

Computation of Taxable Income for Alabama Business Privilege Tax (BPT) Purposes

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The Alabama Department of Revenue has identified a significant volume of errors in Alabama business privilege tax returns filed by limited liability entities concerning the amount of Taxable Income used in computing the business privilege tax rate for a determination period and the 30% of Taxable Income Deduction allowed to pass-through entities in computing Net Worth in Alabama (30% of Taxable Income allowed by Sections 40-14A-24(b)(8) and(9), Code of Alabama 1975).

This document is intended to provide clarity in the preparation of the Alabama business privilege tax return.

The document especially addresses the computation of the business privilege tax rate for a determination period as well as the computation of the deduction allowed to pass-through entities in computing Net Worth in Alabama (The 30% of Taxable Income Deduction allowed by Sections 40-14A-24(b)(8) and(9), Code of Alabama 1975 – see item 6, below).

The document also addresses the question of whether the taxable income amount should be adjusted in any way for certain guaranteed payments to partners.

Please note, the computation/process is complex for certain taxpayers with complex multistate allocation and apportionment issues, but it is a much simpler process for those taxpayers conducting 100% of their business in Alabama, and which do not have nonbusiness income.

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1. Section 40-14A-1(m), Code of Alabama 1975, defines the term “taxable income” as follows:

“...In the case of a C corporation, the amount of its federal taxable income. In the case of an Alabama S corporation, other than a qualified subchapter S subsidiary, the amount taken into account by its owners pursuant to 26 U.S.C. §1366. In the case of a limited liability entity, the amounts taken into account by its owners pursuant to 26 U.S.C. §702. In the case of a real estate investment trust, the real estate investment trust taxable income determined pursuant to 26 U.S.C. §857. In the case of a disregarded entity, the amount taken into account by its owner pursuant to 26 U.S.C. §1361 or §61. In each case, taxable income of the entity subject to tax shall mean its taxable income for the determination period. In each case, taxable income shall be apportioned and allocated to Alabama in accordance with Chapter 18 or in the case of a financial institution, Chapter 16, or in accordance with Title 27 relating to insurance companies...”

2. To summarize Section 40-14A-1(m) for limited liability entities; taxable income for a limited liability entity is the total amount that must be taken into account by its owners pursuant to Internal Revenue Code § 702, which shall be apportioned and allocated in accordance with the Alabama Multistate Tax Compact (Chapter 27, Title 40, Code of Alabama 1975). This taxable income amount generally does not appear on Alabama or federal partnership income tax returns, and must be computed separately for the Alabama business privilege tax return.

3. Also, to determine the tax rate to use in computing the Alabama business privilege tax, a limited liability company must follow Alabama regulation number 810-2-8-.01, Taxable Income for Determining the Applicable Privilege Tax Rate, which states for limited liability entities:

“...The taxable income used to determine the tax rate for the privilege tax shall be the federal ordinary income or (loss) from trade or business activities plus any items of income or expenses passed through to the shareholders that were determined pursuant to 26 U. S. C. §702. This income shall be apportioned in accordance with §40-27-1, Code of Alabama 1975, and the accompanying rules...”

4. Internal Revenue Code § 702 generally requires the owners to report as income their distributive share of the separately-stated and nonseparately stated items of partnership taxable income.

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5. Internal Revenue Code § 707 allows a partnership to deduct as an ordinary and necessary business expense certain guaranteed payments to partners, in computing the partnership's taxable income. But, the partner to whom the guaranteed payment is made must report the guaranteed payment as income accordance with Internal Revenue Code § 61, not Internal Revenue Code § 702. Therefore, for Alabama business privilege tax purposes, if the guaranteed payment to partners is properly allowed as a deduction in computing the partnership taxable income, no adjustment of the taxable income amount is required.

6. A limited liability entity computes the taxable income amount for determining the Alabama business privilege tax rate by following the four steps listed below.

Step Number One. Compute the total amount to be taken into account by its owners pursuant to 26 U.S.C. §702 by computing the income (loss) effect of the items listed in federal Form 1065, Schedule K, lines 1 through 13d, as follows:

2008 Form 1065 – Schedule K

Ordinary business income (loss)	Line 1,
Net rental	Line 2,
Other gross rental income	Line 3c,
Interest income	Line 5,
Dividends	Line 6a,
Royalties	Line 7,
Net short-term capital gain(loss)	Line 8,
Net long-term capital gain (loss)	Line 9a,
Net Section 1231 gain (loss)	Line 10,
Other income (loss)	Line 11,
Section 179 deduction	Line 12,
Contributions	Line 13a,
Investment interest expense	Line 13b,
IRC Section 59(e)(2) expenditures	Line 13c(2),
Other deductions	Line 13d, and
Total foreign taxes	Line 16l.

The total income (loss) effect of the items listed, above, equals the total amounts to be taken into account by the partnership's owners pursuant to 26 U.S.C. §702.

NOTE: If the limited liability entity does not have income subject to allocation for the determination period and operates solely in the State of Alabama, then Steps Number Two, Three and Four are not required. The taxable income for Alabama business privilege tax purposes would have been fully computed in Step Number One.

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Step Number Two – Adjustment for Income Subject to Allocation.

The total amount to be taken into account by the limited liability entity owners pursuant to 26 U.S.C. §702 (the amount computed in Step Number One) is adjusted for income subject to allocation (See the Alabama Multistate Compact - Chapter 27, Title 40, Code of Alabama 1975).

The total amount of income subject to allocation in accordance with the Alabama Multistate Compact is computed on Alabama Form 65, Schedule B, Allocation of Nonbusiness Income, Loss, and Expense and equals the total of the amounts shown on Alabama Form 65, Schedule B, Line 1d, Column E, and Line 1h, Column E.

NOTE: Step Number Two is not required if for the determination period the limited liability entity does not have nonbusiness income subject to allocation in accordance with the Alabama Multistate Compact.

Step Number Three – Apportionment of Income to Alabama.

The income computed in Step Number One is adjusted by the amount of nonbusiness income computed in Step Number Two. The resulting amount is then multiplied by the Alabama Apportionment Factor.

The Alabama Apportionment Factor is computed on Alabama Form 1065, Schedule C, Apportionment Factor Schedule. The Alabama Apportionment Factor is should be found on Line 26 of Schedule C, and is a percentage computed to four decimal places.

If the entity does business only in Alabama, the Alabama Apportionment Factor would be 100.0000%.

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Step Number Four – Adjustment of Income Apportioned to Alabama for Income Allocated to Alabama Resulting in Federal Taxable Income Allocated and Apportioned to Alabama .

The amount computed in Step Number Three is added to income allocated to Alabama in accordance with Chapter 27 - resulting in Federal Taxable Income Allocated and Apportioned to Alabama.

The total amount of income allocated to Alabama in accordance with Chapter 27 is computed on Alabama Form 65, Schedule B, Allocation of Nonbusiness Income, Loss, and Expense and equals the total of the amounts shown on Alabama Form 65, Schedule B, Line 1d, Column F, and Line 1h, Column F.

NOTE: Step Number Four is not required if for the determination period the limited liability entity does not have nonbusiness income subject to allocation in accordance with the Alabama Multistate Compact.

NOTE: If the limited liability entity does not have income subject to allocation for the determination period and operates solely in the State of Alabama, then Steps Number Two, Three and Four are not required. The taxable income for Alabama business privilege tax purposes would have been fully computed in Step Number One.

7. Thirty Percent Deduction Available to Pass-through Entities. The amount available to pass-through entities in accordance with Section 40-14A-24(b)(8) and (9) is equal to 30% of the Federal Taxable Income Allocated and Apportioned to Alabama as computed in item 6, above.