

STATE TAX TRAPS - ARKANSAS

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PROPERTY TAX

1. **Manufacturer's Inventory Exclusion.** Many manufacturers are not aware that a substantial portion of their inventories of raw materials, work in process and finished goods are excluded from assessment under the Arkansas "freeport" or no-situs law, if destined for shipment out of state. Ark. Code §26-26-1102. Exclusion is claimed on a Manufacturer's Inventory Report form, which is only provided by assessors on request. The form is also available on the Arkansas Assessment Coordination Department website.

2. **Classification/Listing Errors - Personal Property.** Tax and accounting departments sometimes learn that property has been sold or taken out of service long after commercial personal property reports are filed, and assessors are reluctant to cooperate in correcting such mistakes. No provision exists for paying personal property taxes "under protest." However, the law requires that classification and listing errors be corrected by an assessor at any time prior to payment in the next assessment year, even if the deadline for appeal to the county board of equalization has passed. Ark. Code §26-28-111.

3. **Classification/Use Errors - Real Property.** Beware errors cropping up in manufacturer real property listings as assessors convert to new computer assisted mass appraisal (CAMA) systems in 2005, based on Marshall & Swift, L.P. valuation data. Arkansas appraisers have limited familiarity with Marshall & Swift, multi-million dollar valuation errors are not uncommon, and errors are obscured based on the "black-box" calculations being used in some counties.

SALES/USE TAX

1. Taxable Repairs/Exempt Replacements. Arkansas taxes repairs and partial replacements of components of machines and equipment used directly in manufacturing, but not the replacement of machines and equipment “in their entirety.” Ark. Code §26-52-301(3)(c); §26-52-402. The term “repair” is over-used on purchase orders and work orders, and will result in automatic assessments on audit. Manufacturers familiar with the issue apply the exempt replacement of “complete” machines as liberally as possible.

2. Taxable Repairs/Expansions. Partial replacements of machinery and equipment used in manufacturing are also exempt if an increase in output results for reasons other than improving general operating conditions or state of repair. Reg. GR-55.C.2. Experienced tax managers also claim exemption whenever “de-bottlenecking” is used to justify the modifications.

3. Special Compliance Rules for Contractors. Contractors constructing, replacing or repairing improvements to real estate are subject to special rules that require that the contractor pay tax on materials at time of purchase or “withdrawal from stock.” By contrast, replacing or repairing building mechanical systems, and the portions of “turn-key” projects that involve sale and installation of manufacturing machinery and equipment, are taxable to the owner of the project. In addition, manufacturers which are direct pay permit holders sometimes attempt to “assume” reporting and payment responsibility on materials purchased by contractors for use in construction contracts, which is not permitted by law. If services and sales are not classified properly on the front end, then the “true taxpayer” may be assessed tax on audit, after it is too late for the taxpayer in error to file for refund on materials or services on which tax was erroneously paid. Many of the Arkansas Sales/Use Tax Regulations in this area are obsolete, and careful study is required to avoid issues on audit.

4. Local Sales/Use Taxes - Single Transaction. Local sales and use taxes only apply to the first \$2,500 of receipts from a “single transaction.” The term “single transaction” is defined by local ordinance, and can mean anything from a single item on an invoice, to the total invoice price. Other special rules apply depending on the transaction and property involved. Beware of numerous instances where city and county ordinances adopt radically different definitions for the local taxes that apply to the same business or manufacturing facility.

INCENTIVE PROGRAMS.

1. Advance Filing Requirement. The InvestArk Program provides one of the most valuable development incentives available for mid-sized capital projects. A 6½% sales and use tax credit is available for projects of \$5 million or more undertaken by manufacturers and certain other businesses which have been doing business in the state for at least 2 years. Unfortunately, the application for the incentive must be filed with the Arkansas Department of Economic Development not less than 30 days prior to the start of construction, and many businesses and manufacturers do not become aware of the credit until it is too late to apply for benefits. A failure to file in advance cannot be waived, or cured. Ark. Code §15-4-2706(c)(1). Most other incentives may be claimed during construction, or after a project is complete.