Department of Finance and Administration

Legislative Impact Statement

Bill: HB1866 As Engrossed: 3/20/2013
Bill Subtitle: TO ADOPT CURRENT INTERNAL REVENUE CODE PROVISIONS CONCERNING THE COMPUTATION OF INCOME TAX WHEN A TAXPAYER RESTORES AN AMOUNT HELD UNDER A CLAIM OF RIGHT.

Basic Change :

Representative Kerr

This amendment enacts portions of IRC §1341, known as the Claim of Right Doctrine. Arkansas law currently requires a taxpayer to report and pay tax on unrestricted income in the year the income is received. If the income item must later be repaid, the taxpayer may file an amended tax return for the tax year in which income tax was paid on the item. If the 3 year statute of limitations for filing an amended return has expired, the taxpayer may not file an amended return under current law.

Under HB1866, if the unrestricted income must be repaid in a future year, the taxpayer will be allowed to claim a deduction in the tax year the repayment is made, even if the unrestricted income was reported in a year that is outside the statute of limitations for filing an amended return. The 3/20/13 engrossment provides that net operating losses or capital losses generated as a result of the deduction shall be calculated and deducted as provided in current state law.

Revenue Impact :

FY2014 - $100,000 Loss

FY2015 - $125,000 Loss

Taxpayer Impact :
Taxpayers may be entitled to a deduction on their current year tax return if they reported income on a prior year tax return and it is later determined that the taxpayer is required to repay the income.

Resources Required :
Computer programming changes, booklet changes, return processing changes

Time Required :

Adequate time is provided.

Procedural Changes :

Tax forms and instructions will need to be modified. Return processing will need to be modified.

Other Comments :

IRC 1341 has been abused by tax protesters who use the claim of right doctrine to incorrectly claim their income is not subject to tax

Legal Analysis :

HB1866 as engrossed March 20, 2013 adopts portions of 26 U.S.C. §1341. Specifically, if a taxpayer repays money that was included in gross income in a previous tax year because it appeared at that time that the taxpayer had an unrestricted right to the income, and the amount repaid is in excess of $3,000.00 and is deductible, then the taxpayer may claim an Arkansas income tax deduction for the amount repaid on the income tax return for the tax year of the repayment. Net operating and capital losses will be calculated and deducted under state law.

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The deduction will not be available with respect to an item which was included in gross income by reason of the sale or other disposition of stock in trade of the taxpayer (or other property of a kind which would properly have been included in the inventory of the taxpayer if on hand at the close of the prior taxable year) or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. However, the deduction will be available if it arises out of refunds or repayments with respect to rates made by a regulated public utility if such refunds or repayments are required to be made by the Government, political subdivision, agency, or instrumentality, or by an order of a court, or are made in settlement of litigation or under threat or imminence of litigation.

The bill addresses concerns voiced by DFA that unilaterally adopting 26 U.S.C. §1341 would result in a conflict between federal and existing state law in the calculation of net operating and capital losses for purposes of the deduction. The act is effective for tax years beginning on or after January 1, 2013.