

(1) Scope. These Rules are intended to set forth guidance concerning the application of the apportionment and allocation provisions of §40-27-1, Code of Ala. 1975 titled "Multistate Tax Compact". The apportionment guidelines set forth in these rules are applicable to any taxpayer having business income, regardless of whether or not it has nonbusiness income, and the allocation rules set forth in these rules are applicable to any taxpayer having nonbusiness income, regardless of whether or not it has business income.

(a) The only exceptions to the allocation and apportionment guidelines contained in these rules are those allowed pursuant to the authority of §40-27-1, Code of Ala. 1975, and the rules promulgated there under.

(b) These rules are not intended to modify existing guidelines concerning jurisdictional standards.

(2) Business and Nonbusiness Income Defined. "Business income" was originally defined by §40-27-1, Code of Ala. 1975. This definition has been superseded by Act 2001-1113 which codified, §40-27-1.1, Code of Ala. 1975, and provides that "business income" is income arising from transactions *or* activity in the taxpayer's trade or business. "Business income" also includes a gain or loss resulting from the sale, exchange, or other disposition of stock in another corporation if the activities of the other corporation were operationally related to the taxpayer's trade or business carried on in Alabama while the stock was owned by the taxpayer.

(a) Nonbusiness income means all income other than business income.

(b) The classification of income by the labels occasionally used, such as manufacturing income, compensation for services, sales income, interest, dividends, rents, royalties, gains, operating income, nonoperating income, etc., is of no aid in determining whether income is business or non-business income. Income of any type or class and from any source is business income if it arises from transactions or activity occurring in the regular course of a trade or business. Accordingly, the critical element in determining whether income is "business income" or "nonbusiness income" is the identification of the transactions or activity which are the elements of a particular trade or business. In general, all transactions or activities of the taxpayer which are dependent upon or contribute to the operations of the taxpayer's economic enterprise as a whole constitute the taxpayer's trade or business and will be transactions or activity arising in the regular course of, and will constitute integral parts of, a trade or business.

(3) Business and Nonbusiness Income: Application of Definitions. The following are rules for determining whether particular income is business or nonbusiness income.

(a) Rents and Royalties from real and tangible personal property. Rental and royalty income from real and tangible property is business income if the property with respect to which the income was received is used in the taxpayer's trade or business, or if the property while owned by the taxpayer was operationally related to the taxpayer's trade or business, or incidental thereto.

(b) Gains or losses from sales of assets. Gain or loss from the sale, exchange or other disposition of real property or of tangible or intangible personal property constitutes business income if the property while owned by the taxpayer was used in the taxpayer's trade or business, operationally related to the taxpayer's trade or business carried on in Alabama or operationally related to sources within Alabama, or the property was operationally related to sources outside this state and to the taxpayer's trade or business carried on in Alabama; or gain or loss resulting from the sale, exchange, or other disposition of stock in another corporation if the activities of the other corporation were operationally related to the taxpayer's trade or business carried on in Alabama while the stock was owned by the taxpayer.

(c) Interest. Interest income is business income where the intangible with respect to which the interest was received arises out of or was created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the intangible is related to or incidental to such trade or business operations.

(d) Dividends. Dividends are business income where the stock, with respect to which the dividends are received, arises out of or was acquired in the regular course of the taxpayer's trade or business operations, or where the purpose of acquiring and holding the stock is related to, or incidental to, such trade or business operations.

(e) Patent and copyright royalties. Patent and copyright royalties are business income where the patent or copyright with respect to which the royalties were received arises out of or was created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring or holding the patent or copyright is related to or incidental to such trade or business operations.

(4) Proration of Deductions. In most cases, an allowable deduction of a taxpayer will be applicable to only the business income arising from a particular trade or business or to a particular item of nonbusiness income. In some cases, an allowable deduction may be applicable to business income or several items of nonbusiness income. In such cases, the deduction shall be prorated among those items of nonbusiness income in a manner which fairly distributes the deduction among the classes of income to which it is applicable. Any allowable deduction that is applicable both to business and nonbusiness income of the taxpayer shall be prorated to each class of income in determining income subject to tax as provided below:

(a) Interest Expense. Interest expense shall be prorated to nonbusiness assets by multiplying total interest expense by the ratio of average cost of the

nonbusiness assets to the average cost of the total assets. If any assets were acquired with stock of the taxpayer's corporation, the value of such assets to the extent attributed to the taxpayer's stock shall be excluded from the computations.

(b) Other Expenses. Other type expenses applicable both to business and nonbusiness income shall be prorated in such a manner as to equitably assign such expenses to business or nonbusiness categories, as appropriate.

(c) Year to year consistency. In filing returns with this state, if the taxpayer departs from or modifies the manner of prorating any such deduction used in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

(d) State to state consistency. If the returns or reports filed by a taxpayer with all states to which the taxpayer reports under Article IV of this Compact or the Uniform Division of Income for Tax Purposes Act or §40-27-1.1 Code of Ala. 1975, are not uniform in the application or proration of any deduction, the taxpayer shall disclose in its return to this state the nature and extent of the variance.

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