EXHIBIT E

pfm

State of Arkansas Tax Relief and Reform Legislative Task Force

Corporate Income Tax

January 8, 2017

PFM Group Consulting LLC.

1735 Market St.
43rd Floor
Philadelphia, PA, 19103

(267) 713-0700
pfm.com

Discussion Topics

- Overview and History
- Corporate Income Tax Revenues
- Corporate Income Tax Characteristics and Benchmarking
- Corporate Tax Avoidance and State Responses
- Corporate Income Tax Expenditures
- Key Issues

Overview and History

Overview

- States Generally Assess a Corporate Income Tax
  - 44 states
  - Includes states without a broad-based individual income tax (Alaska, Florida, New Hampshire, Tennessee)
- Primary Alternative is a Gross Receipts Tax
  - Four states levy (Nevada, Ohio, Texas, Washington)
  - Two states do not levy either a corporate income or gross receipts tax (South Dakota, Wyoming)
- Makes Up a Comparatively Small Portion of Overall State Tax Revenue
  - Totals 5.4 percent of FY2014 state tax revenue (U.S. Census Bureau)
  - Trend is downward in share of state revenue
  - Factors include changes in how states apportion income and other tax changes, how businesses are structured
- Economic Efficiency, Equity Concerns
  - Income taxed twice – at corporate level when earned and shareholder level when distributed
  - Higher income less ‘ability to pay’ connection than on individual income tax

History of State Corporate Income Taxes

- Form of corporate income tax dates to colonial times
  - Earliest forms of ‘faculty’ (or ability) taxes used property as the sole proxy
  - Continued to evolve to include ‘artists and tradesmen’ and their ‘returns and gains’
  - First enacted in Massachusetts (1643), spread to other colonies, such as Connecticut (1650), Rhode Island (1673), New Jersey (1684)
  - Expanded and enhanced in other locales (such as Southern states) in the 1700s
- Modern state corporate income taxes:
  - Hawaii Territory (prior to statehood) in 1901
  - Wisconsin 1911 – with reliance on state rather than local collection
  - Virginia 1916, New Mexico and North Dakota 1919, Mississippi and North and South Carolina 1921, Tennessee 1923
- Similar rise/expansion as with individual income taxes
  - Replacement for existing property-based and excise taxes
  - Need for new revenue replacement during the Great Depression era
  - Oklahoma 1931, Alabama and Kansas 1933, Iowa and Louisiana 1934

Corporate Income Taxes vs. Business Taxes in General

- Corporate income taxes only apply to c-corporations
  - Vast majority of businesses are not organized as c-corporations
  - Of 26 million businesses, 5 percent organized as c-corporations (U.S Department of Treasury, tax year 2014)
  - Rest are pass through entities, where owners are taxed via the individual income tax
  - Nationally, these businesses make up a majority of business income
- Businesses also pay other taxes
  - Property tax, sales and use tax, severance, excise and other taxes
  - According to the Council on Sate Taxation (COST), In FY2016, businesses accounted for $724.1 billion (approximately 44 percent) of all state and local tax revenue
  - For Arkansas, COST estimates the amount at $4.8 billion, 40.3 percent of all state and local taxes

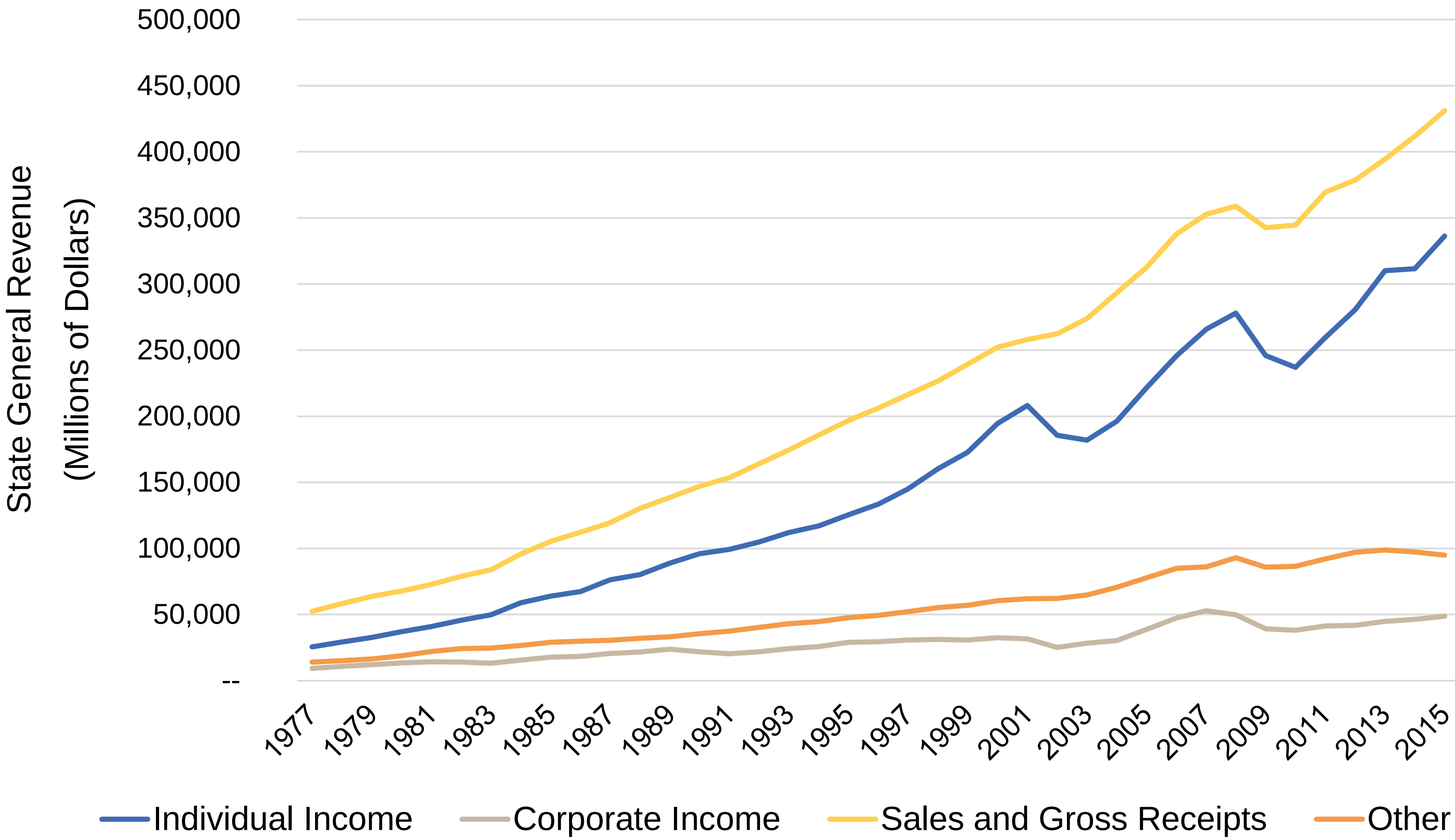
Sources: Brookings Report, "9 Facts About Pass Through Businesses," May 15, 2017
Ernst &Young, STRI, COST, "Total State and Local Business Taxes, FY2016," August 2017

Corporate Income Tax in Arkansas

- Enacted in 1929 as a 2 percent tax on net income
- Major changes from the original tax:
  - 1941 introduced five brackets with rates ranging from 1 percent to 5 percent
  - 1969 rates were increased by 1 percentage point for top two brackets
  - 1991 introduced 6.5 percent tax rate on all corporate net income if income is over $100,000

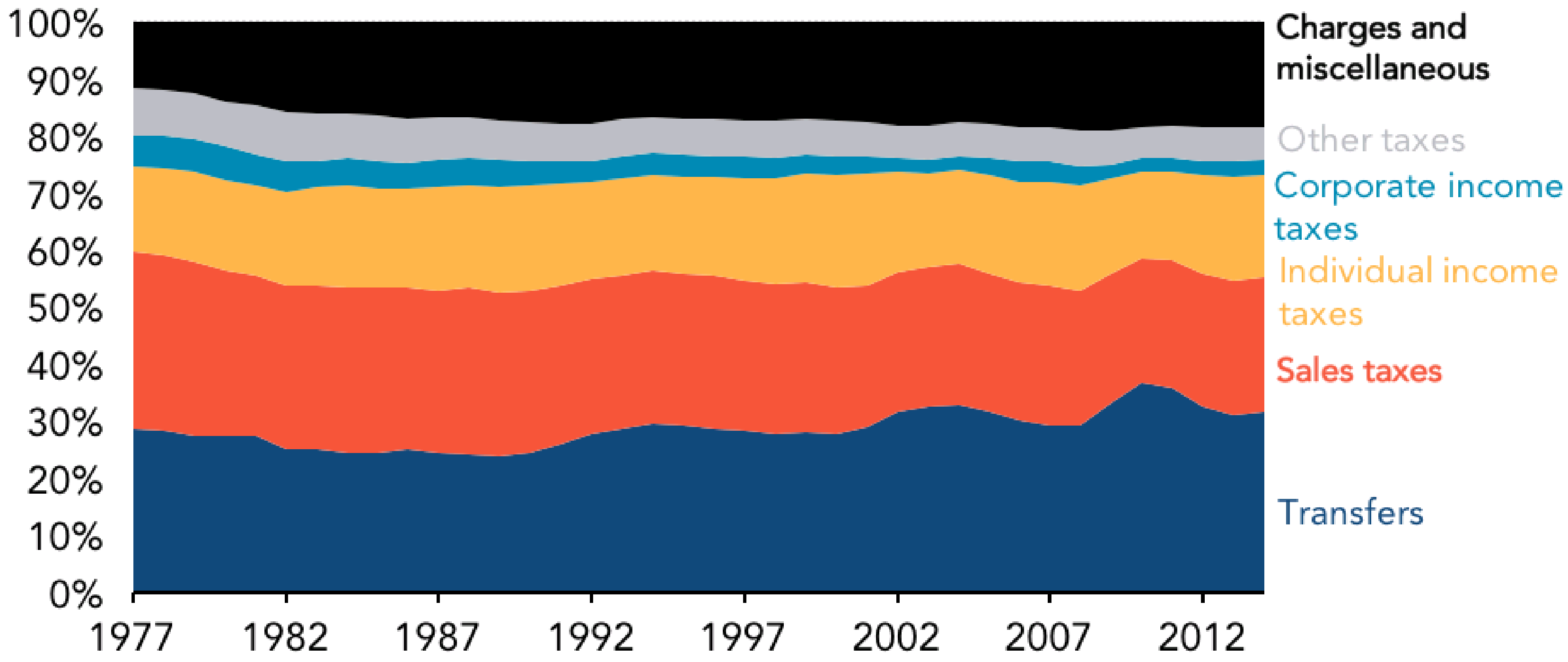
Corporate Income Tax Revenues

State Tax Revenues by Tax Category, Historic (1977-2015)



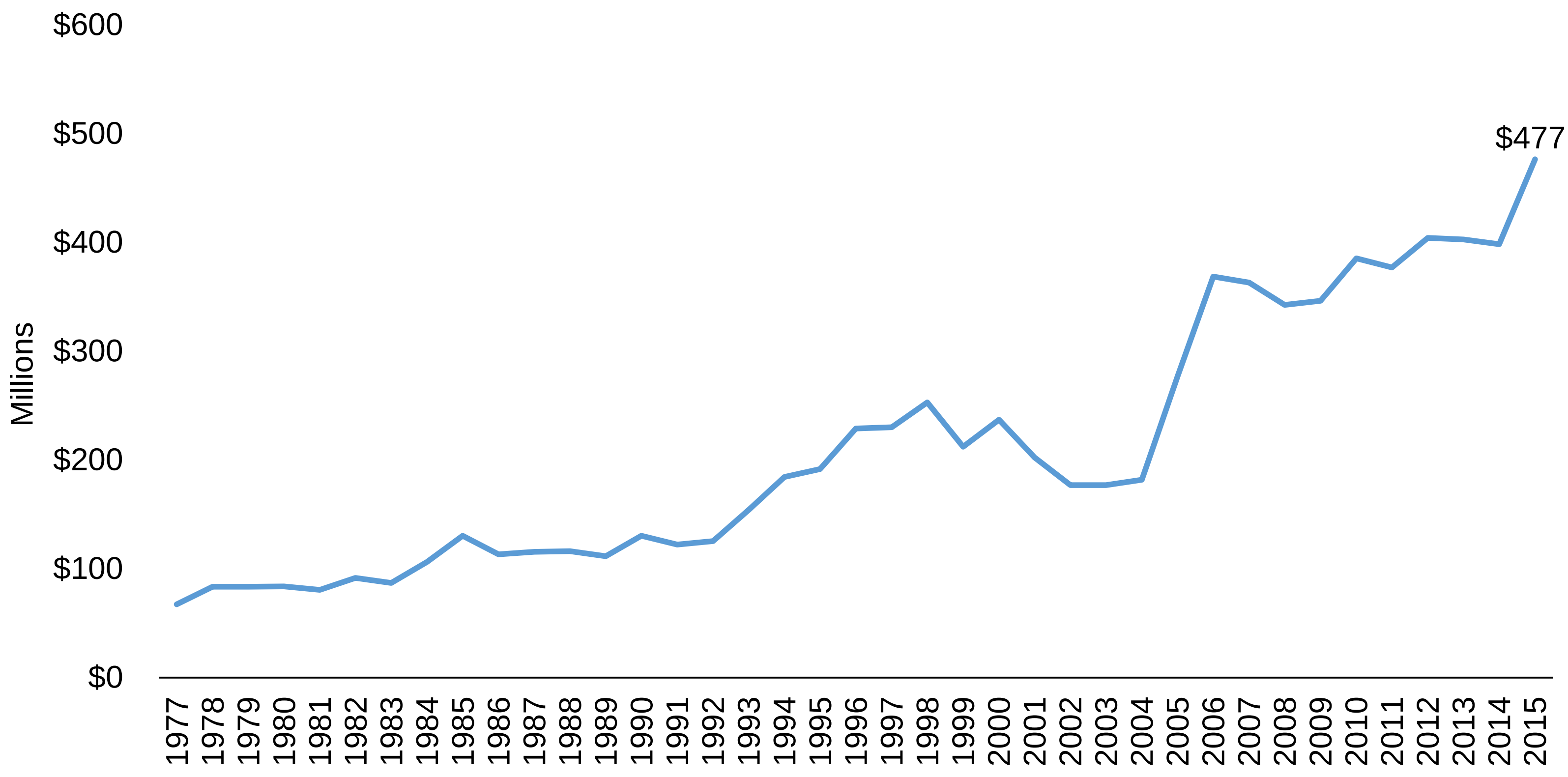
Source: Tax Policy Center, State & Local Government Finance Data Query, 2017.

State General Revenues by Share (1977-2014)



Source: Tax Policy Center, State & Local Government Finance Data Query, 2017.

Arkansas Corporate Income Tax Revenue (1977 to 2015 in millions)



Source: Tax Policy Center, State & Local Government Finance Data Query, 2017

Corporate Income Tax Characteristics and Benchmarking

Share of Overall Tax Collections

- Arkansas corporate income tax revenue slightly below national average (5.4 percent) and around the middle of benchmark states

State	Percent of Total Tax Collections
Tennessee	11.5%
Mississippi	6.0%
Nebraska	6.0%
Indiana	5.9%
Kansas	4.9%
Arkansas	**4.8%**
North Carolina	4.1%
Iowa	3.9%
Oklahoma	3.9%
Alabama	3.8%
Missouri	2.7%
Louisiana	1.8%
Texas	--

Source: Federation of Tax Administrators

State Corporate Income Tax Comparisons

- Most states have a flat rate (31 states)
  - Range is from low of 3.0 percent (North Carolina) to high of 9.99 percent (Pennsylvania)
  - Average rate is 6.76 percent, median rate is 6.5 percent, most common rates are 6 and 6.5 percent (four states each)
- Remaining states have a progressive tax with income brackets
  - Most remaining states have either 2 or 3 brackets, with one state each having 5, 6 and 10 brackets
  - A few states have compressed brackets, such as Mississippi ($5,000 to $10,001), North Dakota ($25,000 to $50,001), Vermont $10,000 to $25,000)
  - Four states allow a deduction for federal taxes paid (Alabama, Iowa, Louisiana, Missouri)

Federal Starting Point

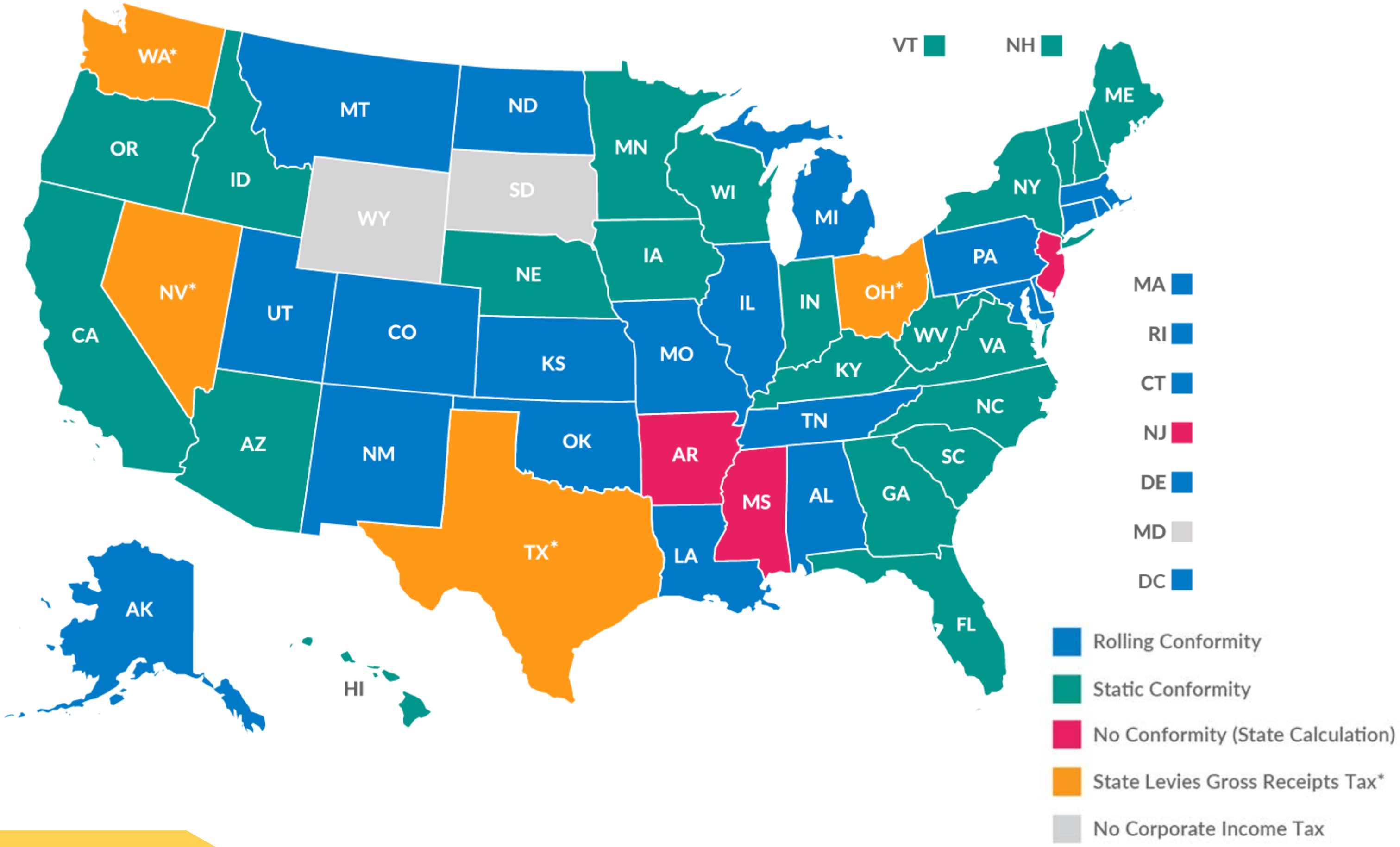
- Most states start from taxable or net taxable income. The primary difference is net operating losses are subtracted from taxable income
- Arkansas starting point is gross sales

State	Federal Starting Point
Alabama	---
Arkansas	**---**
Indiana	Taxable Income
Iowa	Net Taxable Income
Kansas	Net Taxable Income
Louisiana	Taxable Income
Mississippi	---
Missouri	Net Taxable Income
Nebraska	Net Taxable Income
North Carolina	Taxable Income
Oklahoma	Taxable Income
Tennessee	Taxable Income
Texas	Gross Income

Source: *Federation of Tax Administrators*

State Conformance with the Federal Tax Code

- Arkansas is one of three states that does not conform to either taxable or net taxable income



Source: Tax Foundation, Federation of Tax Administrators

State Corporate Income Taxes, Benchmark States

State	Tax Rate Lowest	Tax Rate Highest	Number of Brackets	Income Bracket Lowest	Income Bracket Highest	Federal Taxes Deductible
Arkansas	**1.0%**	**6.5%**	**6**	**$3,000**	**$100,001**	**No**
Alabama	6.5%	6.5%	1	Flat Rate		Yes
Iowa	6.0%	12.0%	4	$25,000	$250,001	Yes
Kansas	4.0%	4.0%	1	Flat Rate		No
Louisiana	4.0%	8.0%	5	$25,000	$200,001	Yes
Mississippi	3.0%	5.0%	3	$5,000	$10,001	No
Missouri	6.25%	6.25%	1	Flat Rate		Yes
Nebraska	5.58%	7.81%	2	$100,000	$100,000	No
Oklahoma	6.0%	6.0%	1	Flat Rate		No
Tennessee	6.5%	6.5%	1	Flat Rate		No
Texas	Franchise tax imposed on various entities at differing rates					

Source: Federation of Tax Administrators, November 29, 2017

Net Operating Loss Carry Forward/Carry Back

- Federal IRC allows 20 years of losses to be carried forward and for 2 years to be carried back
- 'Levels the playing field' for cyclical industries or unusual events

State	Carry Forward	Carry Back
Alabama	15	2
Arkansas	**5**	**-**
Indiana	20	-
Iowa	20	-
Kansas	10	2
Louisiana	20	-
Mississippi	20	2
Missouri	20	2
Nebraska	20	-
North Carolina	15	-
Oklahoma	20	2
Tennessee	15	-
Texas	NA	NA

Source: Federation of Tax Administrators

Apportionment of State Corporate Income

- Apportionment is the process of assigning to a particular state that portion of a multistate corporation’s income that the state may tax
- Traditional method (sales, property and payroll equally weighted) is now only used in eight states
- Most common method is to apportion solely on the sales factor (20 states)
- Arkansas is one of nine states that double weight sales while also using property and payroll in its formula
- Other formulas are also used:
  - Choice between single sales factor or double weighted sales (four states)
  - Triple weighted sales (one state), quadruple weighted sales (one state)
  - 80 percent sales, 10 percent each of property and payroll (one state)

Apportionment Formula of Benchmark States

State	Apportionment Formula
Alabama	Double weighted sales
Arkansas	**Double weighted sales**
Indiana	Sales
Iowa	Sales
Kansas	3 Factor
Louisiana	3 Factor
Mississippi	Sales/Other
Missouri	3 Factor
Nebraska	Sales
North Carolina	Quadruple weighted sales
Oklahoma	3 Factor
Tennessee	Triple weighted sales
Texas	Sales (Gross Receipts Tax)

Source: Federation of Tax Administrators

Corporate Tax Avoidance and State Responses

Overview

- Corporate tax revenue decline as a share of revenue has been the norm

Share of State Tax Revenue

- Corporate tax planning has impacted on corporate tax collections
- States have devised various strategies to combat that
- Generally opposed by business groups as onerous or overly complicated

Combined Reporting

- Corporations can use passive investment companies (PICs) located in states without corporate taxes to offset income in other states
- Combined reporting treats corporations as a unit for purposes of allocating profits for tax purposes – 25 states have adopted

State	Throwback Rules
Alabama	No
Arkansas	**No**
Indiana	No
Iowa	No
Kansas	Yes
Louisiana	No
Mississippi	No
Missouri	No
Nebraska	Yes
North Carolina	No
Oklahoma	No
Tennessee	No
Texas	Yes

Source: Institute on Taxation and Economic Policy, February 2017

Corporate Income Tax Expenditures

Significant Corporate Income Tax Expenditures

- The State offers a variety of credits, deductions and exemptions that reduce corporate income tax liability
- Deductions reduce taxable income by a given amount, while credits are a subtraction against liability
- In 2016, the State provided 18 corporate income tax credits, 7 of which were in excess of $1 million

Program Name	Amount Claimed in 2016
Waste Reduction and Recycling Equipment Credit	$11,907,856
Create Rebate Program (Payroll Rebate)	$11,378,089
ArkPlus Income Tax Credit	$9,776,510
Equity Investment Incentive Act of 2007	$3,226,267
Research and Development Credits	$4,169,960
Advantage Arkansas Income Credit	$3,540,409
Historic Rehabilitation Income Tax Credit	$2,450,722

Source: DFA – Business Incentives and Tax Credit Program Costs Through December 31, 2016

Significant Corporate Income Tax Expenditures

- **Deduction for Business Expenses:** Allows a deduction for trade or business expenses ($8.7 billion in 2014)
- **Interest Deduction:** Allows a deduction for interest expense pursuant to IRC § 163 ($352 million in 2014)
- **Depreciation Deduction:** Allows a deduction for depreciation and the expensing of property pursuant to IRC § 167, 168(a)-(j), 179 and 179A ($318 million in 2014)
- **Worthless Debts Deduction:** Allows a deduction for debts ascertained to be worthless and charged off the books ($225 million in 2014)
- **Taxes Deduction:** Allows a deduction for certain taxes ($188 million in 2014)

Source: DFA Income Tax Section – IIT and CIT – Tax Expenditures

Key Issues

Key Corporate Tax Issues

- Federal Tax Reform
  - Changes to Section 179 pass-through expensing and bonus depreciation
  - Adjustments to net operating loss provisions
  - Changes to deductions for net interest expense
- Consideration of rate changes
  - State corporate rate changes in past five years mostly rate reductions
  - Possible move to a single rate
- Apportionment
  - State movement has been toward a single sales factor
  - Arguments/data on both sides of the issue
  - Recent study for New Mexico suggested that increasing the sales factor weigh showed ‘a small but positive gain in employment and income’
- Other Issues
  - Options to improve on current business tax climate rankings
  - Conforming with federal IRC after Tax Cuts and Jobs Act

Questions and Discussion