

Issues Concerning the Preparation of the Alabama Schedule K-1 (Form 65 and Form 20S)

Qualified Investment Partnerships. §40-18-24.2, *Code of Alabama 1975*, generally defines a Qualified Investment Partnership (QIP) as 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 meets the gross income and asset requirements for a QIP 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 requirements. Proper certification of a QIP requires the completion of Alabama Schedule QIP-C, *Qualified Investment Partnership Certification*, which must be filed by the due date of the Alabama partnership income tax return for the entity.

Alabama Form 65 and Schedule K-1 for Alabama Form 65 have been revised to accommodate the QIP income tax return requirements. An Alabama partnership return filed by a QIP must be indicated by completing the QIP indicator on page one of the Form 65 and on each K-1 accompanying the return. Nonresident members of the QIP that receive exempt income from the QIP would receive an Alabama Schedule K-1 with the QIP indicator properly marked and with the total amount of Alabama exempt income reported on Line AB, *Alabama Exempt Income*. Regulations to implement the law are on the Department's Web site at www.revenue.alabama.gov.

Qualifying Employers Deduction for Employee Health Insurance (Small Business Health Insurance Premium Deduction). The Alabama Legislature passed Act Number 2011-155 during the 2011 legislative session. The law allows qualifying employers to deduct one hundred percent (100%) of the amount paid as health insurance premiums on qualifying employees in connection with an employer-provided health insurance plan.

The amount of the deduction should be entered on Line 10 of the Schedule K for the Alabama partnership income tax return or the Alabama S-Corporation return. Each owner/shareholder should receive an Alabama Schedule K-1 reporting on Line Y (Small Business Health Insurance Premiums) the amount of the deduction.

For additional information concerning the deduction, see §40-18-15.3, *Code of Alabama 1975*. Alabama Department of Revenue Regulation Number 810-3-15.3-.01, *Deductions for Small Business Health Insurance Premiums*, is available on the Department's Web site.

Reemployment Act of 2010. The Reemployment Act of 2010, Act Number 2010-557, provides an income tax deduction to employers who hire individuals collecting unemployment or whose unemployment benefits have expired. Employers will receive an income tax deduction up to 50 percent of the gross wages paid to each individual hired from these categories who remains with the employer for 12 consecutive months. The deduction is limited, depending on the wage rates paid to employees and is effective for tax years 2011 and 2012 for employees hired during 2010 and 2011, respectively. This deduction should be reported on line AC. Regulations to implement the new law are being drafted. For additional information, visit our Web site.

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 2011 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. Also indicate if the entity qualifies as a Qualified Investment Partnership (QIP).

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). Check the box if the pass-through entity owner is tax exempt.

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 nonresident or a single member LLC.

Line K. Line K applies only to owners of Subchapter K entities. Enter the amount of the owner's capital account at the end of the year, as shown on the federal Schedule K-1 for the owner.

Line L. Enter additional notes, as needed.

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

Please note: The term "gross income," in the case of a resident individual, includes income from sources within and outside Alabama,

and in the case of a nonresident individual, includes only income from property owned or business transacted in Alabama. The Alabama K-1 has two columns in some boxes of Part III. The first column of Part III is income allocated and apportioned to Alabama. This column should be completed for both residents and nonresident partners/shareholders. The second column of Part III should be completed for resident partners/shareholders only. This column should include the resident's share of income (loss) from all sources, including income (loss) earned from other states.

For example, a multistate entity has \$100,000.00 of income. 27% is allocated to Alabama. The entity has a nonresident and resident partner/shareholder each receiving 50% of income (loss). On Schedule K-1, the entity would report \$13,500.00 in Column 1, Box M, for **both the nonresident partner/shareholder and resident partner/shareholder**. The entity would report \$50,000.00, income (loss) from all sources, in Column 2, Box M, for the resident partner/shareholder.

Line M. Enter the pass-through entity owner's pro rata share of the nonseparately stated income allocated and apportioned to Alabama.

Line N. Line N applies only to owners of subchapter K entities.

Enter the pass-through entity owner's pro rata share of guaranteed payments apportioned to Alabama.

Line O. Enter the pass-through entity owner's pro rata share of the section 179 expense apportioned to Alabama.

Line P. Enter the pass-through entity owner's pro rata share of the interest expense related to portfolio income apportioned to Alabama.

Line Q. Enter the pass-through entity owner's pro rata share of the portfolio income apportioned to Alabama. 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. Enter the pass-through entity owner's pro rata share of the other expenses related to portfolio income apportioned to Alabama. 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. Enter the pass-through entity owner's pro rata share of the charitable contributions apportioned to Alabama.

Line T. Enter the pass-through entity owner's pro rata share of the other separately stated business items apportioned to Alabama. 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. Enter the amount of the Alabama composite payment made on behalf of the pass-through entity owner.

Line V. Enter the pass-through entity owner's pro rata share of the U.S. income taxes paid by the pass-through entity and apportioned to Alabama, if any.

Line W. Enter the pass-through entity owner's pro rata share of the casualty losses apportioned to Alabama.

Line X. Enter the amount of withdrawals and distributions made to the pass-through entity owner.

Line Y. Enter the pass-through entity owner's pro rata share of the small business health insurance premiums.

Line Z. Enter the pass-through entity owner's pro rata share of the oil and gas depletion apportioned to Alabama. 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. Enter the pass-through entity owner's pro rata share of separately stated nonbusiness items allocated to Alabama. 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. Enter the pass-through entity owner's pro rata share of income exempt from Alabama income taxation. The pass-through entity owner must be provided with the nature and amounts of the different Alabama exempt income reported on Line AB.

Line AC. Enter the pass-through entity owner's pro rata share of qualified wages as allowed by Act Number 2010-557.

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 Web site (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.

Note: Nonresident owners/shareholders would report income (loss) allocated and apportioned to Alabama as stated in Part III, Column 1 of Schedule K-1. Resident owners/shareholders are required to report income from sources within and outside Alabama as indicated on Part III, Column 2 of Schedule K-1.

Line M. Pass-through entity owners that are individuals would report this amount, less any amount shown on Line Y, on Schedule E of the Alabama Form 40 or Alabama Form 40NR.

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

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

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

Line W. 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. 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 Y. Pass through owners should subtract the amount shown on line Y from the amount shown on line M. This figure represents the additional health insurance deduction allowed for small business employers with Alabama employees. For more information on this deduction, see §40-18-15.3.

Line Z. 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. 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. 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.

Line AC. Pass-through entity owners that are individuals would enter this amount (as a negative) on Alabama Form 40 or Alabama Form 40NR, Page 2, Part I, Line 8.

Domestic Production Activities Deduction

Internal Revenue Code Section 199

Added by the American Jobs Creation Act of 2004 (P.L. 108-357), Internal Revenue Code Section 199 allows taxpayers the Domestic Production Activities Deduction – which is a deduction for income attributable to domestic production activities. The deduction is effective for tax years beginning in 2005 and thereafter. According to federal income tax law, a taxpayer engaged in a qualified production activity (QPA) may claim a deduction against gross income equal to the applicable percentage of its qualified production activities income, with certain limitations.

Alabama Income Tax Treatment (Issued: January 1, 2006)

Individuals: Individual taxpayers subject to the Alabama individual income tax law are not allowed to claim the Domestic Production Activities Deduction in computing the taxpayer's Alabama taxable income. The deduction is not allowed to individual taxpayers even if the individual taxpayer is an owner or shareholder of a pass-through entity which has gross receipts derived from qualifying production activities (QPA). Unlike Alabama's corporate income tax, Alabama's individual income tax is not directly tied to federal taxable income. A statutory change to Alabama's individual income tax law would be required to conform to the federal deduction.

Pass-through Entities: Alabama pass-through entities (S-corporations, subchapter K entities, and trusts) do not take the Domestic Production Activities Deduction, but rather report (as a separately stated item) the information required for computing the Domestic Production Activities Deduction to pass-through entity owners and shareholders.

Corporations: Corporations subject to Alabama corporate income tax law are allowed the deduction. The computation of corporate taxable income according to Alabama income tax law is tied to federal taxable income (see Section 40-18-33, *Code of Alabama 1975*).