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Alabama: Financial institution excise tax reform legislation

House Bill 419—the Financial Institution Excise Tax Reform Act of 2019—has been presented to the governor for signature.

If signed, this bill would significantly revise the state’s financial institution excise tax (FIET) effective for tax years beginning after December 31, 2019.

Rolling conformity to the IRC

House Bill 419 adds to Ala. Code § 40-16-1 a new definition of “Internal Revenue Code and U.S.C.”

For FIET purposes, all references to the “Internal Revenue Code” or to “26 U.S.C.” would mean the Internal Revenue Code of 1986 as “in effect from time to time.” Thus, going forward, the FIET would conform to the Internal Revenue Code on a rolling basis. Within the definition, authority is granted to the Department of Revenue to adopt “reasonable rules” addressing the adoption for FIET purposes certain provisions of federal law that relate to the determination of federal taxable income.

Net income and NOLs

Currently, the definition of net income for purposes of the FIET is based on gross income with numerous modifications.

House Bill 419 would amend the definition of “net income” to mean:

...federal taxable income without the benefit of federal net operating losses, plus the additions prescribed and less the deductions and adjustments allowed by this chapter, as allocated and apportioned to Alabama according to rules adopted by the Department of Revenue pursuant to Ala. Code § 40-16-4.

The bill specifically provides that financial Institutions not subject to federal income tax would begin the calculation of net income by performing a pro forma calculation of federal taxable income.

Under House Bill 419, a new section would be added to the Alabama law that addresses the modifications that must be made to the federal taxable income starting point. Specifically, new Ala. Code § 40-16-1.2 provides that the following would need to be added to federal taxable income:

- The Alabama FIET due that is deducted in computing federal taxable income
- State and local taxes deducted in calculating federal taxable income for which a credit is claimed under Ala. Code § 40-16-8 to the extent such credit is utilized to reduce the FIET
- Refunds of federal income tax deducted in prior tax periods for FIET purposes
- Dividends received from a corporation in which the taxpayer owns less than 20% of stock—only to extent deducted for federal purposes
- State/county/municipal interest income from loans and securities that is exempt for federal income tax purposes
- Interest treated as paid or incurred in the current tax year under IRC section 163(j)(2)
- The amount of foreign-derived intangible income and global intangible low-taxed income (GILTI) deducted under IRC section 250
- The amount of any capital loss carryback or carryforward deducted for federal purposes

The following items would be deducted from federal taxable income for purposes of computing Alabama net income:

- Refunds of FIET that were included in computing federal taxable income
- Federal income taxes paid or accrued
- If the taxpayer owns 20% or more of the stock, by vote or value, of the distributing corporation, dividend income, including amounts described in IRC section 951 from non-U.S. corporations to the same extent such dividend income would be deductible under IRC section 243 if received from U.S. corporations
- FDIC insurance premiums not deductible for federal purposes under IRC section 162(r)
- Interest not deductible for federal purposes under IRC sections 163(j), 265 or 291
- The amount of GILTI included in gross income under IRC section 951A
- Amounts treated as dividends under IRC section 78.
- Expenses otherwise deductible that were not deducted for federal income tax purposes as a result of electing to claim a federal income tax credit
- Solely for credit unions, amounts paid out as dividends on withdrawable shares of such credit union

Another new section Ala. Code § 40-16-1.3 provides specific rules for determining the net income of credit unions, which would be based on financial statement income.

House Bill 419 provides certain transition rules addressing the tax base.

First, conformity to federal bonus depreciation, as well as the “express rejection” of certain provisions of the 2017 federal tax law commonly known as the “Tax Cuts and Jobs Act” (specifically, the limits on the deductibility of FDIC premiums under IRC section 162(r), limits on deductibility of interest under IRC section 163(j), inclusion of GILTI under IRC section 951A, and the deductions allowed under IRC section 250) would apply retroactively to all open tax years, since these are “merely a clarification of existing law.”

Net operating loss (NOL) measures

New Ala. Code § 40-16-5.10 provides guidance on the FIET net operating loss (NOL) deduction.

Under House Bill 419, NOLs incurred in tax years beginning after December 31, 2019, could be carried forward and deducted only during the 15 consecutive years immediately following the tax year in

which the loss arose. Unlike current law which allows an eight-year carryforward and a two-year carryback, no NOL carrybacks would be allowed.

In the case of a financial institution classified as an acquiring corporation under IRC section 381, or classified as a new loss corporation under IRC section 382, or in the case of the recognized built-in gains of a financial institution classified as a gain corporation under IRC section 384, only the NOLS as allowed under IRC sections 381, 382, and 384 would be allowed as a deduction for Alabama purposes. NOLs incurred by members of a qualified corporate group (as defined) would be deducted in the following order:

- NOLs could be carried forward only on account of the member that incurs the loss and would have to be deducted before consolidating taxable income with other members' income on the consolidated return. The member's remaining losses could be carried forward.
- Current year NOLs of the parent of a qualified corporate group would be allocated among other group members based on percentage of gross assets of the member over all the assets of the other group members (excluding the parent). These losses would also be deducted before consolidating taxable income. If this allocation creates or increases a members' current loss, the loss would become part of that member's carryforward.

Rules for captive real estate investment trusts (REITs)

House Bill 419 would allow a financial institution a deduction for the applicable percentage of dividend income from a "captive REIT" (as defined) if such dividends would be deductible under IRC section 243 had they been received from an entity that is not a REIT. The applicable percentage of dividends that could be deducted would be as follows:

- For tax years beginning after December 31, 2019, and before January 1, 2021 – 100%
- For tax years beginning after December 31, 2020, and before January 1, 2022 – 80%
- For tax years beginning after December 31, 2021, and before January 1, 2023 – 60%
- For tax years beginning after December 31, 2022, and before January 1, 2024 – 40%
- For tax years beginning after December 31, 2023, and before January 1, 2025 – 20%
- There is no deduction available for tax years beginning after December 31, 2024.

Consolidated returns

"Qualified corporate groups" could elect to file one FIET return on a consolidated basis.

Under current law, a \$6,000 fee is imposed on groups that elect to file a consolidated return. House Bill 419 would eliminate the \$6,000 fee.

Further, there are two tests that would have to be met for a financial institution member to be eligible to file on a consolidated basis with other entities—a stock ownership test and a filing test (meaning the member must be a financial institution required to file an Alabama FIET return). Under current law, includable financial institutions connected through stock ownership with a common parent corporation are includable corporations if there is at least 80% direct stock ownership by another includable corporation or the common parent. House Bill 419 would revise the ownership test to include both direct ownership and indirect ownership of stock by another includable corporation or the common parent applying the attribution rules of IRC section 318.

Any election to file on a consolidated basis would be binding on the Department of Revenue and on the qualified corporate group for a period of not less than 10 tax years. However, the election would terminate automatically upon the revocation or termination of the federal consolidated return election.

Estimated payments and due dates

Under current law, no estimated FIET payments are required.

New Ala. Code § 40-16-5.1 provides that financial institutions would generally “pay estimated financial institutions excise tax in accordance with 26 U.S.C. § 6655.” There are, however, certain modifications to federal law that would apply in making Alabama estimated FIET payments. The balance of the FIET owed, after being reduced by credits and prior estimated payments, would be due and paid at the same time as the due date of the original return.

Under current law, the FIET return is due within the first 15 days of April each year. New Ala. Code § 40-16-11 would provide transition rules for the implementation of the Financial Institution Excise Tax Reform Act given that, previously, no estimated payments were required. Accordingly, the Department of Revenue would be required to waive penalties and interest attributable to underpayments of estimated tax occurring within the first two applicable tax years. Penalties and interest would not be waived if they are attributable to intentional disregard of law.

House Bill 419 ties the due date of the FIET return to the due date, including applicable extensions, of the financial institution’s federal income tax or information return.

For more information, contact a KPMG State and Local Tax professional:

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