Establishment of Qualification for §40-18-35(b) Exceptions.

Pursuant to §40-18-35(b) and Rule 810-3-35-.02, related member interest and/or intangible expenses must be added back to the taxpayer’s apportionable income, unless the taxpayer “shows” or “establishes” that it satisfies an exception described in §40-18-35(b) and Rule 810-3-35-.02. If the taxpayer incurred related member intangible and/or interest expenses that were not added back to apportionable income on its Alabama Corporate Income Tax Return, it must establish that it satisfies an exception. The possible exceptions are listed below:

Section 5 – The recipient related member’s corresponding item of income was, post-allocation and apportionment, subject to a tax on net income in Alabama or another state or a foreign nation (of which, the recipient related member is a resident) which has in force an income tax treaty with the United States. §40-18-35(b)(1).

Section 6 – The taxpayer establishes that the add-back of interest and/or intangible expenses is unreasonable or the Commissioner of Revenue and the taxpayer have agreed, in writing, to an Alternative Adjustment Agreement. §40-18-35(b)(2) and §40-18-35(b)(4).

Section 7 – The recipient related member is a) not primarily engaged in the acquisition, use, licensing, etc. of intangible property or the financing of related entities and b) the underlying transaction(s) giving rise to the related member intangible/interest expenses did not have as a principal business purpose the avoidance of Alabama tax. §40-18-35(b)(3).

General Instructions

1. Schedule AB must be completed for all recipient related members receiving interest and/or intangible payments. Columns are provided on Schedule AB to report each recipient separately. For more detailed help on how to complete this form, see the example following these instructions.

2. If a partnership makes interest/intangible payments to a related member, Schedule PAB should be completed and attached to the partnership’s return.

3. For partnership purposes, to determine Lines 2 and 3, multiply the total interest/intangible payment by the partner’s ownership percentage of the partnership.

Section 5 – Exemption related to §40-18-35(b)(1)

To verify that the related member intangible/interest expense qualifies for the exception in §40-18-35(b)(1), please provide the following:

A. The jurisdiction(s) where the recipient related member is “subject to tax” and income is not being allocated. The recipient related member interest/ intangible income must be “subject to tax” on a post-allocation and apportionment basis in these jurisdictions. A document listing the applicable jurisdictions may be attached if the space provided is not sufficient. Do not include consolidated/combined return jurisdictions where intercompany expenses are eliminated or are offset.

B. The amount of expense subject to apportionment that the taxpayer paid to the recipient related member but is not required to add back pursuant to §40-18-35(b)(1).

C. Enter the sum of all recipient related member apportionment factors for the jurisdictions listed on Line 5a.

D. Multiply the sum of all apportionment factors on Line 5c by the amount of expense subject to apportionment on 5b.

E. If the recipient related member files in a jurisdiction where intangible and/or interest income is allocated rather than apportioned, enter the amount of intangible and/or interest income allocated to this jurisdiction. Also enter the jurisdictions where the expense is allocated in the blank line provided. If necessary, attach a statement.

F. Enter the sum of amounts apportioned to jurisdiction(s) on Line 5d and the amounts allocated to jurisdiction(s) on Line 5e.
termine line 12, the taxpayer would divide the interest paid to related party C ($5,000,000) by the total interest expense ($10,000,000) and then multiply that percentage by the amount of interest disallowed under IRC 163(j) ($2,000,000).

12a. Calculate the amount of IRC 163(j) interest expense that would have been exempt under §40-18-35, if not disallowed under federal rules. Divide Line 11 Exempt Amount by the Total Intangible/Interest expenses paid on line 4, then multiply this amount by the Disallowed Interest Expense on line 12. This is the portion of interest expense that would be exempt from add back pursuant to §40-18-35 but is not deductible pursuant to IRC 163(j). However, this interest expense may be carried forward and deducted in a subsequent tax year in accordance with IRC 163(j).

13. Enter the total of all intangible/interest payments made to related members less the total of all disallowed IRC 163(j) interest (sum of all Line 4’s for each related member recipient minus all line 12’s for each related member recipient). This amount should also be entered on line 6a, Schedule A, Form 20C.

14. Enter the total exempt amount by subtracting line 12a for all related members from line 11 for all related members. The total from line 14 should also be entered on line 6b, Schedule A, Form 20C.