

MEMORANDUM

TO Members, Tax Section of the Alabama State Bar

FROM Bruce P. Ely/James E. Long, Jr. (State Legislative Review Committee)

DATE July 24, 2008

SUBJECT New Withholding Requirement for Alabama Real Estate Transactions

As most of you are aware, effective next Friday, August 1, Alabama will impose a withholding tax requirement on the sale or transfer of real property and related tangible personal property in Alabama by a “nonresident of Alabama” (as specially defined). HB 357, now Acts of Ala. 2008-504 (the “Act”), generally requires the buyer or transferee to withhold and remit to the Alabama Department of Revenue (“ADOR”) a certain percentage of the purchase price from a seller or transferor of Alabama real estate who is a “nonresident of Alabama.” Several other states, including Georgia, have similar withholding provisions. Indeed, the Act is closely patterned after Ga. Code Ann. § 48-7-128. **Thankfully, the ADOR advised us yesterday, however, that they intend to “phase-in” the Act’s provisions, applying only to property transfers in excess of \$800,000 this year and \$300,000 beginning January 1, 2009.** They promise to post the forms and proposed reg’s on their website on Monday: www.revenue.alabama.gov.

Definition of Nonresident Seller or Transferor – The Act applies to the sale of Alabama real property (and related tangible personal property) by a seller who is a “nonresident of Alabama,” including individuals and entities. Obviously, the intent of the Act is to ensure that individuals and entities deriving income from sales of Alabama real estate report and pay taxes to Alabama on this income. By default, the Act appears to assume that all sellers are “nonresidents of Alabama” unless they provide the buyer with a signed affidavit affirming that the following four conditions have been satisfied, in which case the seller will be “deemed” to be a resident of Alabama (and withholding will not be required):

- (1) The seller has filed Alabama income tax returns for the two preceding tax years (or requested extensions);
- (2) The seller is presently in business in Alabama and will continue conducting substantially the same business in Alabama; or in the alternative, the seller will continue to own Alabama real property of greater or equal value than the withholding tax liability after the sale;
- (3) The seller will report the sale on an Alabama income tax return for the current taxable year and file the return by its due date; and

- (4) With respect to corporate or limited partnership sellers, the entity is registered to do business in Alabama (oddly, LLCs and trusts are not included).

Withholding Mechanics – If the seller cannot meet the above definition of a “deemed resident,” an individual buyer must withhold from the purchase price, and remit to the ADOR, a withholding tax equal to 3 percent of the purchase price (or total consideration paid for the property). A corporation, partnership, or unincorporated association (*e.g.*, LLC) that acquires Alabama property must remit to the ADOR a withholding tax equal to 4 percent of the purchase price (or total consideration paid for the property).

The Act does provide for an alternative withholding tax base attributable to the taxable gain recognized on the transfer. A nonresident seller may provide the buyer with a signed affidavit regarding the amount of gain to be recognized by the seller on the transaction, and the relevant withholding tax rate will be applied to this amount. If the amount required to be withheld and remitted, however, exceeds the net proceeds payable to the seller, then the buyer shall remit only the net proceeds otherwise payable to the seller to the ADOR.

Withholding Due Dates – The Act provides that the withholding tax liability shall be assessed and collected in the same manner as all other withholding taxes imposed by the Alabama income tax code. The buyer must file the required return and remit payment to the ADOR by the last day of the next calendar month following the month in which the property transfer occurred.

Exceptions to the Withholding Obligation – Besides sales by Alabama residents (as defined by the above four requirements), the Act provides the following exceptions, virtually identical to Georgia’s statute, where withholding by a buyer who purchases property from a nonresident seller is not required:

- (1) **Personal residence** – The subject property is the “principal residence” of the seller, within the meaning of I.R.C. § 121;
- (2) **Foreclosure action** – The seller is a borrower conveying the mortgaged property to the lender in either a foreclosure or a transfer in lieu of foreclosure, with no additional consideration;
- (3) **Exempt entities** – The seller is either a government agency or a private mortgage insurance company;
- (4) **Composite return** – The pass-through entity-seller certifies to the buyer that a composite income tax return is being filed and the entity is paying Alabama income tax attributable to the seller’s gain recognized on the transfer to the ADOR, on behalf of its nonresident partners, shareholders, or members; or
- (5) **Exempt threshold to be promulgated by the ADOR** – As mentioned above, the ADOR intends to set the minimum purchase price subject to withholding at \$800,000 this year and, beginning January 1, 2009, the Act would apply to transfers of Alabama real estate with a purchase price in excess of \$300,000.

Need for Guidance/Clarity – Unfortunately, the Act does not address several important issues. For example, how should the withholding provisions apply to installment sales and like-kind exchanges? Which withholding rate applies to trusts? Does the alternative “taxable gain” withholding base allow the buyer to avoid liability if the seller recognizes a loss on the transfer? The ADOR may be able to cure some of these uncertainties by promulgating regulations, but a technical corrections bill ultimately may be necessary.

Additionally, while the withholding burden may legally be on the buyer, in practice, the closing agent will be responsible for ensuring compliance with the Act’s provisions. It would be advisable for interim guidance to be provided quickly, defining safe harbors to protect closing agents from liability under the Act. **An informal coalition of real estate and tax attorneys from around the State and representatives from the ADOR are working toward resolving these ambiguities and hopefully providing needed guidance to buyers and their agents.** Please contact Jason Avery or Meade Whitaker of our firm, Hamp Boles or Jim Edwards of Balch & Bingham, or Don Johnson of Sirote & Permutt if you have any specific questions.