

(1) For purposes of Chapter 18 of Title 40, Code of Alabama 1975, when the legislature adopts a specified section or sections of Title 26, United States Code ("26 U.S.C." or "IRC") or a federal public law (Pub. L. or P.L.), references shall be to those specified sections as amended from time to time.

(2) When any gain, loss, income, basis, earnings and profits, or any other item is to be determined in accordance with the provisions of federal law (Title 26, United States Code or public law) which have been adopted, by reference or otherwise, into Alabama law, such computations shall be applied using the principles provided in the pertinent federal laws and regulations.

(3) Federal rules applied on a separate-company basis. Section 40-18-33, Code of Alabama 1975, adopts federal taxable income as the starting point in calculating a corporation's Alabama taxable income.

(a) "Federal taxable income" means federal taxable income calculated on a separate-company basis using federal principles.

(b) A corporate income taxpayer that files as part of a federal consolidated return must determine its federal taxable income on a separate-company basis. In doing so, they must apply the principles of certain federal rules that were applied at the group level in the calculation of federal consolidated income on a separate-company basis.

1. Example. Federal law allows a domestic activities production deduction (DPAD) in the calculation of federal taxable income for corporations that manufacture or produce their goods in the United States. A corporation filing as part of a federal consolidated return may be attributed a portion of a DPAD earned by the federal consolidated group. However, a corporation must determine its DPAD for Alabama tax purposes without regard to the activities and tax attributes of the larger federal consolidated group. See *GKN Westland Aerospace, Inc. v. Alabama Department of Revenue*, Alabama Department of Revenue, Administrative Law Division, Dkt. No. BIT 10-988, July 25, 2011.

(b) Alabama law requires modifications to federal taxable income in calculating Alabama taxable income. Such modifications should not affect the calculation of federal taxable income as defined by this paragraph. See *Sherwin-Williams Co. v. Alabama Department of Revenue*, Alabama Tax Tribunal, Dkt. Nos. BIT 13-359 and BIT 11-741, Nov. 30, 2016.

1. Example. Taxpayers are required to add back to federal taxable income certain inter-company transactions pursuant to Section 40-18-35(b), Code of Alabama 1975. This modification will not affect the calculation of federal taxable income as defined by this paragraph.

(c) Adjustments to Federal Limitations. Alabama's income tax laws are tied to various federal income tax limitations. Certain fundamental differences in the calculation of federal taxable income and Alabama taxable income require that adjustments be made to the federal limitation before they can be used in the calculation of Alabama taxable income as described below.

1. Federal limitations calculated at the corporate consolidated group level and used in the calculation of consolidated federal taxable income for the corporate group must be adjusted to reflect the fact that Alabama corporate taxpayers, even those participating in the filing of a post 2001 Alabama consolidated return, must calculate Alabama taxable income on a separate company basis. For this reason, federal limitations applicable in the calculation of Alabama corporate taxable income must be calculated on a separate entity basis.

(i) Example. Contributing Corporation C, a member of a federal affiliated group filing a consolidated federal corporate income tax return, contributes \$10 to the American Red Cross, which is a qualifying charitable contribution under IRC §170(c) and is the group's only such charitable contribution that year. Contributing Corporation C has \$20 of separate-company federal taxable income before the contribution deduction, but the group has \$200 of taxable income before the contribution deduction. Because the ten percent (10%) charitable contribution deduction limitation of IRC §170(b)(2) is calculated at the group level for corporations filing federal consolidated returns, Contributing Corporation C's contribution deduction is not limited for federal purposes. However, because Alabama tax law requires separate company calculations, for purposes of calculating Contributing Corporation C's Alabama taxable income, only \$2 ($\$20 \times 10\%$) of the \$10 contribution is deductible. The remaining \$8 contribution may be carried forward under the federal carryforward rules.

(4) Federal limitations subject to allocation and apportionment. Federal limitations are calculated without regard to allocation and apportionment, which are state income tax concepts that have no counterpart in the federal income tax system. Federal limitations must be adjusted to reflect the fact that Alabama multistate taxpayers must calculate Alabama taxable income on a post-allocation and apportionment basis. For this reason, federal limitations applicable in the calculation of the Alabama taxable income of multistate taxpayers must be calculated on a post-allocation and apportionment basis.

(a) Example. Alabama's net operating loss (NOL) rules are tied to IRC §382, a federal limitation to the utilization of NOLs. See Code of Ala. 1975, §40-18-35.1(6). When a loss corporation experiences an ownership change and the provisions of IRC §382 apply, the Alabama apportionment factor of the loss corporation for the reporting period including the ownership change must be used to compute the IRC section 382 limitation applicable to Alabama multistate taxpayers. For example, Loss Corporation L

experiences an ownership change that triggers an IRC §382 limitation. The annual federal limitation is \$10. For the reporting period including the ownership change Loss Corporation L's Alabama apportionment factor is twenty percent (20%). The federal limitation of \$10 must be apportioned to Alabama using Loss Corporation L's Alabama apportionment factor of 20%, creating an Alabama limitation of \$2.

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