of Revenue's assessment of BPT against a taxpayer who failed to properly dissolve its formation or forfeit its qualification to do business in the state. The taxpayer argued that the business had ceased to exist three years prior and no business was conducted within the state for the specific tax year at issue, and thus the ADOR's BPT assessment was improper. The ATT, however, rejected this argument and noted that its predecessor, the Administrative Law Division, had previously upheld an assessment of BPT against a corporation that had discontinued business but failed to withdraw its qualification to do business. Relying on this established precedent, the ATT affirmed the ADOR's assessment because the BPT is on the *privilege* of doing business in Alabama, and whether a taxpayer actually conducts business or not is irrelevant.

AmerisBank v. Alabama Department of Revenue, Ala. Tax Trib. Dkt. No. Bit. 16-255 (Feb. 9, 2017): The ATT determined that dividends received by a bank from a real estate investment trust subsidiary ("REIT") were deductible for purposes of Alabama's financial institution excise tax. The bank formed a controlled subsidiary ("Southland") incorporated under Alabama law and elected to qualify the subsidiary as a REIT, and thus argued that any dividends received by the bank were deductible pursuant to the dividends received deduction ("DRD") afforded by Section 40-16-1(2)(g) of the Code of Alabama 1975, which applies to the "amount received as dividends from a corporation organized and existing under the laws of the State of Alabama."

The Department challenged the taxpayer's claim that the REIT for the years in question was a "corporation" for Alabama tax purposes. The ADOR's principle argument was that the REIT could not simultaneously exist as both a REIT and a corporation, even though the governing authority for Alabama REITs at the time the corporation was formed recognized that REITs could be organized as "corporations" by incorporating the language of Section 856(a) of the Internal Revenue Code. Judge Thompson disagreed, holding that "the [dividends received] deduction applies if the entity that pays the dividends, Southland in this case, is a corporation organized and existing under Alabama law … The fact that Southland elected to operate and be taxed as a REIT for federal and Alabama income tax purposes is irrelevant."

The Department also argued that the intent of the Alabama Legislature in enacting the statutory provision was not to treat REITs as corporations for tax purposes, due to the opportunity for any income earned by a REIT and subsequently paid as a dividend to an entity subject to Alabama's FIET to wholly escape taxation. The REIT in this case filed Alabama corporate income tax returns (as instructed by the Alabama REIT Act), and properly deducted the dividends it paid to the bank in computing its Alabama corporate taxable income each year. Judge Thompson soundly rejected this argument as well, holding that "the Legislature could have amended the [DRD] so as to exclude from the deduction dividends paid by corporate REITs organized and existing under Alabama law. The Legislature elected not to, and the Department is now asking the Tribunal to so amend the statute by judicial fiat. It is the role the Alabama Legislature to amend a statute, not the courts." Notably the 2008 amendment to Alabama's add-back statute to target captive REITs specifically exclude a REIT that is controlled by a financial institution. The Department did not appeal.

Sherwin-Williams Co. v. Alabama Department of Revenue, Ala. Tax Trib. Dkt. No. BIT 13-359 (November 30, 2016): Relying on an earlier decision by its predecessor Administrative Law Division, the ATT rejected the taxpayer's argument that its Section 199 deduction must include any Alabama-specific additions or deletions from taxable income; rather the Tribunal held that may only compute its Section 199 deduction based on its pro forma federal separate company taxable income. In *GKN Westland Aerospace, Inc. v. Alabama*, Admin. Law Div., Dkt. No. BIT 10-988 (July 25, 2011), the Administrative Law Division rejected the Department' argument that the federal consolidated group's net operating loss prevented the Alabama taxpayer from claiming a Section 199 deduction when the taxpayer had taxable income on a separate company basis. While not in effect during the years at issue in *GKN*, the Tribunal held that Department Rule 810-3-1-.01 was consistent with this holding and required federal consolidated return limitations to be applied on a separate company basis. It did not, however, hold in *GKN* that the Section 199 deduction should be calculated based on any Alabama-specific addition or deductions from federal taxable income; rather, the Section 199 deduction is purely a function of Alabama's adoption of federal taxable income as the starting point for corporate income tax purposes.

Moody v. Alabama Department of Revenue, Ala. Tax Tribunal Dkt. No. Inc. 15-797 (Final Order on Rehearing Feb. 24, 2017): Readers may recall that Alabama Act 2012-427 permitted Alabama residents that owned interests in multistate pass-through entities (*e.g.*, LLCs, partnerships, and S corporations) to claim a credit against their Alabama income tax liability for certain taxes paid by the entity to other states. This claim could be either on behalf of the nonresident owners as an income tax withholding or as a composite return filing obligation, or for certain entity-level taxes levied on the pass-through entity itself (*e.g.*, Texas' margin tax and Tennessee's excise tax). The Act did not impose any additional restrictions on the calculation of the credit for taxes paid to other states.

However, shortly after the passage of Act 2012-427, the ADOR changed the credit calculation on Form CR and promulgated a regulation, Rule 810-3-21-.03, effective January 1, 2013, which imposed new restrictions on the credit. Specifically, the Rule requires the allowable credit for taxes paid to other states on non-Alabama income to be calculated by multiplying the tax paid to other states by a fraction: total non-Alabama AGI divided by total Alabama AGI (the "percentage limitation"). This new credit computation effectively limited the amount of credit available based on Alabama's effective tax rate (*i.e.*, the rate *after* a taxpayer claims his or her federal income tax deduction). By limiting the amount of the credit available for taxes paid in other states, many Alabama residents were unable to receive the full benefit of their FIT deduction.

Chief Tax Tribunal Judge Bill Thompson concluded that the formula limitation imposed by Rule 810-3-21-.03 exceeded the scope of the statute on which it was purportedly based, Ala. Code § 40-18-21. In this case, the husband-wife taxpayers appealed a final assessment issued by the ADOR on income earned in the state of Mississippi. The taxpayers reported only $2,065,702 in Alabama adjusted gross income (AGI) for the 2013 taxable year, while reporting $601,536 in non-Alabama AGI for the same tax year. They claimed a credit for 2013 Mississippi income tax paid in the amount of $29,439. Upon review, the ADOR reduced the allowable credit to $18,145, based on the percentage limitation in Rule 810-3-21-.03.

Judge Thompson explained that Ala. Code § 40-18-21 plainly provides that a tax credit is allowed for income tax paid by an Alabama resident to another state, but in an amount equal to the lesser of the actual tax paid or the amount of tax that would be due to the state of Alabama on an equivalent amount of income, applying Alabama tax rates. Judge Thompson found that the additional percentage limitation imposed by Rule 810-3-21-.03 unlawfully reduced the credit and resulted in double taxation of a portion of the taxpayers' non-Alabama source income. Thus, the final assessment was voided. The Department appealed to Circuit Court, but then subsequently dismissed the appeal. A second "test" case is currently pending before the ATT.

Wilson Investment Co., LLC v. Alabama Department of Revenue, Ala. Tax Trib. Dkt. No. BPT. 16-541 (June 16, 2017): The ATT issued a ruling focusing on the requisite qualifications for Family Limited Liability Entity treatment. In *Wilson*, the taxpayer timely filed its 2009, 2012, and 2014 Alabama BPT returns making the Family LLE election and dutifully reporting $500 of tax for each year. The taxpayer's election form stated that it was directly or constructively owned by an individual and her four children, and therefore met the statutory requirements. The ADOR, however, contended that the taxpayer did not qualify for Family LLE treatment because it was solely owned by the individual, after applying constructive ownership/attribution rules.

On appeal, the ATT held that the taxpayer did, in fact, qualify for Family LLE status in the 2009 tax year, but not for either the 2012 or 2014 tax year. Associate Judge Christy Edwards first noted that under Ala. Code § 40-14A-1(h), an entity doesn't qualify for the Family LLE election unless at least 80 percent of its profits and capital interests are directly or constructively owned by an individual and one or more members of that individual's "family." Judge Edwards found that for the 2009 tax year, the taxpayer was owned by an individual and her four children, and thus the entity qualified as a Family LLE.

Not so for the 2012 and 2014 tax years. In those years, 1 percent of the LLC was instead owned by a marital trust established for the benefit of the individual and 99 percent by an irrevocable grantor trust also "owned" by the individual. Applying the ownership attribution rules of IRC § 318(a), the ATT agreed with the ADOR that the taxpayer was owned entirely by the individual. The ATT also rejected the taxpayer's alternative argument that the applicable law should be interpreted as allowing an entity to qualify for Family LLE status so long as one individual owned at least 80 percent of the entity. According to the ATT, that contention didn't comport with the plain language of the statute (individual and family members) or the generally understood rules of statutory construction.

Harris Investments, LTD v. Alabama Department of Revenue, Ala. Tax Trib. Dkt. No. BPT. 17-712-CE (Sept. 26, 2017): The ATT recently issued a second ruling focusing on the procedures that entities and their return preparers must follow to properly make the Family LLE election. In that case, the taxpayer-limited partnership timely filed its 2016 Alabama BPT return, claiming the Family LLE election and paying tax in the amount of $500. The taxpayer, however, failed to check the box on line 17 of its BPT return labeled "Family LLE Election attached." The ADOR also argued that the taxpayer's CPA didn't attach the required Family LLE election form, Form BPT-E, either.

On appeal, the taxpayer didn't dispute that the Family LLE election box on line 17 was not checked. Instead, the taxpayer argued that the ADOR should grant an abatement of tax because the LP had elected treatment as a Family LLE for numerous years prior to 2016, and this was the first time the taxpayer had failed to check the box. The taxpayer also contended that the

Family LLE election was properly claimed because the CPA had attached the Form BPT-E to its original 2016 return, and had resubmitted a copy of the election form after the ADOR claimed it had not been attached when received.

The ATT, however, did not find the taxpayer's arguments convincing. The ATT began its analysis by stating that the taxpayer failed to offer any evidence that a BPT-E election form was included with the original return, as required by ADOR Rule 810-2-8-.05. Pointing to the regulation, the judge explained that to be considered an electing Family LLE, a completed Form BPT-E must be attached to the subject year's original return, which must be filed on or before the return date. Relying on its own precedent in B&B Enterprises, LLC v. ADOR, Ala., Dkt. No. BPT. 14-439 (Jan. 30, 2015), the ATT concluded that although the consequences may sometimes be harsh, failing to make the Family LLE election precisely in accordance with the manner prescribed by the regulation results in the loss of Family LLE status. The ATT affirmed the ADOR's assessment of the additional BPT tax.

Woods v. Alabama Department of Revenue, Ala. Tax Trib. Dkt. No. INC. 16-1079 (Apr. 18, 2017): Noting that a metropolitan statistical area is simply a creation of the federal government, the ATT held that this area is not relevant for purposes of determining if an Alabama resident physician is entitled to the annual rural physician tax credit. The tax credit at issue involved a taxpayer residing in Elberta in Baldwin County but practicing medicine in Foley. The ADOR disallowed the rural physician tax credit because it determined that the taxpayer resided in the Daphne-Fairhope-Foley Metropolitan Statistical area, and therefore did not reside in a small or rural community. The ATT, however, rejected the ADOR's argument, finding that for purposes of the credit, a small or rural community is determined as a community that has less than 25,000 residents according to the latest census. Noting that the most recent census indicated Elberta contained a population of less than 1,500 residents, the Tax Tribunal stated that the taxpayer qualified for the credit.

C. ADMINISTRATIVE DEVELOPMENTS

Alabama Actively Participating in MTC Transfer Pricing Efforts: Deputy Commissioner Joe Garrett chairs the MTC's State Intercompany Transactions Advisory Services (SITAS), formerly called the Arm's Length Adjustment Services (ALAS). At the annual meeting last August, Garrett remarked that the Committee's early work exploring economic expertise is now paying off because several states have since entered agreements with vendors. In addition, Garrett added that the MTC held an initial exploratory meeting with IRS officials last February on how the agency and states might collaborate on future transfer pricing issues. State officials were particular interested in IRS training materials and other resources that would be helpful to the states. Alabama is one of the five charter members that has committed financially to SITAS.

Changes to Corporate Income Apportionment Rules: The ADOR finalized numerous changes to its apportionment rules for corporate income taxpayers, with the stated intention of adopting "recommended amendments to the … MTC Rules approved by the MTC Executive Committee." Ala. Admin. Code r. 810-27-1 et seq., effective June 25, 2016. After the initial hearing in February, the ADOR proposed a few additional changes to the Section 18 so-called "special" apportionment rules. One proposed change, requested by the Council On State Taxation (COST) and our firm, was to clarify that taxpayers may "file a valid refund petition when seeking an alternative allocation or apportionment method for a tax year with less than 91 days left in the statute of limitations period for refund." This clarification ensures that the initial review process by the ADOR's Secretary of a taxpayer's request for alternative apportionment won't shorten the time period in which the taxpayer may petition for a refund based on that request.

The stated purpose for the other changes to the Section 18 rule was to "move special [industry] rules for allocation and apportionment into separate rules in order to make the information more readily available to taxpayers." Under the proposed rule, the seven special industry rules – construction, railroads, airlines; trucking, TV and radio broadcasting, publishing, and telecommunications and ancillary services – will now each be separate rules under the Section 18 rule. Finally, the proposed Section 18 rule also provides that the special industry rules will be applied by the ADOR for purposes of applying Alabama's factor presence nexus statute.

Amendments to Nonresident Partner Composite Return Rule: Effective March 4, 2017, the Department amended its composite return Rule 810-3-24.2-.01 for Subchapter K entities (i.e., partnerships and multi-member LLCs) with nonresident partners/members. In general, the amendments allow a composite return filer to exclude from the return those partners/members that are: tax-exempt entities; affordable housing development partnerships; real estate investment trusts/corporations that are not "captive REITs" and have no Alabama source income after applying their dividends paid deduction; nonresidents whose only Alabama source income arises from a "capital credit project" and their share of the capital credit is expected to fully offset their potential Alabama income tax liability; insurance companies subject to the Alabama insurance premium tax; and any 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."

Alabama Conformity with Federal Return Filing Deadlines for Estates and Trusts: The Department has issued Prop. Ala. Admin. Code r. 810-3-25-.07 to align the due date for filing a state fiduciary income tax return (Alabama Form 41) with an estate or trust's federal filing due date. If an estate or trust filing a return with the state is not required to file a federal return for the same year, the state return would be due on the date the entity would have been required to file a federal return, if filing had been required.

Automatic Extension for Alabama S-Corporation Tax Return Filing: Prop. Ala. Admin. Code r. 810-3-174-.02 would provide for an automatic extension for Alabama S corporations subject to any built-in gains tax. The extension would be for six months from the original due date. Any tax liability would remain due upon the original filing due date, notwithstanding any extension. The proposed rule would provide for an identical filing extension for S corporations with liability under the passive investment income tax.

Ala. Rev. Rul. 2017-001 (June 1, 2017) – Carryforward of Investment Credits: One of the new features of the Jobs Act credits is that if the project does not have an income tax liability during or otherwise need the credit during the first three years, the investment credit may be transferred to an investor for cash. The Department concluded that a purchaser of such credits is entitled to carryforward any credits that it cannot use from a qualifying project for the same time period that the project could have carried the credits forward (which is set in the specific project agreement with the State).

Ala. Rev. Proc. 2017-01 (Aug. 3, 2017) – Credits Against Estimated Taxes: Since the landmark Alabama Accountability Act was enacted in 2013, allowing individual and corporate donors to provide scholarship funds for underprivileged children in our state who are zoned for underperforming public schools, there has been some confusion regarding how those donations interact with the estimated tax penalty rules. Many donors and their tax advisers interpreted the Alabama Department of Revenue's position to mean that they could only donate money to a qualified scholarship granting organization (SGO) in the fourth quarter of the year if they wanted to avoid the risk of estimated tax penalties.

This revenue procedure was issued at the request of the Alabama Opportunity Scholarship Fund (AOSF) and provides a safe harbor that allows donors to minimize the risk of quarterly estimated tax penalties. The Revenue Procedure confirms that no penalty will be assessed if the amount of estimated tax payments made to the ADOR by the quarterly due date, *plus the amount of creditable donations made to SGOs during that quarter*, exceed the total amount of estimated tax payments otherwise required to be made for that quarter.

General Fund Revenue Increased by $34 Million in 2017: At the end of the 2017 fiscal year, the state's General Fund budget ended with roughly $34 million more in revenue than expected. This is positive news for state legislators who are looking at some sizable new expenses in 2018, and a substantial hole to fill in 2019 as well. This spring, legislators were able to carry forward more than $90 million from the 2017 budget through 2018 and into 2019, in large part, with the help of the state's BP oil spill settlement. According to the Legislative Fiscal Office, an additional $34 million in increased revenues in the General Fund have boosted that expected carryover to approximately $128 million. This unexpected increase is extremely important, however, because when lawmakers return to Montgomery in January, they may be forced to find new funding for both in-state children on Medicaid and improvements to the state's system for treating mentally ill prisoners. Lawmakers were already looking at a fiscal hole before these new expenses emerged, and the 2018 budget year has $105 million in one-time BP money for Medicaid that will not be available in 2019.

D. LIKELY TRENDS/OUTLOOK FOR 2018: Legislative Proposals – Spring 2018 Regular Session

S.B. 67 – Mandatory Unitary Combined Reporting (MUCR): This perennial bill would repeal portions of the Alabama corporate income tax code that permit separate entity reporting and consolidated tax returns and required all corporate groups with at least one member doing business in Alabama to begin filing a unitary combined return, effective for tax years beginning after December 31, 2017. A public hearing before the Senate Fiscal Responsibility and Economic Development Committee was held on Wednesday, April 5, and several interested parties submitted well-reasoned and comprehensive testimony in opposition to the bill. The vote was 12-2 against this bill.

The bill would have essentially adopted the MTC's Proposed Model Statute of Combined Reporting, except that it does not provide any common ownership threshold in determining whether an entity is included in the unitary group. Almost all other states that impose MUCR (as well as the MTC's model MUCR regulations) require at least 50% common ownership. Consistent with prior MUCR proposals, this bill specifically restricts the use of tax credits, net operating losses ("NOLs") and other post-apportionment deductions solely to the member that generated the attribute. In other words and despite the label "combined" report, all NOLs and other enumerated tax attributes could only be used by the individual member that generated such attribute and couldn't be used to offset the income or liability of other members of the unitary group.

The bill did *not* repeal either (a) Alabama's add-back statute that disallows certain intangible and interest expenses incurred between related parties, which will severely increase the risk of double taxation on these transactions, or (b) the relatively unproven restrictions on intercompany transfer pricing that largely parallel I.R.C. section 482.

S.B. 123 – Credits for Donations to Scholarship Granting Organizations ("SGOs") under the Alabama Accountability Act: This bill amends the Alabama Accountability Act by providing income tax credits to participating trusts and estates and clarifies that corporations may offset their quarterly estimated income tax payments by the credit. Additionally, the bill expands the credit to include utility gross receipts tax liability. The bill also increases the cap on income tax credits for donations to scholarship granting organizations such as the Alabama Opportunity Scholarship Fund (AOSF).

Conformity to New Federal Partnership Audit/Assessment Rules? As a result of the Bipartisan Budget Act of 2015 (the "Budget Act"), the IRS will now have authority to audit *and assess* certain Subchapter K entities, i.e., many partnerships and multi-member LLCs. The new rules apply to tax years beginning after December 31, 2017, but Sub K entities can opt-in early. We expect to see legislation introduced next Spring to conform Alabama law to certain aspects of the Budget Act. Most other states that levy net income-based taxes will be doing the same. Arizona has already done so. COST, TEI, the ABA Tax Section SALT Committee and the AICPA have teamed up to work with the Multistate Tax Commission, the states, and others to study whether various state laws may need to conform to the new federal law, including state RAR statutes. *Fred Nicely and Nikki Dobay are COST's liaisons to the working group. Bruce Ely and Will Thistle Co-Chair the ABA SALT Committee Task Force.*

II. TRANSACTIONAL TAXES

A. Legislative Developments

Reporting Requirements for Sellers; Simplified Seller's Use Tax Program Amended – Act 2017-82 (S.B. 86): This Act authorizes, effective July 1, 2017, the Department of Revenue requires reporting of retail sales and customer notification if the seller does not collect either sales, use, or simplified sellers use tax. The Act subjects noncompliance with these reporting requirements to penalties, but leaves all the details to be fleshed out by Department regulations.

With respect to the Simplified Seller's Use Tax Program, the Act expands the definition of an "eligible seller" to remove the condition that would have prohibited an otherwise qualifying participant from establishing physical presence for at least six months after entering the program and removed the requirement that the invoice contain the eligible seller's Alabama account number. The Act also permits the Department to disclose the name of eligible sellers, the date they began participating in the program, and the date they ceased participating (if applicable).

Professional Photography Services Sales/Use Tax Exemption – Act 2017-397 (H.B. 290): This act comes in the wake of last year's landmark Alabama Court of Civil Appeals ruling in *Ala. Dep't of Revenue v. Omni Studio, LLC,* and codifies a sales and use tax exemption for services provided by photographers, such as sitting fees and consultation fees, even when provided as part of transaction ultimately involving the sale of photographs, provided that the exempt services are separately stated to the customer on the bill of sale, invoice or similar receipt. Additionally, the bill prohibits the Department and localities from seeking payment for uncollected sales tax or unremitted use tax on these services *prior to October 1, 2017*. The provisions of the bill "shall apply retroactively to all open tax years and tax periods for which a preliminary assessment or final assessment could be entered," but also prohibits the filing of any refund claims for periods prior to May 26, 2017.

Equalization of Local Interest Rates and Expanded Delivery License Exception – Act 2017-415 (S.B. 316): This act equalizes state and local interest rates on delinquent sales, use, lodging and rental taxes (tied to the federal underpayment rate), and thus would prohibit self-administered municipalities and counties from charging 1% per month (12% annually). This act also exempts any business who delivers tangible personal property into a municipality in an amount less than $10,000 annually from the requirement to purchase a business license if it otherwise lacks physical presence in that jurisdiction. Unfortunately, the act does not lower the interest rate on municipal business license tax assessments from its current 12% per annum rate.

Montgomery County Rental Tax Authorized – Act 2017-465 (H.B. 594): This act authorizes Montgomery County to levy a rental tax on the leasing or rental of all tangible personal property in the county, except for vehicles, at a rate of up to 2%. The leasing or renting of any automotive vehicle, truck trailer, semi-trailer, or house trailer is subject to a rental tax rate of 0.75%. Rental passenger vehicles and rental trucks, however, are exempted from this tax.

Sales/Use Tax Exemption for Southern Research Institute – Act 2017-386 (S.B. 75): One of the few tax exemption bills that passed during the most recent session, this act exempts the Southern Research Institute from paying any state, county, and municipal sales and use taxes. In accordance with the reporting requirements enacted in 2015, the Southern Research Institute is required to file an annual informational report with ADOR. However, the information on such reports is not subject to Alabama's statutory confidentiality provisions and must be provided to the Legislative Fiscal Office on an annual basis.

Tax Exemption Reform Act of 2017 – Act 2017-149 (S.B. 181): This act repeals certain language related to "community chests" and "united appeal funds" and substitutes a defined term for "United Way," including its member agencies. Existing (usually church-related) united appeal funds are grandfathered, provided they continue to maintain their annual exemption certificate issued by the ADOR.

B. JUDICIAL DEVELOPMENTS

Scholastic Book Clubs, Inc. v. Alabama Department of Revenue, Case No. CV-2016-900562 (August 18, 2017) (on appeal): the Montgomery County Circuit Court reversed the decision of the ATT and voided the seller's use tax assessment against an out-of-state retailer that sold books and other educational items exclusively to school children in Alabama and other states. SBC initially appealed the final assessment to the Tax Tribunal, and Chief Judge Bill Thompson concluded that "teacher's activities in Alabama were clearly and significantly associated with the Taxpayer's ability to establish and maintain a market for its sales in Alabama, and thus Scholastic was not protected under the Commerce Clause of the U.S. Constitution and required to collect and remit seller's use tax under the catch-all provision, Ala. Code § 40-23-68(b)(9).

On appeal, the Montgomery County Circuit Court disagreed with now retired Judge Thompson and held that the "Alabama school teachers and parent educators were not acting on behalf of or under the authority of SBC and were not retained under contract by SBC" and thus these activities could not be characterized as the "other activity" described in the catch-all provision cited above. In addition, the court noted that the Department's and Tribunal's interpretation presented "serious issues" under the Constitution because SBC did not have the requisite physical presence in Alabama required under the Supreme Court's jurisprudence. The Department has appealed the Circuit Court's order to the Alabama Court of Civil Appeals.

Newegg, Inc. v. Alabama Department of Revenue, Ala. Tax Tribunal Dkt. No. S. 16-613: The ADOR eventually filed its Answer in the challenge to the so-called economic nexus threshold set forth in Ala. Admin. Code r. 810-6-2.90.03 for certain out-of-state retailers. In that Answer, the ADOR addresses Newegg's argument that the U.S. Supreme Court's 1992 holding in *Quill Corp. v. North Dakota* exempts it from having to collect and remit use tax because it lacks physical presence within the state. The ADOR mounted a frontal assault by asking the ATT to adopt a new "substantial nexus" framework, as set forth in *Complete Auto*, asserting that an expansive "economic presence" rule is more appropriate for contemporary society. According to the ADOR, this "economic presence" rule addresses the reality that domestic brick-and-mortar stores are placed at a competitive disadvantage by having to collect sales tax on purchases when out-of-state online retailers, such as Newegg, may avoid collecting use tax altogether for purchases made in-state.

The ADOR further argued that its economic nexus rule, when combined with the list of nexus-creating activities specified in Ala. Code §40-23-68, causes Newegg to have "substantial nexus." The ADOR asserts that the California-based catalog and online retailer not only sold more than $250,000 of tangible personal property within the state during 2015, which brings its activities within the purview of Rule 810-6-2.90.03, but it also "maintain[ed] other contact[s] with [Alabama] that would allow [Alabama] to require the seller to collect and remit the tax due under the provisions of the Constitution and laws of the United States." Specifically, Newegg allegedly "distribut[es] catalogs or other advertising matter, and by reason thereof receives and accepts orders from residents, within the State of Alabama" (Ala. Code § 40-23-68(b)(10)).

In response to the ADOR's Answer, the Tribunal entered a preliminary order authorizing pre-hearing discovery to commence, but did not set a hearing date.

84 Lumber Company, Inc. v. City of Northport, 2017 WL 1967723 (Ala. Civ. App. May 12, 2017): The Alabama Court of Civil Appeals reversed the circuit court's grant of summary judgment dismissing the taxpayer's appeal of sales and use tax assessments entered by the City of Northport, the City of Tuscaloosa, and the Tuscaloosa County Special Tax Board. The taxpayer at issue operated a lumber store within Northport's corporate limits but frequently delivered goods sold in its stores to job sites throughout Tuscaloosa County. The taxpayer collected and remitted sales tax based on the zip code of the delivery address. On audit, the taxing authorities determined that the taxpayer had remitted sales taxes to the incorrect taxing authority using the zip code method since their taxing jurisdictions did not correspond to zip code areas. Subsequently, the taxing authorities determined what they deemed to be an appropriate amount by using a sampling method where they randomly selected three months out of each audit period. The circuit court determined that the use of this sampling method was, in fact, proper because the taxpayer failed to meet its duty to maintain adequate records.

The Court of Civil Appeals, however, disagreed. First they explained that the taxing authorities could not point to any legal authority requiring taxpayers to include in their records what specific taxing jurisdiction a particular delivery is made. Instead, they noted, taxpayers are only required maintain accurate and complete records from which that information could be determined. Thus, because the records supplied by the taxpayer contained sufficient information from which the taxing authorities could determine the taxes due, the taxpayer had satisfied its duty requirements. Next, the Court of Civil Appeals noted that sampling methods are only appropriate when a business minimally complies with record-keeping requirements or fails to comply altogether. In this case, the taxpayer maintained invoices covering the entire assessment periods and consequently the taxing authorities were not be allowed to resort to sampling. The Court rejected the taxing authorities' argument that it would be too time consuming to audit each and every invoice to determine the proper allocation of the sales tax. The Court noted that the legislature had explicitly provided that a taxing authority should calculate the correct taxes due from the most accurate and complete information available and it did not provide an exception for a significant number of transactions that includes substantial amounts of documentation.

CSX Transportation, Inc. v. Alabama Department of Revenue, 2017 WL 1164766 (N.D. Ala. March 29, 2017): On remand again from the 11th Circuit Court of Appeals, District Judge Abdul Kallon again sided with the Department and held that the sales tax levied on sales of dyed diesel to rail carriers, but not water or motor carries, was not discriminatory. In support of its ruling, the court noted that rail carriers, like motor carriers, are taxed at a rate of 19 cents per-gallon on sales of clean diesel fuel, which they can opt to use. As such, noted the court, any discrimination which occurs is due to CSX's business practices and its decision to purchase dyed diesel [i.e., "self-imposed discrimination"]. The court also determined that Alabama provided sufficient justification for exempting water carriers' fuel purchases from sales tax. Subjecting them to the sales tax would expose the state to liability under various federal laws as well as the Commerce Clause (4th prong), the court said, adding that because water carriers impose virtually no financial burden on the state, CSX has suffered no competitive injury.

Jefferson County v. Taxpayers and Citizens of Jefferson County, Case No. 1150326 (Ala. March 17, 2017), cert. denied U.S. S. Ct. Dkt. No. 17-281 (Oct. 2, 2017): The Alabama Supreme Court affirmed the validity of a Jefferson County local sales and use tax, which involved a unique scenario of both business groups and local governments supporting potentially retroactive tax legislation. The local legislation at issue involved H.B. 573 / Act2015-226 to refinance Jefferson County warrants backed by sales tax revenues that were issued in 2004, and to use the interest savings for both education and non-educational construction projects. The non-educational use resulted in a class action lawsuit by individual taxpayers and local legislators.

The class claimed that H.B. 573 passed the House of Representatives in violation of Section 71.01(C) of the Alabama Constitution of 1901, which provides that a non-appropriations bill may be passed by the House before passage of a basic annual appropriations bill only if a special "budget isolation resolution" (or "BIR") is passed by "three-fifths of a quorum present." Notwithstanding Alabama House Rule 36, which defines such a quorum as those "present *and* voting," the class plaintiffs claimed that a mere total of 16 legislators voting on H.B. 573 didn't constitute a quorum for purposes of satisfying the Alabama Constitution. Following the trial court's surprising invalidation of Act 2015-226 on that ground, both parties filed appeals to the state Supreme Court.

While the decision was on appeal, business groups and local elected officials across the state warned of catastrophic consequences—statewide—if an amendment to the Alabama Constitution was not passed to clear up the mess. The state legislature quickly passed, and the state's voters overwhelmingly approved on the November 2016 ballot, Amendment No. 14 (Act 2016-430). That bill contained a one-line amendment adding Section 71.01(G) to the Constitution of Alabama, retroactively validating <u>all</u> BIRs pertaining to local laws (e.g., those affecting a single county or municipality) passed prior to November 8, 2016.

With this change enacted, the Alabama Supreme Court reviewed the class plaintiffs' appeal. Relying on a narrow exception established by Alabama case law, the Court affirmed the validity of the local sales and use tax act, citing of course Amendment No. 14. The Court, in delivering its opinion, noted that the constitutional amendment's "clear and express terms" validated the longstanding voting process used by the House of Representatives in passing the BIR at risk, which then cleared the way for the favorable—and constitutionally-blessed – vote on the new county sales and use taxes. This case presents an alternative view on the debate regarding the propriety of retroactive tax legislation. The fact, however, that a statewide referendum approved the retroactive constitutional amendment may be unique among the current retroactivity cases.

Ipsco Steel (Alabama), Inc. v. State Dep't of Rev., Ala. Tax. Trib., Dkt. No. S. 07-370, 10-269, 11-564, and 12-1435 (Feb. 23, 2017): The ATT issued a key ruling focusing on the ingredient/component part exclusion with respect to manufacturers and contractors. In *Ipsco Steel*, Judge Thompson was asked to consider multiple issues involving denied refund claims, and the most important issue centered on whether certain work and coiler rolls become ingredients or component parts of the steel the taxpayer manufactured and thus exempt from sales tax on their purchase.

Tangible personal property that is purchased by a manufacturer and enters into and becomes an ingredient or component part of the final product manufactured for sale may be purchased at wholesale, tax-free, for both sales and use tax purposes. *See* Ala. Code §§ 40-23-1(a)(9)b and 40-23-60(4)(b), and Ala. Admin. Code r. 810-6-1-.80(1). In order to qualify for the ingredient/component part exclusion, the tangible personal property purchased by the manufacturer must be present in the final product and its cost must not be deducted as depreciation or as an I.R.C. § 179 expense on the manufacturer's Alabama income tax return. Ala. Admin. Code r. 810-6-1-.80(2).

The work and coiler rolls at issue in *Ipsco* are parts of machines the taxpayer uses to produce steel products. Specifically, the rolls come into contact with and are used to shape the raw steel into the thickness specified by the taxpayer's customers. The taxpayer argued that parts of the rolls become an ingredient or component part of either the steel products or the residue mill scale, both of which are subsequently sold by the taxpayer. Thus, the taxpayer requested a refund of the sales tax it originally paid when it purchased the rolls.

The Department denied the taxpayer’s refund petition, claiming that the taxpayer failed to present sufficient technical and/or scientific evidence to show that parts of the rolls became an ingredient or component part of the steel products or the mill scale. While it’s common for taxpayers claiming a refund of sales/use tax paid on materials pursuant to the ingredient/component part exclusion to provide a lab report or other technical study to establish that some portion (even microscopic) of the materials remain in the finished product, the taxpayer in *Ipsco* produced no such evidence. The only evidence presented in this case appears to have been the testimony of the plant manager that the rolls “wear off” while in contact with the steel being manufactured, and that miniscule parts remain in the finished steel.

Judge Thompson apparently found that testimony to be persuasive, ruling that “[t]he evidence is sufficient to find that the rolls wear during the manufacturing process, and that parts of the rolls become an ingredient or component part of the steel or mill scale.” He further reiterated his holding in *Carlisle Engineered Products, Inc. v. State Dep’t of Rev.*, Admin. Law Div., Dkt. No. U. 99-524 (Aug. 28, 2000), *aff’d*, Tuscaloosa County Circuit Court, CV-2001-000009 (Sept. 6, 2002), that “Alabama law does not require that the Taxpayer must have intended that the rolls become a part of the steel products or mill scale for the ingredient or component part provision to apply.” However, the Judge denied that portion of the refund claim related to the coiler drum rolls because they had a useful life of more than one year, and were thus depreciable.

AkzoNobel Functional Chemicals, LLC v. State Dep’t of Rev., Ala. Tax. Trib., Dkt. No. S. 15-1278 and County 16-107 (Mar. 23, 2017): The ATT considered whether a manufacturer owed use tax on the price of materials comprising a machine it used in its manufacturing operations, or if the liability rested with the contractor who initially purchased the materials and fabricated and installed the machine.

AkzoNobel manufactures chemicals at a plant located near Mobile. It engaged a North Carolina-based company to fabricate and install a sulfuric acid converter for use at its plant. The parties stipulated to the following description of the converter:

> The Converter is a circular structure approximately 22 feet in diameter and 4 stories, 45 feet high and weighs approximately 110 tons. It is bolted to concrete supports and pilings that are buried into the ground. Steel girders are attached to and support the structure and stairways on each side of the structure. The structure is built to withstand a category 3 hurricane. It is not designed to be moved and can't be moved intact.

AkzoNobel paid Alabama and local use tax on the material cost of the converter but later requested a refund, claiming that the converter was attached to realty, and thus the company who fabricated and installed it should have paid the tax on the materials pursuant to the so-called contractor provision. The Department denied AkzoNobel's refund claim, arguing that the contractor provision could not apply because the converter is a machine used in manufacturing, and thus was taxable to AkzoNobel at the reduced (1.5%) machine rate. The Department's position may have been based on old case law arising from a former statutory regime in which there was no machine rate. Previously, machines purchased for use in manufacturing were statutorily exempt from sales/use tax, but building materials purchased by contractors were statutorily taxable. In other words, prior to the advent of the machine rate, a product could not be both a machine and a building material.

Here, the parties agreed that the converter was an integral part of and used in AkzoNobel's manufacturing process. However, under current Alabama law, it is irrelevant that the structure or machine involved is subsequently used in the manufacturing or production process if the contractor provision applies.

Judge Thompson concluded that the "converter is a permanent part of realty by its weight and size alone" and that "it is also attached to the realty by bolts and a steel support structure." Thus, he ruled that the contractor – not AkzoNobel – was the party that used the materials in fulfilling its obligation to construct the converter. Accordingly, the Judge awarded AkzoNobel a refund of the state and local use tax it erroneously paid on those materials.

Russell County Community Hospital, LLC & Medhost of Tennessee, Inc. v. Alabama Department of Revenue, Ala. Tax Tribunal Dkt. No. S. 15-1683 (June 13, 2016) (on appeal): Chief Judge Bill Thompson held that the taxpayer-hospital was entitled to a refund of the sales tax paid on the purchase of software that was customized for its particular functions. The hospital contracted with a well-known healthcare management company to provide the hospital with various computer software programs. The company started with canned software, and then customized it to meet the specific needs of the hospital. The hospital paid sales tax to the company on the software, and the hospital and the company later jointly petitioned for a refund, which was denied by the Department.

In ruling for the taxpayer, the Tribunal relied heavily on the Alabama Supreme Court's decision in *Wal-Mart Stores, Inc. v. City of Mobile and County of Mobile*, 696 So 2d 290 (Ala.

1996), which held that unmodified, "canned" computer software sold to nonexempt customers was subject to Alabama sales or use tax. Following that ruling, the Department issued Administrative Rule 810-6-1-.37 (the "Regulation"), which the Department cited in support of its refund denial. Judge Thompson found the Regulation to be internally inconsistent.

Paragraph (5) of the Regulation states that software is entirely exempt from sales tax if it is customized, but the same paragraph also states that only the itemized charges for customizing the software are exempt from sales tax. The Department had denied the joint petition in issue because the charges to the hospital were not itemized between the canned software and the customized portion. Judge Thompson added a footnote explaining that it's extremely difficult to determine whether software is custom or canned and, citing the Hellerstein treatise on state and local taxation, that he would support the imposition of sales tax on all software.

Apparently relying on Judge Thompson's footnote, the Department argued in its appeal to Russell County Circuit Court that sales tax should apply to the purchase of *all* software, whether canned or customized. This position, if adopted, would not only remove the court-mandated exemption for custom software, but would also mean that the Department is disavowing its own regulation, which specifies that custom software is not subject to sales tax. The appeal is now in the discovery phase.

***Mudler d/b/a Cypress Creek Antiques v. Alabama Department of Revenue*,** Ala. Tax Trib. Dkt. No. S. 16-1142 (Aug. 1, 2017): The ATT addressed the issue of whether a taxpayer was required to collect and remit sales tax on items sold at estate sales. The taxpayer operated an antique shop and also conducted off-site estate sales where he sold the same type of goods. The taxpayer correctly collected sales tax on retail sales made at his shop, but he did not collect sales tax on the items sold at the estate sales. According to the taxpayer, he was not liable for tax on estate sales because he was not actually selling the goods, but instead merely providing a service to his clients (who were merely making casual sales). The taxpayer also asserted that he was not required to collect and remit this sales tax because he did not take physical possession of the goods and sell them in his shop.

The ATT, however, rejected the taxpayer's arguments, determining that the estate sales were subject to sales tax because the sales were part of the taxpayer's regular business of selling antique and secondhand items at retail. The Tax Tribunal further stated that the estate sales were specifically included in the taxpayer's gross proceeds of sales pursuant to *Ala. Code §* 40-23-1(a)(6) as consignment sales. According to the Tax Tribunal, the fact that the taxpayer's possession of the goods occurred at a location other than the shop was irrelevant.

It is important to note, however, that the Tax Tribunal's holding in this decision is inconsistent with a Madison County Circuit Court ruling in *Loose Ends by MJ, LLC v. Alabama Department of Revenue*, and the taxpayer has appealed the Tribunal's decision to circuit court.

C. ADMINISTRATIVE DEVELOPMENTS

Proposed Regulation to Expand Rental Tax to Digital Goods/Services: Similar to the controversial proposal in the spring of 2015, the Department has again proposed a regulation that, if finalized in its present form, would substantially expand the scope of the state and local rental tax applied to video-on-demand and other digital streaming services. Proposed Ala. Admin. r. 810-6-5-.09. The proposed rule accomplishes this goal by defining "digital transmissions" made available to customers "regardless of the method of transmission, whether rented by subscription or for a definite or indefinite period, or on an demand-basis for a definite or indefinite period" as tangible personal property, within the meaning of the Alabama rental tax statute. Examples of digital transmissions in the proposed regulation include "on demand" movies, television programs, streaming video, streaming audio, and other similar programs that are made available to customers.

The expanded rental tax would be imposed on certain "cable or satellite television providers, online movie and digital music providers, app stores, and other similar providers of digital transmissions." For the purposes of sourcing, a digital transmission would be taxable by Alabama and those localities that levy a parallel rental tax if it is "used in Alabama." The customer's service address will determine whether the digital transmission is "used in Alabama," similar to market-based sourcing for corporate income tax purposes.

We understand from the Department's current leadership that this proposal will not be pursued (at least administratively).

Web Portal Launched by ADOR for Easy Access to Distributions Made under ONE SPOT and Simplified Sellers Use Tax Programs: As an expansion of the My Alabama Taxes (MAT) website administered by the ADOR, a new portal will allow interested parties to research amounts distributed to specific Alabama localities, by date, through the ONE SPOT and Simplified Sellers Use Tax Programs.

Clarification to Lodgings Tax Exemption for Conference Space: In response to the ATT's decision in *Stone Bridge Farms, LLC v. Alabama Department of Revenue* and legislative efforts to codify this decision (including H.B 392), the Department amended Rule 810-6-5-.13 to clarify that Charges made for the rental of ball rooms, dining rooms, club rooms, sample rooms, conference rooms, wedding chapels, or other meeting spaces that are neither intended nor suitable and not used for overnight sleeping purposes are not subject to the tax levied by Section 40-26-1, Code of Alabama 1975, if the charges for the rental are separately stated by the facility and are used exclusively as a meeting room for any conference, seminar, club meeting, private party or similar type activity."

Reporting Requirements for United Appeal Fund Organizations: The Alabama Department of Revenue issued a notice stating that all statutorily exempt organizations categorized as a United Appeal Fund or a United Appeal Fund Supported Charity with Alabama sales and use tax certificate of exemptions are required to file an informational report every four years and maintain a valid certificate of exemption. Failure to comply will result in sales and use tax certificates of exemption being revoked, and the organization or member agency will not be eligible for renewal. Reports are available to file online beginning on October 1, 2017, and will be deemed late if they are filed or submitted after October 31, 2017.

Growing Concern of Software-Enabled Sales Tax Evasion or "Tax Zappers": In a recent conversation with Alabama Commissioner of Revenue Vernon Barnett, Commissioner Barnett expressed that one of the major challenges facing the Department of Revenue continues to be the use of technology related fraud, and software-enabled sales tax evasion in particular. Revenue suppression software, commonly referred to as "Tax Zapper" software, enables retailers to underreport their sales, thereby illegally lowering their sales tax liability. When executed, these revenue suppression programs are used to delete some or all of the business's cash transactions and then reconciles the books of the business. The result is business records that appear to be complete and accurate but, in fact, are false and fraudulent in that they show less than total income earned.

Many states have passed laws outlawing the use of revenue suppression software and commenced efforts to combat the growing problem. To help deal with this particular form of sales tax fraud, Commissioner Barnett has asked that the Department form a cross-divisional dedicated group that can take information from a variety of sources, identify likely cases of fraud, and then directly run those cases to the ground. According to the Commissioner, these criminals use technology to commit the fraud, and the Department must respond by effectively using technology to prevent and pursue fraud.

Department Updates Handbook for Agricultural Related Sales: For purposes of interpreting references to "agriculture" and "agricultural purposes" with respect to sales and use tax and the various exemptions and reduced rates, the Alabama Department of Revenue issued a publication stating that the term "agriculture" is defined to be the art or science of cultivating the ground, as well as the raising and harvesting of crops. In addition, the term also includes tillage, farming, and managing, breeding, and feeding livestock and poultry. Areas that do not fall within the definition of agriculture includes, among other things, lawns and shrubbery around residential and business properties; highway, railroad, or utility right-of-way; and commercial pest control services.

D. LIKELY TRENDS/OUTLOOK FOR 2018: Legislative Proposals – Spring 2018 Regular Session

S.B. 216 – Reliance on ADOR's Website for Correct Local Tax Rate a/k/a "Retailer's Hold Harmless Bill": S.B. 216 would relieve taxpayers of any liability for collecting and charging the incorrect sales, use, rental, or lodgings tax rate if they relied on the rate published on the ADOR's website, including relief from any penalties or interest as under current law.

III. AD VALOREM PROPERTY TAXES

A. LEGISLATIVE DEVELOPMENTS

Excess Funds from Real Estate Tax Sales – Act 2017-130 (S.B. 95): This act clarifies that the process for calculating, distributing and retaining any excess proceeds from the sale of real estate for taxes (including interest on such proceeds) shall be governed by Ala. Code § 40-10-28, regardless of when the tax sale occurred. Further, any prior actions made in good faith reliance on 2014 amendments to this section, regardless of when the sale occurred, are ratified, validated and affirmed.

B. ADMINISTRATIVE DEVELOPMENTS

Optional Personal Property Assessment Link Goes "Live": The ADOR's Optional Personal Property Assessment Link ("OPPAL"), a centralized online filing system for business personal property tax returns, became available October 1, 2016. OPPAL allows any taxpayer required to file a business personal property tax return with any county assessing official or applicable agency the ability and option to file the return electronically. OPPAL is a reporting portal only, the taxpayer's information entered into the system is transmitted to the county taxing official for use in compiling a tax assessment and bill. OPPAL is optional, all Alabama counties must allow taxpayers to utilize and access the OPPAL system for filing any business personal property return. There is no charge to the taxpayer for utilizing OPPAL. The OPPAL web portal (https://www.oppal.alabama.gov) is available to accept taxpayer information from October 1 of each year until the following January 31.

IV. MISCELLANEOUS TAXES / PROCEDURAL MATTERS

A. LEGISLATIVE DEVELOPMENTS

Tax Preparer Requirement / Business Privilege Tax Return Date – Act 2017-363 (H.B. 46): This act: (1) requires tax return preparers located within the state to provide their federal preparer identification numbers on all Alabama tax returns prepared; (2) synchronizes the Alabama business privilege tax return due date with the corresponding date for federal returns, while linking the return date for financial institutions to the same date for excise tax returns; and (3) effectuates a title change of the position of Taxpayer Advocate to "Taxpayer Assistance Officer."

Forest Products Severance and Manufacturer Taxes – Act 2017-301 (H.B. 313): This act overhauls and simplifies the statutory language concerning Alabama's antiquated forest products severance taxes. Notable changes implemented by the bill include allowing and requiring all taxpayers to collect and report the severance taxes due based on weight (as opposed to volume), providing that the former processors (now referred to as manufacturer) tax is only imposed on in-state manufacturers, and also allowing users of pulpwood chips to substantiate their severance tax exemption by obtaining a certificate from the licensed seller. The bill also creates a new exemption for "fuel chips" that are produced at the site of severance to encourage the use of renewable energy. Finally, the bill also clarifies under various scenarios where forest products should not be subject to double taxation, and provides that these clarifications "shall apply retroactively to all open tax periods and all periods for which a preliminary or final assessment of tax could be or was entered."

Combatting Identity Theft-Related Refund Fraud – Act 2017-227 (H.B. 87): This act authorizes the ADOR to partner with other state agencies, federal and private sector programs designed to reduce or eliminate identity theft related refund fraud. This act also amends the Electronic Tax Filing Act to require the ADOR to standardize the method of filing returns, methods of payment and license application, whenever feasible. Finally, this act adds electronic payments to the "bad check" penalty, which is 10% of the payment (or $10 if less than $500).

ATT Will Not Hear Abandoned Motor Vehicle Appeals or Contested Case Proceedings – Act 2017-441 (H.B. 234): This act makes one jurisdictional change and one technical correction to the Alabama Taxpayer Fairness Act of 2014 ("ATFA") that established the ATT. The first is to remove the option to appeal the pending sale of an abandoned motor vehicle and thus require that these appeals be filed in the circuit court of the county where the sale is to occur. The technical change is to clarify that the ATT shall not be subject to declaratory judgment, declaratory ruling or contested cases provisions of the Alabama Administrative Procedure Act, and thus appeals from a final order of the Tax Tribunal continue to be governed by provisions of the ATFA.

Wholesale to Retail Accountability Program – Act 2017-294 (H.B. 75): This act establishes the Wholesale to Retail Accountability Program (or "WRAP") and implements standardized reporting measures for manufacturers, wholesalers, and distributors of beer, wine and tobacco products. This act was likely passed as a direct response to the growing problem of many in-state convenience stores not remitting all of the sales taxes due to the ADOR from the sale of these products. The act also creates an industry advisory group to make recommendations as to how the reports should be filed, and cities are required to electronically submit all municipal business privilege license applications and renewals to the ADOR beginning October 1, 2019.

B. JUDICIAL DEVELOPMENTS

Elbow River Marketing Limited Partnership v. City of Birmingham, Jefferson Cnty Cir. Ct., CV-2014-00624 (Mar. 17, 2017) (on appeal): During the audit period, Elbow River, a Canadian business with no physical presence in the City of Birmingham, arranged for the sale of ethanol and naptha to two customers located in the City. The City assessed business license tax against Elbow River on all of its sales to customers in the City.

During the audit period, Elbow River's sales of product to customers in the City took two different forms. In the first, Elbow River contracted directly with the customer for the sale of product, and arranged for the product to be delivered from outside Alabama by common carrier railroads. Elbow River arranged transportation with the railroads, and maintained title to the product while it was in the railroad tank cars during the rail journey to the City. When the railroad tank cars arrived in the City, they were brought to a transload facility where the product was offloaded into tanker trucks. Title to the product passed from Elbow River to the customer as it was offloaded from the railroad tank car onto the tanker truck. In the second type of sales transaction, Elbow River arranged to purchase the product from third-party suppliers who then arranged for the shipment of the product to the customer. These transactions were akin to drop shipments. As with the first type of transaction, the products were delivered from outside Alabama to the transload facility by rail, and then a third-party trucking company delivered the product to the customer.

The Circuit Court voided the assessment, concluding that "Elbow River did not engage in a trade, occupation, or business within the City as is required both by state law and the City's Business License Code. The fact that Elbow River may have had title to the products for some period of time while they were in possession of the delivering rail or trucking carrier is not enough to allow the imposition of a business license tax. And Alabama law makes clear that a product seller that does nothing more than having its merchandise delivered into a municipality by means of a common carrier cannot be subjected to business license tax." The City has appealed this ruling to the Alabama Supreme Court.

P.J. Lumber Co., Inc. v. City of Prichard, Case No. 2160627 (Ala. Civ. App. Sept. 22, 2017): The Alabama Court of Civil Appeals affirmed the circuit court and held that use of gross receipts from exported goods to calculate city business license tax does not violate the Import-Export Clause of the U.S. Constitution. The city business license tax is based on gross receipts, including gross receipts from domestic and foreign sales. The taxpayer, which sells lumber both domestically and internationality, petitioned for refund of the portion of business license tax imposed on revenue from exported goods, claiming that application of the tax to exported goods violated the Import-Export Clause; however, the cases relied on to support the taxpayer's claim were all decided before 1976 and are no longer valid under current U.S. Court precedent that limited the prohibition on taxation under the Import-Export Clause to "imposts or duties."

Applying the current standards, the Court noted that the business license tax is a nondiscriminatory tax imposed on all businesses located in the city and in no way impedes the regulation of foreign trade, nor does it affect the harmony between the states. In addition, the tax is imposed on the privilege of doing business in the city and taking advantage of city services, and, as the court noted, there is no reason why local taxpayers should subsidize the services used by the importer. Curiously, it does not appear that the circuit court considered whether the Commerce Clause or other Alabama cases, such as *M&A Associates* or *Mobile Marine Radio*, could have prohibited the City from taxing out-of-state receipts.

Taylor v. Alabama Department of Revenue, Ala. Tax Tribunal, Dkt. No. P. 16-103 (Dec. 12, 2016): In a case involving the 100% penalty levied on responsible persons for willfully failing to pay a business's trust fund taxes, the ATT determined the limits as to what constitutes a "responsible person." The case involved an employee of a small business who was afforded authority to pay the all state and local sales and withholding taxes for periods spanning the years of 2012–2014. After receiving an assessment of a 100% penalty on the amount due by the Alabama Department of Revenue, the employee-taxpayer challenged the assessment on the grounds that he was not a "responsible person" as designated in Alabama's governing penalty statute, Section 40-29-72(b) Code of Alabama, due to not being an officer of the entity operating the business.

Acknowledging that the federal penalty statute on which Alabama's statute was modeled defines a "responsible person" broadly as anyone having authority to pay a business's trust fund taxes, the Tribunal pointed out the state statute differs in a material respect by limiting the definition of a "responsible person" to a corporate officer or partnership member charged with paying any taxes owed. Finding the taxpayer to be only an employee of the business, even though he admitted to holding himself out as an owner for advertising purposes, the Tribunal held that the 100% penalty could not be assessed since the taxpayer wasn't a "responsible person" under Section 40-29-72(b).

C. ADMINISTRATIVE DEVELOPMENTS

Ala. Op. Att'y Gen. No. 2017-021 (Feb. 23, 2017): The Office of the Attorney General ruled that while a city could adopt ordinances similar to Ala. Code section 40-1-2(c) or 40-29-20 as a means of collecting delinquent municipal sales or use taxes, the city could *not* use these ordinances to collect its municipal business license tax and could *not* hold an agent or officer of a company personally liable for municipal business license taxes.

Alabama Unclaimed Property Reporting: Businesses and organizations holding unclaimed property with situs in Alabama are required to file an annual report with the State Treasurer's office. This report covers property that is considered to be unclaimed as of June 30, 2017. Because Alabama does not require negative reporting, however, businesses and organizations holding no unclaimed property as of June 30, 2017 are not required to file.

D. LIKELY TRENDS/OUTLOOK FOR 2018: Legislative Proposals – Spring 2018 Regular Session

S.B. 183 – Limiting Interest on Refunds: This bill would delay the accrual of interest on certain refund claims until 30 days after receipt of a "properly documented refund petition." Under current law, interest generally begins to accrue from the date of the overpayment. Thankfully, the proponents of this bill have agreed to stand down for this session, but we could see this proposal resurface in the future.

H.B. 536 – Private Auditing Firms to Conduct BPPT Audits: This bill authorizes the ADOR to hire private auditing firms to audit taxpayers for business personal property tax compliance. ADOR officials advised us that they have no involvement with this bill. It is unclear whether these auditing firms would be subject to the restrictions on private auditing firms imposed by the 1998 Local Tax Simplification Act and Local Tax Conformity Act, as amended (e.g., no contingent fee contracts, hourly rates, certified revenue examiners, etc.).