

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:

- The jurisdiction(s) where the recipient related member is "subject to tax." 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.**
- The amount of expense the taxpayer paid to the recipient related member, but is not required to add back pursuant to §40-18-35(b)(1).
- 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.
- Subtract the intangible/interest income allocated by the recipient related member on Line 5c from the total amount of interest and/or intangible expense paid by the taxpayer on Line 5b.
- Enter the sum of all recipient related member apportionment factors for the jurisdictions listed on Line 5a.
- Multiply the sum of all apportionment factors on Line 5e by the adjusted intangible/interest amount on Line 5d.
- Add the amount allocated to jurisdiction(s) on Line 5c and the amount apportioned to jurisdiction(s) on Line 5f.

Section 6 – Application for Exception Pursuant to Section 40-18-35(b)(2) and Section 40-18-35(b)(4)

• **Section 40-18-35(b)(2)** – Application for the exception provided in Section 40-18-35(b)(2) must be made in the following prescribed manner: Applicants must follow the statutory steps provided in Section 40-18-35(b)(2) and provide: (1) Detailed financial data and corresponding work papers produced in the analysis of the circumstances particular to the taxpayer that make the adjustment unreasonable pursuant to Rule 810-3-35-.02(3)(h) and/or (2) A signed Alternative Adjustment Agreement between the taxpayer and the Commissioner of Revenue. Please note that the presence of a non-tax business purpose, arm's length pricing, and economic substance of these transactions alone do not qualify for an exception pursuant to Section 40-18-35(b)(2) and will not be accepted. See Section 40-18-35(b)(3).

• **Section 40-18-35(b)(4) – Application for the exception provided in Section 40-18-35(b)(4)** must be made in the following prescribed manner: Applicants must provide a detailed calculation of the interest being transferred through the "recipient related member" to an unrelated third party. If the recipient related member receives interest payments from multiple sources and does not pass-through the entire interest payment, the amount passed through is determined on a pro rata basis.

Section 7 – Exemption related to §40-18-35(b)(3)

To establish that the related member intangible/interest expenses qualify for the exception in §40-18-35(b)(3), provide the following:

7. The amount of expense the taxpayer paid to the recipient related member, but is not required to add back pursuant to §40-18-35(b)(3).

NOTE: If the related member is a partnership or disregarded entity for federal income tax purposes, the receipts included on lines 9a. through 9e. should only include the receipts for the related member receiving the interest or intangible income, not the owner or the other disregarded entities that the related member may be owned by or exist in the same group or division within the same group.

8. and 9. The recipient related member's receipts by category.

Example:

- Intangible Receipts – (Royalties, Factoring Expenses, etc.)
- Interest Receipts
- Gross receipts from the sale of tangible property
- Rental Income

10. If interest or intangible receipts are greater than any other category of receipts, the recipient related member is deemed to be "primarily engaged" in the specified activities and is not eligible for the exception in §40-18-35(b)(3). If another category of receipts is greater than interest/intangible receipts, the recipient related member is deemed to be primarily engaged in an activity other than the financing of related members or the management of intangibles and satisfies part of the exception listed in §40-18-35(b)(3).

NOTE: If the taxpayer is not primarily engaged in the financing of related members and the management of intangibles, it qualifies for only part of the exception listed in §40-18-35(b)(3). In order to qualify for the exception in full, the taxpayer must also sign Schedule AB.

NOTE: To be eligible for the exception listed in §40-18-35(b)(3), an informed corporate officer must affirm that the transaction(s) giving rise to the interest/intangible expenses does not have as a principal purpose tax avoidance (which includes the avoidance of a meaningful amount of Alabama tax).

11. – Determining Your Exempt Amount

To determine the taxpayer's deductible amount of interest/intangible expenses, enter the greater of Lines 5g, 6 or 10a/10b.

12. and 13. should be completed by entering the total for all intangible/interest payments made to related members on Line 12 (sum of Line 4 for each related member recipient) and the total exempt amount on Line 13 (sum of Line 11 for each related member recipient). The totals from Lines 12 and 13 should be carried forward to Lines 6a and 6b, Schedule A, Form 20C.



TAXPAYER NAME: _____ TAXPAYER FEIN: _____ FOR THE TAX PERIOD _____, 20 ____ through _____, 20 ____

Related member is defined to include a corporation, association, disregarded entity, or subchapter K entity (Alabama Code section 40-18-1(13) and (15)). Disregarded entities and subchapter K entities are related members separate and apart from their owner. A column must be completed for each recipient related member.

Recipient related member who received interest/intangible income from the taxpayer:	Related Member 1	Related Member 2	Related Member 3	Related Member 4
1 a. Recipient related member FEIN.....	1a ●			
b. Recipient related member name.....	1b ●			
2 List the intangible expense amounts paid to the recipient related member.....	2 ●			
3 List the interest expense amounts paid to the recipient related member.....	3 ●			
4 Total intangible/interest expenses paid (total lines 2 and 3).....	4 ●			

To determine the exempt amount of intangible/interest expense, complete the applicable section(s) below.

5 Exemption related to §40-18-35(b)(1):				
a. Jurisdiction(s) where recipient related member income is "subject to tax":.....	5a ●			
b. Amount of Line 4 expense not added back.....	5b ●			
c. Recipient related member's corresponding intangible/interest income allocated to jurisdiction.....	5c ●			
d. Adjusted intangible/interest amount (Line 5b minus Line 5c).....	5d ●			
e. Recipient related member's total apportionment percentage in the above jurisdiction(s) ..	5e ●	%	%	%
f. Adjusted interest/intangible amount (multiply Line 5d by Line 5e).....	5f ●			
g. Add Line 5c and Line 5f.....	5g ●			
6 Exemption related to §40-18-35(b)(2) and §40-18-35(b)(4) – Amount of Line 4 expense not added back.....	6 ●			

NOTE: For Section 7, 8, 9, and 10 the receipts of a disregarded entity/subchapter K entity, which may be a related entity in and unto itself, may not be combined with receipts of its owner for purposes of this schedule.

7 Exemption related to §40-18-35(b)(3) – Amount of Line 4 expense not added back.....	7 ●			
8 Recipient related member receipts by category: a. Intangible receipts.....	8a ●			
b. Interest receipts.....	8b ●			
9 a. ●	9a ●			
b. ●	9b ●			
c. ●	9c ●			
d. ●	9d ●			
e. ●	9e ●			
10 a. If either Lines 8a or 8b are greater than Lines 9a, 9b, 9c, 9d or 9e, enter zero.....	10a ●			
b. If Lines 9a, 9b, 9c, 9d or 9e are greater than Lines 8a or 8b, enter amount from Line 7.....	10b ●			
11 Exempt Amount. Enter the greater of Lines 5g, 6, 10a or 10b.....	11 ●			
12 Total Intangible/Interest expenses paid to all related members. (Sum all Line 4 for all related members from all pages, enter here and on Form 20C, Schedule A, Line 6a).....	12			
13 Total Exempt Amount. (Sum line 11 for all related members from all pages and enter this amount on Form 20C, Schedule A, Line 6b).....	13			

Attach additional pages as needed and enter the totals of Lines 4 and Lines 11 for all related members from all pages on Page 1, Line 12 and 13.

In order to qualify for the exemption presented in §40-18-35(b)(3), Line 10b must be greater than zero and an informed corporate officer must sign the statement below, executed under penalty of perjury. With respect to the transaction(s) giving rise to the related member's interest/intangible expenses and costs, including both the direct interest/intangible expense transaction(s) between the taxpayer and the related member and any prior organizational restructuring transaction(s) that facilitated such direct interest/intangible expense transactions, tax avoidance (which included the avoidance of a meaningful amount of Alabama tax) was not a principal motivating factor.

Signature _____

Title _____ Date _____



TAXPAYER NAME: _____ TAXPAYER FEIN: _____ FOR THE TAX PERIOD _____, 20 ____ through _____, 20 ____

A column must be completed for each recipient related member. Attach additional pages as needed and enter the totals of Lines 4 and Lines 11 for all related members from all pages on Page 1, Line 12 and 13.

Recipient related member who received interest/intangible income from the taxpayer:	Related Member 1	Related Member 2	Related Member 3	Related Member 4
1 a. Recipient related member FEIN.....	1a ●			
b. Recipient related member name.....	1b ●			
2 List the intangible expense amounts paid to the recipient related member.....	2 ●			
3 List the interest expense amounts paid to the recipient related member.....	3 ●			
4 Total intangible/interest expenses paid (total lines 2 and 3).....	4 ●			
To determine the exempt amount of intangible/interest expense, complete the applicable section(s) below.				
5 Exemption related to §40-18-35(b)(1):				
a. Jurisdiction(s) where recipient related member income is "subject to tax":.....	5a ●			
b. Amount of Line 4 expense not added back.....	5b ●			
c. Recipient related member's corresponding intangible/interest income allocated to jurisdiction.....	5c ●			
d. Adjusted intangible/interest amount (Line 5b minus Line 5c).....	5d ●			
e. Recipient related member's total apportionment percentage in the above jurisdiction(s) ..	5e ●	%	%	%
f. Adjusted interest/intangible amount (multiply Line 5d by Line 5e).....	5f ●			
g. Add Line 5c and Line 5f.....	5g ●			
6 Exemption related to §40-18-35(b)(2) and §40-18-35(b)(4) – Amount of Line 4 expense not added back.....	6 ●			
<i>NOTE: For Section 7, 8, 9, and 10 the receipts of a disregarded entity/subchapter K entity, which may be a related entity in and unto itself, may not be combined with receipts of its owner for purposes of this schedule.</i>				
7 Exemption related to §40-18-35(b)(3) – Amount of Line 4 expense not added back.....	7 ●			
8 Recipient related member receipts by category: a. Intangible receipts.....	8a ●			
b. Interest receipts.....	8b ●			
9 a. ●	9a ●			
b. ●	9b ●			
c. ●	9c ●			
d. ●	9d ●			
e. ●	9e ●			
10 a. If either Lines 8a or 8b are greater than Lines 9a, 9b, 9c, 9d or 9e, enter zero.....	10a ●			
b. If Lines 9a, 9b, 9c, 9d or 9e are greater than Lines 8a or 8b, enter amount from Line 7..	10b ●			
11 Exempt Amount. Enter the greater of Lines 5g, 6, 10a or 10b.....	11 ●			

FOR RECIPIENT RELATED MEMBERS WHO RECEIVED INTEREST/INTANGIBLE INCOME FROM THE TAXPAYER, PLEASE ATTACH ADDITIONAL SCHEDULES AB. (ONLY USE THIS PAGE FOR ADDITIONAL MEMBERS)