

ARKANSAS TAX DEVELOPMENTS - 2005

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2005 LEGISLATIVE SESSION

The 85th General Assembly of the Arkansas Legislature (2005 Regular Session) convened January 10, 2005 and adjourned May 13, 2005. The Session was not as active from a tax standpoint as other recent Sessions, based on improvements in the economy and general tax collections, and a temporary hiatus in tax increases to fund court ordered improvements in public education.

Legislation which was introduced but failed to pass was noteworthy, including a unitary combined reporting bill and bills that would further conform and accelerate the effective date of SSTP legislation, which were instead postponed to 2007.

Manufacturers will be particularly interested in sales and use tax changes which the Department of Finance and Administration (DFA) agreed to make by regulation. These Regulations should be formally issued later this year.

PART I-SALES AND USE TAX CHANGES

A. 2005 Legislative Developments

Act 647: Eliminates the state sales and use tax on groceries when tax collections on sales and services by sellers who have no physical presence in the state are equal to or greater than 150% of collections of sales and use tax on food (groceries). Not expected to become effective until Congress acts on SSTP Commerce Clause issues.

Act 1693. Requires decals be affixed to heavy equipment by dealers at the time of sale indicating sales tax has been paid on the equipment or it is exempt from tax.

Act 2008: Changes the effective date for changes to comply with the Streamlined Sales Tax Agreement to July 1, 2007.

B. Administrative Developments

On March 1, 2005, the 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 certain recent enforcement positions taken by the Department. These included the following:

1. 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.
2. Palletizers and shrink-wrap equipment used directly in manufacturing are exempt.
3. Testing equipment used in the intermediate stages of the manufacturing process is exempt.
4. 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.
5. The Department will work with the business community to clarify the molds and dies exemption.

PART II-INCOME TAX CHANGES

A. 2005 Legislative Developments

Act 63: Repeals the 3% Income Tax Surtax for all tax years beginning with tax year 2005. The Income Tax Surtax is limited to tax years beginning in calendar years 2003 and 2004.

Acts 1232 and 1296. Several revisions to business incentive act programs, including the Consolidated Incentive Act.

Act 1309. Requires withholding of income tax from deferred income.

Act 1769. Requires cost benefit analysis and reports to the legislature on the value of incentives under the Consolidated Incentive Act.

Act 1981: Requires pass-through entities to withhold Arkansas income tax on income of the entity that is distributed to non-resident taxpayers, unless the taxpayer has filed a written agreement to jurisdiction and to file applicable returns and pay taxes due.

B. Litigation Developments

McFadden v Weiss: The Pulaski County Chancery Court has ordered an income tax refund in *McFadden, et al v. Weiss*, in which the court held that the State of Arkansas unconstitutionally taxed the after-tax contributions made to retirement plans. Pursuant to the Court's decision, the State of Arkansas is paying income tax refunds for the 1999-2002 tax years to qualifying class members in the case. The class members represented in the case include: (1) all federal retirees who participated in the Civil Service Retirement System or Federal Employees Retirement System and who filed Arkansas state income tax returns since July 27, 1999; (2) all persons reporting income to the state since July 27, 1999 from non-deductible individual retirement accounts; and (3) all other persons reporting income to the state from employer-sponsored retirement plans in which they made after-tax contributions. Under the refund methodology, taxpayers are entitled to deduct the after-tax contributions they did not deduct in tax years before 1999 to the extent of their retirement income received during the tax years 1999-2002. Refunds will be calculated by excluding such amounts of retirement income from the amount of income that is subject to Arkansas income tax.