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ALABAMA DEPARTMENT OF REVENUE

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Summary of Alabama Taxes and Tax Incentives

Secretary of State Qualification

The Department of Revenue administers a variety of taxes that affect companies based inside and outside of Alabama. Before transacting business in Alabama, a foreign corporation (corporation incorporated outside of Alabama) must qualify with the Alabama Secretary of State. Foreign corporations must file an application for certificate of authority (form CD-2) with the Alabama Secretary of State along with a certified copy of the articles of incorporation and must pay a \$175 qualification fee.

In order to form a domestic corporation (a corporation incorporated inside of Alabama), the corporate name must first be reserved with the Alabama Secretary of State. Then, articles of incorporation must be filed with the probate judge of the county in which the corporation has its initial registered office. The fees for filing articles of incorporation are \$50 for the Alabama Secretary of State and \$35 for the probate judge.

Alabama Business Privilege Tax

The Business Privilege Tax applies to all corporations and limited liability entities, including disregarded entities, which do business in Alabama or are organized under the laws of Alabama. This tax replaces the former franchise tax that was declared unconstitutional in March 1999. The tax accrues as of January 1 of every taxable year and is due March 15. In the case of a taxpayer organized during the year, qualifying during the year, or doing business in Alabama for the first time, the tax accrues as of the date of organization, qualification, or beginning to do business and is due 45 days thereafter.

The tax base is the taxpayer's net worth apportioned to Alabama. The rate ranges from \$.25 to \$1.75 for each \$1,000 of net worth in Alabama. The minimum privilege tax is \$100; the maximum privilege tax is \$15,000, except for financial institutions, financial institution groups and insurance companies, which have a maximum privilege tax liability of \$3 million. An electing family limited liability entity is capped at \$500.

Under certain conditions, an enterprise zone credit (Section 5) or exemption (Section 11) for business privilege tax is available for qualified participants. Please be aware that although this program does apply to business privilege tax, the program is administered by the Alabama Department of Economic and Community Affairs (ADECA). Therefore, ADECA will determine whether the project meets the requirements for the program and must certify that to the Alabama Department of Revenue.

Sales and Use Tax

Alabama sales tax is a privilege tax imposed on the retail sale (a sale made to the end-user) of all tangible personal property sold in Alabama by businesses located in Alabama. The use tax is complementary to the sales tax. Businesses or individuals that purchase tangible personal property outside of Alabama upon which no tax is paid to the seller and bring the property back to Alabama for storage, use, or consumption should remit consumer's use tax on the purchase, provided that the property purchased is not for resale.

There are four state rate differentials, which include:

- a 1.5 percent rate for manufacturing and farm machinery,
- a 2 percent rate for automotive vehicles,
- a 3 percent rate for food sold through vending machines, and
- a 4 percent general rate for all other items.

Local governments may also impose a sales and/or use tax. The average combined state and local general tax rate is approximately 8 percent; the average combined state and local manufacturing machinery tax rate is approximately 2.75 percent. Please see the specific sales and use tax rates for the requested locations on the Department's website at www.revenue.alabama.gov. Currently, the department administers the sales and use taxes for over 180 localities, but numerous localities have chosen to administer their own local sales and use taxes. If a locality has chosen to administer its own local taxes, you would be responsible for insuring that the local filing requirements are met.

Statutory Sales and Use Tax Abatements and Exemptions

Alabama's sales and use tax statutes contain many items that give Alabama a definite advantage over other states. These statutes allow exemptions for specific organizations and commodities (see Section 40-23-et al, Code of Alabama 1975). Some of the more common items that are exempt include: gasoline, lubricating oil, fertilizer and insecticides, feed for livestock, wholesale sales, and sales to governmental entities.

There are several sales and use tax abatements and exemptions that are statutorily available. Please see the following paragraphs regarding these abatements and exemptions.

Abatements. If the proper procedures are followed, qualifying industries may abate all state and the local non-educational portion of construction related transaction (sales and use) taxes associated with constructing and equipping a project. For state purposes, the general state sales tax rate of four percent and the state manufacturing machinery and equipment tax rate of 1 and 1/2 percent can be abated to qualifying industries.

Statutory requirement(s):

- Any trade or business in the 2007 North American Industrial Classification System (NAICS), promulgated by the Executive Office of the President of the United States, Office of Management and Budget as:
 - Sectors 31 (except National Industry 311811), 32, and 33 (manufacturing),
 - Subsector 423 and 424 (merchant wholesalers, goods),
 - 511 (publishing industries (except internet)),
 - 927 (space research and technology),
 - Industry Group 5417 (scientific research and development services),
 - 5415 (computer systems design and related services),
 - 5182 (data processing, hosting, and related services),

- Industry 11331 (logging),
- 48691 (pipeline transportation of refined petroleum products),
- National Industry 115111 (cotton ginning),
- 517110 (wired telecommunications carriers),
- 541380 (testing laboratories),
- 561422 (in bound call centers only), or

Any process or treatment facility which recycles, reclaims, or converts materials, which include solids, liquids, or gases, to a reusable product

- Headquarters facilities as defined in NAICS 551114 (where at least 50 new jobs are created);
- Data processing centers (where at least 50 new jobs are created);
- Renewable energy facilities;
- Research & development facilities;
- Projects owned by utilities that produce electricity from alternative energy resources;
- Projects owned by utilities that produce electricity from hydropower production;
- Subsector 493 (Warehousing and Storage), Industry Number 488310 (Port and Harbor Operations), or Industry Number 488320 (Marine Cargo Handling), when such trade or business is conducted on premises in which the Alabama State Port Authority has an ownership and are used as part of the operations of the Alabama State Port Authority; or
- Any underground natural gas storage facility which is located in the Gulf Opportunity Zone, developed from existing geologic reservoirs.

Capital Investment Requirement

New Project:

There is no threshold or limiting investment amount for a new abatement project with the exception of projects owned by utilities producing electricity.

- Projects owned by utilities which produce electricity from alternative energy resources must have capital costs of at least \$100,000,000;
- Projects which produce electricity from hydropower production must have capital costs of at least \$5,000,000.

Major Addition:

The additional capital investment by an industry that is **expanding their current facilities in Alabama** must equal the **lesser** of:

- 30% of the original cost of the currently existing industrial property (sum total of the original facilities and equipment or any expansions or additions prior to the current addition), **or**
- \$2,000,000

Please note that the local granting authority must grant the abatement for the qualifying project before the abatement is effective. Therefore, any purchases made prior to the granting of the abatement are ineligible for the sales and use tax abatement. The abatements for the state and local non-educational sales and use taxes end once the project is placed in service.

Enterprise Zone Exemption. Under certain conditions, an enterprise zone exemption for sales and use tax is available for qualified participants. Please be aware that although this program does apply to sales and use tax, the program is administered by the Alabama Department of Economic and Community Affairs (ADECA). Therefore, ADECA will determine whether the project meets the requirements for the program and must certify that to the Alabama Department of Revenue.

Raw Materials Exemption. Raw materials used by manufacturers or compounders as an ingredient or component part of their manufactured or compounded product are specifically exempt from sales and use

taxation. Alabama Department of Revenue Regulations 810-6-1-.137 and 810-6-1-.80 addresses the raw materials exemption.

Pollution Control Equipment Exemption. All equipment or materials purchased primarily for the control, reduction or elimination of air or water pollution are exempt from state sales and use tax. Section 40-23-4(a)(16) and Section 40-23-62(18), Code of Alabama 1975 addresses the pollution control exemptions.

Utility Gross Receipts Tax Exemptions. There are several exemptions from the utility gross receipts tax. Sewer costs are not taxed. Water used in industrial manufacturing in which 50 percent or more is used in industrial processing is also exempt from the utility gross receipts tax. Additionally, Alabama law allows exclusions from the utility gross receipts tax and the utility service use tax for utility services used in certain types of manufacturing and compounding processes. The law allows exemptions for:

- The furnishing of electricity to a manufacturer or compounder for use in an electrolytic or electrothermal manufacturing or compounding process,
- Natural gas which becomes a component of tangible personal property manufactured or compounded (but not used as fuel or energy), and
- Natural gas used by a manufacturer or compounder to chemically convert raw materials prior to the use of such converted raw materials in an electrolytic or electrothermal manufacturing or compounding process.

Property Tax

All real and personal property is subject to property tax unless specifically exempted by law. The Constitution contains various property tax provisions that may be considered as industrial incentives. For example, Section 214 of the Constitution limits the state millage rate on both real and personal property to 6.5 mills. This rate is equivalent to a tax of \$6.50 for every \$1,000 of assessed value. However, both counties and cities may levy millage rates in addition to the state's 6.5 mills. These local rates vary, but the average state millage rate for any one locality is 43 mills, including the state's 6.5 mills. The average tax on property with a market value of \$1,000,000 would be \$8,600 ($\$1,000,000 \times 20\% \times .043$).

The property tax is levied on the owners of real and personal property within Alabama. All non-exempt property must be reported each year between October 1 and December 31 with the county tax assessor of the county in which the property is located. The initial appraisal is based on a fair and reasonable market value.

- The property is assessed in one of the following four classes and assessment ratios:
 - Class I - property of utilities used in the business of such utilities, 30 percent;
 - Class II - property not otherwise classified (this includes business property), 20 percent;
 - Class III - agricultural, forest, and residential property and historic buildings and sites, 10 percent; and
 - Class IV - private passenger automobiles and motor trucks commonly known as "pickups" owned and operated by an individual for personal or private use and not for hire, rent, or compensation, 15 percent.

Although the Department of Revenue oversees the administration of property taxes, the county tax assessors and collectors are responsible for assessing property and collecting the property tax. Property taxes are paid annually to county tax collectors between October 1 and December 31, following assessment.

Statutory Property Tax Abatements and Exemptions

Inventory Exemptions. Unlike many other states, Alabama does not levy a property tax on inventory of goods, wares, and merchandise that is offered for sale. However, inventory that is used for lease or rental purposes is subject to the property tax. Materials that are to be compounded or manufactured and are stocked at plants or furnaces for manufacturing purposes are also exempt from property tax.

Pollution Control Equipment Exemption. All equipment, facilities or materials constructed or acquired primarily for the control, reduction or elimination of air or water pollution are exempt from property tax. Section 40-9-1(20), Code of Alabama 1975 addresses the pollution control exemption.

Abatements. For qualifying industries, it is possible to abate the non-educational portion of property tax. These abatements are valid for a maximum period of ten years and must be granted by the local granting authority prior to placing the project in service. No additional property (real or personal) may be eligible for abatement once the project is placed in service, unless a “major addition” is made.

Statutory requirement(s):

- Any trade or business in the 2007 North American Industrial Classification System (NAICS), promulgated by the Executive Office of the President of the United States, Office of Management and Budget as:
 - Sectors 31 (except National Industry 311811), 32, and 33 (manufacturing),
 - Subsector 423 and 424 (merchant wholesalers, goods),
 - 511 (publishing industries (except internet)),
 - 927 (space research and technology),
 - Industry Group 5417 (scientific research and development services),
 - 5415 (computer systems design and related services),
 - 5182 (data processing, hosting, and related services),
 - Industry 11331 (logging),
 - 48691 (pipeline transportation of refined petroleum products),
 - National Industry 115111 (cotton ginning),
 - 517110 (wired telecommunications carriers),
 - 541380 (testing laboratories),
 - 561422 (in bound call centers only), or

Any process or treatment facility which recycles, reclaims, or converts materials, which include solids, liquids, or gases, to a reusable product

- Headquarters facilities as defined in NAICS 551114 (where at least 50 new jobs are created);
- Data processing centers (where at least 50 new jobs are created);
- Renewable energy facilities;
- Research & development facilities;
- Projects owned by utilities that produce electricity from alternative energy resources;
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- Subsector 493 (Warehousing and Storage), Industry Number 488310 (Port and Harbor Operations), or Industry Number 488320 (Marine Cargo Handling), when such trade or business is conducted on premises in which the Alabama State Port Authority has an ownership and are used as part of the operations of the Alabama State Port Authority; or
- Any underground natural gas storage facility which is located in the Gulf Opportunity Zone, developed from existing geologic reservoirs.

Capital Investment Requirement

New Project

There is no threshold or limiting investment amount for a new abatement project with the exception of projects owned by utilities producing electricity.

- Projects owned by utilities which produce electricity from alternative energy resources must have capital costs of at least \$100,000,000;
- Projects which produce electricity from hydropower production must have capital costs of at least \$5,000,000.

Major Addition

The additional capital investment by an industry that is **expanding their current facilities in Alabama** must equal the **lesser** of:

- 30% of the original cost of the currently existing industrial property (sum total of the original facilities and equipment or any expansions or additions prior to the current addition), **or**
- \$2,000,000

Corporate Income Tax

Corporations pay Alabama income tax based on their net taxable income derived from business conducted within the state. The amount of net income apportioned to Alabama is determined by applying a four factor formula of property, payroll, and double weighted sales to total net income. The rate of corporate income taxation is 6.5% (Individuals are taxed at a rate of 5%). Corporations that anticipate having a tax liability of \$5000 or more must file and pay estimated tax on a quarterly basis.

There are several credits and deductions that are statutorily available for Alabama corporate taxpayers. The taxpayer may participate in any or all of the statutory tax credits for which requirements are met. Please see the following paragraphs regarding these deductions and credits.

Income Tax Credits and Deductions

Federal Income Tax Deduction. There are constitutional restrictions that add to the stability of the Alabama corporate (and individual) tax environment. Amendment 212 of the Constitution allows the corporate (and individual) taxpayer to deduct from its gross apportioned and allocated income, the apportioned (to Alabama) amount of federal income tax paid or accrued, creating a lower net effective income tax rate.

Net Operating Loss Carryforward. For Alabama corporate income tax, a net operating loss is applied to the first taxable year to which it may be carried and can be carried forward 15 consecutive years. However, corporations may not carry back a net operating loss to offset Alabama income in prior years.

Capital Credit. A capital credit is available to be applied to the income tax liability generated by income from a project approved by the Alabama Department of Revenue. The capital credit is available each year, for 20 years. The annual capital credit is calculated at five percent (5%) of the total capital costs of the qualifying project and the credit begins in the year the qualifying project is 'placed in service'. There are several types of projects under the capital credit, all of which statutory requirements must be met in order to qualify for the credit.

- *Business Activity Requirement*
 - Industrial, Warehousing or Research Activity - Any trade or business in the 2007 North American Industrial Classification System (NAICS), promulgated by the Executive Office of the President of the United States, Office of Management and Budget as:

- Sectors 31 (except National Industry 311811), 32, and 33 (manufacturing),
- Subsector 423 and 424 (merchant wholesalers, goods),
- 511 (publishing industries (except internet)),
- 927 (space research and technology),
- Industry Group 5417 (scientific research and development services),
- 5415 (computer systems design and related services),
- 5182 (data processing, hosting, and related services),
- Industry 11331 (logging),
- 48691 (pipeline transportation of refined petroleum products),
- National Industry 115111 (cotton ginning),
- 517110 (wired telecommunications carriers),
- 541380 (testing laboratories),
- 561422 (in bound call centers only), or

Any process or treatment facility which recycles, reclaims, or converts materials, which include solids, liquids, or gases, to a reusable product.

- Headquarters facilities as defined in NAICS 551114;
 - Data processing centers;
 - Renewable energy facilities;
 - Research & development facilities;
 - Projects owned by utilities that produce electricity from alternative energy resources; or
 - Projects owned by utilities that produce electricity from hydropower production;
- *Minimum Investment*
 - \$100,000,000 for utility owned projects producing electricity from alternative energy resources;
 - \$5,000,000 for utility owned projects producing electricity from hydropower production;
 - \$2,000,000 for all projects except utility owned projects, small business additions and projects located in favored geographic areas;
 - \$1,000,000 for small business addition projects;
 - \$500,000 for projects located in favored geographic areas
 - *Employment Requirement*
 - At least 50 new employees at headquarters facilities and data processing centers;
 - At least 20 new employees at all projects except small business additions and projects located in favored geographic areas;
 - At least 15 new employees at small business addition projects;
 - At least 5 new employees at projects located in favored geographic areas;
 - New employees must meet the statutory definition of new employees, found in Section 40-18-190, Code of Alabama 1975. “New employees” cannot have worked at the site before, and cannot have worked for the project entity in Alabama before. Required jobs must be provided by the date that is not later than one (1) year after the project is placed in service, continuing each year thereafter.
 - *Base Wage Requirement*
 - For projects located in favored geographic areas, the average wage of all new employees at the project must meet the lesser of:
 - \$12.18 per hour, indexed annually as provided in Section 25-5-68, Code of Alabama 1975, or

- Average hourly wage of the county where qualifying project is located
- For all other projects, the average wage of all new employees at the project must meet the lesser of:
 - \$15.23 per hour, indexed annually as provided in Section 25-5-68, Code of Alabama 1975, or
 - Average hourly wage of the county where qualifying project is located
- There is an exception for direct processors of agriculture food products. These wages shall be determined by the local labor market rate. Contact the Commissioner’s Office for more information.
- *Filing Requirements*
 - Qualifying projects can be set up as either a ‘one step’ project or as a ‘phased’ project.
 - A company seeking the capital credit must file a “written statement of intent” (Form INT) with the Department of Revenue prior to the date the project is placed in service. If the Form INT is not received by the department before the project is placed in service, the project will not qualify for the capital credit. However, for phased projects, the Form INT must be submitted before the first phase is placed in service and the capital credit cannot be utilized until the last phase is placed in service.
 - A company must file a “report of investment in project’ (Form INT-2) when the project is placed in service.
 - A company must file an “Accounting Practices Agreement” with the Department before the capital credit can be utilized. This agreement denotes how the income from the project will be determined and is not necessarily the same method used in determining Alabama income.
- *Noncompliance Provisions*
 - Minimum statutory requirements must be met by the first year the project is placed in service and maintained annually thereafter to receive the credit. Each qualifying project must meet minimum statutory requirements by the first year the project is placed in service or the project becomes ineligible for the credit. After the first year, minimum requirements must be met to be eligible to receive the annual credit. However, after the first year, the law allows a project to fall below minimum employee and wage requirements for up to three of the twenty years of the life of the credit. No credit is available in a noncompliance year. After the third noncompliance year, the project is disqualified from the capital credit program.
 - If the qualifying project meets the minimum requirements by the first year but fails to meet such requirements in a subsequent year, the investing company shall forfeit a percentage of the capital credits claimed in the prior five years as follows:
 - 100% of the capital credit claimed in the year immediately preceding the year in which the investing company fails to maintain the employment and wage requirements (noncompliance year); and
 - 20% of the credits claimed in the 2nd, 3rd, 4th, and 5th years preceding the noncompliance year.

State Docks Capital Credit. A capital credit is available to be applied to the income tax liability generated by income from a project with written approval from the Governor of Alabama, the Finance Director of Alabama, and Alabama State Port Authority. The state docks capital credit is administered by the Alabama Department of Revenue. The capital credit is available each year, for 20 years. The annual capital credit is calculated at five percent (5%) of the total capital costs of the qualifying project and the credit begins in the year the qualifying project is ‘placed in service’. The operations must be conducted on the premises in which the Alabama State Port Authority has an ownership, leasehold, or other

possessory interest and such premises are used as part of the operations of the Alabama State Port Authority. Statutory requirements must be met in order to qualify for the credit:

- *Business Activity Requirement*
 - Any trade or business in the 2007 North American Industrial Classification System (NAICS), promulgated by the Executive Office of the President of the United States, Office of Management and Budget as:
 - Subsector 493 (Warehousing and Storage),
 - Industry Number 488310 (Port and Harbor Operations), or
 - Industry Number 488320 (Marine Cargo Handling)
- *Minimum Investment*
 - \$8,000,000

For more information, contact the Commissioner's Office of the Alabama Department of Revenue.

Enterprise Zone Credit/Exemption. Under certain conditions, an enterprise zone credit (Section 5) or exemption (Section 11) for income tax is available for qualified participants. Please be aware that although this program does apply to income tax, the program is administered by the Alabama Department of Economic and Community Affairs (ADECA). Therefore, ADECA will determine whether the project meets the requirements for the program and must certify that to the Alabama Department of Revenue.

Miscellaneous Licenses and Taxes

It is important to note that the state and most localities require businesses to obtain a privilege license. The type of license required and the fee for the license are determined at the local level. Additionally, the state does not administer any local occupational taxes; such taxes are administered at the local level. To ensure compliance with local registration and filing requirements, the taxpayer should contact the appropriate local jurisdictions.

Conclusion

The above exemptions, credits, and abatements are all statutory. If a project meets the legal qualifications for a tax incentive, the qualifying business will be eligible to receive the incentive. However, please understand that some incentives, as noted, do require prior approval. If you have any questions or need additional information, please contact the Alabama Department of Revenue Office of Economic Development at (334) 242-1175.