The Dust Settles: Arkansas Tax Developments from the 2017 Legislative Session

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The 2017 legislative session saw significant but not ground-breaking changes to the world of Arkansas taxes and economic development incentives. While the General Assembly is controlled by Republican majorities, there was little tax relief for businesses amidst a deteriorating revenue situation: The main tax cut was the Governor's $50 million income-tax cut for low-income individuals, with most of the benefit to those earning under $21,000. At least critical business exemptions and incentives to ensure Arkansas competitiveness were largely preserved.

This update focuses on several developments likely of interest to AEF members. For a full Arkansas tax legislative summary, please contact the authors or view the summary and blog posts on our website, www.doverdixonhorne.com.

Simplification for Manufacturers: InvestArk Repeal and Manufacturing Repair Parts and Services Exemption Phase-In

The most significant change for Arkansas industry is the end of the InvestArk investment incentive and the phase-in of an exemption for manufacturing machinery and equipment repair parts and services. These changes are provided by **Act 465**, which was a consensus bill negotiated by the State Chamber and the Arkansas Department of Finance and Administration (DFA) to simplify the Arkansas tax code.

The InvestArk program will stop taking new applications after June 30, 2017. InvestArk is an investment incentive that generates a credit equal to 7% of the qualified investment amount. That credit can be used to offset up to 50% of a business's sales and use tax liability. Qualifying projects must be in excess of $5 million. No job creation is required. To be eligible, a company must have been doing business in Arkansas for at least two years.

As of the writing of this article, businesses are getting their final InvestArk applications submitted ahead of the June 30 deadline. Projects that already are underway or that beat the deadline will continue to earn credits without change. The program will sunset naturally as the current pipeline of projects are completed: businesses have four years to generate the credits by making the investment, and credits carry forward for five years.

Act 465 offsets the loss of InvestArk with the phase-in of a tax exemption for manufacturing machinery and equipment repair parts and services. These items currently are eligible for a refund of 1%, effectively reducing the state-level rate from 6.5% to 5.5%. Under Act 465, the refund will increase by 1% each year beginning on July 1, 2018, until complete phase-in occurs on July 1, 2022. At that point, this rebate will transform into an ordinary tax exemption. This will be the date at which the exemption also will apply to local sales taxes.

To be more precise about what is eligible, the rebate and eventual exemption apply to the sale of machinery and equipment purchased to modify, replace, or repair machinery or equipment used directly in manufacturing. They also apply to services relating to the initial installation, alteration, addition, cleaning, refinishing, replacement, or repair of such machinery and equipment. The "manufacturing" operations eligible for the refunds include the ordinary meaning of manufacturing as well as thirteen other operations that are not often thought of as manufacturing, such as mining and printing of all kinds. Consider carefully what will qualify. This is a tax exemption, and DFA will interpret it narrowly.

Act 465 also has provisions to make it easier for taxpayers to claim their refunds while the phaseout is ongoing. Thus far, businesses must obtain a direct pay permit or limited direct pay permit in order to benefit from the 1% rate reduction. Beginning July 1, 2018, businesses can simply net out the rebate on their sales and use tax returns instead of having to go through the process of self-assessing under a direct pay or limited direct pay permit.

Act 465 will also sunset a little-known but very lucrative program that increases the refunds available for taxes paid on major maintenance and improvement projects (over $3 million) from 1% to 5.875%, which effectively reduces the state sales tax rate to 0.625% for these projects. The phase out of this program is achieved by prohibiting acceptance of new applications after June 30, 2022, at which point the program is moot since the complete exemption will be in place.

The background of Act 465 was a concern that InvestArk was slated for repeal as a revenue raiser. InvestArk has been the most expensive of the state's economic development incentives, and it is not tied to job creation. It did, however, provide relief from a state tax system that unduly burdens manufacturing. In this climate, it made sense for the business community to exchange InvestArk for a change in the tax structure that would benefit manufacturers: the phase-in of an exemption for maintenance and repair parts and services for manufacturing equipment. Smaller manufacturers will benefit in particular because their projects often were not large enough for InvestArk.

Look Out for a New Property Tax Recovery Fee on Leased Equipment

If you are involved with leased equipment, start reviewing your agreements. **Act 394** authorizes a 1.25% property tax recovery fee to be collected by lessors of

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heavy equipment. This authorization is limited to lessors in NAICS sectors 532310 (general rental centers) or 532412 (construction, mining, and forestry machinery and equipment rental and leasing). The rate is 1.25%, and the lessor must use the monies collected to pay its property taxes. You could have a situation where the lessor is collecting both sales tax and property tax on equipment rentals.

The property tax fee is a negotiable item. The tax still is imposed on the property owner, and a lessee negotiating ahead of time could contract that the lessor will not pass on its property tax fee. If the parties do not expressly address the tax recovery fee, the permissive language in Act 394 would appear to allow invoicing of the fee without prior lessee consent.

DFA Business Closure Authority Expanded

Businesses that have serious state tax problems or that do business with those who do should be aware of expanded DFA enforcement powers. **Act 762** broadens DFA's authority to deny or cancel sales tax permits or other licenses or registrations for any failure to comply with state tax laws, as well as any failure to pay assessed interest or penalties. A taxpayer could find its failure to pay an income tax liability causing it to lose a state sales tax permit or other permit. Act 762 is effective January 1, 2018. In addition, **Act 759** made a DFA hearing officer's determination to close a business (for tax noncompliance) automatically effective 20 days after the decision.

Local Economic Development Powers Dramatically Enhanced

The voters approved **Amendment 97** to the Arkansas Constitution in November 2016; the 2017 session provided implementing legislation. Recall that Amendment 97 uncapped the state's authority to issue Amendment 82 megaproject bonds (previously 5% of state revenue), authorized local governments to pay local chambers of commerce for economic development purposes, and clarified and expanded local government powers to supporting economic development, including expanding the definition of eligible economic development projects.

Act 685 and **Act 686** expand local economic development powers in light of Amendment 97. Act 685 establishes the Local Job Creation, Job Expansion, and Economic Development Act of 2017. This will provide the framework for local economic development activity. It authorizes local governments to finance economic development projects and sets forth a basic governance framework, including requiring a cost-benefit analysis for projects over $100,000 and limiting local economic development expenditures at 5% of general revenue unless the local government opts for a financial forecast and then chooses to continue with the project. Act 686 updates the local economic development sales tax and economic development corporation provisions to follow Amendment 97 and Act 685.

Act 685 also implements Amendment 97 in authorizing local governments to pay for economic development services. This allows restoration of the historic practice where local chambers of commerce lead economic development efforts, which had recently been called into question by litigation.

Property Tax Procedures Made Fairer

Act 659 made a number of procedural changes to the property tax laws that should benefit all taxpayers with a fairer system. This included requiring more uniform procedures for county equalization board hearings and lowering the taxpayer's burden of proof when appealing an equalization board's decision.

Revenue Situation Deteriorating

The last few months have seen revenues come in below where the state expected for the current fiscal year ending June 30, 2017. At the end of April, budget cuts of $70 million were implemented under the revenue stabilization act. While the Arkansas fiscal situation is better than many of our neighboring states, the revenue shortfall limits the scope of the state's ability to cut taxes as much as many members of the General Assembly would desire.

Online Sales Tax Failed to Pass

Amidst this revenue shortfall, the House and Senate were unable to pass bills requiring collection of sales and use tax by remote sellers, SB 140 and HB 1388. Either of these would have effectively required tax collection by online sellers, including B2B transactions. With sellers not collecting tax, buyers need to consider whether they have Arkansas use tax obligations on purchases from online sellers.

Tax Reform Task Force Underway

Among other things, **Acts 78** and **79** created an Arkansas Tax Reform and Relief Legislative Task Force comprised of 16 legislators. Its mandate is to consider tax reforms ahead of the 2019 legislative session. The task force last convened on June 7, 2017. An interim report is due by December 1, 2017, and a final report due by September 1, 2018.

Arkansas businesses need to stay current on the direction the task force takes and become involved as necessary to ensure industry specific favorable tax schemes remain in place or reformed for the better. The general goal of the task force is likely to remove exemptions and incentives in order to pay for income tax rate cuts. Comments made by the task force indicate that no state tax, incentive, or exemption will be left unturned, and so businesses need to be ready to defend their Arkansas tax provisions.