

Qualified Investment Partnership Certification

Definition of Qualified Investment Partnership (QIP).

A partnership or other entity classified as a subchapter K entity, or a business trust as defined in §40-18-1, *Code of Alabama 1975*, that for a tax period which begins on or after January 1, 2009, meets the gross income and asset tests for a Qualified Investment Partnership as required by §40-18-24.2; and, for which an authorized officer, partner, member or manager of the entity has certified for the tax period that the entity meets the gross income and asset tests

QIP Requirements.

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

1. **Asset Test.** No less than 90% of the cost of the total assets owned by the entity consists of qualifying assets: qualifying investment securities; office facilities; and, tangible personal property reasonably necessary to carry on the activities of the entity as an investment partnership in the State of Alabama. See Line 2, Page 1, Alabama Schedule QIP-C, Qualified Investment Partnership Certification.

2. **Gross Income Test.** No less than 90% of the gross income of the entity consists of qualifying gross income: interest; dividends; distributions; management fees paid by owners of the entity; and gains or losses from the sale or exchange of qualifying investment securities (QIS). See Line 3, Page 1, Alabama Schedule QIP-C, Qualified Investment Partnership Certification.

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

The QIP Asset Test – Line 2, Page 1, Alabama Schedule QIP-C.

For purposes of applying the Asset Test, the cost of an asset shall be determined for Alabama income tax purposes without regard to depreciation or amortization of the asset, except that the cost of an asset shall include any accrued interest or discount, and shall be reduced by any premium amortization, that has been recognized in the computation of Alabama taxable income of the entity and that is included on the entity's balance sheet as of the date the asset cost is determined.

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

Note: If the information concerning the entity's assets is only

available on a quarterly basis, the entity may then use available quarterly assets costs to calculate the Average Qualifying Asset Percentage.

The QIP Gross Income Test – Line 3, Page 1, Alabama Schedule QIP-C.

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

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

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

Gross income does not include any item of income that is excluded in computing the Alabama taxable income for the entity. Further, the income items used to compute the Alabama QIP Gross Income Test for an entity shall not include income that is exempt from Alabama income taxation or is not subject to Alabama income taxation (i.e., interest earned on obligations of the United States or its possessions and interest earned on obligations of the State of Alabama).

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

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

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

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

1. An entity cannot be a QIP for a tax period when more than 50 percent of its ownership interest or voting interest is owned or controlled, directly or indirectly, by one owner or member, at any time during the tax period. For purposes of this definition, own or control means to own or control directly, indirectly, beneficially, or constructively more than fifty percent (50%) of the voting power or value of an entity. The attribution rules of 26 U.S.C. §318 and the constructive ownership rules of 26 U.S.C §267 will apply in determining ownership and control.

2. An entity that, at any time during a tax period, holds or derives gross income from any qualifying investment security in which it is a dealer shall not qualify as a QIP for that tax period. An entity is a dealer in qualifying investment securities if it regularly purchases qualifying investment securities from or sells qualifying investment securities to customers in the ordinary course of a trade or business or regularly offers to enter into, assume, offset, assign or otherwise terminate positions in qualifying investment securities with customers in the ordinary course of a trade or business. The definition

provided in 26 U.S.C. §475(c) can also be relied upon to determine if an entity shall be classified as a dealer in qualifying investment securities.

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

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

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

6. A Financial Institution, as defined under §40-16-1, cannot be a QIP.

7. **Business Trusts.** The term “business trust” is defined in §40-18-1, *Code of Alabama 1975*. For federal income tax purposes, a business trust is classified as a business entity, not as a business trust. The business entities that a business trust may be classified include only: disregarded entity; partnership; or, corporation.

A business trust that is treated as a partnership for federal income tax purposes can qualify as a QIP, if the entity satisfies the requirements of §40-18-24.2.

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

Definition of Qualifying Investment Securities (QIS). Financial investments as defined by §40-18-24.2, *Code of Alabama 1975*, that must be owned by an entity; and must make up a specified percentage of the entity's total assets; in order for the entity to qualify as a QIP, in accordance with §40-18-24.2. Identified in §40-18-24.2 as being included in the definition of QIS are the following:

1. Common stock;
2. Preferred stock;
3. Preferred securities convertible into common stock;
4. Debt securities convertible into common stock;
5. Debt securities convertible into preferred stock;
6. Bonds, debentures, and other debt securities;
7. Deposits and other obligations of banks and other financial institutions;
8. Stock and bond index securities, future contracts, derivative securities, warrants or options on securities, and, other similar financial securities and instruments;
9. And, other similar or related financial or investments contracts, instruments, or securities.

QIS Restrictions.

The term “qualifying investment securities” does not include:

1. An investment in a captive REIT, as defined by §40-18-1.
2. An interest in a partnership unless the partnership is a Qualified Investment Partnership, as defined in §40-24.2.
3. Loans that are not debt securities.
4. Deposits with a financial institution or bank that are not regulated by the United States government, a state, or by any other political subdivision thereof.

A QIP Must File an Alabama Partnership Income Tax Return.

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

A QIP must file an annual composite income tax return, as required by §40-18-24.2., if the QIP is required to make a composite payment for a nonresident member.

The allocation and apportionment requirements set out in the Multi-state Tax Compact, codified in Chapter 27, Title 40, *Code of Alabama 1975*, and all rules pertaining to such laws are applicable to Alabama income tax returns required to be filed Qualified Investment Partnerships.

Taxpayer Treatment of QIP Income.

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

The term “majority owned” is defined in §40-18-24.3, and includes the attribution rules of 26 U.S.C. §318.

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

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

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

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

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

The QIP Alabama income tax reporting requirements do not change the Alabama income tax return filing requirements for business entities that own an interest in a QIP.

Status of Consent Agreements (Alabama Schedule NRA) Previously Filed for Subchapter K Entities.

Any consent agreements filed by a subchapter K entity, as defined in §40-18-1, *Code of Alabama 1975*, for its nonresident members prior to the passage of the Entertainment Industry Incentive Act of 2009 by the Alabama Legislature are void, effective for tax years beginning after December 31, 2009.

Revenue Commissioner's Authority to Correct Tax Avoidance Efforts by Taxpayers.

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

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

General Instructions

Page 1 – Heading. Please check the appropriate box indicating if the taxable year for the return is a calendar year, a short year or a fiscal year. Please provide the beginning date and the ending date of the taxable year, if the taxable year is other than a calendar year.

Page 1 – Line 1. Please enter the legal name of the partnership and the FEIN of the partnership.

Page 1 – Line 2. Please enter the Average Qualifying Asset Percentage for the Taxable Year from page 2, line 2n, of the return.

Page 1 – Line 3. Please enter the Qualifying Gross Income Percentage for the Taxable year from page 2, line 3g, of the return.

Page 1 – Lines 4 through 7. Please check the appropriate boxes and provide the name and tax ID number for the applicable nonresident owners or members. If more room is needed please provide the requested information as an attachment to the Alabama partnership income tax return.

Page 1 – Signature Area. Please provide the signature and information requested.

Page 2 – Line 2. QIP Asset Test. Please provide the information for each column as of the beginning of the taxable year and as of the end of each month of the taxable year. The percentage required for line 2n is an average of the percentages entered on Lines 2a through 2m. If quarterly figures are being used, complete line 2a beginning of the year information, lines 2b through 2e one for each quarter and line 2n Average Qualifying Asset Percentage for the Taxable Year.

Page 2 – Line 3. QIP Gross Income Test. Please enter the qualifying income for the taxable year as requested on lines 3a through 3f. Please provide a total of the qualifying income for the taxable year on line 3e. Please enter the gross income for the taxable year on line 3f. Please enter, as a percentage on Line 3g, the amount entered on line 3e (Total Qualifying Income for the Taxable Year) divided by the amount entered on line 3f (Gross Income for the Taxable Year).

Note: For entities needing additional information about transitional year relief and for composite filing requirements for Affordable Rental Housing Developments please refer to www.revenue.alabama.gov/incometax/ICcurrenttaxissues.htm.