

ARKANSAS STATE TAX UPDATE 2005 LEGISLATIVE SESSION

The 85th General Assembly (2005 Regular Session) of the Arkansas Legislature convened January 10, 2005 and adjourned May 13, 2005. New revenues were not a major topic in the 2005 session, in contrast with other recent sessions. However, there were a number of technical changes and changes of limited effect, and a few bills with broader implications. In addition, the Department of Finance and Administration announced changes in the interpretation of certain sales and use tax exemptions of interest to manufacturers. These are noted at the end of the Sales and Use Tax section.

The following summaries are taken in part from descriptions compiled by the Office of Revenue Legal Counsel and the Assessment Coordination Department, with appreciation to these agencies for use of these materials. Unless a specific date is noted, new Acts are effective August 12, 2005, and in the case of Income Tax Acts, apply to tax years beginning on or after January 1, 2005.

A. Income Tax.

Act 29. Adopts sections of the Internal Revenue Code (IRC) in effect on January 1, 2005, to clarify that combat zone compensation is exempt from Arkansas individual income tax and that the income of a member of the armed forces is exempt in the year of the person's death.

Act 63. Repeals the 3% income tax surcharge adopted in 2003, for tax years beginning in 2005.

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Act 94. Under prior law, neither contributions to health savings accounts nor interest earned on such accounts are exempt from Arkansas income tax.

Act adopts specific subdivisions of the IRC as in effect January 1, 2005, concerning health savings accounts and provides that health savings accounts are exempt from Arkansas income tax as long as the account meets the requirements of the IRC. The Act also excludes contributions by an employer to a health savings account from the employee's gross income, and provides for deductibility from income for contributions made to a health savings account by the taxpayer or the taxpayer's employer. Applies to tax years beginning on or after January 1, 2004.

Act 189. Clarifies current law regarding cost recovery for annuitants under the state income tax law. Provides that IRC §72 as in effect on January 1, 2005 is the sole method by which a recipient of retirement benefits from an employment related retirement plan may recover cost of contribution for purposes of computing state income tax. Intended to resolve issues raised in *McFadden et al. v. Weiss*, (Ark., Dec. 9, 2004).

Act 261. Requires a corporation to have elected Subchapter S treatment for federal income tax purposes if electing Subchapter S treatment for Arkansas income tax purposes for the same tax year.

Act 668. Allows a taxpayer to take an income tax deduction of up to \$10,000 for unreimbursed expenses incurred by the taxpayer or one of his dependents related to the donation of an organ liver, pancreas, kidney, intestine, lung, or bone marrow to another human being.

Act 675. Adopts changes to the IRC involving: exclusion of gain from the involuntary conversion of a taxpayer's property; gain on the sale of property owned and used as a taxpayer's principal residence; exclusion from income for dependent care assistance; exclusion from income of child care benefits provided to members of the United States military; Subchapter S of the IRC regarding small business corporations; installment method of accounting; annuities; retirement savings, and employee benefit plans; trade or business expenses; deductions for charitable contributions; deductions of expenses for entertainment, amusement, recreation, business meals, travel, etc.; deduction of costs paid or incurred for the cleanup of certain hazardous substances; amortization of qualified reforestation expenses; computing the depletion deduction for natural resources; leasing transactions between taxpayers; capitalization and amortization of a corporation's organizational expenses; amortization of partnership organizational expenses; educational individual retirement accounts; definition of dependent; determining the allowable credit for household and dependent care services; definition of head of household and qualifying widow or widower with a dependent child.

Act 686. Allows DFA to grant an extension of time for filing an Arkansas income tax return of not more than 120 days, and an additional extension of 60 days. Conforms the Arkansas extension provisions to those of federal law.

Act 1309. Adopts IRC provision to require withholding from certain periodic and lump sum payments of deferred income, with certain modifications. Withholding from non-periodic payments will be at the rate of 3%. Withholding from rollover distributions will be at the rate of 5%. Requires employees with 250 or more employees to file the required annual withholding statement electronically, by magnetic media, or by other machine readable form approved by the director. Applies to tax years beginning on or after January 1, 2006.

Act 1973. Allows a deduction from the taxpayer's adjusted gross income for contributions to a tuition savings account established under the Arkansas Tax-Deferred Tuition Savings Program. Deductible contributions cannot exceed \$5,000 per taxpayer per tax year.

Act 1982. Requires pass-through entities to withhold income tax on the applicable distributions to nonresidents that are attributable to income from sources within the state. The pass-through entity is required to file an annual return in electronic format that shows the total amount of income distributed or credited to its nonresident members and the amount of tax withheld and remit the tax.

Among other exceptions, a pass-through entity is not required to withhold tax for a nonresident member if: the member's share of income is less than \$1,000; the entity has filed the member's signed agreement to file and pay Arkansas nonresident income tax; the member elects to have the tax paid as part of a composite return filed by the pass-through entity as allowed by the Act; or the entity is a publicly traded partnership that is treated as a partnership for federal tax purposes and has agreed to file an annual information return reporting the name, address, and taxpayer identification number of each member with Arkansas income greater than \$500.

Act 2187. Exempts from Arkansas income tax the first \$9,000 of military pay to Arkansas or U.S. enlisted personnel. Officers are exempt on only the first \$6,000 of service pay.

Act 2247. Allows an income tax credit in the amount of \$15.00 for each ton of rice straw in excess of 500 tons that is purchased by an Arkansas taxpayer who uses the straw for processing, manufacturing, generating energy or producing ethanol.

B. Miscellaneous Taxes.

Act 260. Allows title companies to purchase real property transfer tax stamps on consignment in the same manner as banks currently do.

Act 671. Increases the annual registration fee for underground and aboveground storage tanks from \$50 to \$75.

Act 685 (3/9/05). Authorizes the Arkansas Highway Commission, upon voter approval, to issue bonds to pay for the construction and renovation of the Interstate Highway System. Establishes the Arkansas Interstate Highway Financing Act of 2005 and uses the existing special motor fuel tax revenues that are currently designated for funding the Arkansas Interstate Highway Financing Act of 1999. These revenues include four (4) cents of the current twenty-two and one-half (22½) cents per gallon tax on diesel fuel.

Act 918 (3/18/05). Requires the Executive Chief Information Officer to promulgate rules governing the retention and management of public records commonly found in state agencies. Agencies are required to comply with those rules on the earlier of July 1, 2007 or the date of an appropriation to the agency of funds to comply with the rules.

Act 1157. Allows the Alcoholic Beverage Control Division (ABC) to issue a temporary wine permit, not to exceed a five-day period, and not to exceed two auctions per year, to an IRC §501(C)(3) or (4) organization to sell wine in Arkansas during live or silent auctions for fundraising purposes. The sale of wines at an auction as provided in the Act is not taxable.

Act 1544. Allows native wineries and wholesalers to conduct wine tasting events without obtaining wine sampling permit if timely notice is given to ABC. Wine retailers must obtain a wine sampling permit from ABC in order to conduct wine tasting events. The wine sample permit license fee is \$1,000 and expires on June 30 of each year. Wine purchased for sampling is not exempt from sales and use tax, including withdrawals from stock.

Act 2188 (4/13/05). Extends the 3% beer excise tax to June 30, 2007. After June 30, 2007 the State Board of Education and the Department of Education are required to replace the revenue to fund the programs that the 3% beer tax currently funds.

Act 2223 (7/1/05). Provides a tax refund of the diesel fuel tax paid by a supplier, at the time an Arkansas biodiesel fuel producer can produce at least one million gallons of biodiesel fuel in a 12-month period. The refund is equal to 50¢ per gallon of biodiesel fuel and expires on June 30, 2007.

Act 2275. Regional Mobility Authority Act allows a county or contiguous counties to create a Regional Mobility Authority whose purpose is to plan, construct, operate, fund, or purchase improvements to a surface transportation system, and provides several funding alternatives.

C. Procedural/Legal.

Act 262. Clarifies that interest on overpayments of tax is to be calculated from the due date of the return or the date the return was filed, whichever occurs later. Allows the Director 90 days from the return due date or the date the return was filed, whichever occurs later, to refund an overpayment of tax without interest.

Act 919. Establishes uniform fees to be paid to the circuit clerk of each county by the Department of Finance and Administration for filing a certificate of indebtedness, a release of a certificate of indebtedness, and an execution on a certificate of indebtedness.

Act 1845. Pertains to leave time, witness fees and mileage fees when state employees are subpoenaed to give evidence in legal proceedings.

Act 2263. Requires that any communication, form, notice, announcement, publication, or other similar document from a state agency must include a telephone number for inquiries or comments and, if practicable, the name of a contact person.

Act 2274. Adds additional filing requirements to the present requirements for notaries public.

D. Property Tax.

Act 27. Repeals the provision requiring county clerks to publish summaries of the actions taken by equalization boards.

Act 73. Changes the date for county clerks to file abstracts of assessment with the ACD, from October 1 to no more than 30 days after the adjournment of the equalization board.

Act 84. Exempt entities do not have to pay property taxes on a property to claim it by adverse possession.

Act 135. Delinquent tax penalties shall not be assessed against deployed members of the armed forces, armed forces reserves or Arkansas National Guard units during their deployment and for up to one year after their deployment ends.

Act 659. Technical changes to the distribution of the Property Tax Relief Fund, effective January 1, 2006.

Act 1242. Directs the Constitutional Issues Subcommittee of the Interim House State Agencies and Governmental Affairs Committee and a similar subcommittee of the Interim Senate State Committee to study property taxes and the impact of Amendments 59, 74, and 79 of the Arkansas Constitution, and issue a report no later than October 31, 2006.

Act 1268 (3/29/05). Technical corrections to the Amendment 79 implementing legislation, to define the term “homestead” consistently for the property tax credit and assessment increase limitations, and change the deadline for homestead owners to apply for the property tax credit from October 31 to October 10.

Act 1275. Prohibits the diversion of library property tax proceeds to finance TIF district improvements.

Act 1281. Exempts all county owned property from property tax. Previous statute limited the exemption to ten acres of land.

Act 1417 (3/30/05). Requires the Assessment Coordination Department (ACD) to adopt rules defining computer assisted mass appraisal (CAMA) specifications by July 1, 2005, and further provides that ACD may pay CAMA providers directly in compliance with the ACD rules.

Act 1432. Lands enrolled in the NRCS Wetland Reserves Program or the Department of Agriculture Conservation Reserve Program shall be valued as agricultural, pasture or timber lands for ad valorem tax purposes.

Act 1445. Moves the deadline for counties filing appraisal plans with the ACD to November 1 of the year preceding a new reappraisal cycle.

Act 1772 (4/6/05). Changes the ACD Ratio Study report date for reports to counties from August 1 to September 15.

Act 1947. Changes the date by which the county court must hear property owners’ appeals from the first Monday in November to November 15th.

Act 2228. Changes the person responsible for reporting mobile home sales from the seller to the purchaser. Repeals requirement that property owners show proof of assessment of mobile homes by attaching decals given to them by the assessor at the time of assessment.

Act 2231 (4/13/05). Amends law concerning TIF districts to include the State of Arkansas as a “taxing unit,” and provides that the local governing body cannot approve an ordinance creating a redevelopment district unless the body determines that the boundaries of the proposed district are in a blighted area that includes the presence of at least one of the factors listed in the Act.

Act 2259. Changes the beginning point for calculating growth to determine whether a county will be appraised over a three year cycle or a five year cycle. Beginning in 2005, the growth will be calculated from the year before the beginning of a reappraisal cycle to the year the cycle is completed with the net effect that more counties will be on three year cycles.

Act 2284 (1/1/06). All properties that are sold will be ineligible for Amendment 79's limitations on increases in assessed value. The assessed value of the property will be 20% of its appraised value in the year following transfer.

E. Sales & Use Taxes.

Act 647. Provides for a reduction in sales and use tax rates on food and food ingredients from 6% to 0.625%, at such time as the net available revenues attributable to the collection of the sales and use taxes from remote sellers having no physical presence in Arkansas are equal to 150% of the sales and use tax collected on food and food ingredients. Local option city and county sales and use taxes are specifically excluded from the reductions contained in the Act.

Act 877. Exempts the sale of electricity used for the production of chlorine and other chemicals using a chlor-alkali manufacturing process from sales and use tax.

Acts 1160 and 1161. Clarify that a county may change the purposes of a county sales tax levy by a vote of the people. However, an approved change in the use of the county tax does not alter the allocation of tax collections among the county and its municipalities.

Act 1269. Authorizes municipalities to change the uses of revenues derived from a municipal sales and use tax for capital improvements upon the approval of the voters (except for revenues pledged to lease rentals or bonds). Also allows the ballot tile for a municipal tax levy to contain an expiration date and authorizes a municipality to change the use of the revenues upon the approval of the voters.

Act 1270. Amends the procedures for abolishing municipal sales and use taxes.

Act 1274 (01/01/06). Clean-up legislation to provide that the rate of supplemental gross receipts tax on sales of alcoholic beverages and on the preparation and serving of mixed drinks in private clubs is 10%; and levies a supplemental tax of 4% on the

sale of alcoholic beverages other than beer or wine and on the preparation and serving of mixed drinks in private clubs. Act simply clarifies existing 10% or the 4% tax rates. Replaces existing law with levies at the same rate beginning January 1, 2006.

Act 1294. Allows DFA to disclose the names and addresses of taxpayers that are subject to business closure by posting on the DFA Internet site the business name and address and the city and county in which the business is located, as appearing on the sales tax permit.

Act 1441. Further defines “instructional materials” for purposes of exemption to include sheet music, electronic software, maps, globes, art supplies, workbooks, flash cards, educational models, manipulatives, charts for classroom use, video tapes, DVDs, and films or cassettes containing instructional information designed to be presented to students as part of a course of study. Excludes items purchased for use in interscholastic extracurricular activities or administration or maintenance of the school, or construction materials or supplies.

Act 1693 (7/1/05). Requires a decal to be placed on heavy equipment to prove that Arkansas tax was paid on the equipment or that it is exempt from tax. A heavy equipment dealer is required to obtain the decals from DFA and place them on the equipment at the time of sale. Purchasers of equipment out-of-state must obtain the decals directly from DFA upon proof of payment of the tax on the equipment. Emergency Rule 2005-04 issued June 9, 2005, clarifies that Act generally applies to construction type equipment propelled by an internal engine or power source and intended for outside use, and heavy duty air compressors.

Act 1865. Provides a sales and use tax exemption for tangible personal property or service purchased by a “Qualified Museum” or its contractor or agent for use in the construction, repair, expansion or operation of the museum facility. A “Qualified Museum” is a nonprofit organization that acquires a collection of artwork for public viewing and exhibition in an Arkansas facility prior to January 1, 2013, the fair market value of which exceeds \$100,000,000. The aggregate costs of construction and acquisition must exceed \$30 million.

Act 1879 (4/18/05). Clarifies the definition of telecommunication services that are subject to tax. Taxable services include one-way or two-way transmission of messages, voice messages, images, or other real-time or essentially real-time communications whether accomplished by any means including wire, cable, fiber optics, laser, microwave, radio, satellite, voice-over Internet protocol, or similar facilities. Clarifies sourcing rules for purposes of administration.

Act 2008. Postpones the effective date of substantive changes required under the Streamlined Sales Tax Agreement in Arkansas to July 1, 2007.

Act 2132 (7/1/05). Exempts sales of tangible personal property or services to the Arkansas Symphony Orchestra from sales and use tax.

Act 2162 (4/13/05). Exempts the parking charges or fees collected by educational institutions owned and operated by the State of Arkansas from the sales tax on the service of parking a motor vehicle or allowing the motor vehicle to be parked. The exemption does not apply to parking for athletic events or other special events.

Act 2163 (7/1/05). Adopts administrative provisions of the Streamlined Sales Tax Agreement for purposes of Arkansas compliance. Provisions include definitions; authority for Arkansas to participate in the online sales and use tax registration system; participation with other states in the development of an address-based system referencing tax rates for taxing jurisdictions for use by registered vendors; relief for improper charging and collecting incorrect amounts of tax if erroneous data was provided by DFA; administration of exemptions through a direct pay, exemption certificate, or other means that does not burden the sellers; an alternative method for making payments if an electronic funds transfer fails on its due date and to develop a simplified tax reporting form for all state and local sales and use taxes; consistent customer refund procedures; amnesty for prospective tax registration; authority to DFA to participate in certification of service providers and automated computer systems and to provide monetary allowances in accordance with terms of the Agreement; clarification for effective dates of rate changes for contracts extending before and after the tax rate increase date; and specifies the Arkansas representatives to the Streamlined Sales and Use Tax Governing Board.

Act 2168. Exempts any livestock reproduction equipment or livestock reproduction substance from sales and use tax.

Act 2254. Currently, sellers of manufactured homes collect tax on 62% of the gross sales price of the manufactured home. Modular home manufacturers are treated as contractors and pay tax on the materials used to construct the modular home.

Act repeals the current law regarding taxation on both modular and manufactured homes. On and after the effective date of the Act, sellers of new manufactured homes and modular homes are required to obtain a permit and collect and remit tax on 62% of the sales price of new manufactured or modular homes. No tax is due on the sale of mobile homes or on sales of used manufactured or modular homes.

Administrative Developments. On March 1, 2005, DFA delivered a letter to representatives of the Arkansas State Chamber of Commerce and Associated Industries of Arkansas, agreeing to issue regulations to clarify or change recent enforcement positions taken by the Department to the following effect: labor performed in connection with the modification and replacement of manufacturing machinery and equipment will be exempt if the machinery and equipment installed in connection with the project is exempt; palletizers and shrink-wrap equipment used directly in manufacturing are exempt; testing equipment used in the intermediate stages of the manufacturing process is exempt; computers and related peripheral equipment that control, measure or record any aspect of the manufacturing

process or the operation of machinery and equipment used directly in the manufacturing process are exempt; and the Department will work with the business community to clarify the molds and dies exemption. Draft regulations in all areas are expected to be issued shortly.

F. Tax Credits and Incentives.

Act 241 (2/17/05). Allows Tourism Project Development Credits to be applied against both the state Sales Tax and the 2% Tourism Tax collected and reported by qualified amusement parks.

Act 443. Requires that employees qualifying for Enterprise Zone credits be hired within sixty (60) months of project approval for the program.

Act 1151. Allows wagering on electronic games of skill at horse racing or greyhound racing parks, subject to a local election requested by the holder of a horse racing or greyhound racing franchise. Franchise holders would be required to pay the state a privilege fee of 18% of wagering revenues, plus 0.5% to the county and 1.5% to the city or town.

Act 1232. Amends the Targeted Business Special Incentive program by reducing minimum payroll, investment thresholds, and average hourly wage thresholds for increased program participation. Participants may carry-forward for up to 9 years the income tax credits calculated on annual payroll. Also modifies the Research and Development Tax Credits by providing a 5 year renewable term, amends the definition of “industry” to include technology based enterprises, and amends the Tuition Reimbursement tax credit to allow the credit to employers who pay the tuition instead of reimbursing the employee.

Act 1277. Establishes the Nonprofit Incentive Act of 2005, which allows a state and local sales and use tax refund and payroll rebate incentives to eligible nonprofit organizations approved by ADED. Requirements include project spending in excess of \$500,000 for the sales and use tax refund, and a minimum of \$1,000,000 payroll for new full time permanent employees for the payroll rebate. ADED may authorize the payroll rebate incentive for up to 5 years.

Act 1296 (7/1/05). Amends the Arkansas Consolidated Incentive Act of 2003, by: (1) clarifying definitions; (2) adding intermodal facilities as a business type eligible for incentives; (3) providing authority to the Director of the Arkansas Department of Economic Development (ADED) to classify additional non-retail businesses as eligible if the business receives at least seventy-five percent of sales revenue from outside Arkansas; (4) lowering annual payroll thresholds and investment thresholds for determination of eligibility for the incentive benefits; (5) providing that certain lease payments may be used to determine if investment thresholds have been met; (6) providing that sales and use tax refunds for eligible expenditures exclude those sales and use taxes dedicated to the Educational Adequacy Fund and the Conservation Tax Fund; (7) allowing the ADED Director to authorize higher payroll rebate payments to certain businesses; (8) changing tax incentive

carry forward periods from 3 years to 9 years for certain businesses; and (9) repealing the provisions of Ark. Code Ann. §15-4-2713 regarding Industrial Development Compacts.

Act 1759 (4/5/05). Amends the Arkansas Capital Development Company Act to limit the maximum amount of tax credits available to \$5,000,000 per calendar year, with an additional \$1,250,000 allowed if approved by the Director of DFA, who must certify that that issuance of the additional amount will not harm or adversely affect public education or other government programs or functions funded by general revenues. Also clarifies what types of transactions are eligible for the tax credit and makes other administrative changes.

Act 1769. Requires Legislative Audit to do a cost-benefit analysis of the programs under the Consolidated Incentive Act on a rotating basis so that each program is evaluated at least once every five years.

Act 1981 (4/11/05). The Arkansas Amendment 82 Implementation Act, implements Amendment 82 and allows the General Assembly to authorize the Arkansas Development Finance Authority (ADFA) to issue general obligations bonds to finance infrastructure or other needs to attract large economic development projects to the state. Bonds may be issued up to 5% of state general revenues collected during the most recent fiscal year. The prospective employer must be planning an economic development project that will invest more than \$500 million in capital expenditures and plan on hiring at least 500 new employees.

Act 2308. Amends the provisions of the Arkansas Tourism Development Act by modifying definitions, changing minimum investment thresholds, changing the percentage applied to project investment when calculating sales tax credits, and changing the method for calculating income tax credits generated from employment.

Mike Parker is a Board recognized tax law specialist by the Arkansas Board of Legal Specialization; is co-author of the American Bar Association's annual Sales and Use Tax Desk Book, a regular contributor to the ABA's State and Local Tax Lawyer and the Council on State Taxation's (COST's) semi-annual Audit Session Notebooks, and a frequent speaker on state and local tax issues. Mr. Parker is a member of the Board of Directors of the Arkansas State Chamber of Commerce/Associated Industries of Arkansas and serves as special tax counsel for the organizations.

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