

ALABAMA TAX TRIBUNAL

PAUL C. & LYNNE H. STEINFURTH,	§	
	§	
Taxpayers,	§	DOCKET NO. INC. 18-789-LP
	§	
v.	§	
STATE OF ALABAMA		
DEPARTMENT OF REVENUE.		

FINAL ORDER

This appeal involves a final assessment of 2014 income tax. The parties requested that the appeal be decided without a hearing. Thus, this Final Order is entered based on the parties' filings.

Facts

The parties stipulated to the following facts:

1. The petitioners in this appeal are Paul C. Steinfurth and Lynne H. Steinfurth, referred to herein as “the Taxpayers.”
2. The tax year at issue in this case is the calendar year 2014 (“the Tax Year”), and the liability sought to be imposed is individual income tax.
3. The Taxpayers were husband and wife during the whole of the Tax Year and at all times since.
4. During all of the Tax Year, and at any other material time, the Taxpayers were “non-residents” of the State of Alabama, as that term is defined in Ala. Code § 40-18-24.2(a)(2)a (1975).
5. NBFRE 30, LLC (“NBFRE”), issued the Taxpayers a 2014 K-1 that states that the Taxpayers owned an 80% interest in the LLC; Line G of the K-1 indicates that the Taxpayers are “limited partners or other members” of the LLC.

6. During the Tax Year, NBFRE was a pass-through entity, as that term is defined in Ala. Code § 40-18-24.2(3).

7. Other members of NBFRE were also non-residents of Alabama during the Tax Year.

8. During the Tax Year, NBFRE conducted business in Alabama and generated Alabama-sourced income.

9. NBFRE did not file a composite income tax return on behalf of its nonresident members; nor did it report and pay the income tax imposed by Chapter 18 on the nonresident members' distributive shares of the income of NBFRE, as required by Ala. Code § 40-18-24.2(b)(1).

10. Line M of the K-1 issued by NBFRE to the Taxpayers states that the Taxpayers' share of NBFRE's 2014 nonseparately stated income allocated and apportioned to Alabama equaled \$3,723,466; Line X of the K-1 does not list any withdrawals or distributions paid by NBFRE to the Taxpayers.

11. The Taxpayers had no other Alabama income during the Tax Year.

12. The Taxpayers filed a 2014 joint Alabama personal income tax return.

13. The 2014 income-tax return filed by the Taxpayers indicated that they owed \$147,525 in Alabama income tax for the 2014 tax year.

14. On July 24, 2018, the Department issued its final assessment against Paul C. and Lynne H. Steinfurth in the original tax amount of \$147,525, plus interest of \$18,382, plus late-payment penalty of \$36,881, for a total assessment of \$202,788.

15. The Taxpayers filed a timely appeal to the Alabama Tax Tribunal on August 14, 2018.

16. During the Tax Year, NBFRE was not exempt from the requirement of Ala. Code § 40-18-24.2 (c)(1) to remit the tax due, nor was it exempt from the reporting requirements of Ala. Code

§ 40-18-24.2 (c)(2).

Law

The Alabama Code provides that “[i]n addition to all other taxes now imposed by law, there is hereby levied and imposed a tax on the taxable income, as defined in this chapter, which tax shall be assessed, collected, and paid annually at the rate specified herein and for each taxable year as hereinafter provided” on “[e]very nonresident individual receiving income from property owned or business transacted in Alabama.” Ala. Code § 40-2A-2(a)(6).

A taxpayer is defined as “[a]ny person subject to a tax imposed by this chapter, or whose income is, in whole or in part, subject to a tax imposed by this chapter.” Ala. Code § 40-18-1(37).

“Every taxpayer having gross income . . . for the taxable year exceeding the sum of the allowable standard deduction . . . and the personal exemption . . . shall each year file with the Department of Revenue a return.” Ala. Code § 40-18-27(a).

“Returns shall be filed by the same date as the corresponding federal income tax returns are required to be filed as provided under federal law.” Ala. Code § 40-18-27(c).

Ala. Code § 40-18-24.2(b)(2) provides that “[a] nonresident member that has been included in a composite income tax return filed pursuant to this section may file its own Alabama income tax return and shall receive credit for Alabama income tax paid on the member's behalf by the pass-through entity.”

Analysis

The Taxpayers cite § 40-18-24.2 to argue that they are not liable for income tax or required to file a return. Specifically, the Taxpayers quote the following: “Every nonresident owner or shareholder whose income is reported on a composite return must file an Alabama income tax

return and report the Alabama-sourced income . . . **unless** the nonresident owner or shareholder is a nonresident individual who has no other Alabama source income.” The Taxpayers’ reliance on that quote is misplaced. That provision speaks to a taxpayer whose income has been reported to Alabama on a composite return. As stipulated, no composite return was filed. A nonresident owner can only be excepted from the general rule if the general rule first applies. Since no composite return was filed, the general requirement does not apply.

The Taxpayers quote Regulation 810-3-24.2-.01(2)(1)(1975) to further support their position: “Any additional composite payment to be due after the filing of the initial composite return shall be made by the pass-through entity.” The Taxpayers emphasize “by the pass-through entity” in their Reply Brief but ignore “after the filing of the initial composite return.” Again, as no composite return was filed by the entity, this regulation has no bearing.

All taxpayers liable to Alabama are required to file a return. Ala. Code § 40-18-27(a). The Taxpayers are considered taxpayers under the code as they are subject to income tax under § 40-2A-2(a)(6). Ala. Code § 40-18-1(37) (defining taxpayer as “[a]ny person . . . whose income is . . . subject to a tax imposed by this chapter”).

The Taxpayers also argue that penalties and interest cannot accrue because no return is due from them under § 40-18-24.2. Again, the requirement under that section is not at issue. Section 40-18-27 requires the Taxpayers to file a return with a due date.

The Taxpayers next cite the Alabama Limited Liability Company Law to prove liability falls on the entity and not the members. However, the tax of § 40-2A-2(a)(6) is not an obligation of the LLC but of the members as it passes through the entity. As the Department responded, the Alabama Code looks to 26 U.S.C.A. § 701 to determine the liability of a member of an LLC, as well as that

of the LLC. Alabama Code § 40-18-25(a) states that “[t]he 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.”

“Therefore, the liability of the member should be determined as follows: A partnership as such shall not be subject to the income tax imposed by this chapter. Persons carrying on business as partners shall be liable for income tax only in their separate or individual capacities.” 26 U.S.C. § 701.

The Taxpayers cite *Tsitalia, LLC v. State of Alabama*, Dkt. No. BIT. 12-492 (Admin. Law Div. 2/1/2013), to support their position that the tax is levied on the entity and not the nonresident owner: “while the tax is measure by the nonresident’s distributive share of the entity’s income, it is levied on the in-state entity.” However, the facts in *Tsitalia* are flipped from those here. *Tsitalia*, the pass-through entity, was assessed the tax due on the non-residents’ distributive shares. “The issue is not, however, whether Alabama has jurisdiction to tax nonresident owners of a pass-through entity. Rather, the issue is whether Alabama can require the pass-through entity over which the State clearly has jurisdiction to report and pay Alabama tax on the nonresident’s distributive share of the entity’s Alabama-sourced income. Clearly, it can.” *Tsitalia* at 2. The Alabama Tax Tribunal did not state that assessment on the pass-through entity was the exclusive means of assessment.

Similarly, the 2015 Alabama Tax Tribunal ruling in *Tanner & Guin, LLC v. State of Alabama*, Dkt. No. BIT. 14-502 (Admin. Law Div. 5/4/2015), also involved a pass-through-entity-as-taxpayer appealing an assessment that was based on its nonresident members’ distributive shares. That ruling also does not determine whether Alabama can tax a nonresident member separately from the entity.

The Taxpayers do not argue due process but quote Alabama case law to summarize their argument: “The question presented in this appeal is not whether the State of Alabama may impose an obligation to collect and remit use tax on [a non-resident taxpayer] for the activities it conducts, but whether it did so pursuant to the statutes that were applicable during the period involved.” *Ala. DOR v. Scholastic Book Clubs*, 276 So.3d 698 (Ala. Civ. App. 2018).

Alabama is permitted to impose a tax on the Taxpayers as nonresident owners of an LLC and require their filing of a return by statute (§ 40-18-2(a)(6) and § 40-18-27(a)). The Taxpayers have not met their burden to prove that the requirements of § 40-18-24.2 imposed on pass-through entities relieves them of the obligations under § 40-18-2(a)(6) and § 40-18-27(a).

The Taxpayers attempt to distinguish their case from *Bell v. State of Alabama*, Dkt. No. Inc. 14-1097 (F.O. on Rehearing 3/10/2016). While *Bell* involved an employee rather than a nonresident owner, the fact remains that both the employer and employee were responsible for payment of the tax due. “The Taxpayer also was not relieved of liability for the above amount because the Taxpayer’s employer failed to withhold Alabama tax from the Taxpayer’s wages.” As the Department pointed out, “[t]he composite return provision is in the nature of a withholding provision whereby the entity is required to pay tax on the income paid to a nonresident partner/member. The tax is computed on the total amount paid to a nonresident partner, including any guaranteed payments paid by the entity to the partner. See Department Reg. 810-3-14.05(d)(4).” *Tanner & Guin v. State* at 7. Like the withholding provision addressed in *Bell*, the composite return requirement does not relieve the owner of a pass-through entity from the obligations imposed elsewhere in the chapter.

The 2014 final assessment is affirmed. Judgment is entered against the Taxpayers for \$202,788.33. Additional interest is also due from the date the final assessment was entered on July

24, 2018.

This Final Order may be appealed to circuit court within 30 days, pursuant to Ala. Code § 40-2B-2(m).

February 19, 2020.

/s/ Leslie H. Pitman

LESLIE H. PITMAN

Associate Tax Tribunal Judge

lhp:dr

cc: James M. Sizemore, Jr., Esq.
Craig A. Banks, Esq.