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Alabama ALJ holds Sec. 199 deduction may be claimed on separate company basis

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An I.R.C. Sec. 199 domestic production activities deduction may be computed and claimed on a separate company basis for purposes of Alabama income tax if an Alabama taxpayer has sufficient taxable income to claim the deduction, even where the deduction is limited for federal purposes because of a consolidated group's lack of taxable income, an Alabama Administrative Law Judge recently held. [[GKN Westland Aerospace, Inc. v. Ala. Dept. of Rev.](#), Admin. Law Div., Dkt. No. BIT. 10-988, 7/25/2011]

Background

GKN Westland Aerospace, Inc. ("GKN") operated a manufacturing facility in Tallassee, Alabama during the tax periods in issue, 2005 through 2007. During all relevant times, GKN filed federal income tax returns on a consolidated basis and filed on a separate return basis for Alabama income tax purposes.

For federal tax purposes, GKN's consolidated group incurred a net operating loss. The loss operated to limit the group's I.R.C. Sec.199 domestic production activities deduction ("DPAD") to zero. For Alabama tax purposes, GKN computed its DPAD on a separate company basis and reported a DPAD for each of the tax periods in issue.

On examination, the Alabama Department of Revenue disallowed GKN's DPAD because it believed that GKN did not meet the requirements to take such a deduction. GKN appealed this assessment to the Department's Administrative Law Division.



I.R.C. Sec. 199 deduction computed on a separate company basis for Alabama purposes

On appeal, the Administrative Law Judge held that GKN was entitled to compute and claim the DPAD on a separate company basis for Alabama purposes. In so ruling, the ALJ reasoned that computing the DPAD limitation on a separate return basis is consistent with how the Department requires corporations to compute the charitable contributions deduction limitation. For federal purposes, a consolidated group's charitable contribution deduction is limited to ten percent of the group's consolidated taxable income. Alabama law requires that the ten percent charitable contribution deduction limitation be computed using the corporation's separate company taxable income. According to the ALJ, it follows that the DPAD limitation must also be computed using a corporation's separate company taxable income.

The Department sought to distinguish the charitable deduction from the DPAD insofar as a "charitable contribution deduction comes from an actual expense incurred by a taxpayer at the separate company level...", whereas "[t]he DPAD is not an item of expense that is associated with the outlay of an asset by a separate company." The Department argued that the DPAD is an additional deduction taxpayers may take if they meet certain criteria, and that GKN did not meet these criteria.

The ALJ disagreed. In reaching a decision, the ALJ reasoned that to take a DPAD, a corporation must expend money and other resources. The DPAD reflects certain positive economic outlays or activities engaged in by a corporation just as the charitable deduction reflects certain economic outlays by the corporation. In this case, the ALJ held that GKN incurred certain economic outlays that entitled it to a DPAD and, because the DPAD limitation must be calculated on a separate company basis, GKN had sufficient Alabama taxable income as a separate entity against which the DPAD could be applied.

The Department has 30 days from the date on which the final order was entered to appeal the ALJ's decision to the circuit court.

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