

PUBLICATION

Spotlight on Alabama: New Regulations Propose Filing Requirements for Pass-Through Entities with One or More Non-Resident Members

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The Alabama Department of Revenue recently promulgated regulations dealing with new filing requirements for pass-through entities having one or more non-resident members. Soon after the new regulations were proposed, the Department amended the proposed regulations, and will be holding a hearing on April 28, 2010 to discuss the changes to the new regulations. When finalized, the new regulations (with the proposed changes) will provide that for tax years beginning January 1, 2009 or after, all pass-through entities will have to file a composite return and make composite payments on behalf of their non-resident members if there are one or more non-resident members at any time during the taxable year. A pass-through entity is defined as a partnership or other entity classified as a subchapter K entity, but does not include estates or trusts (except in their capacity as non-resident members) or single-member limited liability companies.

As drafted, the Department's Proposed Regulation 810-3-24.2-.01 provides that in computing the composite payment for each non-resident member, a pass-through entity must apply the maximum income tax rate to each non-resident member's distributive share of income. The allocation and apportionment requirements and all rules pertaining to the Multistate Tax Compact are applicable to composite returns required to be filed by pass-through entities.

A transition rule is included in this proposal for pass-through entities filing composite returns for tax years beginning between January 1, 2009 and December 31, 2009. Under Proposed Regulation 810-3-24.2-.01, for tax the tax year ending December 31, 2009, a pass-through entity may elect to reduce the amount of its composite payment to the extent that its non-resident member made required tax payments (including estimated tax deposits) and files the required Alabama income tax return for the tax year.

The Department has also promulgated proposed regulations dealing with qualified investment partnerships (QIPs). QIPs are generally partnerships used as investment funds. Under Alabama Code § 40-18-24.3, a non-resident member of a QIP is generally exempt from Alabama income tax if the nonresident member does not actually participate in the management of the QIP. Under Proposed Regulation 810-3-24.2-.01, a composite return is due for a QIP only if such QIP is required to remit a composite payment for one or more of its non-resident members. Under that Proposed Regulation, however, a QIP must file an annual Alabama partnership tax return that properly reports required K-1 information for each resident and nonresident member holding an interest in the QIP at any time during the taxable year. In addition, Proposed Regulation 810-3-24.2-.03 provides that each non-resident member of a QIP that has Alabama source income must file an Alabama income tax return (even if the income earned in Alabama is included on composite return), unless such nonresident member's only Alabama source income is income from the QIP. The regulation, as drafted, also requires a nonresident member of a QIP to file an Alabama income tax return in order to establish net operating losses generated by such QIP.

If you have any questions about or wish to discuss the Proposed Regulations, please contact any attorney in the Firm's Tax Department.