

Supplement to the Department's Analysis of Federal Tax Law Revisions on the State of Alabama

On July 30, 2018, the Department of Revenue (DOR) published initial guidance regarding the statutory ties between the federal tax law changes made by the Tax Cuts and Jobs Act (TCJA) and Alabama law. This analysis addressed the ties between the federal tax code and the Alabama tax code for relevant TCJA provisions.

At the time the analysis was published, the Financial Institution Excise Tax (FIET) law defined net income broadly as encompassing all gross income of the financial institution, less certain deductions that for the most part were not expressly tied to federal income tax provisions. Under this statutory scheme, the DOR traditionally allowed items of income reported by the financial institution to be computed similarly to those same items of income addressed in federal law, unless Alabama rules provided direct guidance on these items. Absent express ties to federal provisions, however, it was not clear whether changes effected by the TCJA would affect the calculation of FIET.

Due to these uncertainties, a working group was formed consisting of the DOR personnel, representatives of financial institutions, and tax practitioners; facilitated by the Alabama Bankers Association. In the course of this collaboration, it became evident that fundamental reforms were needed to clarify the calculation of net income for FIET taxpayers, simplify reporting, and simplify the distribution of FIET collections to local governments.

The Alabama Legislature recognized the need for FIET reform and enacted the Financial Institution Reform Act of 2019 (FIETRA), [Act 2019-284](#). This act updates the antiquated FIET statute, which had not been substantially revised since being adopted in 1935. The act provides clarity, simplicity, and administrative ease for taxpayers and the DOR. The act is operative for tax years beginning after December 31, 2019, with limited exceptions.

An updated analysis of the TCJA and how it affects Alabama FIET law is provided in this supplement and applies to tax years beginning on or after January 1, 2020.

Financial Institution Excise Tax Reform

(Tax years beginning on or after 1/1/2020)

The computation of Alabama's financial institution excise tax (FIET) for all financial institutions, except credit unions, begins with federal taxable income without the benefit of federal net operating losses plus certain additions and subtractions allowed by §40-16-1.2. The FIET statute also provides for a deduction for federal income taxes paid (§40-16-1.2 (b)(2)). This analysis addresses the existing ties between the federal tax code and the Alabama FIET for relevant TCJA provisions. For purposes of the FIET, the calculation of Alabama net income for credit unions is not tied to federal taxable income. As a result, the provisions included in this analysis are applicable to financial institutions, other than credit unions.

Reduces corporate income tax rate (IRC 11 and 1445)

- Reduces the corporate income tax rate from 35% to 21%.

Effective Date: *Tax years beginning after 12/31/2017*

Tied to Federal: *No*

Repeals alternative minimum tax (AMT) (IRC 55, 56, and 59)

- The corporate AMT is repealed.

Effective Date: *Tax years beginning after 2017*

Tied to Federal: *No*

Modifies net operating losses (NOL) (IRC 172)

- Repeals the carryback rule for NOLs and allows for indefinite carryforward.
- NOL deduction is limited to 80% of the taxable income for any given year.

Effective Date: *Repeal of carryback: NOLs arising in tax years ending after 12/31/2017.*

NOL limited to 80%: Losses arising in tax years beginning after 12/31/2017.

Tied to Federal: *No*

Repeals domestic production activities income deduction (IRC 199)

- Repeals deduction for income attributable to domestic production activities. The current maximum deduction is 9% of the related income and is intended to provide tax relief for businesses that produce goods in the United States rather than producing it overseas.

Effective Date: *Tax years beginning after 12/31/2017*

Tied to Federal: *Yes, for tax years beginning on or after 1/1/2020*

Corresponding State Authority: *§40-16-1(3)*

Qualified business income (QBI) (IRC 199A)

- Allows taxpayers other than corporations a deduction of 20% of QBI earned in a qualified trade or business, subject to certain limitations.

Effective Date: *Tax years beginning after 12/31/2017 and before 1/1/2026*

Tied to Federal: *No, QBI deduction is not allowed for Alabama purposes*

Adjusts section 179 expensing (IRC 179)

- Expands section 179 expensing cap from \$500,000 to \$1,000,000 and increases the phase out threshold to \$2,500,000.
- Otherwise-qualifying residential property is no longer excluded from section 179 property and more building improvements are made eligible under section 179 property.

Effective Date: *Property placed in service in tax years beginning after 12/31/2017*

Tied to Federal: *Yes, for tax years beginning on or after 1/1/2020*

Corresponding State Authority: *§40-16-1(3)*

Extension, expansion, and phase-down of bonus depreciation (IRC 168)

- Increases bonus depreciation for qualified property placed in service on or after 9/27/2017 and before 1/1/2023 from the current rate of 50% to 100%.
- Beginning in 2023 (2024 for longer production assets), the bonus depreciation decreases by 20% each year.

Effective Date: *Property placed in service after 9/27/2017*

Tied to Federal: *Yes, for tax years beginning on or after 1/1/2020*

Corresponding State Authority: *§40-16-1(3)*

Limits like-kind exchange treatment (IRC 1031)

- Allows for like-kind exchanges only with respect to real property that is not held primarily for sale. Formerly, like-kind exchanges included a wide range of property from real estate to tangible personal property.

Effective Date: *Exchanges beginning after 12/31/2017*

Tied to Federal: *Yes, for tax years beginning on or after 1/1/2020*

Corresponding State Authority: *§40-16-1(3)*

Limits net interest deduction (IRC 163, 381, and 382)

- Limits the business interest deduction for any taxable year to the sum of (1) business interest income; (2) 30% of the taxpayer's adjusted taxable income; and (3) floor plan financing interest. Disallowed interest expense may be carried forward indefinitely to succeeding taxable years.
- The business interest limitation does not apply to taxpayers with average annual gross receipts, over the prior three-year period, that are \$25,000,000 or less.

Effective Date: *Tax years beginning after 12/31/2017*

Tied to Federal: *Yes, for tax years beginning on or after 1/1/2020*

Corresponding State Authority: *§40-16-1(3)*

Section 40-16-1.2(a)(5) provides for a deduction for any interest not deductible under 26 U.S.C.

§163(j)(1). Therefore, an Alabama deduction will be allowed if these amounts are included in federal taxable income.

Small business accounting method changes (263A, 447, 448, 460, and 471)

- The new law includes the following provisions to reform and simplify small business accounting methods:
 - Increases threshold for cash method of accounting – The three-year average annual gross receipts test is increased to \$25,000,000 (IRC 447 and 448).
 - Modifies accounting for inventories - Alternatives to inventory accounting are made available to most small businesses meeting a \$25,000,000 gross receipts test (IRC 471).
 - Modifies accounting method for qualifying small construction contracts - Gross receipts limit to qualify for small construction contract exception to percentage of completion method is raised to \$25,000,000 (IRC 460).
 - Increases exemption for capitalization and inclusion of certain expenses in inventory costs - Expanded to apply to producers and resellers meeting the \$25,000,000 gross receipts test (IRC 263A).

Effective Date: *Tax years beginning after 12/31/2017*

Tied to Federal: *Yes, for tax years beginning on or after 1/1/2020*

Corresponding State Authority: *§40-16-1(3)*

+ Amortization of research and experimental (R&E) expenditures (IRC 41, 174, and 280C)

- Requires taxpayers to capitalize and amortize section 174 R&E expenditures over a five-year period (fifteen years for businesses conducted outside of the U.S).
- Specified R&E expenditures subject to capitalization include expenses for software development, but not expenses for land or for depreciable or depletable property used in connection with the research or experimentation. Exploration expenses incurred for ore or other minerals (including oil and gas) are also excluded.

Effective Date: *Tax years beginning after 12/31/2021*

Tied to Federal: *Yes, for tax years beginning on or after 1/1/2020*

Corresponding State Authority: *§40-16-1(3)*

+ Limits deduction by employers of expenses for fringe benefits and entertainment expenses (IRC 274)

- Repeals the exclusion and deduction for qualified moving expense reimbursements and qualified transportation fringes, including reimbursement of employee commuting expenses.
- Limits employer deduction for employee achievement awards such as cash, gift cards, and certain other property.
- Eliminates the employer's tax deduction for most entertainment, amusement, and recreation expenses - even if those expenses are related to the employer's business (such as hosting a client at a sporting event), as well as on premise gyms or other amenities, and membership dues for employees that are primarily personal in nature.
- Business deduction is denied for entertainment expenses.

Effective Date: *Tax years beginning after 12/31/2017*

Tied to Federal: *Yes, for tax years beginning on or after 1/1/2020*

Corresponding State Authority: *§40-16-1(3)*

+ Base erosion and anti-abuse tax (BEAT) (IRC 59A)

- Establishes a base erosion minimum tax to prevent income shifting by imposing a tax on corporations that make substantial payments to foreign affiliates.
- The tax is structured as an alternative minimum tax that applies when a multinational company reduces its regular U.S. tax liability to less than a specified percentage of its taxable income, after adding back deductible base eroding payments and a percentage of tax losses claimed that were carried from another year.

Effective Date: *Tax years beginning after 12/31/2017*

Tied to Federal: *No*

Note: *Any additional federal payments made as a result of tax due under 26 U.S.C. §59A may not be considered in computing the federal income tax deduction for taxpayers subject to FIET.*

Global intangible low-taxed income (GILTI) (IRC 951A)

- Provides that a U.S. shareholder of any controlled foreign corporation (CFC) must include in taxable income its pro-rata share of GILTI.
- GILTI is considered the excess of the shareholder's net CFC income over the shareholder's net deemed tangible income.

Effective Date: *Tax years beginning after 12/31/2017*

Tied to Federal: *Yes, for tax years beginning on or after 1/1/2020*

Corresponding State Authority: *§40-16-1(3)*

Section 40-16-1.2(a)(7) provides a deduction for the amount of global intangible low-taxed income that is included in gross income under 26 U.S.C. §951A. Therefore, an Alabama deduction will be allowed if these amounts are included in federal taxable income.

Note: *Any additional federal payments made as a result of tax due under §951A may not be considered in computing the federal income tax deduction for taxpayers subject to FIET.*

Deduction limits for FDIC premiums (IRC 162)

- Limits the amount certain financial institutions may deduct for premiums paid pursuant to an assessment by the Federal Deposit Insurance Corporation to support the deposit insurance fund.

Effective Date: *Tax years beginning after 12/31/2017*

Tied to Federal: *Yes, for tax years beginning on or after 1/1/2020*

Corresponding State Authority: *§40-16-1(3)*

Repatriation Income (IRC 965)

- Provides deduction for pre-2018 accumulated deferred foreign income; disallows foreign tax credit for deducted portion and recaptures expatriated entities.
- Pre-2018 accumulated deferred foreign income must be included in Subpart F income upon transition to a participation exemption system. Foreign earnings and profit deficits reduce the pre-2018 accumulated deferred foreign income included in Subpart F.

Effective Date: *Last tax year of a deferred income corporation beginning before 1/1/2018*

Tied to Federal: *Yes. However, because the provisions of §965 only applied to the last tax year beginning before 1/1/2018, financial institutions subject to the new net income calculation under Act 2019-284 will not be affected by this federal provision. Although eligible taxpayers could elect to pay their §965 federal tax liability in installments over an eight-year period, these federal payments may not be considered in computing the federal income tax deduction for taxpayers subject to FIET.*

Corresponding State Authority: *§40-16-1(3)*