

TRANSMITTAL SHEET FOR
NOTICE OF INTENDED ACTION

Control 810 Department or Agency REVENUE

Rule Nos. 810-3-14-.01

Rule Title: Gross Income In General

New; Amend; Repeal; Adopt by Reference

Would the absence of the proposed rule significantly harm or endanger the public health, welfare, or safety?

No

Is there a reasonable relationship between the state's police power and the protection of the public health, safety, or welfare?

Yes

Is there another, less restrictive method of regulation available that could adequately protect the public?

No

Does the proposed rule have the effect of directly or indirectly increasing the costs of any goods or services involved and, if so, to what degree?

No

Is the increase in cost, if any, more harmful to the public than the harm that might result from the absence of the proposed rule?

N/A

Are all facets of the rulemaking process designed solely for the purpose of, and so they have, as their primary effect, the protection of the public?

Yes

Does the proposed rule have any economic impact?

Yes

If the proposed rule has an economic impact, the proposed rule is required to be accompanied by a fiscal note prepared in accordance with subsection (f) of Section 41-22-23, Code of Alabama 1975.

Certification of Authorized Official

I certify that the attached proposed rule has been proposed in full compliance with the requirements of Chapter 22, Title 41, Code of Alabama 1975 and that it conforms to all applicable filing requirements of the Administrative Procedure Division of the Legislative Reference Service.

Signature of certifying officer 

Date 3-21-11

APA-6
10/96

**ECONOMIC IMPACT STATEMENT
FOR APA RULE
(Section 41-22-23(f))**

Control No. 810 Department or Agency REVENUE

Rule No: **810-3-14-.01**

Rule Title: **Gross Income in General**

 New XX Amend Repeal Adopt by Reference

This rule has no economic impact.

This rule has an economic impact, as explained below:

1. **NEED/EXPECTED BENEFIT OF RULE:**

To conform the regulation to the requirements of the underlying statute consistent with the Administrative Law Division's ruling in McNees v. Department of Revenue, DOCKET No. 06-523, December 12, 2006.

2. **COSTS/BENEFITS OF RULE AND WHY RULE IS THE MOST EFFECTIVE, EFFICIENT, AND FEASIBLE MEANS FOR ALLOCATING RESOURCES AND ACHIEVING THE STATED PURPOSE: N/A**

3. **EFFECT OF THIS RULE ON COMPETITION: N/A**

4. **EFFECT OF THIS RULE ON COST OF LIVING AND DOING BUSINESS IN THE GEOGRAPHICAL AREA WHERE THE RULE IS TO BE IMPLEMENTED: N/A**

5. **EFFECT OF THIS RULE ON EMPLOYMENT IN THE GEOGRAPHICAL AREA WHERE THE RULE IS TO BE IMPLEMENTED: N/A**

6. **SOURCE OF REVENUE TO BE USED FOR IMPLEMENTING AND ENFORCING THIS RULE: N/A**

7. **THE SHORT-TERM/LONG-TERM ECONOMIC IMPACT OF THIS RULE ON AFFECTED PERSONS, INCLUDING ANALYSIS OF PERSONS WHO WILL BEAR THE COSTS AND THOSE WHO WILL BENEFIT FROM THE RULE:**

The economic impact is substantial, but unquantifiable.

8. UNCERTAINTIES ASSOCIATED WITH THE ESTIMATED BENEFITS AND BURDENS OF THE RULE, INCLUDING QUALITATIVE/QUANTITATIVE BENEFITS AND BURDEN COMPARISON: N/A
9. THE EFFECT OF THIS RULE ON THE ENVIRONMENT AND PUBLIC HEALTH: N/A
10. DETRIMENTAL EFFECT ON THE ENVIRONMENT AND PUBLIC HEALTH IF THE RULE IS NOT IMPLEMENTED: N/A
11. OTHER COMMENTS: None

APA-2
11/96

**ALABAMA DEPARTMENT OF REVENUE
Individual & Corporate Tax Division**

NOTICE OF INTENDED ACTION

RULE NO. & TITLE:

810-3-14-.01	Gross Income in General
810-3-28-.01	Partnership Returns
810-3-162-.01	Income to be Reported by Shareholders

INTENDED ACTION: Amend the above rules

SUBSTANCE OF PROPOSED ACTION: The purpose of the proposed action is to conform the regulations to the requirements of the underlying statute and associated case law (McNees v. Department of Revenue, DOCKET NO. 06-523, December 12, 2006).

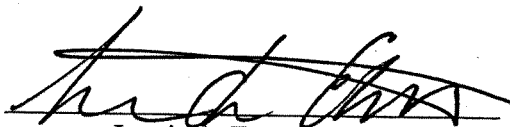
TIME, PLACE, MANNER OF PRESENTING VIEWS: A public hearing will be held at **10:00 a.m.** on **Thursday, May 5, 2011**, in the **Office of the Legal Division, Room 3114**, Gordon Persons Building, located at 50 N Ripley Street, Montgomery, Alabama. Copies of the rule(s) can be obtained at www.revenue.alabama.gov/rulehear.html.

All interested parties may present their views in writing to the **Secretary of the Alabama Department of Revenue, Room 4112, Gordon Persons Building, 50 N Ripley Street, Montgomery, Alabama 36132** at any time during the thirty-five (35) day period following publication of the notice or by appearing at the hearing.

FINAL DATE FOR COMMENT AND COMPLETION OF NOTICE:
Friday, May 6, 2011

CONTACT PERSON AT AGENCY:

Patricia Toles
Alabama Department of Revenue
4131 Gordon Persons Building
Montgomery, Alabama 36132
(334) 242-1380


Lewis A. Easterly
Alabama Department of Revenue

810-3-14-.01 Gross Income In General.

(1) The term "gross income" means all wealth flowing to the taxpayer from whatever source derived other than as a return of his capital and other than those items exempted by Section 40-18-14(2)(3) Code of Ala. 1975. Gross income includes income realized in any form, whether in money, property, or services. Income may be realized in the form of services, meals, accommodations, stock, or other property, as well as in cash. Such income is to be reported for the year in which received, or accrued and reported in accordance with accepted accounting procedures applicable to the taxpayer's particular type of business. See Reg. 810-3-13-.03 for discussion of accounting methods.

(2) In the case of a manufacturing, merchandising, or mining business, gross income means the total sales less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources. In determining the gross income of a business, subtraction should not be made for losses, or for items not ordinarily used in computing the cost of goods sold.

(3) Earnings constitute gross income before deductions for withholding for federal income tax, social security tax, insurance and retirement programs (including those allowable as a deduction under Code of Ala. 1975, Section 40-18-15(11)) or other voluntary or involuntary withholdings.

(4) Income actually received or accrued must be included in gross income, although losses may later incur against this income. An exception to this general rule occurs in situations involving the renegotiation of war contracts under federal statutes. Where repayment is made to the government as a result of renegotiation, the amount of income for the year of original payment is the amount of such payment less the amount refunded to the government, even though the repayment is made to the government in a later year. As long as the matter of renegotiation is open, the extent of the gain or profit of the contractor, if any, for that year of payment remains undetermined.

(5) If services are paid for with something other than money, the fair market value of the property or services taken in payment is the amount to be included as gross income. If living quarters or meals are furnished to employees for the convenience of the employer, the ratable value need not be added to the compensation of the employees, but if a person receives a compensation for service rendered compensation in the form of living quarters or meals, the value to such person of the quarters furnished constitutes income subject to tax. For living quarters furnished to ministers, see Reg. 810-3-14.02(1)(g).

(6)(a) An employee who is given an annuity by his employer must pay income tax on the amount of the premium in the year in which the premium is paid. The annuity is considered as additional compensation for services

rendered and not as a gratuity. The payments that qualify as a deduction under Code of Ala. 1975, §40-18-15(11) shall be included in gross income.

(b) An employee who is the insured or owner of a group life insurance policy with a face value in excess of \$50,000, and the premiums on such policy are paid by the employer, must include in gross income the value of such premiums for coverage in excess of \$50,000.

(7) For procedure in reporting the income of minors, see §40-18-27 and regulations thereunder.

(8) The Federal Internal Revenue Code contains provisions similar to those of §40-18-14(1). Decisions and interpretations of the federal courts and agencies will be given due weight in interpreting this section.

(9) Gross income includes recovery of items deducted in previous years. See Reg. 810-3-14-.04.

(10) For tax years beginning after December 31, 1981, gross income includes alimony and separate maintenance according to I.R.C. §71 in effect January 1, 1982. For tax years beginning after December 31, 1984, gross income includes alimony and separate maintenance payments as defined in I.R.C. §71, as in effect on January 1, 1985. For tax years beginning after December 31, 1989, gross income includes alimony and separate maintenance payments as defined in I.R.C. §71, as in effect from time to time. Decisions and interpretations of the federal courts and agencies interpreting I.R.C. §71 will be given due weight in interpreting Code of Ala. 1975, Section 40-18-14(1) and this regulation as it relates to alimony and separate maintenance payments. Regulations pertaining to I.R.C. §71 are hereby made a part of this regulation.

(a) Alimony or separate maintenance payments received under a divorce or separation instrument executed after March 1, 1954, but prior to January 1, 1985, will be included in gross income as follows:

1.(i) Periodic payments, (for definition of periodic payments see section 2. below) whether or not received at regular intervals, received after January 1, 1982 are includible in gross income if -

(I) Payments received are in discharge of (or attributable to property transferred, in trust or otherwise, in discharge of) a legal obligation, and

(II) the obligation is imposed on or incurred because of a marital or family relationship, and

(III) the legal obligation is under the decree, or written agreement incident to divorce or separation, and

(IV) the payment received does not represent payment in support of minor children, and

(V) the payment received does not represent a settlement of property rights.

(ii) The source of the payments is immaterial. The payments may be from property held in trust, life insurance, endowment or annuity contract, any other interest in property or from income or capital of the payor whether paid directly or indirectly by him.

(iii) If the decree or written agreement specifies an amount to be paid in support of minor children, the payment received goes first to satisfy this obligation. If the payment is less than the amount specified as support of minor children, then the payment received shall be considered a payment of support of minor children.

(I) If the decree or written agreement specifies one amount as payment of both alimony or separate maintenance and child support, the entire amount will be considered as alimony or separate maintenance and will be included in gross income of the recipient.

2. In general, periodic payment means "payable over a period of indefinite duration". Payments made for an unspecified principal amount are considered periodic payments even if, by provision of the decree or written agreement or local law, payments will be terminated by death of either spouse, remarriage, or change in economic status of either spouse.

3. Payment of a specified amount, in terms of money or property, under the decree or written agreement to be made over a period of 10 years or less from the date of the decree or agreement will be considered periodic payments if -

(i) payments are subject to one or more of the contingencies of death, remarriage, or change in the economic status of either spouse, and

(ii) payments are in the nature of alimony or an allowance for support.

4. If payment of a specified amount, in terms of money or property, under the decree or written agreement, is to be made over a period of more than 10 years from the date of the decree or agreement, payments will be considered periodic payments but only to the extent that the installment payment, or sum of the installment payment, received during the recipient's taxable year does not exceed 10 percent of the principal sum. This 10 percent limitation applies to installment payments made in advance, but does not apply to delinquent

installment payments for a prior taxable year of the recipient made during the current taxable year.

5. A transfer of property in settlement of marital rights may result in a recognizable gain or loss. The gain or loss is the difference between the adjusted basis of the property and its fair market value at the time of the transfer.

(i) If the property has appreciated, there may be a taxable gain on the transfer. Property has appreciated if its fair market value is more than its adjusted basis. The difference is a gain.

(ii) If the fair market value is less than the adjusted basis, a loss is realized. Such a loss is deductible if it is on business or investment property, but is not deductible if it is on property held for personal use.

(iii) An equal division of property that is co-owned by husband and wife does not result in a gain or loss.

(iv) If husband and wife each keep their separately owned property in a divorce settlement, there is no taxable gain or loss.

(v) If one spouse transfers separately owned property to the other spouse, the spouse transferring the property realizes a gain or loss. The spouse receiving the property has no gain or loss on the transaction. The basis of the property to the receiving spouse is its fair market value on the date of the transfer.

(vi) Taxpayers report the gain or loss in a property settlement the same as any sale or exchange of an asset.

(b) Alimony or separate maintenance payments received from divorce or separation instruments executed after December 31, 1984, (and to divorce or separation agreements executed prior to January 1, 1985, if modified to expressly provide for the application of this subparagraph) is includible in gross income as follows:

1. the term "alimony or separate maintenance payment" means any payment in cash, if -

(i) such payment is received by (or on behalf of) a spouse under divorce or separation instrument, and

(ii) the divorce or separation instrument does not designate such payment as a payment which is not includible in gross income under §40-18-14 and not allowable as a deduction under §40-18-15, and

(iii) in the case of an individual legally separated from his spouse under a separate maintenance instrument or decree of divorce, the payee and payor are not members of the same household at time such payment is made and do not file a joint income tax return, and

(iv) there is no liability to make any such payment for any period after the death of the payee spouse and there is no liability to make any payment (in cash or other property) as a substitute for such payments after the death of the payee spouse.

2. The term "divorce or separation instrument" means:

(i) a decree of divorce or separate maintenance or a written instrument incident to such a divorce, or

(ii) a written separation agreement, or

(iii) a decree (not described in subsection (I) above) requiring a spouse to make payments for the support of the other spouse, such as temporary alimony.

3. The term "alimony or separate maintenance" shall not apply to that part of any payment which the terms of the divorce or separation instrument designates (in terms of an amount of money or a part of a payment) as a sum which is payable for the support of children of the payor. If any amount specified in the instrument will be reduced -

(i)(I) on the happening of a contingency specified in the instrument relating to a child (such as attaining a specified age, marrying, dying, leaving school, or a similar contingency), or

(II) At a time which can be clearly associated with a contingency of a kind specified in (I); an amount equal to the amount of such reduction will be treated as an amount designated or fixed as payable for the support of children of the payor.

(ii)(I) If any payment is less than the amount specified in the instrument as support of the children of the payor, then so much as such payment as does not exceed the sum payable for support shall be considered a payment for such support.

(II) If the instrument specifies a single amount in payment of both alimony or separate maintenance and child support with no more contingency of the type provided in sections 3.(I)(I) or (II) above, or no support of money or part of the payment specifically designated as child support, the entire payment will

be considered as alimony or separate maintenance and will be included in gross income of the recipient.

4. Alimony or separate maintenance payments in excess of \$10,000 during any calendar year paid to a single payee will not be treated as alimony or separate maintenance unless such payments are to be made by the payor to the payee in each of the six (6) post-separation years (not taking into account any termination contingent on the death of or remarriage of either spouse).

5. If there is an excess amount determined under section 6. below for any computation year –

(i) the payor spouse shall include such excess in gross income for the taxable year beginning in the computation year, and

(ii) the payee spouse shall be allowed a deduction in computing adjusted gross income for such excess amount for the taxable year which ends on or after the taxable year of the payor spouse beginning in the computation year.

6.(i) The excess amount determined under this section for any computation year is the sum of -

(I) the excess (if any) of –

I. the amount of alimony or separate maintenance payments paid by the payor spouse during the immediately preceding post-separation year, over

II. the amount of alimony or separate maintenance payments paid by the payor spouse during the computation year increased by \$10,000, plus

(II) a like excess for each of the other post-separation years.

(ii) In determining the amount of alimony or separate maintenance payments made by the payor spouse during any preceding post-separation year, the amount paid during such year shall be reduced by any excess previously determined in respect of such year under this section 6.

(I) EXAMPLE: H makes alimony payments to W of \$25,000 in 1985 and \$12,000 in 1986. The excess amount with respect to 1985 that is recaptured in 1986 is \$3,000 ($\$25,000 - (\$12,000 + \$10,000)$). For purposes of subsequent computation years, the amount deemed paid in 1985 is \$22,000. If H makes alimony payments to W of \$1,000 in 1987, the excess amount that is recaptured in 1987 will be \$12,000. This is the sum of an \$11,000 excess amount for 1985 ($\$22,000 - (\$1,000 + \$10,000)$) and a \$1,000 excess amount with respect to 1986 ($\$12,000 - (\$1,000 + \$10,000)$). If, prior to the end of 1990 (the end of the

six year post-separation period), payments decline further, additional recapture will occur.

7. For purposes of this subparagraph, the term "post-separation year" means any calendar year in the six (6) calendar year period beginning with the first calendar year in which the payor spouse paid alimony or separate maintenance payments to the recipient spouse, and the term "computation year" means the post-separation year for which the excess under section 6. above is being determined.

8. The recapture rule provided in section 5. above shall not apply to any post-separation year (and subsequent post-separation years).

(i) either spouse dies or the payee spouse before the close of such post-separation year, and

(ii) the alimony or separation maintenance payments cease by reason of such death or remarriage, or

(iii) the payments are received under a decree described in section 2. (iii) above, or

(iv) the payment is made pursuant to a continuing liability (over a period not less than six years) to pay a fixed portion of the income from a business or property or from compensation or employment or self-employment.

9. To qualify for the deduction provided in §40-18-15, alimony or separate maintenance payments may not be made in any form other than cash. Transfers of services or property (including a debt instrument of a third party or any annuity contract), executing of a debt instrument by the payor, or the use of property of the payor, do not qualify as alimony or separate maintenance payment. See §§40-18-8~~(p)(m)~~ 40-18-6(a)~~(15)(13)~~ for treatment of gain or loss on transfers of property incident to a divorce.

(c) Alimony or separate maintenance payments received from divorce or separation instruments executed after December 31, 1989 (and to divorce or separation agreements executed prior to January 1, 1990, if modified to expressly provide for the application of this subparagraph (is includible in gross income in the same manner as provided in subparagraph (b) of this regulation with the following exceptions;

1. the payments must be cash payments received by (or on behalf of) a spouse or former spouse:

2. the payments must be under a divorce or separation instrument;

3. the payments must not extend after the death of a payee-spouse (need not be expressly stated in the instrument);

4. the spouses (or former spouses) must not be members of the same household and must not file joint returns;

5. the divorce or separation instrument can designate such payment which is not includible in gross income under I.R.C. §71 and not allowable as a deduction under I.R.C. §215 (if so designated, the payments are not considered as alimony):

6. the payment must not be for child support; and

7. the payments need not be made in discharge of marital obligations imposed by state law, nor need the payments be "periodic."

(11) Except for plans specifically exempt by law from tax, payments received from pension, profit-sharing, stock bonus, retirement, annuity, or bond purchase plans, in excess of the taxpayer's investment in such plans, shall be included in gross income.

(a) This includes all payments received, not just those received upon completion of the plan.

(b) The taxpayer's investment in the above plans is the taxpayer's contributions to such plans, excluding those allowable as a deduction under §§40-18-15(a)(11) and 40-18-15(a)(12) and/or those allowable as an exclusion from gross income under §40-18-14(1)(I). See also Reg. 810-3-14-.10.

(c) Those employer contributions previously included in gross income of the taxpayer but not allowable as a deduction by the taxpayer are included in the taxpayer's investment.

(12)(a) For tax years beginning after December 31, 1981, but before January 1, 1990, in accordance with §40-18-14(2)e (I.R.C. §105 as in effect January 1, 1982), any amount an employee receives for disability through an accident and health insurance plan that is attributable to his employer's contributions is included in gross income except:

1. Payments for permanent loss of, or loss of use of a member or function of the body, or for permanent disfigurement,

2. Payments under a plan as reimbursement for expenses incurred by the employee for medical care for himself, spouse or dependents, or

3. Payments, within limits that are in lieu of wages for a period during which an employee is absent from work on account of permanent and total disability if the employee has not attained age 65 before the close of the taxable year and has retired on disability.

(i) The disability income exclusion of this paragraph (c) is limited to \$100 per week, and

(ii) The disability exclusion to which the taxpayer would be entitled shall be reduced by the amount that adjusted gross income, including disability income, exceeds \$15,000.00.

(iii) **EXAMPLE:** A disabled taxpayer under age 65 received \$6,000.00 in disability retirement income in lieu of wages. He also had \$10,000.00 of other income which, together with the \$6,000.00 of disability payments in lieu of wages, gave him an adjusted gross income of \$16,000.00. Assume that before reduction the taxpayer is entitled to an exclusion of \$5,200.00 for the year. Since the taxpayer's adjusted gross income exceeds \$15,000.00, his exclusion is reduced by the \$1,000.00 excess. Consequently, his maximum exclusion is \$4,200.00 (\$5,200.00 minus \$1,000.00).

(b) The exclusion provision of paragraph (a) above does not apply to disability income received after December 31, 1989.

(13) Gross income includes the fair market value of the personal use (including commuting) of an employer (including a governmental employer) owned automobile, together with the fair market value of any fuel furnished by the employer. The rates and methods for determining the values for this paragraph will be as provided in I.R.C. §61(a)(1) (and I.R.C. Reg. 1-61-2T) as in effect January 1, 1985.

(14)(a) For taxpayers who are shareholders of an Alabama S corporation with a tax year which began before January 1, 1990 –

1. Gross income includes the deemed distributive share of separately stated and nonseparately stated income (or loss) for shareholders of an electing Alabama S corporation.

(i) For electing Alabama S corporations with income from more than one state, gross income includes only the deemed distributive share attributable to Alabama.

2.(i) Gross income does not include actual distributions from electing Alabama S corporations which have been previously included in gross income under subparagraph (a)1. above.

(ii) For resident shareholders, all other actual distributions from a S corporation, including distributions representing income taxable in other states, is included in gross income.

3. Gross income does include actual distributions from S corporations which have not elected to be Alabama S corporations, but does not include deemed distributive shares of income (or losses) of such corporations.

4. See §§40-18-160, et seq., and regulations thereunder, relating to Alabama S corporations.

(b) For taxpayers who are shareholders of an Alabama S corporation with a tax year which began after December 31, 1989 and before January 1, 1997 –

1. Gross income includes the deemed distributive share of separately stated and nonseparately stated income (or loss) of the Alabama S corporation.

2. Gross income does not include actual distributions from an Alabama S corporation which have been previously included in gross income under subparagraph (a)1. above.

(c) For taxpayers who are shareholders of an Alabama S corporation with a tax year which began after December 31, 1996 **and before January 1, 2011:**

1. Gross income includes the shareholder's pro rata share of separately stated and nonseparately stated items of income, loss, deduction, or credit attributed to Alabama by the Alabama S corporation for the corporation's taxable year which ends with or during the individual's tax year.

2. Gross income does not include actual distributions from an Alabama S corporation which have been previously included in gross income under subparagraph (a)1. above.

3. Gross income does not include actual distributions from an Alabama S corporation which are determined to be nontaxable under the provisions of §40 18 165 and the regulations thereunder.

(d) For taxpayers who are shareholders of an Alabama S corporation with a tax year which began after December 31, 2010 gross income is determined in accordance with Alabama Code §§ 40-18-162 and 40-18-14 (1975) and without regard to (c) above.

(15)(a) For taxpayers providing foster care services who are not engaged in the trade or business of providing such services, gross income includes

payments received in excess of expenses incurred in providing such services but does not include expenses in excess of receipts.

(b) For taxpayers engaged in the trade or business of providing foster care services, gross income includes all payments received for such services, less expenses incurred in the performance of such services. A taxpayer will be presumed to be engaged in the trade or business of providing foster care services when such services are provided for more than ten (10) minors or more than five (5) adults.

(c) The provisions of this paragraph are substantially similar to the provisions of I.R.C. §131, and regulations and decisions regarding the interpretation and implementation of I.R.C. §131 will be given due consideration in the administration of this paragraph.

(16) (a) For tax years beginning after December 31, 1996 and before January 1, 2011, Gross income for a resident partner or member of a subchapter K entity includes the following:

(a) (1) For a multi state subchapter K entity doing business within and without the State of Alabama, only that income which is required to be allocated and apportioned to Alabama under the rules of Section 40 18 22. (If the multi state subchapter K entity is not doing business in Alabama, no income is reportable to Alabama from that subchapter K entity.)

(b) (2) For a subchapter K entity doing business in only one state, whether the State of Alabama or another state, the distributive share of the entire income from that subchapter K entity.

(b) For tax years beginning after December 31 2010, the amount of income, deduction, gain, loss, or credit includable or deductible by an owner of an interest in a subchapter K entity shall be determined in accordance with subchapter K of the Internal Revenue Code, 26 U.S.C. §§ 701-761, Alabama Code §§ 40-18-24 and 40-18-14 (1975) and without regard to (a) above.

(17) Property transferred in connection with performance of service Tax years beginning after December 31, 1989.

(a) Inclusion in gross income.

1. If stock or other property is transferred to any person other than the person for whom the services are performed, the excess of

(i) the fair market value of such property (determined without restrictions other than restrictions that will never lapse) at the first time the rights

of the person having beneficial interest in such property are transferable or are not subject to substantial risk of forfeiture, whichever occurs first, over

(ii) the amount actually paid for such property, shall be included in the gross income of the transferee who performed the service in the first tax year during which a fair market value under provisions of (a)(I) above can be determined.

2. Paragraph (a)1 shall not apply if the transferee sells or otherwise disposes of such property in an arms length transaction before his rights in such property become transferable or not subject to substantial risk of forfeiture.

(b) Election to include in gross income in the year of transfer.

1. The transferee may elect to have paragraph (a) above apply in the year of transfer.

2. The election must be made in the same manner and within the same time frame as required by regulations pertaining to 26 U.S.C. §83.

3. The statement of election required by regulations pertaining to 26 U.S.C. §83 shall be made a part of the Alabama income tax return for the year of transfer.

(c) Special rules For the purpose of this regulation –

1. Substantial risk of forfeiture - The rights of a person in property are subject to a substantial risk of forfeiture if such person's rights to full enjoyment of such property are conditioned upon the future performance of substantial services by the individual.

2. Transferability of property - The rights of a person in property are transferable only if the rights in such property of the transferee are not subject to substantial risk of forfeiture.

3. Sales which give rise to suit under section 16(b) of the Securities Exchange Act of 1933 -So long as the sale of property at a profit could subject a person to suit under section 16(b) of the Securities Exchange Act of 1934, such person's rights in such property are –

(i) subject to substantial risk of forfeiture, and

(ii) not transferable.

(d) Restrictions which will never lapse.

1. Valuation Property subject to restrictions which by its terms will never lapse, and which allows the transferee to see such property for a price determined under some formula, the formula price shall be determined to be the fair market value of the property.

2. Cancellation - If, property subject to a restriction which by its terms will never lapse has the restriction canceled, then unless the transferee establishes –

(i) that such cancellation was not compensatory, and

(ii) that the taxpayer, if any, who would be allowed a deduction for compensation, will treat the transaction as non compensation:

(I) the excess of the fair market value of the property (computed without regard to the restrictions) at the time of the cancellation over the fair market value of the property (computed by taking the restriction into account) immediately before the cancellation plus the amount paid for the cancellation, shall be treated as compensation for the tax year in which the cancellation occurs.

(e) Applicability, This regulation shall not apply to –

1. a stock option to which 26 U.S.C. §421 applies.

2. a transfer to or from a trust described in 26 U.S.C. §401(a) or a transfer under an annuity plan which meets the requirements of 26 U.S.C. §404(a)(2).

3. the transfer of an option without a readily ascertainable fair market value.

4. the transfer of property upon the exercise of an option with a readily ascertainable market value at the date of the grant, or

5. group term life insurance to which 26 U.S.C. §79 applies.

(f) Code of Ala. 1975, §40-18-14(1) stipulates that 26 U.S.C. §83 will be the guiding document for determining amount and time that income under this regulation is to be included in gross income; therefore, regulations pertaining to 26 U.S.C. §83 are hereby made a part of this regulation. Judicial and administrative decision of Federal agencies will govern in administering this regulation.

(18) The amendments to this regulation which were filed with the Legislative Reference Service on March 21, 2011 are effective for tax years

beginning on or after January 1, 2011. These amendments are consistent with the Administrative Law Division's Ruling, *McNees v. Department of Revenue*, DOCKET NO. 06-523, entered December 12, 2006. The Department of Revenue will not enforce these regulatory changes for tax periods ending prior to January 1, 2011.

Authors: ~~Rebecca Whisenant, Roy Wiggins and Ann Fondren-Winborne, CPA, Individual Income Tax Division~~
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Authority: Sections 40-2A-7(a)(5), 40-18-1.1(c), 40-18-14, Code of Alabama 1975

History: Adopted through APA September 30, 1982.
Amended: February 8, 1989.
Amended: December 4, 1992.
Amended: Filed March 26, 1998, effective April 30, 1998.
Amended: Filed May 4, 2004, effective June 8, 2004.
Rule was rejected as amended by the Joint Council on Administrative Regulation Review on June 4, 2004.
Amended: Proposal to amend rule filed February 18, 2005 – rule was not adopted.