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ARKANSAS STATE TAX UPDATE
2007 LEGISLATIVE SESSION

The 86th General Assembly (2007 Regular Session) of the Arkansas Legislature convened January 8, 2007, recessed April 3rd, and adjourned “sine die” on May 1, 2007. For the first time in recent memory, tax cuts dominated the legislative agenda, fueled by a budget surplus projected to exceed \$900 Million as Arkansas enters the next budget cycle. Unfortunately, legislative veterans remember that only three short years ago, the Legislature passed the largest tax increase in Arkansas history (\$370 Million per year) primarily in the form of a 7/8% increase in sales tax. This tax increase turned out to be much larger than necessary to meet revenue objectives during the recent period of economic expansion. Based on the “populist” nature of most of the 2007 tax cuts, the net result will be to shift a significant amount of state tax burden from individual consumers to business and industry.

These events recall the similar tax shift that occurred when the voters approved property tax rebates for individual homeowners funded through a 1/2% sales tax increase in 2001. This increase has also produced excess tax revenues, which the Legislature was quick to pass to the same special interest group by increasing property tax rebates for 2007 and future years.

This trend is worrisome for those who believe that the State would be better served by eliminating many of the significant anti-competitive features of the Arkansas tax structure that were clearly identified in recent studies commissioned by the Arkansas Department of Economic Development. Many in the business community believe these issues are much more important than state leaders recognize.

Other key business tax issues this Session include a modest reduction in sales tax on electricity and natural gas “used directly” in manufacturing, that takes effect July 1, 2007 (with a further reduction next year), and a number of “Streamlined Sales Tax” changes that become effective January 1, 2008.

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 90 days following adjournment (July 30, 2007), and in the case of Income Tax Acts, apply to tax years beginning on or after January 1, 2007.

A. INCOME TAX.

Act 160. Provides an annual exemption from income tax of \$9,000 for all members of the armed services (United States or Arkansas forces). This increases the exemption for officers and warrant officers to the present level for enlisted military personnel.

Act 195. Provides tax credits to taxpayers whose gross income falls between the income threshold for filing of a return and an amount determined according to federal poverty guidelines. The amount of credit depends upon the taxpayer's filing status and gross income for the income year. The income and corresponding credit for each category of filer for tax year 2007 are included in the Act. Beginning in 2008, and for each succeeding year, both the income amounts that qualify the taxpayer for the credit, and the amount of the credit, are indexed by using the percentage, not to exceed 3%, that the CPI-U for the current calendar year exceeds the CPI-U for the preceding calendar year.

Act 196. Adopts Section 408(d)(8) of the Internal Revenue Code (IRC), as in effect on January 1, 2007 to allow a taxpayer to exclude from gross income an amount, not to exceed \$100,000, for qualified charitable distributions from a traditional or Roth IRA to a qualified charitable organization, after the IRA owner reaches age 70 1/2. Applies only to distributions made in 2006 and 2007. There is no carryover provision.

Act 218. Updates reference dates to January 1, 2007 for several (but not all) IRC sections adopted in Arkansas by reference, including:

- 26 U.S.C. §21 (credit for household and dependent care services)
- 26 U.S.C. §72 (recovery of cost of contribution to retirement plans; exclusion from gross income of proceeds from life insurance, endowment, and annuity contracts)
- 26 U.S.C. §101 (benefits paid on illness or death of insured)
- 26 U.S.C. §112 (combat zone compensation)
- 26 U.S.C. §121 (gain from sale or exchange of residential property)
- 26 U.S.C. §135 (definition of "higher education institution")
- 26 U.S.C. §152 (definition of "dependent")
- 26 U.S.C. §163 (deductions for interest expenses)
- 26 U.S.C. §170 (deductions for charitable contributions)
- 26 U.S.C. §194 (amortization of qualified reforestation expenses)
- 26 U.S.C. §197 (amortization of goodwill and other intangibles)
- 26 U.S.C. §219, 404, 406-416, 457 (annuities, retirement savings, employee benefit plans)
- 26 U.S.C. §223 (deduction for deposit to health savings accounts)
- 26 U.S.C. §263A (inventory cost treatment of certain expenses)
- 26 U.S.C. §274 (expense deductions for entertainment, business meals, travel, etc.)
- 26 U.S.C. §332, 334, 337, 338 (liquidation of corporations)
- 26 U.S.C. §351, 354-358, 361, 362, 367, 368 (gain or loss on corporate organization and reorganization)
- 26 U.S.C. §401 (qualified deferred compensation plans)
- 26 U.S.C. §470 (leasing transactions between taxpayers)
- 26 U.S.C. §529 (tuition savings)
- 26 U.S.C. §611-613, 614, 616, 617 (depletion allowance)
- 26 U.S.C. §664 (charitable remainder trusts)

- 26 U.S.C. §692 (combat zone compensation)
- 26 U.S.C. §709 (amortization of partnership organizational expenses)
- 26 U.S.C. §911 (foreign income exclusion)
- 26 U.S.C. §912 (foreign income exclusion)
- 26 U.S.C. §1033 (gain from involuntary conversion of property)
- 26 U.S.C. §1211-1237, 1239-1257 (capital gains and losses)
- 26 U.S.C. §7872 (taxation of below-market loans)
- Subchapter M (RIC's, REIT's and REMIC's)
- Subchapter S (S Corporations)

Additionally, the Act:

- Extends the time a taxpayer has to report adjustments to income made by the IRS from 30 days to 90 days; and
- Clarifies that railroads and public utilities are required to pay income tax levied under any applicable provision of Title 26, Chapter 51, Subchapter 2.

Act 369. Clarifies and adjusts extension periods for returns, including:

- Provides a maximum allowable extension of 180 days to file any tax return, except for a corporation income tax return;
- Allows DFA to grant a corporation income taxpayer's written request for an extension of 60 days in addition to any extension period granted to the file a federal return; and
- Provides an extension period to file an income tax return for an exempt organization that is required to file an income tax return that corresponds to the extension allowed to file a federal return.

Act 380. Updates IRC Subchapter S reference date to January 1, 2007; requires that S election and shareholder consents be filed on forms prescribed by DFA; and requires that an S corporation attach a copy of its federal Subchapter S income tax return to its Arkansas Subchapter S income tax return.

Act 553. Includes county collectors and county treasurers as claimant agencies for purpose of setoff against Arkansas income tax refunds. The definition of "debt" was amended to include costs and penalties resulting from delinquent taxes.

Act 613. Updates the reference date for IRC §179 regarding the depreciation and expensing of property to January 1, 2007, but in an interesting twist, only takes effect when (if) the Chief Fiscal Officer of the State certifies that additional funding has been provided to state general revenues from other funding sources and is available for use in fiscal years 2008 and 2009 in an amount sufficient to replace the general revenue reduction caused by the Act.

Act 695. Provides for an income tax checkoff to fund a newborn umbilical cord blood initiative in support of stem cell research.

Act 857 (7/1/07). Includes the Department of Workforce Services as a claimant agency for purpose of setoff against Arkansas income tax refunds for repayment of tuition assistance under the trucking, transportation and logistics fields tuition forgiveness program.

Act 990. Provides a 25 year income tax exemption for a prospective windmill blade manufacturing company if it locates in the state in 2007, spends \$150 million within 4 years, hires 500 employees within 2 years and hires 1000 employees within 5 years.

B. LEGAL AND PROCEDURAL.

Act 143 (2/23/07) Requires each state agency to provide an analysis as to whether means exist to make any new or amended rule less costly for small businesses without compromising the objective of the rule, and submit an economic impact statement to the Director of ADED. Requires consideration of ADED Director recommendations. Does not apply to emergency rules, federally mandated rules, or rules that substantially codify existing state or federal law.

Act 212. Extends the time to protest a proposed assessment of tax or the denial of a claim for refund from 30 to 60 days.

Prohibits consideration of a request for revision unless it is received by the Director within 20 days of the mailing of the hearing decision. Clarifies wording and procedures for revisions of administrative decisions by hearing officers.

Act 218. Extends the time a taxpayer has to report adjustments to income made by the IRS from 30 days to 90 days, (and updates IRC reference dates as noted above).

Act 437. Amends confidentiality of taxpayer information to allow DFA to disclose to ADED information regarding tax incentive programs that provide a tax credit, rebate, discount, or other economic incentive that is jointly administered by DFA and ADED. ADED is required to maintain the confidentiality of any information it receives.

Act 666. Authorizes the direct assessment of liquor and wine excise taxes by imposing a civil penalty, in addition to the misdemeanor sanctions now provided by law.

Act 817. Authorizes the direct assessment of tobacco excise taxes on consumers who purchase untaxed tobacco products or unstamped cigarettes, and provides for forms and procedures for consumers to report excise taxes due.

Act 827. Makes numerous technical corrections to the Arkansas Code, including Act sections 195 through 234 that amend various provisions in Title 26 (Taxation).

Act 865 (4/3/2007). Amends the confidentiality of franchise tax reports filed by limited liability companies to provide that the names of members are not subject to disclosure, unless designated as a manager or officer, or unless the organization has no registered agent.

C. **MISCELLANEOUS TAXES.**

Act 276 (1/1/08). Adopts Uniform Estate Tax Apportionment Act providing detailed rules for apportioning federal estate tax and state estate taxes, if any, among the beneficiaries of estates.

Act 582 (3/28/07). Imposes a service charge of fifty cents per month on prepaid cellular service, voice over internet protocol and other non-traditional telephone service to fund 911 service network.

Act 732 (5/1/07). Levies a tax of 3% on any single payment of \$1,200 or more in winnings on a single wager from electronic games of skill at Oaklawn Jockey Club and Southland Greyhound Park. Tax is deducted and withheld in the same manner as the 7% racing winnings tax.

D. **SALES, USE AND OTHER EXCISE TAXES.**

Act 87 (7/1/07). Exempts all dyed distillate special fuel (generally, diesel fuel used for agricultural, construction and other off road purposes that is exempt from special highway taxes) from sales and use tax and levies a substitute excise tax of 64 per gallon, with exception for any portion of the fuel that is biodiesel fuel. Continues to exempt vessels, barges, and commercial watercraft; railroads; municipal buses; and the United States Government. The tax is to be collected by suppliers and reported and paid by the 20th of the month by electronic funds transfer, or by any person that uses dyed distillate special fuel on which the 64 gallonage tax has not been paid.

Act 110 (7/1/07). Reduces the state sales tax on food and food ingredients to 3% beginning on July 1, 2007. Remaining tax includes 2.875% levied by statute and 0.125% levied in the Arkansas Constitution. Includes definitions for food and food ingredients. Continues prospect that rate may decrease to 0% in the event of Congressional action authorizing the state to collect sales and use tax from sellers with no physical presence in the state resulting in revenues equal to or greater than 150% of the sales tax collected on food and food ingredients.

Act 116 (2/26/07). Authorizes special elections for adoption of municipal sales and use taxes to be called by petition of voters in the city, as well as by ordinance of the governing body as provided by existing law. The petition must be signed by a number of voters that is least 15% of the number of votes cast for the city clerk at the preceding general election. The city is required to provide by ordinance for the calling of the election, regardless of whether the tax is levied by ordinance or by petition.

Act 140. Amends the sales and use tax exemption for a wheelchair lift or automobile hand controls purchased in conjunction with the purchase of a motor vehicle. Under current law, the equipment must be prescribed by a physician before the patient purchases the wheelchair lift or hand control. Act allows a patient to claim the exemption after the purchase date if the prescription is obtained before the motor vehicle is registered.

Act 154 (2/28/07). Repeals the tax levied on the value of admissions to places of amusement, entertain, and athletic or recreational facilities that are given away without consideration (free passes).

Act 166 (2/28/07). Allow certain local sales taxes on aviation fuel to be remitted directly to regional airports by the State Treasurer. Tax on aviation fuel in effect on December 30, 1987 may not be remitted directly to the regional airport.

Act 179 (1/1/08). Part of Streamlined Sales Tax conformity package. Under existing law, local sales and use taxes only apply to the first \$2,500 of any single transaction, but this cap is removed 01/01/2008. Single transaction is defined by local ordinance. Act provides for a rebate of local sales and use tax paid on business purchases (only) in excess of the first \$2,500 on a single transaction beginning 01/01/2008. Other purchases in excess of \$2,500 will be subject to full combined state and local rate, subject to exceptions for motor vehicles, aircraft, watercraft and manufactured homes. "Single transaction" is uniformly defined as any sale of tangible personal property or a taxable service reflected on a single invoice for which an aggregate sales or use tax amount has been paid.

Act 180 (6/30/07). Part of Streamlined Sales Tax conformity package. Extends the effective date of various code sections implementing the Streamlined Sales and Use Tax Agreement from July 1, 2007 to January 1, 2008.

Act 181 (1/1/08). Part of Streamlined Sales Tax conformity package.

- Amends Arkansas law to adopt definitions required for Arkansas to be in compliance with the Streamlined Sales and Use Tax Agreement;
- Amends §26-52-427, concerning property purchased for use in the performance of a construction contract to provide for a rebate instead of an exemption;
- Amends §26-52-433 to extend the exemption for medical equipment to durable medical equipment, mobility enhancing equipment, prosthetic devices, and disposable medical supplies;
- Repeals §26-52-507 concerning sales by florists (but see Act 860 below).

Act 182. Part of Streamlined Sales Tax conformity package. Moves taxes presently codified in the gross receipts tax chapter of the Arkansas code to a new Chapter 63 for special excise taxes. The taxes included are:

- Short-term rental tax;
- Short-term rental vehicle tax;
- Residential moving tax; and
- Tourism tax

Act 185 (3/1/07). Reduces the state sales and use tax rate on natural gas and electricity purchased by Arkansas manufacturers for use directly in their manufacturing processes to 4.5% effective July 1, 2007; further reduced to 4% effective July 1, 2008. Natural gas and electricity purchased by the manufacturer for other purposes is not subject to the reduced rate. The manufacturer must separately meter the natural gas and electricity or otherwise establish the separate uses according to rules issued by DFA. Only manufacturers falling within NAIC sectors 31, 32 or 33 are eligible for the reduced sales and use tax rates. DFA may require that a utility company obtain a certificate of eligibility from a manufacturer prior to the sale of natural gas or electricity at the reduced rate.

Act 277 (3/16/07). Prohibits a state-supported institution of higher education from placing on its, or its bookstore's, website a link to the website of a textbook retailer unless the retailer obtains a use tax permit from DFA and reports and pays sales and use tax on sales of textbooks to Arkansas residents.

ACT 361. Clarifies that all taxable services may be purchased by holders of retailers permits on a tax free basis, in the event the services are purchased for resale and the tax will be charged to and collected from the ultimate consumer.

Act 368 (7/1/07). Provides that the rental of portable toilets is taxable regardless of the rental term (short-term or long-term) and whether tax was paid when the toilet was purchased. The tax is due on the gross receipts from both the rental and any service associated with the rental. The sale of a portable toilet for subsequent rental is exempt from tax.

Act 388. The "Charitable Bingo and Raffles Enabling Act," provides for the administration of charitable bingo and raffles in Arkansas by the Department of Finance and Administration. Levies an excise tax of one cent (1¢) of each bingo face (card) sold by a licensed distributor to a licensed authorized organization and an excise tax of ten percent (10%) of the gross receipts derived from the sale of all bingo equipment other than bingo faces. The excise tax is due and payable from the licensed distributors that sell the bingo faces and other bingo equipment. The tax shall be reported and paid to the DFA on or before the fifteenth (15th) day of the month following the month of the sale, along with the required information.

Act 450. Repeals the requirement of a surety bond for licensees who place amusement devices only at carnivals and county, district, and state fairs for periods not to exceed 3 months within a calendar year.

Act 455. Extends "tasting" events currently allowed at wineries and by wine wholesalers to include beer and spirits. Licensed retail sellers of wine, beer, and spirits must obtain a sampling permit from ABC. The Act limits the number of ounces or servings that may be provided in a "sample." Any wine, beer, or spirits withdrawn from inventory and used for a tasting event are subject to tax as a withdrawal from stock.

Act 548 (1/1/08). Exempts from sales and use tax the sale of natural gas and electricity used in the manufacturing of new motor vehicle tires for motor vehicles that are required to be registered for highway use. The natural gas and electricity must be separately metered from natural gas and electricity used for other purposes or the separate uses must be established according to rules issued by DFA. Passed for the benefit of a manufacturer in a border city area (Texarkana) that is impacted by the elimination of the special border city exemption under the Streamlined Sales and Use Tax Agreement.

Act 550. Repeals conflicting language in the Code to make it clear that a motor vehicle lessor has the option of purchasing the vehicle exempt from tax and collecting tax on the rental payments, or paying tax at the time of registration of the vehicle.

Act 657. Makes the sales tax exemption for sales of tickets or admissions to places of amusement or to athletic, entertainment or recreational events by municipalities available to counties and clarifies that the exemption also includes free or complimentary passes and tickets.

Act 690. Clarifies that alternative motor fuels derived from nonpetroleum sources, such as animal oils and cooking oil, are not classified as motor fuels or distillate special fuels for motor fuel and special fuel tax purposes.

Act 860. Director is authorized to delay destination sourcing for florists until July 1, 2009 if permitted by the Streamlined Sales Tax Governing Board, to prevent undue hardship to Arkansas florists.

Act 869 (7/1/07). Levies a 1% excise tax on retail sales of beer, to replace an expiring 3% excise tax.

Act 1011. Levies sales tax on fishing guide services provided as part of a guided fishing trip if the service is purchased in conjunction with the sale or lease of taxable tangible personal property by the person providing the fishing guide service, including without limitation a boat, boat motor, fish bait or meals.

E. PROPERTY TAXES.

Act 12. Allows a Mayor to designate a voting representative to attend the meeting for choosing city representatives to the county equalization board.

Act 142. Increases the maximum allowable homestead credit from \$300 to \$350 beginning with 2007 taxes collected in 2008.

Act 215. Property tax payments in mailed envelopes postmarked on or before October 10, or the next business day after October 10 if falling on a Saturday, Sunday or holiday, are not delinquent.

Act 411. Reinstates the DAV tax exemption for a surviving spouse when a subsequent marriage is terminated.

Act 467. County collectors are to notify taxpayers they may be eligible for additional benefits under Amendment 79 if they are 65 years of age or older or disabled.

Act 660. Where the surface rights to land and the mineral rights are severed, the value of surface rights where a well is drilled shall reflect diminished utility of the land resulting from the drilling. No more than one acre of use/productivity valuation eligible land will be assessed at its minimum value per acre where the well is drilled. The value of market value based land, up to one acre in size, shall reflect diminished utility caused by drilling. The amount of diminished utility will be proved in the market place or when no market evidence is readily available a 25% reduction from the value of otherwise comparable land will be used to reflect the assessed value of the surface right.

Act 827. Technical corrections to the Arkansas Code noted under Legal and Procedural above. Sections 202 through 204 amend ad valorem tax provisions and Section 203 clarifies that the assessed value of homestead property is not adjusted based on the current appraised value if title to the homestead is transferred subject to a life estate retained by the homestead owner or beneficiary of the homestead if held in a revocable trust.

Act 994. Clarifies the methods and procedures for establishing the productivity valuation of agricultural, pasture and timber land based on capitalization rates ranging from 8% to 12%. The values of these lands are to be calculated annually and updated in each county when completing reappraisal.

Act 1036. Shortens the minimum time between certification of delinquent lands to the Land Commissioner and tax sale from 2 years to 1 year. Shortens the time for contesting the validity of a conveyance of delinquent lands by the Land Commissioner from 2 years to 1 year. Clarifies the provisions that apply when the Land Commissioner transfers tax-forfeited lands to state institutions or government entities.

Act 1037. Expands the notice requirements for quiet title actions, and clarifies the taxes that must be paid, settled or released prior to confirming a public sale.

F. TAX CREDITS AND INCENTIVES.

Act 566 (3/28/07). Establishes the "Equity Investment Incentive Act of 2007" to be administered by the Department of Economic Development. Provides income tax credits equal to 33 1/3% of approved investments in start-up companies in targeted business sectors that sign incentive agreements and meet certain criteria. Credits may offset up to 50% of the investor's state income tax liability, over a total period of up to 10 years.

Act 990. Provides a 25 year income tax exemption for a prospective windmill blade manufacturing company if it locates in the state in 2007, spends \$150 million within 4 years, hires 500 employees within 2 years and hires 1000 employees within 5 years.

Act 1039 (7/1/06). Adjusts the procedures and credits available under the Arkansas Tourism Development Act, on (an unusual) retroactive basis:

- Provides for review and advice by the Director of the Department of Parks and Tourism prior to approving eligible companies.
- Requires specific approval by the Director of ADED in order for a lodging facility exceeding a specific cost and size to qualify for benefits, prior to April 1, 2009.
- Provides a 25% credit for project costs incurred by qualified amusement parks in excess of \$1 million and additional flexibility in the special rules amusement parks must follow to qualify for credits. Credits may offset liability for up to 100% of gross receipts tax (sales tax) and tourism gross receipts tax over a total period of up to 10 years.

Act 1045 (4/4/07). Adopts the "Research Park Authority Act."

- Authorizes the authority board to levy and collect a tax or fee upon tenants of the research park or from property owners within the district.
- Authorizes the authority board to issue tax exempt revenue bonds.
- Property of research park authorities is exempt from local and municipal taxes.

- Extends the existing income tax credit for donations of “state-of-the-art” machinery and equipment to qualified educational institutions to donations to support a research park authority.
- Includes research parks among projects that can be funded using local sales taxes for capital improvements.

Act 1203 (4/4/07). Provides a tax rebate to small beer and malt beverage manufacturers (less than 25,000 barrels per year) of \$7.50 per barrel of beer or malt beverage sold or offered for sale in Arkansas, with a claim period beginning January 1, 2006.

Act 1596. Amends the Consolidated Incentive Act of 2003 in various respects, but only takes effect when the Chief Fiscal Officer of the State certifies that additional funding has been provided to state general revenues from other funding sources and is available for use in fiscal years 2008 and 2009 in an amount sufficient to replace the general revenue reduction caused by the Act. When effective, the Act:

- Allows the Directors of ADED and DFA to authorize the counting of existing employees as new full-time permanent employees.
- Provides for a new incentive program for “technology based enterprises” in targeted business sectors, in the form of an alternate income tax credit or sales and use tax credit of 2% to 8% of project costs depending on project size in a range of \$250,000 to over \$2 million. Credits may offset 50% to 100% of state income tax liability depending on wage levels, over a total period of up to 10 years.
- Provides additional incentives for “technology based enterprises” of 5% of payroll for new full time permanent employees for a period of up to 10 years.
- Increases the research and development tax credit for businesses that conduct in-house research and qualify for federal research and development tax credits from 10% to 20% of the amount spent, and adjusts the time for earning credits from 5 years to 3 years, with an additional 2 years available for incremental increases in expenditures after the 3rd year. Also eliminates the maximum \$10,000 credit limit in existing law. Credits may offset up to 100% of state income tax liability, over a total period of up to 10 years.
- Establishes an “Innovate Arkansas Fund” for the support of a contract between ADED and an entity to provide support for the development of knowledge-based and technology-based companies in Arkansas.

Act 1607. Increases the amount of income tax credit that may be claimed in any year for donations of “state-of-the-art” machinery and equipment to qualified educational institutions from 50% to 100% of a taxpayer’s net tax liability.

Mike Parker is co-author of the American Bar Association's annual Sales and Use Tax Desk Book, is a regular contributor to the ABA's State and Local Tax Lawyer and the Council on State Taxation's (COST's) Audit Session Notebooks, is a frequent speaker on state and local tax issues, and is listed in Best Lawyers in America - Tax (2007). 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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