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Arkansas Tax Update

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2017 Legislative Session

The 91st General Assembly 2017 Regular Session convened January 9 and recessed April 3. The Senate and House will reconvene for adjournment *sine die* on May 1.

Arkansas is coming out of the 2017 legislative session with significant but not ground-breaking changes in tax law, including the repeal of the InvestArk credit in exchange for an expanded manufacturing exemption, technical changes to income tax laws (particularly for passthroughs), property tax administrative reforms, and creation of a tax reform and relief legislative task force.

New legislation generally is effective 90 days following final adjournment. Unless a specific date is noted, the Acts listed below were passed during the 2017 Regular Session, and are likely to be effective July 30, 2017 (90 days following adjournment *sine die*).

I. INCOME/FRANCHISE TAXES

Act 48 accelerates the extension of the corporate income tax return deadline from March 15 to April 15, so that it applies for tax years beginning on or after January 1, 2016, instead of for tax years beginning on or after January 1, 2017, as provided in 2015 legislation.

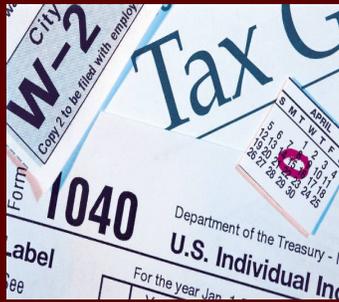
Acts 78 and 79 enact identical House and Senate bills that implement the Governor's \$50 million income tax cut for low-earners. The Acts reduce rates for individuals with income under \$21,000 across the board, as well as providing a small reduction to the first marginal rate bracket for "middle class" persons earning between \$21,000 and \$75,000. Effective for tax years beginning on and after January 1, 2019. Unfortunately, Arkansas continues to have one of the most complicated bracket systems in the country.

These Acts also create a 16-member Arkansas Tax Reform and Relief Legislative Task Force to consider tax reforms ahead of the 2019 legislative session. The task force will convene within 30 days of adjournment *sine die*. An interim report is due by December 1, 2017 and a final report is due by September 1, 2018.

Act 141, effective for tax years and periods beginning January 1, 2018, was the second part of the Governor's tax package. It exempts military retirement benefits from income tax.

To preserve revenue-neutrality, the Act imposes income tax on unemployment benefits, imposes sales and use tax on digital products, and increases tax on candy and soft drinks from the low grocery tax rate to the higher general rate.

The Act also reduces the soft drink tax and exempts from that tax simple syrup used in making tea. The effective date of this simple syrup for tea exemption was accelerated by Act 596, which made it 90 days after adjournment—likely July 30, 2017.



2,105 bills were introduced during the 2017 session, the same number introduced in 2015, of which 1,127 became law and assigned act numbers.

Act 155 is an Internal Revenue Code conformity bill that updates numerous cross-references in the Arkansas income tax laws. In addition, Act 155 specifically provides that child support payments are not includable in income, and it allows netting of gambling winnings and losses. Effective for tax years beginning on or after January 1, 2015.

Act 433 moves up the deadline for filing an employer's wage withholding statement from February 28 to January 31, which will tie to the federal deadline. As a practical matter, January 31, 2018 will be the first deadline affected by Act 433.

Act 434 eliminates the separate Arkansas S corporation election. Effective for tax years beginning on or after January 1, 2018, the federal S corporation election will control.

Act 481 allows a 4-year carryforward of §529 tuition savings plan contribution deductions, which are capped at \$5,000 per taxpayer annually. Effective for the 2017 tax year.

Act 482 changes Arkansas law to require passthrough entities taxable in multiple states to determine Arkansas income using Arkansas's UDITPA statute (with throwback and double-weighted sales factor) instead of the current law requiring separate accounting. The resulting Arkansas income will continue to be allocated up to the owners; apportionment factors do not and will not flow up. The practical effect of Act 482 may be limited because many or most multistate passthrough businesses currently use some form of de facto apportionment in determining Arkansas income. Act 482 is effective for tax years beginning on or after January 1, 2018.

Act 666 allows up to a \$500 deduction by teachers for purchases of supplies and equipment for students. Effective for tax years beginning on or after January 1, 2017.

Act 760 changes Arkansas income tax withholding laws so that nonresident C corporation owners of passthrough entities are subject to withholding. Until now, C corporations had been exempt from passthrough withholding. Corporations can avoid withholding by participating in a composite return or by filing a form agreeing to be subject to Arkansas income tax. Effective for tax years beginning on or after January 1, 2018.

Act 763 provides an income tax exemption for rural physician community match income incentives. Effective for tax years beginning on or after January 1, 2017.

Act 883 allows taxpayers to deduct up to \$3,000 from Arkansas income tax for contributions to an out of state tuition savings program, unless the contribution has already been deducted from the income tax owed to the other state. Deductions of up to \$7,500 are permitted for rollovers from out of state plans to Arkansas plans. Effective for tax years beginning on or after January 1, 2017.

Act 1125 extends the carry forward of unused income tax credits earned for construction, installation or restoration of water impoundments or water control structures from nine years to fifteen years. Effective January 1, 2017.

HB2100 did not pass but is worth noting. It was a bill to adopt the Multistate Tax Commission's recommended amendments to UDITPA, such as the broader "apportionable income" classification, market-based sourcing of services and intangibles, and adjustments to the alternative apportionment provisions. HB2100 also would have adopted a throwout rule for services and would have broadened the throwback rule. The HB2100 proposals are likely to return in some form as part of the tax reform task force and in the 2019 regular legislative session.

II. TRANSACTIONAL TAXES (SALES/USE TAXES)

Act 141, discussed in Part I above, paid in part for the military retirement income tax exemption with two sales and use tax revenue raisers, both effective January 1, 2018:

Arkansas will begin taxing digital products using the Streamlined definitions ("digital audio works," "digital audio-visual works," "digital books," etc.).

The Act will also tax candy and soft drinks at the high general rate instead of the low rate for groceries; reduces the soft drink tax; and exempts from that tax simple syrup used in making tea.

Act 262 removes the superfluous definition of "facilitator" from the click-through nexus provisions of Arkansas Code Section 26-52-110.

Act 465 is the InvestArk / repair and partial replacement parts and labor swap, which essentially phases in an exemption for the repair and partial replacement of certain machinery and equipment, while phasing out the InvestArk investment tax incentive.

The exemption phase-in for repairs and partial replacements occurs beginning July 1, 2018, with annual 1% rate reductions (effectively partial exemptions) until the exemption is completely phased in on July 1, 2022. Act 465 also expands taxpayers' ability to claim this benefit without having a direct pay permit or limited direct pay permit.

The InvestArk phase out is achieved by prohibiting acceptance of new applications after June 30, 2017. Any final InvestArk applications should be filed on or before June 30, 2017. InvestArk then will naturally phase itself out as existing projects proceed to completion and earn credits.

Act 465 also prohibits the increased sales tax refund for major maintenance and improvement projects (Act 1404 of 2013; Ark. Code Ann. § 15-4-3501) after June 30, 2022. Similar to the InvestArk phase out, major maintenance and improvement projects then will naturally phase out as existing projects proceed to completion and earn refunds.

Act 465 as a whole is effective March 13, 2017, but most of its operative provisions have their own dates on which they begin having an effect.

Act 595 expands the fly-away sales tax exemption to sellers of large aircraft when the seller is located in the state and the aircraft is sold in the state but will be based outside of the state. This will continue to expand the use of Arkansas aircraft flight testing, inspection and maintenance facilities for closings of aircraft sales. Effective March 23, 2017.

Act 661 broadens the sales tax exemption for purchases of new motor vehicles by nonprofits providing transportation services under contracts with the Department of Human Services or purchased with Federal Transit Administration funds. It does so by eliminating a requirement that vehicles be purchased in lots of 10 or more in order to qualify for the exemption. Likely effective October 1, 2017.

Act 665 removes the requirement that sales by a charitable organization must be made with a dominant motive of making a charitable contribution in order to be exempt. For example, this could apply to sales of concessions at a fundraiser or auction items at a charity ball. It is likely to be effective October 1, 2017.

Act 672 adds lease and rental transactions to the exemption from sales tax for beer kegs used to sell beer wholesale by a wholesale manufacturer.

Act 673 requires Arkansas wineries making direct shipments to consumers to source the collection of sales taxes to the purchaser's delivery address.

Act 759 tightens DFA's already draconian business closure powers by making a DFA hearing officer's determination to close a business (for tax noncompliance) effective 20 days after the decision and simultaneously effective as an injunction prohibiting further operation of the business. Apparently DFA has been dealing with a surfeit of frivolous appeals under the current statutory framework. Act 759 is likely effective October 1, 2017.

Act 1126 limits the 2% sales tax discount available for early payment of city and county sales and use tax as follows: For the tax year beginning January 1, 2018, the discount shall not exceed \$5,000; For the tax year beginning January 1, 2019, the discount shall not exceed \$4,000; For the tax year beginning January 1, 2020, the discount shall not exceed \$3,000; For the tax year beginning January 1, 2021, the discount shall not exceed \$2,000; For the tax year beginning on and after January 1, 2022, the discount shall not exceed \$1,000. Effective October 1, 2017.

SB140 failed to pass but worth mentioning as a hybrid economic nexus and use tax reporting bill that was intended to compel sales and use tax collection by remote sellers. The bill failed to pass the House over apparent concern that it constituted a tax increase or new tax; complicated by the fact that the United States Supreme Court has not yet revisited its *Quill* decision from 1992, as Justice Kennedy has signaled a willingness to do.

III. PROPERTY TAXES

Act 49 clarifies administration of the homestead property tax credit by expressly limiting property owners to one homestead tax credit and allowing irrevocable trusts to claim the homestead credit. Effective January 26, 2017.

Act 152 delays the beginning of accrual of penalty and interest on delinquent property taxes from October 11 in the year of delinquency to October 16, and allows a homestead property tax credit to be claimed on the following business day if the deadline falls on a weekend or a holiday observed by the US Postal Service.

Act 162 clarifies that the county equalization board does not have jurisdiction over the valuation of agricultural, pasture or timberland, which are based on valuation tables issued by the Assessment Coordination Department; or the county assessor's determination of a property's tax exempt status.

Act 197 extends the deadline by which a county collector must transfer taxes to the county treasurer from within 5 days of the first day of the month to within 10 days. Removes the requirement that penalties associated with personal property taxes shall be divided fifty percent (50%) to the county general fund and fifty percent (50%) to the county common school fund.

Act 375 authorizes a local petition and ballot question process to provide funding for seat belts on school buses through a property tax increase.

Act 394 authorizes lessors of heavy equipment to include in their rental agreements property tax recovery fees of 1.25% of rental charges, to be used for payment of property taxes. Effective January 1, 2018.

Act 514 requires a county collector, before initiating collection on delinquent mineral interest taxes, to prepare a list of such delinquent taxes, including the owner and location of the interest, and publish the list on a dedicated website as well as provide the list to the Association of Arkansas Counties. Effective for tax years beginning on or after January 1, 2017.

Act 656 removes the requirement that deeds representing transactions that are exempt from the Real Property Transfer Tax be accompanied by a receipt from the Department of Finance and Administration showing proof of tax payment.

Acts 78 and 79
 create a 16-member
 Arkansas Tax Reform
 and Relief Legislative
 Task Force to consider
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Act 659 provides training, hearing guidelines and additional resources to County Equalization Boards, and a procedural warning to corporate taxpayers appealing EQ Board decisions to the judicial level; lowers the taxpayer burden of proof in court appeals; clarifies and improves taxpayer refund rights for various types of reporting and assessment mistakes; and addresses various procedural handicaps for taxpayers appealing assessments by the Tax Division of the Public Service Commission.

Act 729 prohibits the clerk of a county court from charging a filing fee to a taxpayer petitioning for a property tax refund.

Act 1053 amends provisions governing the Land Commissioner's handling of tax-delinquent lands that do not sell at auction.

Act 1076 provides that property owned by the state and leased to private businesses is subject to property tax, with certain exceptions. This is intended to reverse the result of *Washington County v. Board of Trustees of the Univ. of Arkansas*, 2016 Ark. 34 (Feb. 4, 2016).

IV. MISCELLANEOUS TAXES

Act 141. Note the reduction in the soft drink syrup tax and the exemption from that tax of simple syrup used in preparing tea, discussed in part I and noted in part II above.

Act 671 changes the excise tax provisions of Arkansas Code Section 3-7-104 to tax hard cider at the same \$7.50 per-barrel rate applicable to beer under 5% alcohol by weight. Likely effective September 1, 2017.

Act 734 reduces the unemployment insurance wage base from \$12,000 to \$10,000. It also reduces the period for benefits eligibility from 20 weeks to 16 weeks and provides that employer separation payments restrict availability of unemployment benefits.

Act 1098 imposes a 4% of gross receipts privilege tax on marijuana cultivation facilities, dispensaries, or other marijuana businesses. Effective July 1, 2017.

V. TAX CREDITS AND INCENTIVES

Amendment 97 to the Arkansas Constitution was adopted in the 2016 General Election. The amendment (2016 Ballot Question #3) has the following impacts:

Removes the 5% of state revenue cap on Amendment 82 megaproject bonds. The state had been limited to issuing Amendment 82 bonds totaling no more than 5% of annual revenue.

Allows local governments to pay for economic development services. Historic practice in Arkansas has been for chambers of commerce to lead local economic development efforts, and for such organizations to receive financial support from local governments. This practice had been called into question by a circuit court ruling in 2015 prohibiting Little Rock, Arkansas and North Little Rock, Arkansas from paying the Little Rock Chamber of Commerce for economic development services. *Lynch v. Stodola*, No. 60CV-1 3-360 (Pulaski Cty. Cir. Ct.); see also Ark. Atty. Gen. Op. No. 2015-005 (Apr. 30, 2015).

The constitutional amendment clearly allows local governments to resume paying chambers of commerce or other organizations for economic development services.

The amendment also clarifies and expands the framework for local governments to finance economic development projects, including authorizing appropriations for economic development projects as well as the issuance of capital improvement bonds in support of such projects.

Note Act 686 below makes conforming statutory changes to implement Amendment 97.

Act 208 repeals the Nonprofit Incentive Act of 2005, which had provided a little-used sales and use tax refund and a payroll rebate designed to persuade nonprofits to locate, invest and hire within the state.

Act 374 made technical corrections to the economic development statutes of title 15, including repeal of obsolete provisions.

Act 393 increases the maximum allowable claim under the Arkansas historic rehabilitation income tax credit program from \$125,000 to \$400,000 for income-producing properties for projects that start after July 1, 2017. Effective July 1, 2017.

Act 426 repeals the Arkansas Development Finance Corporation Act and the Arkansas Capital Development Company Act and removes references to corporations and companies creatable under those acts.

Act 465 discussed in part II above phases out the InvestArk retention investment tax credit by prohibiting approval of applications filed after June 30, 2017. Taxpayers should consider filing applications covering projects that are pending or “on the drawing board” before the filing deadline.

Act 533 amends the Local Government Bond Act of 1985 to authorize local governments to fund economic development projects including land, buildings, equipment, improvements and infrastructure for development or expansion of certain private industries.

Act 685 creates the Local Job Creation, Job Expansion, and Economic Development Act of 2017, which provides that a municipality or county may obtain or appropriate money for a corporation, association, institution, political subdivision of the state, the federal government, or an individual to finance economic development projects or provide economic development services but limited to projects or services that do not exceed five percent (5%) of the city or county's total unobligated general revenue. Repeals the five percent (5%) limitation on the issuance of Amendment 82 bonds.

Act 686 creates local government provisions that implement the economic development expenditure provisions of Amendment 97. Effective March, 27, 2017.

Act 1042 revises the tax credit allowed for an apprenticeship program, which is currently the lesser of \$2,000 or 10% of the wages earned by the apprentice. The Act increases the maximum annual credit to \$10,000 effective for tax years beginning on or after January 1, 2018.

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Act 1046 adds various provisions to the recycling tax credit program that would apply to certain major expansions by qualified manufacturers of steel and new steel specialty products manufacturing facilities for taxpayers that elect to take advantage of these provisions.

VI. PROCEDURE

Acts 78 and 79 discussed in part I above, create a 16-member legislative taskforce on taxation composed of members of the House and Senate for the purpose of examining, identifying and recommending legislation to simplify the state tax code, make Arkansas more complete, create jobs, and ensure fairness. The Task Force will convene 30 days after adjournment, likely in late May or early June.

Act 435 loosens the taxpayer confidentiality statute to allow DFA to provide more information to a bankruptcy trustee, and it expands the confidentiality exception to apply to all bankruptcy trustees; not just Chapter 13 bankruptcy trustees.

Act 762 broadens DFA's authority to deny or cancel sales tax permits or other licenses or registrations to also apply to any failure to comply with state tax laws, as well as any failure to pay assessed interest or penalties. Effective on and after January 1, 2018.

Act 999 defines an erroneous refund as an underpayment and establishes a 3-year limitation period for the recovery of such an underpayment from when the refund was issued.

Act 997 establishes an appeal procedure for the DFA's decisions regarding reexamination or audit of a mileage claim.

Act 881 requires assessment notices that are delivered to taxpayers to include contact information for use in obtaining tax records from the DFA and requires additional detail in the notice requirements of the Tax Procedure Act and the Taxpayer's Bill of Rights.

VII. ABANDONED AND UNCLAIMED PROPERTY

Act 421 extends the holding period for presumption of abandonment of stock or other equity interests from 5 to 7 years, and it adds presumed abandonment under 17 C.F.R. § 240.17Ad-17 as a starting point for the 7-year period.

Act 622 extends the deadlines for providing notice to the apparent owner of property presumed abandoned to not more than 180 or less 90 days before filing the report of abandonment with the State Auditor instead of not more than 120 or less than 60 days. It also provides that notice for the contents of a safe deposit box must be sent by letter.

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About the Authors

Matthew C. Boch focuses his practice on Arkansas and multistate taxes and incentives. His practice encompasses all stages of the tax cycle, including planning, administrative proceedings, and litigation. Matt also assists companies seeking economic development incentives and dealing with incentives compliance or clawback issues. He previously was based in Chicago as a partner in the SALT practice group of an international law firm. Matt received both his J.D. and his B.A. (with honors) from Harvard University. Matt writes and speaks frequently on state tax and incentive issues. He serves as an Assistant Editor of the *Journal of Multistate Taxation & Incentives*; as Editor-in-Chief of *Con-Nexus*, the American Bar Association SALT Committee newsletter; as the author of the Bloomberg BNA *Arkansas Corporate Income Tax Navigator*; and as co-author of the Arkansas chapter of the American Bar Association's *Sales and Use Tax Deskbook*. He is the current Chair of the Arkansas Tax Advisory Council and also authors the Arkansas Tax and Incentives Update blog.

Thane J. Lawhon's practice also emphasizes taxation, business law and regulatory issues. He received his B.S. degree from the University of Arkansas at Fayetteville, his M.B.A. degree from the University of Arkansas at Little Rock, and his J.D. degree, with honors, from the William H. Bowen School of Law. Mr. Lawhon is a member of the American, Arkansas and Pulaski County Bar Associations. He is co-author of the Arkansas chapter of the American Bar Association's *Sales and Use Tax Deskbook*, and is a frequent contributor to articles, updates and materials regarding state and local tax issues.

Michael O. Parker received his B.A. degree from Vanderbilt University and his J.D. degree with honors from the University of Arkansas at Fayetteville. Organizational activities include service as special tax counsel and legislative resource on tax issues for the Arkansas State Chamber of Commerce and Associated Industries of Arkansas for almost 30 years. Mr. Parker is a past chairman of the Section on Taxation of the Arkansas Bar Association and has served by appointment as a Special Justice to the Arkansas Supreme Court. Honors include continuing selection for Best Lawyers in America in Tax Law and Litigation and Controversy-Tax as well as his continued listing among Super Lawyers for the Mid-South.

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