

INSTRUCTIONS FOR THE PREPARATION OF
ALABAMA DEPARTMENT OF REVENUE
Pass Through Entity

2006

Owner's/Shareholder's Statement of Income and Deductions

Instructions to Pass-Through Entity

General Instructions. The Alabama Schedule K-1 is a required attachment to the Alabama Form 65 and the Alabama Form 20S. The Alabama Schedule K-1 is similar to the federal Schedule K-1 in that it is used to report the pass-through entity owners' share of income, deductions, credits and other items.

The format of the Alabama Schedule K-1 differs from that of the federal Schedule K-1 – therefore the federal Schedule K-1 cannot serve as a substitute for the Alabama Schedule K-1.

The term "pass-through entity" will be used in these instructions to refer to Alabama S corporations and subchapter K entities. Generally, the term "pass-through entity owner" will be used in these instructions to refer to any shareholder of an Alabama S corporation doing business in Alabama or any owner of a subchapter K entity doing business in Alabama. See Section 40-18-160, *Code of Alabama 1975*, for an explanation of an Alabama S corporation. See Section 40-18-1, Code of Alabama 1975, for a definition of subchapter K entity.

Heading Information. Enter in the upper left area of the form whether the pass-through entity is a Subchapter K entity or an Alabama S corporation. Provide the tax period information if the return is filed for other than the 2006 calendar year. Enter in the upper right area of the form if the Schedule K-1 is either a final K-1 or an amended K-1.

Part I – Information About the Pass-Through Entity.

Enter on line A the pass-through entity's Federal Employer Identification Number. Enter on line B the pass-through entity's name and mailing address (street address, city, state and zip code).

Part II – Information About the Pass-Through Entity Owner.

Line C. Enter the pass-through entity owner's social security number or federal identification number.

Line D. Enter the name of the pass-through entity owner.

Line E. Enter the street address of the pass-through entity owner.

Line F. Enter the city, state, and zip code for the pass-through entity owner.

Line G. If the pass-through entity is an Alabama S corporation, line G does not apply. Otherwise, check the appropriate box to indicate if the pass-through entity owner is a general partner or limited liability company member manager or if the pass-through entity owner is a limited partner or a non-manager member of a limited liability company.

Line H. Enter the entity type of the pass-through entity owner (individual, trust, partnership, S corporation, C corporation or disregarded entity).

Line I. Enter the pass-through entity owner's percentage of profit and (loss) sharing during the tax year.

Line J. Check the appropriate box to indicate if the pass-through entity owner is a resident of Alabama or a nonresident. If the pass-through entity owner is a corporation check the resident box if the corporation was incorporated in Alabama, otherwise check the nonresident box. If the pass-through entity owner is a limited liability entity (LLC, LLP, etc.) check the resident box if the limited liability entity was organized in Alabama, otherwise check the nonresident box.

Line K. Enter the pass-through entity owner's basis in the pass-through entity.

Line L. Enter additional notes, as needed.

Part III – Owner's/Shareholder's Share of Current Year Alabama Income, Deductions, Credits, and Other Items.

Line M – Nonseparately Stated Income Allocated and Apportioned to Alabama. Enter the pass-through entity owner's prorate share of the nonseparately stated income allocated and apportioned to Alabama. The total amount apportioned to Alabama for the pass-through entity is reported on Schedule K, line 1 (Alabama Amount column) of the accompanying Alabama Form 65 or Alabama Form 20S.

Line N – Amount of Guaranteed Payments to Partner to be Reported by the Partner as Alabama Source Income.

Line N applies only to owners of subchapter K entities.

The entire amount of guaranteed payments received by the owner of the subchapter K entity should be reported on this line - if the owner is an Alabama resident individual, a subchapter K entity, or a corporation. The apportioned amount of the guaranteed payments received by the owner of the subchapter K entity should be reported on this line, only if the owner is an individual that is not an Alabama resident.

The total amount of guaranteed payments for the subchapter K entity was reported on Schedule K, line 15 (Federal Amount column) of the accompanying Alabama Form 65. The apportioned amount of guaranteed payments for the subchapter K entity was reported on Schedule K, line 15 (Alabama Amount column) of the accompanying Alabama Form 65.

Line O – Section 179 Expense. Enter the pass-through entity owner's prorata share of the section 179 expense apportioned to Alabama. The total amount apportioned to Alabama for the pass-through entity is reported on Schedule K, line 4 (Alabama Amount column) of the accompanying Alabama Form 65 or Alabama Form 20S.

Line P – Investment Interest Expense Related to Portfolio Income. Enter the pass-through entity owner's prorata share of the interest expense related to portfolio income apportioned to Alabama. The total amount apportioned to Alabama for the pass-through entity is reported on Schedule K, line 7 (Alabama Amount column) of the accompanying Alabama Form 65 or Alabama Form 20S.

Line Q – Portfolio Income. Enter the pass-through entity owner's prorata share of the portfolio income apportioned to Alabama. The total amount apportioned to Alabama for the pass-through entity is reported on Schedule K, line 6 (Alabama Amount column) of the accompanying Alabama Form 65 or Alabama Form 20S. The different types and amounts of portfolio income items must be provided to the pass-through entity owner with the Alabama Schedule K-1.

Line R – Other Expenses Related to Portfolio Income – Do Not Include Interest Expense. Enter the pass-through entity owner's prorata share of the other expenses related to portfolio income apportioned to Alabama. The total amount apportioned to Alabama for the pass-through entity is reported on Schedule K, line 8 (Alabama Amount column) of the accompanying Alabama Form 65 or Alabama Form 20S. Interest expense must not be included in this amount. The pass-through entity owner must be provided with the nature and amounts of the different expenses reported on Line R with the Alabama Schedule K-1.

Line S – Charitable Contributions. Enter the pass-through entity owner's prorata share of the charitable contributions apportioned to Alabama. The total amount apportioned to Alabama for the pass-through entity is reported on Schedule K, line 2 (Alabama Amount column) of the accompanying Alabama Form 65 or Alabama Form 20S.

Line T – Other Separately Stated Business Items. Enter the pass-through entity owner's prorata share of the other separately stated business items apportioned to Alabama. The total amount apportioned to Alabama for the pass-through entity unit is reported on Schedule K, line 9 (Alabama Amount column) of the accompanying Alabama Form 65 or Alabama Form 20S. The nature and amount of each different separately stated business item must be provided to the pass-through entity owner with the Alabama Schedule K-1.

Line U – Composite Payment Made on Behalf of the Owner/Shareholder. Enter the amount of the Alabama composite payment made on behalf of the pass-through entity owner. The total amount of composite payments made by the pass-through entity is reported on Schedule K, line 12 (Alabama Amount column) of the accompanying Alabama Form 65 or Alabama Form 20S.

Line V – U.S. Income Taxes Paid. Enter the pass-through entity owner's prorata share of the U.S. income taxes paid by the pass-through entity and apportioned to Alabama, if any. The total amount apportioned to Alabama for the pass-through entity is reported on Schedule K, line 12 (Alabama Amount column) of the accompanying Alabama Form 65 or Alabama Form 20S.

Line W – Casualty Losses. Enter the pass-through entity owner's prorata share of the casualty losses apportioned to Alabama. The total amount apportioned to Alabama for the pass-through entity is reported on Schedule K, line 5 (Alabama Amount column) of the accompanying Alabama Form 65 or Alabama Form 20S.

Line X – Withdrawals and Distributions. Enter the amount of distributions made to the pass-through entity owner. The total amount for the pass-through entity is reported on Schedule K, line 14 (Alabama Amount column) of the accompanying Alabama Form 65 or Alabama Form 20S. Provide with the Alabama Schedule K-1 a detailed explanation of the amount reported on Line X.

Line Y – Additional Information. Enter additional information, as needed.

Line Z – Oil and Gas Depletion. Enter the pass-through entity owner's prorata share of the oil and gas depletion apportioned to Alabama. The total amount apportioned to Alabama for the pass-through entity is reported on Schedule K, line 3 (Alabama Amount column) of the accompanying Alabama Form 65 or Alabama Form 20S. The computation of the amount reported on Line Z of the Alabama Schedule K-1 must be provided to the pass-through entity owner with the Alabama Schedule K-1.

Line AA – Separately Stated Nonbusiness Items. Enter the pass-through entity owner's prorata share of separately stated nonbusiness items allocated to Alabama. The total amount allocated to Alabama for the pass-through entity is reported on Schedule K, line 10 (Alabama Amount column) of the accompanying Alabama Form 65 or Alabama Form 20S. The pass-through entity owner must be provided with the nature and amounts of the different separately stated nonbusiness items reported on Line AA.

Line AB – Alabama Exempt Income. Enter the pass-through entity owner's prorata share of income exempt from Alabama income taxation. The total amount of Alabama exempt income for the pass-through entity is reported on Schedule K, line 13 (Alabama Amount column) of the accompanying Alabama Form 65 or the Alabama Form 20S. The pass-through entity owner must be provided with the nature and amounts of the different Alabama exempt income reported on Line AB.

Instructions to Pass-Through Entity Owner

Important information for pass-through entity owners that are not individuals. Pass-through entity owners that are not individuals, but are corporations or subchapter K entities can create nexus (a presence subjecting the pass-through entity owner to Alabama income taxation) in Alabama by having an ownership interest in a pass-through entity doing business in Alabama. Also, having an ownership interest in a pass-through entity doing business in Alabama can subject the pass-through entity owner (which is a corporation or subchapter K entity) to the requirements of the Alabama Multistate Tax Compact. The Alabama Department of Revenue's website (www.revenue.alabama.gov) has additional information available concerning Alabama income tax laws and regulations; the Alabama Multistate Tax Compact; Alabama tax forms and instructions; as well as, frequently asked questions should you need to conduct more in-depth research.

The remainder of these instructions are directed toward pass-through entity owners that are individual taxpayers.

Line M – Nonseparately Stated Income Allocated and Apportioned to Alabama.

Pass-through entity owners that are individuals would report this amount on Schedule E of the Alabama Form 40 or Alabama Form 40NR.

Line N – Amount of Guaranteed Payments to Partner to be Reported by the Partner as Alabama Source Income.

Line N applies only to owners of subchapter K entities.

Pass-through entity owners that are individuals would report this amount on Schedule E of the Alabama Form 40 or Alabama Form 40NR.

The entire amount of guaranteed payments received by the owner of the subchapter K entity should be reported on this line of the Schedule K-1, if the owner is an Alabama resident individual. The apportioned amount of the guaranteed payments received by the owner of the subchapter K entity should be reported on this line, if the owner is an individual, but not an Alabama resident.

Line O – Section 179 Expense.

Pass-through entity owners that are individuals would claim this amount on the Form 4562, Depreciation and Amortization, which accompanies the individual's Alabama Form 40 or Alabama Form 40NR.

Line P – Investment Interest Expense Related to Portfolio Income.

Pass-through entity owners that are individuals would report this amount on the Alabama Form 4852A that accompanies the individuals Alabama Form 40 or Alabama Form 40NR.

Line Q – Portfolio Income.

Pass-through entity owners that are individuals would report this amount on the appropriate schedule of the Alabama Form 40 or Alabama Form 40NR filed by the individual, depending upon the nature of the portfolio income. Accompanying the Alabama Schedule K-1 should be an explanation of the different types and amounts of portfolio income making up the amount on Line Q.

Line R – Other Expenses Related to Portfolio Income – Do Not Include Interest Expense.

Pass-through entity owners that are individuals would claim this amount on Schedule A of the Alabama Form 40 or Alabama Form 40NR, depending upon the nature of the expense. Accompanying the Alabama Schedule K-1 should be an explanation of the different types and amounts of expenses making up the amount on Line R.

Line S – Charitable Contributions.

Pass-through entity owners that are individuals would claim this amount on Schedule A of the Alabama Form 40 or Alabama Form 40NR.

Line T – Other Separately Stated Business Items.

Pass-through entity owners that are individuals would report or claim these items on the appropriate schedule of the Alabama Form 40 or Alabama Form 40NR, filed by the individual, depending upon the nature of the other separately stated business item. Accompanying the Alabama Schedule K-1 should be an explanation of the different types and amounts of other separately stated business items making up the amount on Line T.

Line U – Composite Payment Made on Behalf of the Owner/Shareholder.

Pass-through entity owners that are individuals would claim this amount on the Alabama Form 40 or Alabama Form 40NR.

Line V – U.S. Income Taxes Paid.

Pass-through entity owners that are individuals would report this amount on the Alabama Form 40 or Alabama Form 40NR.

Line W – Casualty Losses.

Pass-through entity owners that are individuals would claim this amount on the Form 4684 that accompanies the Alabama Form 40 or Alabama Form 40NR.

Line X – Withdrawals and Distributions.

Pass-through entity owners that are individuals would report the portion of this amount that represents reportable income on the Schedule D accompanying the Alabama Form 40 or Alabama Form 40NR. Accompanying the Alabama Schedule K-1 should be a detailed explanation of the amount on Line X.

Line Z – Oil and Gas Depletion.

Pass-through entity owners that are individuals should claim this amount on Schedule E of the Alabama Form 40 or Alabama Form 40NR. Accompanying the Alabama Schedule K-1 should be a computation of the amount reported on Line Z. Alabama income tax law concerning oil and gas depletion differs from the federal law - care should be exercised in claiming this deduction, to ensure that the proper amount is deducted.

Line AA – Separately Stated Nonbusiness Items.

Pass-through entity owners that are individuals would report or claim this amount on the Alabama Form 40 or Alabama Form 40NR, depending upon the nature of the separately stated nonbusiness items. Accompanying the Alabama Schedule K-1 should be an explanation showing the different types of nonbusiness items and amounts making up the amount reported on Line AA.

Line AB – Alabama Exempt Income.

Pass-through entity owners that are individuals are encouraged to disclose the amount of Alabama exempt income on the Alabama Form 40 or Alabama Form 40NR, filed by the individual. Accompanying the Alabama Schedule K-1 should be an explanation showing the different types of Alabama exempt income items and amounts making up the amount reported on Line AB.