



Department of Revenue Issues Guidance on the Alabama Accountability Act of 2013

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On June 21, the Alabama Department of Revenue (“ADOR” or “Department”) released proposed rules interpreting the landmark Alabama Accountability Act of 2013 (“AAA” or “Act”), Acts of Alabama 2013-64, as amended by Acts of Alabama 2013-265. The AAA, which Governor Bentley signed into law earlier this year, provides state income tax credits both to individuals who incur creditable costs in sending their child to a non-failing public school or to a qualifying private school and to individuals or corporations that make cash donations to a qualifying scholarship-granting organization (“SGO”). The proposed rules provide essential guidance to taxpayers interested in taking advantage of the new income tax credits the AAA created and should be reviewed carefully. The rules can be downloaded from the ADOR’s website: <http://revenue.alabama.gov/accountability/>. There will be a public hearing on August 8 to discuss these proposed rules and entertain written comments. This SALT Alert will focus on qualifying SGOs, including the criteria for qualification, how to make gifts to these organizations and who can do so, and the SGOs’ scope of responsibilities. But first, a quick overview of the proposed rules for the parents or guardians of children in one of the 78 listed “failing schools.”

At the outset, we commend the ADOR for issuing guidance on this complex act so quickly. These are only proposed rules, however, and must go through a public review process that could eventually involve the Legislative Council, which is the Legislature’s administrative agency oversight committee. Governor Bentley stated last week that he agrees with each of the rules. Written or email comments on the proposed rules should be sent to Department Secretary Mike Gamble at taxpolicy@revenue.alabama.gov.

Proposed Rules for Section 8 of the Act (Parent Tax Credit)

a. Proposed Rule 810-3-60-.01

The first set of proposed rules addresses Section 8 of the AAA, which allows a state income tax credit to parents who incur “creditable costs” in transferring a child from a failing public school to either a non-failing public school or a nonpublic (i.e., qualifying private) school. A parent is eligible to claim an income tax credit under the AAA if: (1) the parent claims the student as a dependent on their Alabama income tax return; (2) the student is enrolled in or assigned to attend a failing school and receives notification from the local school system that the assigned school is a failing school; (3) the parent



chooses to transfer the student to a non-failing public school or to a nonpublic school; and (4) the parent incurs creditable costs related to the transfer. The Proposed Rule also provides three helpful examples of situations in which parents will *not* meet the eligibility requirements for the AAA income tax credits.

This proposed rule also provides guidance on how to calculate the amount of the Section 8 credit. Parents may claim a maximum credit equal to the lesser of (1) actual creditable costs they incurred for their child to attend the non-failing/nonpublic school or (2) 80 percent of the average annual state cost of attending a K-12 school during the applicable tax year. “Creditable costs” is defined to include “[t]uition and other mandatory fees charged to the parent by the non-failing public school or nonpublic school to which the eligible student is transferred.” It is estimated that the 80 percent figure will be approximately \$3,500 annually per child.

b. Proposed Rule 810-3-60.02

Proposed Rule 810-3-60.02 provides guidance on whether a nonpublic school qualifies for the income tax credits under Section 8 of the AAA. For purposes of the parent tax credit, a nonpublic school is “any private school . . . that is accredited by a state-recognized accrediting agency and has notified the Department of Revenue of its intent to participate in and comply with the requirements of the Section 9 scholarship program.” While parochial schools qualify, the proposed rule states that homeschooling does not qualify parents for the income tax credits under the AAA. This proposed rule also contains helpful examples for parents.

c. Proposed Rule 810-3-60.03

The final proposed Section 8 rule addresses transfers to and from failing public schools. According to the proposed rule, the ADOR will apply a substance over form analysis in determining whether a transfer from a failing school is a “bona fide transfer”. For a transfer to qualify, a student must “remain in the school in which he or she transfers to for a minimum of one semester or 90 school days.” The proposed rule also provides three exceptions to the 90-day/one-semester rule.

Proposed Rules for Section 9 of the Act (Scholarship Donor Tax Credit)

a. Proposed Rule 810-3-61.01

The second set of proposed rules applies to the scholarship program and associated state income tax credits that Section 9 of the AAA created for individual and corporate taxpayers. Proposed Rule 810-3-61.01 provides important definitions that apply to the remaining proposed rules under Section 9. This



proposed rule adopts the U.S. Department of Commerce’s definitions of “household,” “household income,” and “median household income.” In addition, the proposed rule defines “scholarship funds unaccounted for” as the amount of scholarship funds “which have not been paid out, promised or otherwise committed for a particular student, as of a given date.” *Note that the credit is limited to income taxes; thus, financial institutions and insurance companies cannot make creditable donations since they are subject to the separate financial institution excise tax and insurance premium tax, respectively. Also beware that the ADOR strictly interprets the Act, so that if a pass-through entity such as an S corporation or LLC makes a contribution to a qualified SGO, the credit does not pass-through to the owners.*

b. Proposed Rule 810-3-61-.02

Proposed Rule 810-3-61-.02 provides guidance on the creditability of donations made to SGOs. Tax credits are only available for scholarship donations that are considered bona fide gifts. For example, the donor “may not receive anything of value from the SGO in return for the gift” and “no relative of the donor may receive a scholarship from the SGO to which the donation was made.” *Note that donations to SGOs must be made in cash; donations of services, forgiveness of debt, or donations of non-cash assets (e.g., stocks or bonds) will not be creditable.* The amount that is creditable for Alabama income tax purposes generally should also be deductible for federal income tax purposes under IRC § 170, subject to normal limitations.

Donors must use the ADOR’s online verification system for tracking donations and credits. We are advised by ADOR officials that the verification system will be private and not open to public searches. Subject to verification by the SGOs, credits will be *reserved* on a first-come, first-served (filed) basis. Failing to use the ADOR’s online system could result in the loss of the right to claim the credit if the \$25 million cap is reached through others’ gifts. Corporate taxpayers are allowed a credit equal to 100 percent of their donation, while allowable credits for individual taxpayers are limited to the lesser of their actual donation or \$7,500. For all donors, the amount of actual credit that can offset their Alabama taxable income is limited to the lesser of either 50 percent of their Alabama income tax liability or the amount of the allowable credit.

While credits may be claimed only once, the unused portion of an allowable credit may be carried forward up to three tax years. Credits are nontransferable, however, and may only be claimed by the donating individual or corporation. *We urge our corporate clients and friends to strongly consider supporting their local SGOs once they are approved by the Department.*

c. Proposed Rule 810-3-61-.03

To be considered a qualifying SGO, the scholarship organization must apply to the ADOR *beginning on July 1, 2013* through a private website. Along with its application (a form to be provided by the ADOR), an SGO must submit its IRS determination letter exempting the organization from federal income tax under IRC § 501(c)(3) and state that it will comply with all the statutory and regulatory requirements of the AAA. *Note that the Act limits SGOs to only 501(c)(3) entities, and therefore doesn't include certain other types of exempt organizations that might ordinarily be affiliated with public education.* The ADOR will notify those SGOs that applied prior to August 1 of their status and inclusion on the Department's approved organization list by that date. If an application is submitted after that date, the ADOR will notify qualifying SGOs as it processes their application (no time limit specified). *Note: Only after an SGO receives its qualification notice from the ADOR may it accept scholarship donations.*

d. Proposed Rule 810-3-61-.04

This proposed rule provides guidance to SGOs on the receipt, maintenance and disbursement of scholarship funds. Not unexpectedly, SGOs must "maintain separate accounts for all scholarship donations, including any interest or other income on scholarship funds," and the scholarship fund must not be comingled with any other fund. SGOs are required to use "[a]t least 95% of revenue from scholarship donations and all interest and investment income attributable to scholarship funds . . . for educational scholarships." The amount of scholarship funds used for purposes other than educational scholarships will be calculated each calendar year.

Each SGO must make a "reasonable effort" to give scholarships and will be deemed to have made a reasonable effort if the amount of scholarships granted during the year is at least equal to the unexpended scholarship funds on hand at the beginning of the year. Also, the SGO must grant scholarships to eligible students of low-income families in a proportion equal to or greater than "the percentage of low-income eligible students in the county where the SGO expends the majority of its education scholarships." The proposed rule also contains the conditions for ensuring that the SGO meets this test. If an SGO fails to follow the proposed regulatory requirements, the portion of the \$25 million available statewide for tax credits may be released and made available to other donors.



e. Proposed Rule 810-3-61-.05

This Proposed Rule provides reporting requirements that SGOs must comply with in order to participate in the scholarship program. These reporting requirements will assist the Department in tracking the total number and dollar amounts of donations received by SGOs, the counties in which funds are being expended, and the total number and dollar amounts of scholarships granted each year. Additionally, SGOs are required to submit detailed information about each student who receives one of their scholarships.

f. Proposed Rule 810-3-61-.06

If a “nonpublic school” wishes to participate in the scholarship program, it must register on a Department-created (apparently private) website and indicate its willingness to abide by all the statutory and regulatory requirements of the scholarship program. In addition, the nonpublic school must agree to file forms and furnish information as required by an SGO and the ADOR, including financial and academic information. If the nonpublic school is accredited by a regional accrediting agency, the nonpublic school must supply the name of the agency to the Department. If the nonpublic school is not so accredited, the nonpublic school must submit the information required by the Department in Proposed Rule 810-3-61-.06(5). In order to help SGOs and parents comply with the AAA, the Department will maintain a web-based list of participating nonpublic schools.

The rules proposed by the ADOR demonstrate the administrative complexity needed to ensure that the income tax credit system under the AAA is not abused. While the rules will place compliance burdens on SGOs, donors, and parents of children in failing schools, the potential infusion of \$25 million into Alabama’s educational system, particularly the scholarships to low-income families, should be welcomed. *Note:* After a failed challenge before Governor Bentley signed the AAA into law, the Alabama Education Association has again challenged the validity of the act in Montgomery County Circuit Court.

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