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Spotlight On Alabama: A Busy Tax Year in Review

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It has been a busy year for developments in Alabama state taxation. In this tax alert we review many of the significant developments that have occurred over the last 12 months.

"Presence-Factor" Nexus Standard for Income, Business Privilege and Financial Institution Excise Taxes

Act. No. 2015-505, signed into law on August 11, 2015, adopts a controversial "presence-factor" nexus standard to determine whether nonresident individuals and out-of-state businesses have "substantial nexus" with Alabama such that they are subject to income, business privilege or financial institution excise taxes. Significantly, the Act does not impose the "presence-factor" nexus standard for determining whether an out-of-state individual or entity has nexus for purposes of collecting Alabama sales or use tax (however, see the discussion of Proposed Regulation 810-6-2.90.03 below). The Act is effective for tax years beginning after December 31, 2014.

Under the new "presence-factor" nexus rule, a nonresident individual or business entity will be deemed to have "substantial nexus" and therefore be subject to tax in Alabama if any one of the following thresholds is exceeded:

- More than $50,000 of payroll in Alabama
- More than $50,000 of property in Alabama
- More than $500,000 of sales in Alabama
- More than 25% of total property, payroll or sales in Alabama

The dollar-based thresholds provided in the Act are subject to inflation adjustment if there is a change in the Consumer Price Index of five percent or greater.
Importantly, the thresholds apply at the entity level for pass-through entities such as S Corporations, LLCs, partnerships and trusts. If a threshold is exceeded at the entity level, the owner or beneficiary of the entity will be subject to Alabama tax on their allocable share of the entity's Alabama income.

The "presence-factor" nexus standard is controversial. Similar legislation has been challenged on constitutional grounds in other states, and the outcome of that litigation is still pending.

Proposed "Substantial Economic Presence" Sales and Use Tax Regulation

The Department of Revenue recently issued Proposed Rule 810-6-2.90.03, a controversial rule under which a seller with no physical presence in Alabama would be required to collect and remit Alabama sales or use tax if the seller's previous year retail sales of tangible personal property into Alabama exceeded $250,000.

Currently, the rule is not yet final and must go through a review period under the Alabama Administrative Procedure Act before it can become final. The Department of Revenue's target date for the rule to become effective is January 1, 2016. If the rule does become final, it is likely to come under challenge on constitutional grounds as the "substantial economic presence" standard may violate the Supreme Court's decision in Quill v. North Dakota, which held that an out-of-state business has sales tax nexus with a state only if the business has a physical presence in the state.

Certificate of Exemption Requirement for Non-Profits Exempt from Sales and Use Tax

All non-governmental entities which have been granted a general statutory exemption from paying Alabama sales, use and lodging taxes (known as "Applicable Non-Profits") will be required to apply for an annual Certificate of Exemption from the Department of Revenue effective August 19, 2015. Any Applicable Non-Profit which fails to obtain the Certificate of Exemption will be subject to Alabama sales, use and lodging taxes. Additionally, any individual or entity that uses a Certificate of Exemption for a purpose other than its intended purposes will be subject to a fine of the greater of (a) $2,000, or (b) two times the amount of the tax due of the transaction. The Act applies to all non-governmental entities that have a general statutory exemption from sales, use or lodging tax, including churches, schools, universities and not-for-profit hospitals. Under guidance from the Department of Revenue, all Applicable Non-Profits are required to obtain a certificate of exemption prior to January 1, 2016. The certificate must be renewed annually. Additionally, beginning in 2017, all Applicable Non-Profits may be subject to filing additional annual information returns with the Department of Revenue.

Alabama Tax Delinquency Amnesty Act of 2016

Under the Alabama Tax Delinquency Amnesty Act of 2016, the Department of Revenue will be required to conduct a temporary tax amnesty program of at least two months in length, prior to August 2016. Amnesty will be available, with very limited exceptions, for most taxes administered by the Department of Revenue, including income, sales, use and business privilege tax. The amnesty program would apply to taxes due before, or tax periods beginning before, January 1, 2015.

In order to be eligible to participate in the tax amnesty program, the taxpayer must file an application with the Department of Revenue. The taxpayer must pay the taxes that should have been paid for the three preceding taxable periods. In return, the Department of Revenue must waive all penalties and one-half of the interest on the underpayment of the tax. Any taxpayer who has already been contacted by the Department of Revenue pertaining to the tax for which amnesty is sought or who is a party to criminal or civil litigation in relation to nonpayment, delinquency or fraud related to Alabama state taxes is ineligible to participate in the amnesty program. The date for the amnesty program has yet to be set.

Alabama Reinvestment and Tax Abatements Act

The Alabama Reinvestment and Tax Abatements Act significantly expands tax abatements for companies that invest in Alabama. Existing law provides for abatement of non-educational ad valorem property tax, construction-related sales and use tax, and recording taxes. The new law expands the tax abatements available by:

- Extending the maximum period for property tax abatement from the existing 10 years to up to 20 years for eligible projects.
- Significantly expanding the industries and activities that qualify for tax abatement.
- Providing that significant rehabilitation, improvement and refurbishment projects qualify for tax abatement if capital expenditures for the project exceed $2 million.
- Providing an abatement of increased taxes on utility services for projects in which capital expenditures equal or exceed $2 million, as part of an addition, expansion, improvement, renovation, re-opening or rehabilitation of a facility or for replacement of existing tangible personal property.

Alabama Hiring Incentives: The Alabama Jobs Act

The Alabama Jobs Act creates two credits that may be available to employers who invest in projects that create a "significant" number of new jobs in Alabama. Generally, a "significant" number of new jobs will be deemed to have been created if 50 new jobs are created. However, there are a number of exceptions in which the creation of a significantly lower number of jobs will qualify. To be eligible for the program, the employer must be approved by the Department of Commerce and must enter into a project agreement with the state.

An employer who qualifies may be entitled to two credits: a jobs credit and a capital investment credit. The jobs credit may be allowed for up to 3% of the previous year's annual wages of eligible employees and may be applied against utility taxes actually paid or paid to the employer as a refund for utility taxes paid, regardless of the amount of utility taxes actually paid. Unused portions of the jobs credit may be carried forward up to five years. Employers may also receive a capital investment credit equal to 1.5% of their capital investment in the project, which may be used to offset income tax, insurance premium tax, utility tax or financial institution excise tax. The capital investment credit is partially transferable.

Further enhanced incentives may be available for employers who invest in rural counties or who create jobs for veterans.

ABLE Act: Savings Accounts for Disabled Individuals

The recently enacted ABLE (Achieving a Better Life Experience) Act creates a vehicle for family members and guardians of disabled individuals to create tax-preferred ABLE savings accounts to assist disabled individuals in paying qualified disability expenses. The Act parallels the ABLE Program embodied in Section 529A of the Internal Revenue Code.

Conclusion

Please remember that advice and counsel regarding your particular tax-related issues, including the potential impact of the developments referenced above on you, your business or organization, would be dependent upon your specific facts and circumstances. For more information about how these issues may affect your business or related matters, contact the author of this alert, Allen Blow, or any members of the Firm's Tax Group.