

810-3-174-.02 Built-In Gains Tax.

(1) For purposes of this rule, the following definitions shall apply:

(a) "Net unrealized built-in gain" means the excess of the fair market value of the S corporation's assets when it first became an S corporation over the aggregate adjusted basis of those assets at the same time.

(b)1. "Net recognized built-in gain" means, with respect to any taxable year, the lesser of:

(i) The amount which would be taxable income of the Alabama S corporation if only recognized built-in gains and losses were taken into account, or

(ii) The S corporation's taxable income determined without regard to the dividends received deduction under Section 40-18-35(a)(14), Code of Alabama 1975 and the net operating loss deduction under Section 40-18-35.1, Code of Alabama 1975.

2. For any taxable year, any excess of the amount in paragraph (b)(i) over the amount in (b)(ii) is carried forward to the next taxable year.

(c) "Recognized built-in gain" means any gain recognized during the recognition period on the disposition of any asset except for assets not held by the S corporation on the first day of the first S year and for assets on which the gain is attributable to appreciation that occurred after the corporation became an S corporation.

(d) "Recognized built-in loss" means any loss during the recognition period on the disposition of any asset except for assets not held on the first day of the first S year and for assets on which the loss is attributable to depreciation that occurred after the corporation became an S corporation.

(e) "Recognition period" means a ten-year period beginning with the first day of the S corporation's first tax year.

(f) The "first taxable year for which the corporation was an Alabama S corporation" means the first taxable year for which the corporation most recently became an Alabama S corporation.

(2) The tax is imposed upon any Alabama S corporation which has a net recognized built-in gain for any taxable year beginning in the recognition period.

(a) The tax shall not apply to any Alabama S corporation which has always been an Alabama S corporation.

(b) The amount of any net recognized built-in gain taken into account for any taxable year shall not exceed the amount of the net unrealized built-in gain less any net recognized built-in gain for prior taxable years beginning in the recognition period.

1. For example, if an Alabama S corporation has a net unrealized built-in gain of \$100,000, and during the first 5 years of the recognition period reports net recognized built-in gain of \$70,000, then the maximum amount which can be reported as net recognized built-in gain during the final 5 years of the recognition period is \$30,000.

(c) The tax is computed by multiplying five percent times the net recognized built-in gain for the taxable year.

(d) Any net operating loss carryforward arising in a tax year in which the corporation was a C corporation and which would be deductible except for Section 40-18-168, Code of Alabama 1975, may be used to offset the net recognized built-in gain for the taxable year. For purposes of this paragraph, the net recognized built-in gain shall be treated as taxable income. For tax years beginning prior to January 1, 1990, the maximum amount of net operating loss carryforward deductible in any tax year is \$600,000.

(e) Section 40-18-174(d)(5), Code of Alabama 1975, specifies that any items of income or deduction properly taken into account for any tax year in the recognition period but which are attributable to periods before the first taxable year for which the corporation was an Alabama S corporation shall be treated as recognized built-in gains or losses for the tax year in which they are properly taken into account. Therefore, "disposition of any asset" referred to in the definitions of "recognized built-in gain" and "recognized built-in loss" includes not only sales or exchanges but also any income recognition event which effectively relinquishes a taxpayer's right to claim or receive income.

1. For example, the term "disposition of any asset" includes the collection of account receivable by a cash basis taxpayer or the completion of a long-term contract by a taxpayer using the completed contract method of accounting.

2. The amount of net unrealized built-in gain shall be adjusted for amounts treated as recognized built-in gains or losses under this paragraph.

(f) If an asset with a built-in gain or loss is exchanged for another asset and the new asset's basis is determined in whole or in part by reference to the basis of the old asset, the net asset will be treated as having been held by the S corporation as of the first

day of the first taxable year of the S corporation and as having the same built-in gain or loss as the old asset.

(g) If an Alabama S corporation acquires any asset from a C corporation and the basis of the asset in the hands of the S corporation is determined in whole or in part by reference to its basis in the hands of the C corporation, then a tax is imposed on any net recognized built-in gain attributable to any such asset for any tax year beginning in the recognition period.

1. For purposes of subparagraph (g), in computing the amount of the net recognized gain or loss, the day on which the S corporation acquired the asset shall be substituted for the beginning of the first tax year in which the corporation is an S corporation.

2. For purposes of subparagraph (g), the tax shall apply to all Alabama S corporations, including those that have always been Alabama S corporations.

(3) Those companies subject to the tax should complete the appropriate schedules of Alabama S corporation Form 20S, which is due on the fifteenth day of the third month following the end of the tax year (See Rule 810-3-42-.01). The tax is due at the same time as the return.

(a) An extension will be granted up to a maximum of six months to file the Alabama S corporation income tax return. An extension of time to file the return is not an extension of time for payment of the tax. The amount of tax due must be paid on or before the due date of the return without regard to the extension to file the return. Interest and penalties are due on all taxes not paid on or before the unextended due date. See Rules 810-3-42-.01 and 810-3-39-.02.

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