

Stricken language would be deleted from and underlined language would be added to present law.

State of Arkansas
89th General Assembly
Regular Session, 2013

A Bill

HOUSE BILL 1845

By: Representative Nickels

For An Act To Be Entitled

AN ACT CONCERNING THE INCOME TAX LAWS APPLICABLE TO CORPORATIONS AND OTHER BUSINESSES; TO CREATE THE SMALL BUSINESS TAX FAIRNESS ACT; TO REQUIRE COMBINED REPORTING FOR INCOME TAX PURPOSES; TO LEVY A FLAT INCOME TAX ON CORPORATIONS; AND FOR OTHER PURPOSES.

Subtitle

TO CREATE THE SMALL BUSINESS TAX FAIRNESS ACT; TO REQUIRE COMBINED REPORTING FOR INCOME TAX PURPOSES; AND TO LEVY A FLAT INCOME TAX ON CORPORATIONS.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF ARKANSAS:

SECTION 1. Arkansas Code Title 26, Chapter 51, is amended to add an additional subchapter to read as follows:

Subchapter 25 – Arkansas Small Business Tax Fairness Act

26-51-2501. Title.

This subchapter shall be known as the “Arkansas Small Business Tax Fairness Act”.

26-51-2502. Definitions.

As used in this subchapter:

(1) “Combined group” means the group of persons whose income and apportionment factors are required to be taken into account under § 26-51-2503 in determining the taxpayer member’s share of the net business income or



loss to be apportioned to the state;

(2)(A) "Corporation" means an organization of any kind treated as a corporation for tax purposes under this chapter, wherever located, that if it were doing business in this state, would be a taxpayer.

(B) "Corporation" includes the business conducted by a partnership that is directly or indirectly held by a corporation to the extent of the corporation's distributive share of the partnership income, inclusive of guaranteed payments to the extent prescribed by law;

(3) "Doing business in a tax haven" means being engaged in activity sufficient for the tax haven jurisdiction to impose a tax under United States constitutional standards;

(4) "Partnership" means a general partnership, a limited partnership, or an organization of any kind that is treated as a partnership for tax purposes under this chapter;

(5) "Person" means:

(A) An individual;

(B) A firm;

(C) A partnership or a general partner of a partnership;

(D) A limited liability company;

(E) A registered limited liability partnership;

(F) A foreign limited liability partnership;

(G) An association;

(H) A corporation, regardless of whether the corporation is or would be, if doing business in this state, subject to the Income Tax Act of 1929, § 26-51-101 et seq.;

(I) A company;

(J) A syndicate;

(K) An estate;

(L) A trust or trustee;

(M) A trustee in bankruptcy;

(N) A receiver;

(O) An executor or administrator; and

(P) An organization of any kind;

(6) "Tax haven" means a jurisdiction that during the tax year exhibits the following characteristics:

(A) Has no tax or a nominal effective tax on the relevant

income;

(B) Has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime;

(C)(i) Has a tax regime that lacks transparency.

(ii) A tax regime lacks transparency if:

(a) The details of legislative, legal, or administrative provisions are not open and apparent or are not consistently applied among similarly situated taxpayers; or

(b) The information needed by tax authorities to determine a taxpayer's correct tax liability, such as accounting records and underlying documentation, is not adequately available;

(D) Facilitates the establishment of foreign-owned entities without the need for a local and substantive presence or prohibits foreign-owned entities from having a commercial impact on the local economy;

(E) Explicitly or implicitly excludes the jurisdiction's resident taxpayers from taking advantage of the tax regime's benefits or prohibits enterprises that benefit from the regime from operating in the jurisdiction's domestic market; or

(F) Has a tax regime that is favorable for tax avoidance based upon an overall assessment of relevant factors, including without limitation whether the jurisdiction has a significant untaxed offshore financial sector or other services sector relative to its overall economy;

(7) "Unitary business" means a single economic enterprise that is made up of either separate parts of a single business entity or a commonly controlled group of business entities that are sufficiently interdependent, integrated, and interrelated through their activities so as to provide a synergy and mutual benefit that produce a sharing or exchange of value among them and a significant flow of value to the separate parts; and

(8) "United States" means the fifty (50) states of the United States, the District of Columbia, and the territories and possessions of the United States.

26-51-2503. Combined reporting required – Discretion of director.

(a)(1) A combined report shall be filed by one (1) of the following taxpayers engaged in a unitary business with one (1) or more other

corporations:

(A) The federal consolidated parent corporation; or

(B) A subsidiary with a nexus to Arkansas, if the federal consolidated parent is not a member of the combined group.

(2) The combined report required under subdivision (a)(1) of this section shall include the following information for all corporations that are members of the unitary business:

(A) The income determined under § 26-51-2506;

(B) The apportionment factors determined under:

(i) The Uniform Division of Income for Tax Purposes Act, § 26-51-701 et seq.;

(ii) The apportionment and allocation requirements under §§ 26-51-1401 – 26-51-1405; and

(iii) The combined reporting requirements under § 26-51-2505; and

(3) Any other information required by the Director of the Department of Finance and Administration.

(b)(1) To reflect proper apportionment of income of entire unitary businesses, the combined report shall include the income and apportionment factors of any person not included under subsection (a) of this section who is a member of a unitary business.

(2) The director may require the filing of a combined report by persons that are not or would not be, if doing business in this state, subject to the Income Tax Act of 1929, § 26-51-101 et seq.

(3) If the director determines that the reported income or loss of a taxpayer engaged in a unitary business with any person not included under subsection (a) of this section represents an avoidance or evasion of tax by the taxpayer, all or part of the income and apportionment factors of the person shall be included in the taxpayer's combined report.

(4) With respect to inclusion of apportionment factors under this subsection, the director may require:

(A) The exclusion of any one (1) or more of the factors;

(B) The inclusion of one (1) or more additional factors that will fairly represent the taxpayer's business activity in the state; or

(C) The employment of any other method to properly reflect:

(i) The total amount of income subject to apportionment; and

(ii) An equitable allocation and apportionment of the taxpayer's income.

26-51-2504. Determination of taxable income using combined report.

(a) The use of a combined report does not affect the separate identities of the taxpayer members of the combined group.

(b)(1) Each taxpayer member is responsible for tax based on the taxpayer member's taxable income or loss apportioned or allocated to Arkansas, including without limitation the taxpayer member's apportioned share of business income of the combined group.

(2) Business income of the combined group is calculated as a summation of the individual net business incomes of all members of the combined group.

(3) A member's net business income is determined by removing all but business income, expense, and loss from that member's total income under this subchapter and multiplying the remainder by the combined apportionment factors of all members of the combined group.

26-51-2505. Income subject to tax – Application of tax credits – Deductions after apportionment.

(a) Each taxpayer member is responsible for tax based on the taxpayer member's taxable income or loss apportioned or allocated to Arkansas, including without limitation the taxpayer member's:

(1) Share of business income that is apportioned to Arkansas of each of the combined groups of which it is a member, as determined under § 26-51-2506;

(2) Share of business income that is apportioned to Arkansas of a distinct business activity conducted within and without Arkansas wholly by the taxpayer member, as determined under the Uniform Division of Income for Tax Purposes Act, § 26-51-701 et seq., and the apportionment and allocation requirements under §§ 26-51-1401 – 26-51-1405;

(3) Income from a business conducted wholly by the taxpayer member entirely within Arkansas;

(4) Income sourced to Arkansas from the sale or exchange of

capital or assets;

(5) Nonbusiness income or loss allocable to Arkansas, as determined under the Uniform Division of Income for Tax Purposes Act, § 26-51-701 et seq., and the apportionment and allocation requirements under §§ 26-51-1401 – 26-51-1405; and

(6)(A) Net operating loss carryover.

(B)(i) If the taxable income computed under this subchapter results in a loss for a combined group, the combined group has an Arkansas net operating loss reduced by any nontaxable income under § 26-51-427(2)(A).

(ii) A net operating loss of the combined group is applied as a deduction in a subsequent year only to the extent that the combined group has Arkansas source positive net income.

(C)(i) Only a taxpayer member that joins a combined group and has a net operating loss from a tax year before the taxpayer member joined the combined group is subject to the carryover provisions of § 26-51-427, the net operating loss limitations, and the separate return limitation year restriction.

(ii) Separate return limitation year restrictions allow the net operating loss of a member that joins a combined return to offset the combined income of all corporations that were members of the same federal consolidated group when the net operating loss was created or that were members of the same Arkansas combined group when the net operating loss was created.

(b)(1) A tax credit earned by a member may be applied against the total tax liability of the combined group.

(2)(A) A charitable contribution made by a taxpayer member of the combined group is available as a deduction of the combined group subject to the limitations of 26 U.S.C. § 170, as it existed on January 1, 2011.

(B) A charitable contribution under subdivision (b)(2)(A) of this section is subtracted from the business income of the combined group before apportionment, and the remaining balance is treated as a nonbusiness expense allocable to the nonbusiness income of the combined group subject to the income limitations of 26 U.S.C. § 170, as it existed on January 1, 2011.

(C) A charitable contribution under subdivision (b)(2)(A) of this section that is disallowed under the income limitations of this

subsection is allowed as a carryover deduction for up to five (5) years in accordance with 26 U.S.C. § 170, as it existed on January 1, 2011.

26-51-2506. Determination of share of business income of a combined group.

The taxpayer's share of the business income to be apportioned to Arkansas of each combined group of which it is a member is the product of:

(1) The business income of the combined group, as determined under § 26-51-2507; and

(2)(A) The taxpayer member's apportionment percentage, as determined under the Uniform Division of Income for Tax Purposes Act, § 26-51-701 et seq., and the apportionment and allocation requirements under §§ 26-51-1401 – 26-51-1405, including:

(i) In each numerator, the taxpayer's property, payroll, or sales factor associated with the combined group's unitary business in this state; and

(ii) In the denominator, the property, payroll, or sales factor of all members of the combined group, including the taxpayer, that are associated with the combined group's unitary business wherever located.

(B) The property, payroll, and sales factors of a partnership are included in the determination of the partner's apportionment percentage in proportion to a ratio the numerator of which is the amount of the partner's distributive share of partnership's unitary income included in the income of the combined group under § 26-51-2507 and the denominator of which is the amount of the partnership's total unitary income.

26-51-2507. Determination of business income of the combined group.

(a) The business income of a combined group is determined under this section.

(b) To determine the business income of the combined group, subtract any income and add any expense or loss other than the business income, expense, or loss of the combined group from the total income of the combined group, as determined under subsection (c) of this section.

(c)(1) Except as otherwise provided in this section, the total income of the combined group is the sum of the income of each member of the combined

group, as determined under the Internal Revenue Code of 1986, 26 U.S.C. § 1 et seq., as it existed on January 1, 2011, as if the member were not consolidated for federal purposes.

(2) The income of each member of the combined group is determined as follows:

(A) For a member incorporated in the United States or included in a consolidated federal corporate income tax return, the income to be included in the total income of the combined group is the taxable income for the corporation after making appropriate adjustments under the Income Tax Act of 1929, § 26-51-101 et seq.; and

(B)(i) For a member not included in subdivision (c)(2)(A) of this section, the income to be included in the total income of the combined group is determined as follows:

(a) A profit and loss statement shall be prepared for each foreign branch or corporation in the currency in which the books of account of the branch or corporation are regularly maintained;

(b) Adjustments shall be made to the profit and loss statement to conform it to the accounting principles generally accepted in the United States for the preparation of profit and loss statements except as modified by this subchapter;

(c) Except as otherwise provided in this subchapter, the profit and loss statement of each member of the combined group and the related apportionment factors shall be expressed in United States currency; and

(d) Income apportioned to Arkansas shall be expressed in United States dollars.

(ii)(a) In lieu of the procedures in subdivision (c)(2)(B)(i) of this section and subject to the determination of the Director of the Department of Finance and Administration that it reasonably approximates income as determined under the Income Tax Act of 1929, § 26-51-101 et seq., a member not included in subdivision (c)(2)(A) of this section may determine its income on the basis of the consolidated profit and loss statement that includes the member and that is prepared for filing with the United States Securities and Exchange Commission by related corporations.

(b) If the member is not required to file with the commission, the director may allow the use of a consolidated profit and

loss statement prepared for reporting to shareholders and subject to review by an independent auditor.

(c) If the profit and loss statements in this subdivision (c)(2)(B)(ii) of this section do not reasonably approximate income as determined under this chapter, the director may accept profit and loss statements with appropriate adjustments to approximate the income as determined under this chapter.

(d) If a unitary business includes income from a partnership, the income included in the total income of the combined group is the member of the combined group's direct and indirect distributive share of the partnership's unitary business income.

(e)(1) Dividends paid by a member of the combined group to another member of the combined group shall be eliminated from the income of the recipient to the extent that the dividends are paid out of the earnings and profits of the unitary business included in the combined report, in the current or a prior year.

(2) Subdivision (e)(1) of this section does not apply to dividends received from members of the unitary business that are not a part of the combined group.

(f)(1) Except as otherwise provided in this subchapter, business income from an intercompany transaction between members of the same combined group is deferred in the same manner as in 26 CFR § 1.1502-13, as it existed on January 1, 2011.

(2) Deferred business income resulting from an intercompany transaction between members of a combined group is restored to the income of the seller and is apportioned as business income earned immediately before the event if any of the following events occur:

(A) The object of a deferred intercompany transaction is:

(i) Resold by the buyer to an entity that is not a member of the combined group;

(ii) Resold by the buyer to an entity that is a member of the combined group for use outside the unitary business in which the buyer and seller are engaged; or

(iii) Converted by the buyer to a use outside the unitary business in which the buyer and seller are engaged; or

(B) The buyer and seller are no longer members of the same

combined group regardless of whether the members remain unitary.

(g) An expense of a member of the unitary group that is directly or indirectly attributable to the nonbusiness or exempt income of another member of the unitary group is allocated to the other member as corresponding nonbusiness or exempt expense as appropriate.

26-51-2508. Designation of surety.

(a)(1)(A)(i) Members of a combined reporting group shall annually designate one (1) taxpayer member of the combined group to file a single return in the form and manner prescribed by the Director of the Department of Finance and Administration in lieu of each member's filing its own respective return.

(ii) The surety designated under this section shall be either:

(a) The federal consolidated parent corporation; or

(b) A subsidiary with a nexus to Arkansas if the federal consolidated parent is not a member of the combined group.

(B) The taxpayer designated to file the single return under subdivision (a)(1)(A) of this section:

(i) Consents to act as surety with respect to the tax liability of all other taxpayers properly included in the combined report; and

(ii) Agrees to act as agent on behalf of those taxpayers for the year of the election for tax matters relating to the combined report for that year.

(2) The designation of a surety under subdivision (a)(1) of this section does not change the respective liability of the group members.

(b) If for any reason the taxpayer designated as a surety under subsection (a) of this section is unwilling or unable to perform the surety's responsibilities, tax liability shall be assessed against all of the taxpayer members.

26-51-2509. Water's-edge election.

(a) Taxpayer members of a unitary group that meet the requirements of § 26-51-2510 may elect to determine each member's apportioned share of the

net business income or loss of the combined group under a water's-edge election.

(b) Under the water's-edge election, taxpayer members shall take into account the income and apportionment factors of only the following members of the combined group:

(1) The entire income and apportionment factors of any member incorporated in the United States or formed under the laws of the United States;

(2) The entire income and apportionment factors of any member, regardless of the place incorporated or formed, if the average of its property, payroll, and sales factors within the United States is twenty percent (20%) or more;

(3) The entire income and apportionment factors of any member that is a domestic international sales corporation as described in 26 U.S.C. §§ 991-994, as they existed on January 1, 2011;

(4) The portion of the income of a member not described in subdivisions (b)(1)-(3) of this section that is derived from or attributable to sources within the United States, as determined under the Internal Revenue Code of 1986, 26 U.S.C. § 1 et seq., as it existed on January 1, 2011, and the related apportionment factors;

(5)(A) The income of a member that is a controlled foreign corporation, as defined under 26 U.S.C. § 957, as it existed on January 1, 2011, to the extent the income is described under 26 U.S.C. § 952, as it existed on January 1, 2011, not excluding lower-tier subsidiaries' distributions of income that were previously taxed and the apportionment factors related to the income.

(B) An item of income received by a controlled foreign corporation is excluded if the income was subject to an effective rate of income tax imposed by a foreign country greater than ninety percent (90%) of the maximum rate of tax specified in 26 U.S.C. § 11, as it existed on January 1, 2011;

(6) The income and apportionment factors of a member that earns income, directly or indirectly, from intangible property or service-related activities that are deductible against the business income of other members of the combined group; and

(7)(A) The entire income and apportionment factors of any member

that is doing business in a tax haven.

(B) If the member's business activity within a tax haven is entirely outside the scope of the laws, provisions, and practices that cause the jurisdiction to be a tax haven under § 26-51-2502, the activity of the member shall be treated as not having been conducted in a tax haven.

26-51-2510. Initiation and withdrawal of water's-edge election.

(a)(1) A water's-edge election is effective only if made on a timely filed original return for the tax year by each member of the unitary business subject to tax under the Income Tax Act of 1929, § 26-51-101 et seq.

(2) The Director of the Department of Finance and Administration shall develop rules governing the impact, if any, on the scope or application of a water's-edge election, including without limitation termination or deemed election resulting from a change in the composition of the unitary group, the combined group, or the taxpayer members and any other similar change.

(b) In the discretion of the director, a water's-edge election may be disregarded in whole or in part, and the income and apportionment factors of any member of the taxpayer's unitary group may be included in the combined report without regard to the provisions of this section if:

(1) A member of the unitary group fails to comply with this subchapter; or

(2) A person otherwise not included in the water's-edge combined group was designated with the substantial objective of avoiding state income tax.

(c)(1) A water's-edge election is binding for and applicable to the tax year in which it is made and all tax years thereafter for a period of ten (10) years.

(2)(A) A water's-edge election may be withdrawn or reinstated after withdrawal before the expiration of the ten-year period only upon written request for reasonable cause based on extraordinary hardship due to unforeseen changes in state tax statutes, law, or policy, and only with the written permission of the director.

(B) If the director grants a withdrawal of election, the director shall impose reasonable conditions to prevent the evasion of tax or to clearly reflect income for the election period before or after the

withdrawal.

(3)(A) Upon the expiration of the ten-year period, a taxpayer may withdraw from the water's edge election.

(B) Withdrawal under this section shall be made in writing within one (1) year of the expiration of the election.

(C) Withdrawal under this section is binding for a period of ten (10) years subject to the conditions that applied to the original election under this section.

(D) If a withdrawal is not properly made, the water's edge election shall be in place for an additional ten-year period subject to the conditions that applied to the original election under this section.

26-51-2511. Rules.

The Director of the Department of Finance and Administration shall promulgate rules to implement this subchapter.

SECTION 2. Arkansas Code § 26-51-205 is amended to read as follows:

26-51-205. Corporations – Work Force 2000 Development Fund.

(a) ~~Every~~ Each corporation organized under the laws of this state and each foreign corporation doing business within the jurisdiction of this state shall pay annually an income tax with respect to carrying on or doing business on the entire net income of the corporation, as now defined by the laws of the State of Arkansas, received by such corporation during the income year, ~~on the following basis:~~ at a flat rate of six percent (6%).

(1) On the first \$3,000 of net income or any part thereof	1 %
On the second \$3,000 of net income or any part thereof	2 %
On the next \$5,000 of net income or any part thereof	3 %
On the next \$14,000 of net income or any part thereof	5 %
On the next \$75,000 of net income or any part thereof, but not exceeding \$100,000	6 %

~~(2) On net income exceeding one hundred thousand dollars (\$100,000), a flat rate of six and one-half percent (6 ½ %) shall be applied to the entire net income.~~

~~(b) Every foreign corporation doing business within the jurisdiction of this state shall pay annually an income tax on the proportion of its~~

~~entire net income as now determined by the income tax laws of Arkansas, on the following basis:~~

- ~~(1) On the first \$3,000 of net income or any part thereof 1 %~~
- ~~On the second \$3,000 of net income or any part thereof 2 %~~
- ~~On the next \$5,000 of net income or any part thereof 3 %~~
- ~~On the next \$14,000 of net income or any part thereof 5 %~~
- ~~On the next \$75,000 of net income or any part thereof, but not exceeding \$100,000 6 %~~

~~(2) On net income exceeding one hundred thousand dollars (\$100,000), a flat rate of six and one half percent (6 1/2 %) shall be applied to the entire net income.~~

SECTION 3. Arkansas Code § 26-51-419(b), concerning deductions for charitable contributions, is amended to read as follows:

(b) ~~The provisions of subsection~~ Subsection (a) of this section ~~shall apply~~ applies to a corporation that files an Arkansas ~~consolidated corporation~~ combined income tax return pursuant to § 26-51-805, provided that each member of the affiliated group shall follow the provisions of § 26-51-805(f) and calculate its contribution limits separately under the Arkansas Small Business Tax Fairness Act, § 26-51-2501 et seq., in accordance with § 26-51-2505.

SECTION 4. Arkansas Code § 26-51-804(a), concerning income tax returns for corporations, is amended to read as follows:

(a)(1) Every corporation subject to taxation under the Income Tax Act of 1929 shall make a return stating specifically the items of its gross income and the deductions and credits allowed by the Income Tax Act of 1929.

(2) Corporations that are members of a unitary business under the Arkansas Small Business Tax Fairness Act, § 26-51-2501 et seq., shall file a combined return.

(3) Corporations that are not members of a unitary business under the Arkansas Small Business Tax Fairness Act, § 26-51-2501 et seq., shall file returns on either a consolidated basis or a separate entity basis.

SECTION 5. Arkansas Code § 26-51-805(a), concerning consolidated

income tax returns for corporations, is amended to read as follows:

(a)(1)(A) All corporations ~~which that~~ are eligible members of an affiliated group, as ~~that term is~~ defined in 26 U.S.C. § 1504(a) and (b), ~~as of it existed on~~ January 1, 1989, ~~which affiliated group files a federal consolidated corporate income tax return pursuant to 26 U.S.C. §§ 1501-1505 as of January 1, 1989,~~ may elect to shall file a consolidated combined Arkansas corporate income tax return under the Arkansas Small Business Tax Fairness Act, § 26-51-2501 et seq., if the affiliated group files a federal consolidated corporate income tax return under 26 U.S.C. §§ 1501-1505, as they existed on January 1, 1989.

(B) Corporations that are not members of a unitary business under the Arkansas Small Business Tax Fairness Act, § 26-51-2501 et seq., shall file returns on either a consolidated basis or a separate entity basis.

(2) However, only corporations in the affiliated group that have gross income from sources within ~~the State of~~ Arkansas that is subject to taxation under ~~the provisions of~~ the Income Tax Act of 1929, § 26-51-101 et seq., shall be eligible to file consolidated corporate income tax returns in Arkansas.

SECTION 6. EFFECTIVE DATE. This act is effective for tax years beginning on or after January 1, 2014.