

ARKANSAS STATE TAX UPDATE

PROPOSED GROSS RECEIPTS AND USE TAX RULES-2006

On July 19, 2006, the Arkansas Department of Finance and Administration released new proposed Gross Receipts and Use Tax Rules. Business taxpayers are well advised to review the proposed Rules as soon as possible. A public hearing is scheduled for Tuesday, August 8, 2006, in Little Rock. A “black lined” version of the proposed Rules is available on the DFA website at <http://www.arkansas.gov/dfa/> by selecting Most Requested Links, DFA Revenue Rules.

This is the first comprehensive revision of the Rules (formerly Regulations) since 1992 and includes hundreds of changes; some “friendly,” some not so friendly. A complete list and analysis is beyond the scope of this Advisory. However, the following are a few of the changes which may be of particular interest to business taxpayers:

Interstate and Intrastate Sales.

- A parent company is “engaged in business” in Arkansas if a subsidiary has a facility in the state. (GR-5.B.2)
- FOB shipping terms will control the distinction between interstate and intrastate sales. Shipping terms have not previously been a determining factor. (GR-5.C)
- Drop shipment rules are adopted. (GR-5.E)

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Services.

- Changes address the Mobile Telecommunications Sourcing Act, Voice over Internet Protocol and similar services, prepaid telephone calling cards and prepaid authorizations, and identification of non-taxable services. (GR-7)
- Home warranty contracts are taxable. (GR-9E)
- Satellite television or radio services and certain wire services are subject to state tax. (GR-9.1)
- Various dry cleaning and laundry supplies are classified as taxable or exempt. (GR-9.8.F)
- Labor associated with the initial installation, alteration, addition or replacement of machinery and equipment used in manufacturing is exempt. (GR-9.18)

Sales - General.

- “Substantial” modification or refurbishing of an aircraft by a rental or charter business for purposes of invoking the two-year grace period for paying tax on the purchase now means 50% or more of fair market value. (GR-14.F)
- Computer software licenses are taxable if the software is delivered through a tangible medium. The new rules are silent on any exception for custom software development. (GR-25.E)

Manufacturing.

- Refining of brine is manufacturing. (GR-55.F; GR-57)
- Contractors may qualify for the manufacturing machinery and equipment exemption. (GR-55.G)
- Machinery and equipment used in packaging articles of commerce is exempt. (GR-55.H)

- Testing equipment used to measure product quality after manufacturing begins is exempt. (GR-55.I)
- Computers and related equipment that control or measure the manufacturing process are exempt. (GR-55.J)
- The Rules rewrite the exemption for dies and molds and clarify that replacement of any of the component parts of a die or mold are exempt. (GR-56)

Oil, Brine and Natural Gas Wells.

- Pipelines from the well head to the refineries are taxable. (GR-57.B)
- Separate replacements of pumps, motors and protectors are taxable. (GR-57.C)
- New drilling rigs are exempt. (GR-57.C)
- Disposal and injection wells and pipelines are exempt. (GR-57.F)

Administration.

- Extensive rules and new responsibilities will apply to record keeping using electronic records. (GR-80)

Local Taxes.

- Certain “single transaction” definitions are adopted for local tax purposes, including a very broad definition of the common term “major equipment and machinery.” (GR-91.A)
- New rules clarify the collection responsibilities of sellers with multiple locations or when route sales are involved. (GR-91.B)

Compensating Use Tax.

- The new rules assert taxing jurisdiction over out-of-state sellers to the “full extent allowed” by the United States Constitution. (UT-3.C)

- Definitions of “consumption” and “distribution” are adopted. (UT-3.H, I)

Conclusion. These are only the “high points” of the proposed Rules. Many additional changes apply to specific sellers, purchasers and types of goods and services. The Rules are on a fast track, which can be disconcerting when almost 15 years have passed since the last comprehensive update. There is also concern that the Department is “pushing the envelope” on issues of jurisdiction for purposes of future litigation. Comments will be accepted at the hearing on August 8, 2006, and in writing for a short period of time thereafter. Attention to the new proposed Rules, and caution, are advised.

Mike Parker is a Chairman of the Arkansas Tax Advisory Council, 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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