

Title 26. Taxation

Chapter I. Generally, Department of Finance and Administration

Subchapter D. Individual Income Tax

Part 100. Comprehensive Individual Income Tax Rule

Codification Notes. This part as promulgated prior to codification into the Code of Arkansas Rules provided as follows:

"Pursuant to the authority vested in the Commissioner of Revenues and in compliance with Ark. Code Ann. §26-18-301 and §26-51-104, the Commissioner of Revenues of the Department of Finance and Administration, with the approval of the Governor, does hereby promulgate the following rules for the enforcement and administration of Ark. Code Ann. §26-51- 101 et seq.

EFFECTIVE DATE: All rules previously promulgated by the Commissioner of Revenues for purposes of enforcing or implementing the Arkansas Income Tax Act of 1929 (as amended) are hereby specifically repealed as of the effective date of these rules."

"Arkansas Individual Income Tax Regulations

Issued and hereby effective this 2nd day of October, 1997 in the City of Little Rock, Pulaski County, Arkansas.

Richard Weiss, Director

Arkansas Department of Finance and Administration

Tim Leathers, Commissioner of Revenue and Deputy Director Arkansas Department of Finance and Administration"

Subpart 1. Generally

26 CAR § 100-101. Purpose.

(a) This part is promulgated to implement and clarify the Arkansas Income Tax Act of 1929, Arkansas Code § 26-51-101 et seq., as amended.

(b) All persons affected by or relying upon this part are advised to read this part in its entirety, as the meaning of the provisions of one (1) section may depend upon the provisions contained in another section.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-102. Interpretation.

(a) In those instances where Arkansas has adopted a section of the Internal Revenue Code as its own law, the regulations promulgated by the United States Treasury to aid in interpreting the Internal Revenue Code section should be used for guidance in applying the law.

(b) Moreover, when an Internal Revenue Code section is adopted, that section is adopted in its entirety, despite language in the Arkansas adoption statute such as "regarding" that could be construed to limit the scope of the adoption.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-103. Date of performance — Arkansas Code § 26-18-105.

(a) **United States Postal Service postmark — Arkansas Code § 26-18-105(a)(2).** Only the postmark of the United States Postal Service shall qualify for the provisions of this part for the filing of a return, claim, statement, or other documents beyond a prescribed due date.

(b) **When last day is a Saturday, Sunday, or legal holiday — Arkansas Code § 26-18-105(b).** When the last day prescribed under the authority of state tax laws for performing any act or instituting any suit falls on a Saturday, Sunday, or legal holiday, the performance of the act shall be considered timely if it is performed on the next succeeding business day that is not a:

(1) Saturday;

- (2) Sunday; or
- (3) Legal holiday.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-104. Additional penalties and tax — Arkansas Code § 26-18-208.

(a) **Failure to file and failure to pay penalties — Arkansas Code § 26-18-208(3)(B).** For individual income tax purposes only, failure to file penalties of five percent (5%) per month and failure to pay penalties of one percent (1%) per month are assessed simultaneously, not to exceed thirty-five percent (35%).

(b) **Underestimated tax penalty — Arkansas Code § 26-18-208(6).**

(1) The underestimated tax penalty shall not be imposed if the tax liability for the current tax year is two hundred fifty dollars (\$250.00) or less.

(2) The underestimated tax penalty shall not be imposed if the:

(A) Current year payments made equal or exceed:

- (i) Ninety percent (90%) of the current year tax liability; or
- (ii) One hundred percent (100%) of the preceding tax year liability;

and

(B) Preceding tax year was twelve (12) months.

(3) The underestimated tax penalty is calculated by multiplying the underpayment for each quarter by .00027397, then multiplying this product by the number of days from the date the estimated payment was due to the date estimate was paid, the date the return is filed, or the due date of the return, whichever is earlier.

(4)(A) For purposes of this part, payments include taxes withheld from the taxpayer's wages and estimated tax payments.

(B) Estimated tax payments must be made by the required due dates.

(C) Payments made with an extension of time to file individual income tax returns do not constitute estimated tax payments.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-105. Time limitations for assessments, collection, refunds, and prosecution — Arkansas Code § 26-18-306.

(a) Adjustment to federal return — Duty to amend state return — Arkansas Code § 26-18-306(b).

(1) For any given tax year, if the Internal Revenue Service changes and corrects the taxable income, taxable estate, and/or income tax due on an Arkansas taxpayer's federal income tax return, the taxpayer must file an amended Arkansas income tax return within thirty (30) days of receiving such notice from the Internal Revenue Service.

(2) This provision applies to any taxpayer who is required to file an Arkansas individual income tax return, whether the individual is a resident, part-year resident, or nonresident of Arkansas.

(b) Time limitation on refunds and verified claim for credit — Arkansas Code § 26-18-306(i)(2). In the case of a taxpayer who fails to file a return, underreports his or her income by twenty-five percent (25%) or more, or fails to notify the Secretary of the Department of Finance and Administration of any change or correction by the Internal Revenue Service, no amended return or verified claim for credit or refund will be allowed after three (3) years from the date the original return or the notification of change by the Internal Revenue Service was originally due.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-106. Taxpayer relief — Arkansas Code § 26-18-404.

(a) Protest of proposed assessment — Arkansas Code § 26-18-404(c).

(b) A taxpayer cannot file a protest based upon a notice of tax adjustment but must wait until a proposed assessment is received.

(c)(1) The taxpayer must protest a proposed assessment in writing within thirty (30) days of service of the notice.

(2) The protest must include the taxpayer's grounds for protesting the assessment.

(3) If the thirtieth day falls on a Saturday, Sunday, or legal holiday, the next succeeding day that is not a Saturday, Sunday, or legal holiday would be within the prescribed time period in which to file the protest.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-107. Hearing on proposed assessments — Arkansas Code § 26-18-405.

(a) Hearing on proposed assessments — Arkansas Code § 26-18-405(d)(4)(A).

(b) If a proposed assessment is sustained, in whole or part by the Office of Hearings and Appeals of the Department of Finance and Administration, the taxpayer may request in writing, within twenty (20) days of the mailing of the decision, that the Secretary of the Department of Finance and Administration revise the decision of the hearing officer.

(c) If the secretary refuses to make a revision, then a final assessment shall be made upon the final determination of the hearing officer.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-108. Judicial relief — Arkansas Code § 26-18-406.

(a) Judicial relief — Arkansas Code § 26-18-406(a).

(b)(1) A taxpayer may seek further relief from the final decision of the hearing officer or the Secretary of the Department of Finance and Administration on a final assessment of a tax deficiency through the courts within thirty (30) days of the issuance of the final assessment.

(2) The taxpayer may pay the full deficiency, interest, and penalty under protest and file suit for recovery within one (1) year from the date of payment or file a

bond with the secretary in double the amount of the tax deficiency and file suit within thirty (30) days thereafter to stay the effect of the secretary's determination.

(3) A taxpayer's failure to file suit, diligently prosecute the suit, or pay any tax deficiency and court costs shall result in the forfeiture of the bond in the amount of the assessment and court costs.

(c) Jurisdiction for suit shall be in Pulaski County Chancery Court or the chancery court of the county in which the taxpayer resides or has his or her principal place of business.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-109. Extension of time for filing returns — Arkansas Code § 26-18-505.

(a) **First ninety-day extension — Arkansas Code § 26-18-505(a)(3)(A) [repealed].**

(1)(A) Taxpayers may request a ninety-day state extension past the original due date of the state individual income tax return.

(B) This request shall be made on or before the original due date of the return.

(2) Upon receipt, the extension will be approved or denied and a copy sent back to the taxpayer.

(3) If approved, attach a copy of the extension to the return when filed.

(4)(A) An approved extension only extends the filing due date and does not postpone the due date of payment of taxes.

(B) If any tax due is reflected on the filed return and is not paid on or before the original due date, interest as provided by law will be assessed from the original due date until the tax is paid.

(C) Failure to file or pay penalties under Arkansas Code § 26-18-208 will apply to any tax not paid on or before the extended date.

(b) Second ninety-day extension — Arkansas Code § 26-18-505(a)(3)(B) [repealed].

(1) The Secretary of the Department of Finance and Administration may issue a second ninety-day extension for extraordinary circumstances.

(2) This additional extension will run consecutively with the first extension.

(3) This request shall be made on or before the expiration of the first ninety-day extended due date.

(c) Federal extension recognized — Arkansas Code § 26-18-505(a)(4).

(1) The secretary will recognize an automatic extension afforded the taxpayer by the Internal Revenue Service.

(2) This extension will be granted to the federal extended due date.

(3) The taxpayer must attach a copy of the request to the state return in order to receive the automatic extension.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-110. Preservation of records by taxpayer — Arkansas Code § 26-18-506.

(a) Type of records and time period — Arkansas Code § 26-18-506(b).

(1) The taxpayer is required to keep and maintain all records that are necessary to:

(A) Reconcile the amount of tax due; or

(B) Prove the accuracy of any return.

(2) These records:

(A) Must be preserved for six (6) years after a return is filed; and

(B) Are subject to examination by the Secretary of the Department of Finance and Administration at any reasonable time.

(b) Insufficient records and estimated assessment — Arkansas Code § 26-18-506(d).

(1) If the taxpayer cannot produce sufficient records to reconcile the amount of tax due or to prove the accuracy of any return, the secretary may make an estimated assessment based upon information available to him or her.

(2) The burden of proof of refuting this assessment is upon the taxpayer.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-111. Claims for refunds of overpayments — Arkansas Code § 26-18-507.

(a) Grounds for refund claim — Arkansas Code § 26-18-507(a).

(1)(A) A taxpayer who has paid any tax to the State of Arkansas through error of fact, computation, or mistake of law, in excess of the taxes lawfully due, shall be refunded the overpayment of the tax determined by the Secretary of the Department of Finance and Administration to be erroneously paid upon the filing of an amended return or a verified claim for refund.

(B) These claims shall be subjected to certain requirements and other information relative to the overpayment.

(2) If a refund is determined, the secretary shall certify that the claim is to be:

(A) Paid to the taxpayer as provided by law; or

(B) Credited against taxes due or to become due.

(b) Form and procedure for refund claims — Arkansas Code § 26-18-507(i)(1).

(1) A verified claim for credit or a refund may be the signed copy of a previously filed return accompanied by a letter of explanation as to the reason the refund or credit request is being made.

(2)(A) Upon request by the Department of Finance and Administration, it shall be the burden of the taxpayer to prove that all claimed prior income tax or estimated tax payments that are reflected on an amended return or verified claim for credit or refund were made.

(B) The department will accept legible copies of the front and back of canceled checks as proof of prior payments.

(c) Judicial relief — Arkansas Code § 26-18-507(e)(2).

(1) The taxpayer may seek judicial relief according to Arkansas Code § 26-18-406 if the written decision of the secretary denies the claim in whole or part.

(2)(A) A taxpayer must file suit within ninety (90) days after the issuance of the secretary's written decision.

(B) The suit may be filed in Pulaski County Chancery Court or the chancery court of the county in which the taxpayer resides or has his or her principal place of business.

(C) A written decision of the secretary on a refund becomes final and not subject to suit ninety-one (91) days after it is issued.

(3) If the secretary fails to issue a written decision and has not acted on the claim after at least six (6) months have expired from the date of the filing of the claim for refund, the taxpayer may file suit in either Pulaski County Chancery Court or the county in which he or she lives.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-112. Taxpayer Bill of Rights — Arkansas Code § 26-18-801 et seq.

(a) Your rights as a taxpayer — Arkansas Code § 26-18-801 et seq.

(b) You have the right to full explanation of all actions by any agent of the Commissioner of Revenue both during:

(1) An audit; and

(2) Collection activities.

(c) All tax information contained in the records and files of the commissioner pertaining to you or your business is confidential.

(d) You may represent yourself in any proceeding or interview before the commissioner or you may be represented by anyone whom you authorize in writing to be your representative.

(e)(1) You have the right to consult with a lawyer, accountant, or other representative at any time during an interview with an agent of the commissioner.

(2) The commissioner shall terminate the interview to allow you to consult with your representative.

(f)(1) You may record any interview with the commissioner or his or her agent at your own expense.

(2) You should let the commissioner or his or her agent know in advance of your intention to record the interview.

(3) The commissioner may likewise record an interview provided that the commissioner provides you with a copy at your expense.

(g)(1) You may request an administrative review of any proposed assessment of tax.

(2) You must request this review within thirty (30) days of your receipt of a proposed assessment.

(3) The administrative review may be based on either:

(A) An in-person hearing; or

(B) A consideration of written documents.

(h)(1) If you receive an unfavorable decision from your administrative review, then you may request a review of the decision by the commissioner.

(2) This review should be requested within twenty (20) days of your receipt of the administrative decision.

(i)(1) If you receive an unfavorable decision from the commissioner, you may appeal it to chancery court.

(2) To pursue your appeal to chancery court you must, within thirty (30) days of the issuance of the final assessment and demand for payment:

(A) Pay the amount of tax, interest, and penalty under protest; or

(B) File a bond double the tax deficiency amount.

(3) You must file your lawsuit within one (1) year from the date of paying under protest or within thirty (30) days of filing a bond.

(j)(1) A taxpayer may file an amended return or verified claim for credit or refund of an overpayment of any state tax within three (3) years of the time the return was filed or two (2) years from the date the tax was paid, whichever is later.

(2) Any amended return or claim for refund should be filed with the office of the Revenue Division of the Department of Finance and Administration that administers the tax in issue.

(k) Any taxpayer who wishes to file a complaint regarding any activity concerning the administration or collection of any state tax by the division should make the complaint in writing to:

Commissioner of Revenue
P.O. Box 1272
Ledbetter Building, Room 2440
Little Rock, AR 72203

(l)(1) In administering the state tax laws, the commissioner is authorized by law to make an examination or investigation of the business, books, and records of the taxpayer.

(2) If the commissioner determines that an additional amount of tax is due, then a proposed assessment shall be issued to the taxpayer.

(3) The taxpayer may seek relief from the proposed assessment as outlined above.

(4) If the taxpayer fails to preserve and maintain records suitable to determine the amount of tax due or to prove accuracy of any return, the commissioner may make an estimated assessment based upon the best information available as to the amount of tax due by the taxpayer.

(m)(1) The commissioner may issue a jeopardy assessment against any taxpayer:

(A) For whom the tax liability of that taxpayer exceeds any bond on file indemnifying the state for the payment of a state tax;

(B) Who intends to:

(i) Leave the state;

(ii) Remove his or her property; or

(iii) Conceal himself or herself or his or her property;

(C) Who intends to discontinue his or her business without making adequate provisions for payment of state taxes; or

(D) Who does any other act tending to prejudice or jeopardize the commissioner's ability to compute, assess, or collect any state tax.

(2) Any taxpayer seeking relief from a jeopardy assessment must request an administrative hearing within five (5) days from the receipt of the notice of jeopardy assessment.

(n)(1) When collecting any state tax due from a taxpayer, the commissioner is authorized to issue a certificate of indebtedness to the circuit clerk of any county of this state certifying that the person named there is indebted to the state for the amount of tax established by the commissioner as due.

(2) The certificate of indebtedness shall:

(A) Have the same force and effect as the entry of a judgement rendered by a circuit court; and

(B) Constitute a lien upon the title of any real and personal property of the taxpayer in the county where the certificate of indebtedness is recorded.

(o) After the entry of the certificate of indebtedness, the commissioner may take all steps authorized by law for the collection of the tax, including:

(1) The issuance of a writ of execution;

(2) Garnishment; and

(3) Cancellation of any state tax permits or registrations.

(p) Any court or sheriff's fees or costs that result from the commissioner's attempt to collect delinquent taxes shall be collected from the taxpayer in addition to the tax, interest, and penalties included in the certificate of indebtedness.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-113. Definitions — Arkansas Code § 26-51-102.

(a) **Administrator — Arkansas Code § 26-51-102(8).** A person appointed by the court to administer (that is, manage or take charge of) the estate, including liabilities, of a decedent.

(b) **Charitable trust — Arkansas Code § 26-51-102.**

(1) A trust designed for the benefit of a class or the public generally.

(2) Charitable trusts are essentially different from private trusts in that the beneficiaries of a charitable trust are uncertain.

(3) A charitable remainder trust consists of assets that are paid over to the trust after the expiration of a life estate or intermediate estates and designated for charitable purposes.

(c) **Corporate characteristics — Arkansas Code § 26-51-102(5).**

(1) Whether an organization (including an unincorporated entity like a partnership, LLC, or trust) will be taxed as a corporation depends on how many of these corporate characteristics it has:

(A) Associates;

(B) An objective to carry on a business and divide the gain from it;

(C) Continuity of life;

(D) Centralized management;

(E) Liability limited to the organization's assets; and

(F)(i) Free transferability of interests.

(ii) I.R.C. Reg. 301.7701-2(a)(1).

(2)(A) If an entity has more corporate than noncorporate characteristics, it is treated as a corporation (association taxable as a corporation).

(B) I.R.C. Reg. 301.7701-2(a)(3).

(d) **Estate — Arkansas Code § 26-51-102.**

(1) The degree, quantity, nature, and extent of interest that a person has in real estate and all other personal property of whatever kind.

(2) With respect to a decedent, the total property of whatever kind that is owned by a decedent prior to the distribution of that property:

(A) In accordance with the terms of a will; or

(B) When there is no will, by the laws of inheritance in the state of domicile of the decedent.

(e) Estate taxability — Arkansas Code § 26-51-102 — Estate Tax Extension, AY321E — Estate Tax Return, AY321 — Fiduciary Return, AR1002.

(1) Estate income is normally taxed to:

(A) The estate itself, if retained by the estate; or

(B) The distributee, if distributed.

(2) Thus, if the fiduciary (that is, executor or administrator) passes on income to the distributee, the estate deducts the distributed income, which then becomes taxable to the distributee.

(3)(A) What would be gross income in the hands of an individual is gross income when received by an estate – dividends, interest, rents, royalties, capital gains, ordinary gains, etc.

(B) I.R.C. Reg. 1.641(a)-2.

(4)(A) Gross income includes income:

(i) Accumulated or held for future distribution under the terms of a will or trust;

(ii) That is currently distributable;

(iii) Received by a deceased's estate during administration or settlement; and

(iv) That, in the fiduciary's discretion, may be either accumulated or distributed.

(B) I.R.C. § 641(a).

(5) Deductions and credits allowed to estates are basically those allowed to individuals.

(6)(A) An estate's status as a separate taxpayer exists only during the period of administration and settlement of the estate.

(B) I.R.C. § 641(a)(3).

(7) This period starts with the deceased's death and generally extends for the entire time actually required to perform the ordinary duties of administration, such as:

(A) Collecting assets; and

(B) Paying legacies and debts.

(8)(A) If estate administration is unduly prolonged, the Internal Revenue Service considers the estate terminated for tax purposes after expiration of a reasonable period (considering the estate's assets) for performance by the executor of all the duties of administration.

(B) I.R.C. Reg. 1.641(b)-3(a).

(f) Executor — Arkansas Code § 26-51-102(8).

(1) A person appointed by a testator to:

(A) Carry out the directions and requests in his or her will; and

(B) Dispose of the property according to his or her testamentary provisions after his or her death.

(2) The executor would also be responsible for disposing of the estate's debts and other liabilities.

(g) Fiduciary — Arkansas Code § 26-51-102(8) — Fiduciary Return, AR1002 — Extension of Time, AR1055.

(1) A person having a duty, created by his or her undertaking, to act primarily for another's benefit in matters connected with such undertaking.

(2) A fiduciary relationship is considered one of trust and confidence.

(3) A fiduciary has a legal responsibility to act in the beneficiary's (or beneficiaries') best interest.

(4)(A) The term "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any other person.

(B) I.R.C. § 7701(a)(6).

(5) A trustee, for example, possesses a fiduciary responsibility to the beneficiaries of a trust to follow the terms of the trust and the requirements of applicable state law.

(h) Grantor trust — Arkansas Code § 26-51-102.

(1)(A) A trust whereby the grantor retains control over the income, corpus (trust property), or both to such an extent that the grantor will be treated as the owner of the property and its income for income tax purposes.

(B) The general result is that the income from a grantor trust is taxable to the grantor, as "owner" of the trust, and not to the fiduciary.

(C) In determining whether a trust is a grantor trust, the grantor's degree of control over the trust must be analyzed.

(2)(A) If a grantor is considered to be the owner of the entire trust, the grantor computes his or her own personal income tax by taking into account all trust income, deductions, and credits as though the trust did not exist.

(B) However, where a grantor is treated as owner solely because of his or her interest in trust income, the grantor takes into account only his or her share of trust items that would be reported by a current income beneficiary.

(C) I.R.C. Reg. 1.671-3.

(3)(A) The grantor of a trust is treated as its "owner" and is generally taxed on its income if the:

(i) Grantor reserves the power to take back title to (that is, revoke) trust funds for himself or herself where the grantor can exercise this power alone, or it can be exercised only by another who is regarded as a nonadverse party, or it can be exercised by both the grantor and nonadverse party together;

(ii) Trust income is distributed actually or constructively to the grantor or the grantor's spouse;

(iii) Trust income is held or accumulated for future distribution to the grantor or the grantor's spouse; or

(iv) Trust income is applied to pay premiums on life insurance policies taken out on the life of the grantor or the grantor's spouse.

(B) See I.R.C. § 671 et seq.

(C) The income is not taxable to the grantor if the application of the income to any of these purposes requires the approval of an adverse party (such as a beneficiary).

(i) **Irrevocable trust — Arkansas Code § 26-51-102.** A trust that the settlor may not revoke after it has been created.

(j) **Limited liability company — Arkansas Code § 26-51-102.**

(1) Limited liability companies (LLCs) are owned and in some cases managed by members who are not personally liable for the LLCs' debts or obligations.

(2) The Internal Revenue Service may classify an LLC as a partnership if it lacks a preponderance of "corporate characteristics" (see definition), resulting in the flow-through of tax attributes to the LLC's members under the partnership tax rules.

(3) In Arkansas, LLCs are created and governed pursuant to the Small Business Entity Tax Pass Through Act, Arkansas Code § 4-32-101 et seq. [repealed].

(4) An LLC can be created by one (1) or more persons by filing articles of organization with the Secretary of State.

(5) Property may be acquired, held, and conveyed in the name of the LLC, and such property would belong to the LLC, not its members.

(6) Pursuant to Arkansas Code § 4-32-1313 [repealed], every LLC having two (2) or more members must file an income tax return for each taxable year as required for every partnership by Arkansas Code § 26-51-802.

(7) The income and expenses of every LLC having only one (1) member must be reported on the member's individual income tax return.

(k) **Limited partnership — Arkansas Code § 26-51-102(4).** A limited partnership is a partnership with two (2) classes of partners:

(1) General partners, who:

(A) May participate in the management of the partnership's business; and

(B) Have unlimited liability for the partnership's obligations; and

(2) Limited partners:

(A) Who may not participate in management; and

(B) Whose liability is limited to the amount of their capital contribution.

(l) Partnership — Arkansas Code § 26-51-102(4) — Partnership Return, AR1050 — Extension of Time, AR1055.

(1)(A) A "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization through, or by means of which, any business, financial operation, or venture is carried on if it is not, within the meaning of the Internal Revenue Code, a:

- (i) Corporation;
- (ii) Trust; or
- (iii) Estate.

(B) I.R.C. § 761(a).

(2) A partnership exists when two (2) or more persons join in carrying on a trade or business, with each person contributing either:

- (A) Money;
- (B) Property;
- (C) Labor; or
- (D) Skill.

(3)(A) The partnership agreement does not have to be written, it can be oral.

(B) I.R.C. § 761(c), I.R.C. Reg. 1.761-1(c).

(4)(A) A joint undertaking merely to share expenses is not a partnership.

(B) I.R.C. Reg. 1.761-1(a).

(5)(A) Partnerships are treated as a conduit or "pass-through entity" and are, therefore, not subject to taxation.

(B) The various items of partnership income, gains and losses, etc., flow through to the individual partners and are reported on their individual income tax returns.

(6) Moreover, every domestic or foreign partnership doing business within Arkansas or that has received income from sources within Arkansas (regardless of the amount) shall file an Arkansas partnership return.

(m) Publicly traded partnership (PTP) — Arkansas Code § 26-51-102(4).

(1)(A) A publicly traded partnership (PTP) is taxable as a corporation.

(B) I.R.C. § 7704(a).

(2)(A) A partnership is a publicly traded partnership if interests in the partnership either are:

(i) Traded on an established securities market; or

(ii) Readily tradable on a secondary market or its substantial equivalent.

(B) I.R.C. § 7704(b).

(3)(A) However, a publicly traded partnership will not be treated as a corporation if, for each tax year beginning after 1987:

(i) At least ninety percent (90%) of its gross income is specified passive-type income; and

(ii) Certain other requirements are met.

(B) I.R.C. § 7704(c).

(4) Certain existing partnerships that were publicly traded partnerships on December 17, 1987, will not be treated as corporations until tax years beginning after 1997.

(n) Residency determination — Arkansas Code § 26-51-102(9).

(1)(A) A three-pronged test, as set forth below, is used to determine whether or not a person is a resident of Arkansas.

(B) Satisfaction of any one (1) prong is sufficient to establish residency.

(2) The three (3) prongs are:

(A)(i) Any person domiciled in the State of Arkansas.

(ii) Domicile is composed of an act coupled with an intent.

(iii)(a) A domicile is acquired by physical presence at a place coinciding with the state of mind (that is, intent) of regarding the place as a permanent home.

(b) A domicile arises instantaneously when these two (2) facts occur.

(iv) Every person must have one (1) domicile but can have no more than one (1) domicile, regardless of how many residences a person may have at any given time.

(v) A domicile, once established, continues until a new domicile of choice is legally established.

(vi) An established domicile does not end by lack of physical presence alone nor by mental intent alone.

(vii) The old domicile must be abandoned with the intention not to return to it.

(viii) If one moves to a new location but intends to stay there only for a limited period of time (no matter how long), the domicile does not become the new location but rather remains unchanged;

(B)(i) Any person who maintains a permanent place of abode within Arkansas and spends in the aggregate more than six (6) months of the year within Arkansas.

(ii)(a) "Place of abode" means a place where a person has established a permanent home, even though such person may be absent therefrom for a long period of time.

(b) A temporary home or residence would not be considered a place of abode, as there must be at least some degree of permanence.

(iii)(a) In addition, a person must actually spend more than six (6) months of the tax year in Arkansas to fall within the scope of this provision.

(b) A person who has spent either less than six (6) months or exactly six (6) months in Arkansas would not fall within the scope of this provision.

(iv) Place of abode and residence are considered to mean roughly the same thing.

(v)(a) However, domicile and residence are not considered to be synonymous.

(b) Residence denotes only an act (the act of residing), while domicile denotes an act (the act of residing) coupled with the intent that the residence be a permanent home.

(vi) The distinction between domicile and place of abode is that although a person can have several homes (or places of abode) at one time, only one (1) of those homes can be the person's domicile.

(vii) The home that the person intends or considers to be their permanent home (as in home base) would be the domicile; or

(C)(i) In situations where it is not clear if the requirements of either domicile in subdivision *(n)(2)(A)* of this section or place of abode in subdivision *(n)(2)(B)* of this section have been met, a residency determination can only be made after thoroughly reviewing the facts on a case-by-case basis.

(ii) When reviewing the facts, the Supreme Court has held that we are not bound to accept a taxpayer's claims of intent when the circumstances point to a contrary conclusion.

(iii) Furthermore, when acts are inconsistent with a taxpayer's declarations, the acts will control, and our conclusions regarding residency should be based on the facts and circumstances proved.

(iv) The following factors should be reviewed in making a residency determination:

(a) Address used on federal income tax returns;

(b) Address used on telephone, utility, and commercial documents;

(c) Address used on voter registration;

(d) Address used on driver's, hunting, and fishing license;

(e) Address used on motor vehicle, boat, and trailer registration;

(f) Address used on real and personal property tax documents;

(g) Address used on county and other tax assessments;

(h)(1) Address on governmental documents, such as military records.

(2) With respect to military records, the Leave and Earning Statement is a very important document;

(i) If the taxpayer has a spouse, the spouse's address on such things as driver's license, voter registration, vehicle registration, etc., should be checked out;

(j) Employer and withholding information, nature of taxpayer's employment (traveling salesperson, etc.);

(k)(1) Location of taxpayer.

(2) How often and for how long taxpayer is present at the locations at issue;

(l) Location of immediate family, such as spouse and children;

(m) Length of time in Arkansas of taxpayer and immediate family;

(n) Community affiliations, such as club memberships, church, bank accounts, etc.; and

(o) Absence of factors in other states.

(o) **Resident — Arkansas Code § 26-51-102(9).** Any natural person domiciled in the State of Arkansas or any other person who maintains a permanent place of abode within Arkansas and spends in the aggregate more than six (6) months of the tax year within Arkansas.

(p) **Revocable trust — Arkansas Code § 26-51-102.**

(1) A trust in which the settlor (that is, grantor or creator of the trust) reserves the right to revoke the trust.

(2) The settlor would be considered to be the "owner" of such a trust.

(3)(A) Therefore, revocable trusts may be treated as grantor trusts under certain circumstances.

(B) I.R.C. § 671 et seq., Reg. 1.676(a).

(q) **Trust — Arkansas Code § 26-51-102.**

(1) Any arrangement whereby property is transferred with the intention that it be administered by a trustee for another's benefit.

(2) A trust can be created for any purpose that is not:

- (A) Illegal; and
- (B) Against public policy.

(3) The essential elements of a trust are:

- (A) A designated beneficiary and trustee;
- (B) A fund or other property sufficiently identified to enable title to pass to the trustee; and
- (C) Actual delivery to the trustee with the intention of passing title to the trustee.

(4) A fiduciary relationship exists between the trustee and beneficiary.

(r) Trust taxability — Arkansas Code § 26-51-102 — Fiduciary Return, AR1002 — Extension of Time, AR1055.

(1) Trust income is normally taxed to:

- (A) The trust itself, if retained by the trust; or
- (B) The beneficiary, if distributed.

(2) Thus, if the fiduciary (that is, trustee) passes on income to the beneficiary, the trust deducts the distributed income, which then becomes taxable to the beneficiary.

(3)(A) What would be gross income in the hands of an individual is gross income when received by a trust – dividends, interest, rents, royalties, capital gains, ordinary gains, etc.

(B) I.R.C. Reg. 1.641(a)-2.

(4)(A) Gross income includes income:

- (i) Accumulated or held for future distribution under the terms of a trust;
- (ii) That is currently distributable; and
- (iii) That, in the fiduciary's discretion, may be either accumulated or distributed.

(B) I.R.C. § 641(a).

(5)(A) A trust is taxed as a corporation if it:

(i) Has been created or used during the tax period to carry on a business; and

(ii) Has corporate characteristics such as centralized management, continuity of existence, limited liability, etc.

(B) I.R.C. Reg. 301.7701-4(b).

(6) Deductions and credits allowed to trusts are basically those allowed to individuals.

(7)(A) When a trust terminates, it:

(i) Ends as a separate tax entity; and

(ii) No longer reports gross income or claims deductions, credits, etc.

(B) I.R.C. Reg. 1.641(b)-3(d).

(8)(A) Though the duration of a trust may depend on the occurrence of a particular event under the trust instrument, e.g., the life beneficiary reaching a specified age, for tax purposes the trust will nevertheless continue for a reasonable period beyond this time to allow for the orderly completion of administration.

(B) I.R.C. Reg. 1.641(b)-3(b).

(s) Trustee — Arkansas Code § 26-51-102(8).

(1) A person who holds legal title to property in trust for the benefit of another person or people (that is, the beneficiaries).

(2) A trustee is one who is appointed, or required by law, to execute a trust.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. The Small Business Entity Tax Pass Through Act, Arkansas Code § 4-32-101 et seq., was repealed by Acts 2021, No. 1041, § 1.

I.R.C. Reg. 301.7701-2(a)(1) is codified at 26 C.F.R. § 301-7701-2.

I.R.C. Reg. 301.7701-2(a)(3) is codified at 26 C.F.R. § 301.7701-2.

I.R.C. Reg. 1.641(a)-2 is codified at 26 C.F.R. § 1.641(a)-2.

I.R.C. § 641(a) is codified at 26 U.S.C. § 641(a).

I.R.C. § 641(a)(3) is codified at 26 U.S.C. § 641(a)(3).

I.R.C. Reg. 1.641(b)-3(a) is codified at 26 C.F.R. § 1.641(b)-3(a).

I.R.C. § 7701(a)(6) is codified at 26 U.S.C. § 7701(a)(6).

I.R.C. Reg. 1.671-3 is codified at 26 C.F.R. § 1.671-3.

I.R.C. § 671 et seq. is codified at 26 U.S.C. § 671 et seq.

I.R.C. § 761(a) is codified at 26 U.S.C. § 761(a).

I.R.C. § 761(c) is codified at 26 U.S.C. § 761(c).

I.R.C. Reg. 1.761-1(c) is codified at 26 C.F.R. § 1.761-1(c).

I.R.C. Reg. 1.761-1(a) is codified at 26 C.F.R. § 1.761(a).

I.R.C. § 7704(a) is codified at 26 U.S.C. § 7704(a).

I.R.C. § 7704(b) is codified at 26 U.S.C. § 7704(b).

I.R.C. § 7704(c) is codified at 26 U.S.C. § 7704(c).

I.R.C. Reg. 1.676(a) is codified at 26 C.F.R. § 1.676(a)-1.

I.R.C. Reg. 1.641(a)-2 is codified at 26 C.F.R. § 1.641(a).

I.R.C. § 641(a) is codified at 26 U.S.C. § 641(a).

I.R.C. Reg. 301.7701-4(b) is codified at 26 C.F.R. § 301.7701-4(b).

I.R.C. Reg. 1.641(b)-3(d) is codified at 26 C.F.R. § 1.641(b)-3(d).

I.R.C. Reg. 1.641(b)-3(b) is codified at 26 C.F.R. § 1.641(b)-3(b).

26 CAR § 100-114. Nonresidents — Arkansas Code § 26-51-202.

(a) Income producing property — Arkansas Code § 26-51-202(a). A

nonresident individual, partnership, trust, or estate that earns income from property (real property or tangible personal property) located within Arkansas or from a business, trade, or occupation carried on within Arkansas shall pay Arkansas income tax at the rates set forth in Arkansas Code § 26-51-201.

(b) Income producing property — Intangible — Arkansas Code § 26-51-202(a).

(1) Income derived by a nonresident from intangible personal property located within Arkansas is not subject to Arkansas income tax.

(2) For example, the interest income earned on a savings account with a bank located in Arkansas by a nonresident account holder would not be subject to Arkansas income tax.

(c) Nonresident generally — Arkansas Code § 26-51-202(b)(1).

(1) A nonresident who earns income attributable to Arkansas must:

(A) Timely file an Arkansas income tax return; and

(B) Remit with the return the full amount of Arkansas income tax due.

(2) The filing of an Arkansas income tax return and the payment of Arkansas income tax by a nonresident shall be done without regard to the income tax laws of the nonresident's resident state.

(d) **Income from trust or estate — Arkansas Code § 26-51-202(d).** A nonresident beneficiary of a trust or estate administered by a resident trustee, executor, or administrator shall not be subject to Arkansas income tax unless the beneficiary's income has been derived by the trust or estate from:

(1) Any interest in real property (real estate) located within Arkansas, including but not limited to the following:

(A) Lease and rental income;

(B) Income from:

(i) Crops;

(ii) Timber;

(iii) Mining; and

(iv) Other land uses; and

(C) The gain from any sale of such real property;

(2) The use of tangible personal property located within Arkansas, including any gain realized from the sale thereof; or

(3) Any unincorporated business located within Arkansas, such as:

(A) An association;

(B) A sole proprietorship;

(C) A partnership; and

(D) A limited liability company (LLC).

(e) **Allocation of income to Arkansas sources — Arkansas Code § 26-51-202(c).** Where a nonresident individual is paid a salary, lump sum payment, or some other form of payment that encompasses work performed both inside and outside of Arkansas, Arkansas income tax should be paid only on that portion of the individual's income that can be reasonably allocated to work performed in Arkansas.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-115. Fiduciaries — Arkansas Code § 26-51-203.

(a) Fiduciaries, generally — Arkansas Code § 26-51-203.

(b) Arkansas income tax shall be levied against and paid by resident fiduciaries on the net income of:

(1) Estates and trusts that has not been distributed (or become distributable) to beneficiaries during the tax year;

(2) Deceased individuals received during the tax year who:

(A) At the time of their death were residents; and

(B) Died during the tax year without having made a return; and

(3) Resident insolvent or incompetent individuals, whether or not any portion thereof is held for the future use of such individuals, where the fiduciary has complete charge of the net income.

(c) Where there are two (2) or more joint fiduciaries, part of whom are nonresidents of Arkansas, the net income taxable to the fiduciaries shall be allocated equally.

(d) The income tax imposed upon a fiduciary shall be a charge against the estate or trust, as opposed to a charge against the fiduciary personally.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-116. Income from sale of home — Arkansas Code § 26-51-305 [repealed].

(a) **One-time exclusion of gain from gross income — Arkansas Code § 26-51-305(a) [repealed].** A taxpayer may make a one-time (i.e., once-in-a-lifetime) election to exclude from his or her gross income the gain realized from the sale or exchange of a home if the following conditions are met:

(1) The taxpayer has reached the age of fifty-five (55) before the date of the sale or exchange; and

(2) During the five-year period ending on the date of the sale or exchange, the home was owned and used by the taxpayer as his or her principal residence for a period of (or periods aggregating) three (3) years or more.

(b) One-time exclusion of gain from gross income — Amount excludable — Arkansas Code § 26-51-305(b) [repealed].

(1)(A) The maximum amount of gain excludable from gross income under this section is one hundred twenty-five thousand dollars (\$125,000).

(B) In the case of a separate return filed by a married taxpayer, the maximum amount allowable shall be sixty-two thousand five hundred dollars (\$62,500) for such taxpayer.

(2) The exclusion from gross income provided by this part can only be taken once by a taxpayer after reaching the age of fifty-five (55).

(3) After this election has been properly taken by a taxpayer, it shall not be available to the taxpayer again.

(4) However, refer to subsection (c) of this section regarding revocation of the election.

(c) One-time exclusion of gain from gross income — Example — Arkansas Code § 26-51-305(c) [repealed].

(1) An election to exclude from gross income the gain realized from the sale or exchange of a home may be made or revoked at any time before the period expires for filing a claim for credit or a refund of income tax paid for the tax year in which the sale or exchange occurred.

(2) If the taxpayer making the election or revocation is married, the taxpayer's spouse must join in the election or revocation.

Example: A taxpayer well above the age of fifty-five (55) sold his long-time principal place of residence in 1994. The taxpayer realized fifty-five thousand dollars (\$55,000) in gain from the sale. In 1995, the taxpayer made his once-in-a-lifetime election to exclude the fifty-five thousand dollars (\$55,000) of gain from his gross income. The taxpayer now wishes to revoke this election, as he anticipates realizing a larger gain on the pending sale of his current residence. Pursuant to Arkansas Code § 26-18-306(i)(1), the taxpayer must file his revocation with the Department of

Finance and Administration within three (3) years from the date his 1994 Arkansas income tax return was filed or two (2) years from the time his 1994 Arkansas income tax due was paid, whichever period expires later.

(d) One-time exclusion of gain from gross income — Husband and wife — Arkansas Code § 26-51-305(d)(1) [repealed]. With respect to excluding from gross income the gain realized from the sale or exchange of a home, both a husband and wife shall be treated as satisfying the age, holding, and use requirements of subsection (a) of this section if all of the following requirements are met:

- (1) The home is held by the husband and wife as either:
 - (A) Joint tenants; or
 - (B) Tenants by the entirety;
- (2) The husband and wife file an Arkansas joint return or "separate on same" return for the tax year in which the home was sold or exchanged; and
- (3) At least one (1) of the spouses satisfies the age, holding, and use requirements of subsection (a) of this section with respect to the home.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. Arkansas Code § 26-51-305 was repealed by Acts 1997, No. 328, § 8.

26 CAR § 100-117. Compensation and benefits from military service — Arkansas Code § 26-51-306.

(a) Exemption amount — Arkansas Code § 26-51-306.

(1) The first six thousand dollars (\$6,000) of service pay or service allowances received by any active duty member of the United States Armed Forces shall be exempt from Arkansas income tax.

(2) All such service pay or allowances received above and beyond six thousand dollars (\$6,000) for any given tax year shall be subject to Arkansas income tax.

(b) Combat pay — Arkansas Code § 26-51-306(a)(4).

(1)(A) For enlisted personnel, gross income shall not include compensation received while on active service in a combat zone or while hospitalized as a result of serving in a combat zone.

(B) I.R.C. § 112(a).

(2)(A) With respect to commissioned officers, gross income shall not include compensation received while:

(i) On active service in a combat zone; or

(ii) Hospitalized as a result of serving in a combat zone.

(B) I.R.C. § 112(b).

(C)(i) The amount of compensation for a commissioned officer that is excludable from gross income is limited to the "maximum enlisted amount".

(ii) The term "maximum enlisted amount" is defined as the highest rate of basic pay payable during the period of combat zone service to any enlisted member of the United States Armed Forces at the highest pay grade applicable to enlisted members.

(c) Service allowances — Arkansas Code § 26-51-306. Service allowances shall include, but not be limited to, the following:

- (1) Veteran's benefits;
- (2) Medical benefits;
- (3) Disability benefits;
- (4) Professional education;
- (5) Moving and storage;
- (6) Group term life insurance;
- (7) Survivor and retirement protection plan premiums;
- (8) Subsistence;
- (9) Uniform;
- (10) Housing;
- (11) Overseas cost of living;
- (12) Evacuation;

(13) Family separation allowances;
(14) Death gratuities;
(15) Interment (burial) allowance;
(16) Various travel allowances;
(17) Dependent benefits; and
(18) When provided in connection with a permanent change of station,
allowances for:

- (A) Dislocation;
- (B) Temporary lodging; and
- (C) Move-in housing.

(d) United States armed services defined — Arkansas Code § 26-51-306.

United States armed services shall include the following:

- (1) United States Army;
- (2) United States Navy;
- (3) United States Air Force;
- (4) United States Marine Corps;
- (5) United States Coast Guard;
- (6) National Guard;
- (7) Reserve units; and
- (8) United States Public Health Service.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. I.R.C. § 112(a) and (b) are codified at 26 U.S.C. § 112(a) and (b).

26 CAR § 100-118. Retirement plans and disability benefits — Arkansas Code § 26-51-307.

(a) Retirement or disability benefits — Arkansas Code § 26-51-307.

(1) The first six thousand dollars (\$6,000) of retirement or disability benefits received by a resident of Arkansas from an in-state or out-of-state retirement plan or program will be exempt from Arkansas income tax if the:

(A) Retirement plan or program is directly related to either public or private employment; and

(B) Arkansas resident is the employee or former employee owner of the plan or the employee or former employee's spouse.

(2) Plans or programs that could fall within the scope of this exemption are:

(A) Pension plans;

(B) Profit sharing plans;

(C) Stock bonus plans;

(D) Employee stock ownership plans (ESOPs);

(E) Annuity plans;

(F) Thrift and savings plans;

(G) Cash or deferred arrangements (CODAs, also known as 401(k) plans);

and

(H) Simplified employee pension (SEP) plans.

(3) An individual retirement account (IRA) will fall outside the scope of this exemption unless it is established by an employer as an SEP.

(b) **Premature distribution — Arkansas Code § 26-51-307.** A premature distribution taken by an Arkansas resident from a retirement plan or program that meets all of the criteria set forth above would qualify for the exemption.

(c) **Divorce — Arkansas Code § 26-51-307.**

(1) A taxpayer's interest in an ex-spouse's employment-related retirement plan or program acquired through a divorce is eligible for this exemption only if the interest was awarded pursuant to a qualified domestic relations order (QDRO).

(2) I.R.C. § 402(e)(1)(A) requires that an alternate payee (i.e., taxpayer) who is a former spouse of a retirement plan participant be treated just like the participant with respect to any payments made to the alternate payee under a QDRO.

(3) Note that Arkansas has adopted Sections 72, 219, 401 – 404, 406 – 416 inclusive, and 457 of the Internal Revenue Code of 1986.

Example: 1. Mary was divorced from James by a decree dated May 4, 1993. 2. As a part of the property settlement contained in the decree, Mary was awarded an interest in James' 401(k) retirement plan pursuant to a qualified domestic relations order (I.R.C. § 414(p)). 3. Mary received seven thousand dollars (\$7,000) from James' 401(k) retirement plan in 1994. 4. Although Mary would report seven thousand dollars (\$7,000) in the gross income section of her Arkansas individual income tax return for 1994, she would be entitled to the six-thousand-dollar exemption and would pay income tax only on the one-thousand-dollar balance of the distribution.

(d) Military-related benefits — Arkansas Code § 26-51-307.

(1) Only the first six thousand dollars (\$6,000) of military retirement pay based on length of service is exempt from Arkansas income tax.

(2) However, pursuant to I.R.C. § 104(a)(4), the full amount of a military disability pension (with no six-thousand-dollar cap) is exempt from Arkansas income tax so long as the pension is for personal injuries or sickness resulting from active service in the United States Armed Forces.

(3) Likewise, military retirement pay, to the extent that it is based upon a military-related disability, would be exempt above and beyond the first six thousand dollars (\$6,000) received.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. I.R.C. § 402(e)(1)(A) is codified at 26 U.S.C. § 402(e)(1)(A).

I.R.C. § 414(p) is codified at 26 U.S.C. § 414(p).

I.R.C. § 104(a)(4) is codified at 26 U.S.C. § 104(a)(4).

26 CAR § 100-119. Tax year — Accounting method — Arkansas Code § 26-51-401.

(a) Method of accounting — Arkansas Code § 26-51-401(a).

(1) It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his or her judgment best suited to his or her purpose.

(2) Arkansas taxpayers must use the same accounting method as that used for federal income tax purposes.

(3) Each taxpayer is required by law to make an income tax return reflecting his or her true and correct income.

(4) Therefore, adequate accounting records and source documents must be retained to justify that the filed income tax returns are a true and correct accounting of the taxpayer's transactions for each tax year.

(5) As a general rule, the accounting records and source documents should be retained for a minimum of six (6) years.

(6) The essential elements are as follows:

(A) In all cases in which the production, purchase, or sale of merchandise of any kind is an income-producing factor, inventories of the merchandise on hand (including finished goods, work in process, raw materials, and supplies) should be taken at the beginning and end of the year and used in computing the net income for the tax year;

(B)(i) Expenditures made during the tax year should be properly classified as between capital and expense.

(ii) That is to say, expenditures for items of plant, equipment, etc., that have a useful life extending substantially beyond the tax year should be charged to a capital account and not to an expense account; and

(C) In any case in which the cost of capital assets is being recovered through deductions for wear and tear, depletion, or obsolescence, any expenditure (other than ordinary repairs) made to restore the property or prolong its useful life should be added to the property account or charged against the appropriate reserve and not to current expenses.

(b) Method of accounting — Arkansas Code § 26-51-401(a).

(1) Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income.

(2) A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency.

(3)(A) All items of gross income subject to taxation shall be included in the gross income for the tax year in which they are received by the taxpayer, and deductions taken accordingly, unless in order to clearly reflect income such amounts are to be properly accounted for as of a different period.

(B) Refer to 26 CAR § 100-121(a).

(4) For instance, in a case where it is necessary to use an inventory, no other accounting method in regard to purchases and sales will correctly reflect income except the accrual method.

(5) A taxpayer is deemed to have received items of gross income that have been credited to or set apart for him or her without restriction.

(6) On the other hand, appreciation in value of property is not an accrual of income to a taxpayer prior to the realization of such appreciation through sale or conversion of the property.

(7) The true income, computed under the Income Tax Act of 1929, Arkansas Code § 26-51-101 et seq., and where the taxpayer keeps books of account, in accordance with the method of accounting regularly employed in keeping such books (provided the method so used is properly applicable in determining the net income of the taxpayer for purposes of taxation), shall in all cases be entered on the income tax return.

(c) **Change in method of accounting — Arkansas Code § 26-51-401(b).** If for any reason the basis of reporting income subject to tax is changed, the taxpayer shall attach to his or her income tax return a copy of the Internal Revenue Service certification or approval of the change in accounting method.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-120. Tax year — Basis for determining liability — Arkansas Code § 26-51-402.

(a) **Tax year — Calendar year versus fiscal year — Arkansas Code § 26-51-402(a).**

(b)(1) Taxable income is computed on the basis of a period of time called a tax year.

(2) A tax year generally is the annual period on the basis of which the taxpayer regularly computes income in keeping its books and records.

(3) The annual period is usually a calendar year or a fiscal year.

(4) A calendar year is a period of twelve (12) months ending on December 31.

(5) A fiscal year is a period of twelve (12) months ending on the last day of any month other than December.

(c) A taxpayer must calculate income using the same tax year as that used on the federal income tax return.

(d) A change of the tax year must be approved by the Internal Revenue Service, and a copy of the approval letter must be attached to the Arkansas income tax return.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-121. Income generally — Arkansas Code § 26-51-403.

(a) **Income generally — Arkansas Code § 26-51-403(b).**

(1) Each year's return should be completed in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return.

(2) The expenses of one (1) year cannot be used to reduce the income of a subsequent year.

(3)(A) A taxpayer has the right to deduct all authorized allowances, and it follows that if he or she does not within any year deduct certain of his or her expenses, losses, interest, taxes, or other charges, he or she cannot deduct them from the income of the next or any succeeding year.

(B) It is recognized, however, that particularly in a going business of any magnitude, there are certain overlapping items of both income and deductions, and so long as these overlapping items do not materially distort the income they may be included in the year in which the taxpayer, pursuant to a consistent policy, takes them into his or her accounts.

(4) Judgments or other binding adjudications, such as decisions of referees and boards of review under workers' compensation laws, on account of damages for patent infringement, personal injuries, or other causes, are deductible from gross income when the claim is so adjudicated or paid, unless taken under other methods of accounting that clearly reflect the correct deduction, less any amount of such damages as may have been compensated for by insurance or otherwise.

(5) If, subsequent to its occurrence, however, a taxpayer first ascertains the amount of a loss sustained during a prior taxable year that has not been deducted from gross income, he or she may:

(A) Render an amended return for such preceding taxable year including such amount of loss in the deductions from gross income; and

(B) File a claim for refund of the excess tax paid by reason of the failure to deduct such loss on the original return.

(6) A loss from theft or embezzlement occurring in one (1) year and discovered in another year is ordinarily deductible for the year in which sustained.

(b) Long-term intergenerational trusts — Arkansas Code § 26-51-403(b).

(1)(A) A long-term intergenerational trust is a trust established for an individual under the age of eighteen (18).

(B) The purpose of the trust is to provide tax-deferred growth of funds for the minor's retirement.

(C) The trustee must be a resident of Arkansas and cannot distribute any of the trust's funds to the beneficiary until the beneficiary reaches the age of fifty-five (55).

(D) Up to four thousand dollars (\$4,000) per year can be contributed to the trust.

(2) **Contributions.** Contributions to the trust are taken as an adjustment (that is, subtracted) from the contributor's gross income for purposes of calculating the contributor's adjusted gross income.

(3) **Earnings.** Income tax on trust earnings is deferred until such time that the earnings are distributed to the trust's beneficiaries.

(4) **Distributions.**

(A) All distributions from the trust, whether principal, earnings, or a combination thereof, are taxable to the beneficiary who receives them.

(B) Prior to August 1, 1997, distributions of trust principal were not taxable, while distributions of trust earnings were taxable.

(C) All distributions from long-term intergenerational security trusts are taxable pursuant to Arkansas Code § 28-72-505(a)(1).

(c) **Border city tax exemption — Texarkana — Arkansas Code § 26-51-403(b)(14).**

(1) Under certain circumstances, as set forth below in 26 CAR § 100-121(c)(2) – (c)(9), the income of residents of Texarkana, Arkansas, and Texarkana, Texas, which would normally be subject to Arkansas income tax, will be exempt from Arkansas income tax due to Arkansas's border city tax exemption as established by Arkansas Code § 26-52-602.

(2) **Definitions.** The following words shall have, when used in this part, the following meanings:

(A) "Individual taxpayer" means a natural person;

(B) "Texarkana, Arkansas, resident" means an individual who maintains a place of abode within the city limits of Texarkana, Arkansas; and

(C) "Texarkana, Texas, resident" means an individual who maintains a place of abode within the city limits of Texarkana, Texas.

(3) Texarkana, Arkansas, residents are exempt from the Arkansas income tax on income received while a bona fide resident of Texarkana, Arkansas, but they shall be required to file an Arkansas income tax return.

(4) Texarkana, Texas, residents are subject to the Arkansas income tax on taxable income earned in Arkansas, other than income earned in Texarkana, Arkansas.

(5) All other residents of Texas, other than those residents of Texarkana, Texas, are subject to the Arkansas income tax on taxable income earned in Arkansas, including Texarkana, Arkansas.

(6) Texarkana, Arkansas, residents are subject to the Arkansas income tax on taxable income earned in Arkansas while a resident of any city other than Texarkana, Arkansas.

(7)(A) Employers shall verify to the State of Arkansas the residency of those employees on whom they do not withhold Arkansas income tax.

(B) Employees shall file the Employee's Withholding Exemption Certificate with the employer if the employee is claiming a Texarkana, Arkansas, residency exemption or a Texarkana, Texas, residency exemption for income earned in Texarkana, Arkansas.

(C) The employer shall keep this certificate with his or her records, under the penalty of being liable for any taxes not properly withheld on his or her employees.

(D) Employers shall also list the names and addresses of all employees during the course of the quarterly tax period or at the time a report is due from the employer.

(8) Information furnished by the employee to the employer shall include the physical location of the employee if his or her mailing address is different from his or her residence address.

(9) An individual taxpayer who is claiming an exemption from Arkansas income tax because of a Texarkana, Arkansas, or a Texarkana, Texas, residence shall verify to the State of Arkansas that he or she is indeed a bona fide resident of Texarkana, Arkansas, or Texarkana, Texas, in a manner that is acceptable to the State of Arkansas.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. Subsection (c) of this section as promulgated prior to codification into the Code of Arkansas Rules provided as follows:

"The Commissioner of Revenues of the State of Arkansas, pursuant to the authority vested in him by Act 118 of 1929, and Act 132 of 1965, with the approval of the Governor, does hereby promulgate the following rules for the orderly administration of Act 48 of 1977, as amended by Act 177 of 1977."

"The effective date of this rule shall be January 1, 1978."

This section as promulgated prior to codification into the Code of Arkansas Rules of 2024 contained a footnote to subdivision (c)(7) of this section as follows:

"*Withholding forms associated with this exemption are: AR-4EC (TX) -- Texarkana employee's withholding exemption certificate.

AR-TX -- Completed by employer and provided to employee, shows wages paid during the preceding tax year that are exempt from Arkansas income tax because of the border city exemption.

AR-3Q-Tex -- Completed by employer. All of the employees' Form AR-TXs (a copy of one for each employee) are attached to the AR-3Q-Tex form and sent in to the Withholding Unit."

26 CAR § 100-122. Gross income generally — Arkansas Code § 26-51-404.

(a) Classes of income — Arkansas Code § 26-51-404(a)(1).

(1) The tax imposed by the Income Tax Act of 1929, Arkansas Code § 26-51-101 et seq., is upon net income.

(2)(A) In the computation of the tax, various classes of income must be considered.

(B)(i) Income, meaning all wealth that flows into the taxpayer other than a mere return of capital, includes the forms of income specifically described as gains and profits, including gains derived from the sale or other disposition of capital assets.

(ii) Many factors must be taken into consideration in accurately determining income, among which are:

(a) Inventories;

(b) Accounts receivable;

(c) Property exhaustion; and

(d) Accounts payable for expenses incurred.

(C) Gross income is all wealth other than a return of capital received during a tax year less income that is, by statutory provisions or otherwise, exempt from the tax imposed by the Income Tax Act of 1929.

(D)(i) Net income is gross income less statutory deductions.

(ii) The statutory deductions are in general, though not exclusively, expenditures other than capital expenditures connected with the production of income.

(b) Income credited to an account — Arkansas Code § 26-51-404(a)(1).

(1) Income that is credited to the account of or set apart for a taxpayer and that may be drawn upon by him or her at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession.

(2) To constitute receipt in such a case the income must be:

(A) Credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made; and

(B) Made available to him or her so that it may be drawn at any time, and its receipt brought within his or her own control and disposition.

(3) A book entry, if made, should indicate an absolute transfer from one (1) account to another.

(4) Where a corporation contingently credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt.

(c) Gross income — Manufacturing, merchandising, and mining — Arkansas Code § 26-51-404(a)(1).

(1) In the case of a manufacturing, merchandising, or mining business, "gross income" means the total sales less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources.

(2) In determining the gross income, subtractions should not be made for:

(A) Depreciation;

(B) Depletion;

(C) Selling expenses;

(D) Losses; or

(E) Items not ordinarily allowable in computing the cost of goods sold.

(d) Gross income — Independent contractor — Arkansas Code § 26-51-404(a)(1). The profit of an independent contractor from a contract with the United States Government must be included in gross income.

(e) Services paid for with other than money — Arkansas Code § 26-51-404(a)(1).

(1)(A) Where services are paid for with something other than money, the fair market value for the item taken in payment is the amount to be included as income.

(B) If the services were rendered at the stipulated prices, in the absence of evidence to the contrary, such price will be presumed to be the fair value of the compensation received.

(2)(A) Compensation paid an employee of a corporation in its stock is to be treated as if the corporation sold the stock for its market value and paid the employee in cash.

(B) When living quarters are furnished to the employees for the convenience of the employer, the ratable value need not be added to the cash compensation of the employee, but where a person receives as compensation for services rendered a salary and in addition thereto living quarters, the value to such person of the quarters furnished constitutes income subject to tax.

(3)(A) Premiums paid by an employer on policies of group life insurance covering the life of its employees, beneficiaries of which are designated by the employees, are not taxable to the extent that these premiums cover the first fifty thousand dollars (\$50,000) worth of coverage.

(B) Premiums paid by an employer to purchase group life insurance in excess of fifty thousand dollars (\$50,000) are reportable as excess compensation to the covered employee with the exception of if:

- (i) The employee is disabled;
- (ii) The employer is directly or indirectly the beneficiary; or
- (iii) A charitable organization is the sole beneficiary.

(f) Notes of indebtedness used in payment — Arkansas Code § 26-51-404(a)(1).

(1) Notes or other evidence of indebtedness received in payment for services and not merely as security for such payment constitutes income to the amount of their fair market value.

(2) The taxpayer receiving as compensation a note regarded as good for its face value at maturity, but not bearing interest, shall treat as income as of the time of receipt the fair discounted value of the note at such time.

(3) Thus, if it appears that such a note is or could be discounted on a six-percent basis, the recipient shall include such note in his or her gross income as to the amount of its face value less discount computed at the prevailing rate for such transactions.

(4) If the payments due on a note so accounted for are made as they become due, they should be included as income in respect of such payment so much thereof as represent recovery of the discount originally deducted.

(g) Scholarships, fellowships, grants, and stipends — Arkansas Code § 26-51-404(a)(1).

(1) A scholarship is a grant of money to further the undergraduate education of the recipient without a quid pro quo to the university or the donor.

(2) A fellowship is a grant of money for the primary purpose of furthering the education and training of the recipient toward a higher degree or for independent research with no corresponding benefit to the donor.

(3) Stipend means wages, salary, or the equivalent thereof, where the context shows that it refers to something given as compensation for services, as for example, where a student for an advanced degree performs services of some type for a school or organization in return for:

- (A) Room;
- (B) Board;
- (C) Tuition; or
- (D) Other equivalent compensation.

(4) Grants made to students for scholarships and fellowships are gifts and therefore not included in taxable income, but stipends are fully taxable.

(5) The Secretary of the Department of Finance and Administration reserves the right to examine the substance of the transaction rather than the name given to it.

(h) Commissions, tips, and other types of compensation — Arkansas Code § 26-51-404(a)(1).

(1) Commissions paid salesmen, compensation for services on the basis of percentage of profit, commissions on insurance premiums, tips, and pay of persons in the service of the State of Arkansas are income to the recipients.

(2) Marriage fees, baptismal offerings, sums paid for saying masses for the dead, and other contributions received by clergymen, evangelists, or religious workers for services rendered are also income to the recipient.

(i) Farm defined — Arkansas Code § 26-51-404(a)(1).

(1) The term “farm” includes:

- (A) Stock, dairy, poultry, fruit, and truck farms;
- (B) Plantations;
- (C) Ranches; and
- (D) All land used for farming operations.

(2) The term farm does not include tree farms except those farms that have trees bearing fruit or nuts.

(j) Gain on sale of property or capital assets — Arkansas Code § 26-51-404(a)(1).

(1) When property is acquired and later sold for an amount in excess of the cost or other basis, the gain on the sale is income.

(2) When a corporation sells its capital assets in whole or in part it shall include in its gross income for the tax year in which the sale was made the gain from such sale computed as provided in Arkansas Code §§ 26-51-411 – 26-51-413.

(3) If the purchaser takes over all of the assets and assumes the liability, the amount so assumed is part of the selling price.

(k) Annuities and endowment contracts — Arkansas Code § 26-51-404(a)(1).

(1) Amounts received as an annuity under an annuity or endowment contract are in general subject to tax to the extent that the aggregate amounts received by the annuitant exceed the amounts paid as a consideration of the contract.

(2)(A) An annuity contract charged upon devised property is taxable income to the annuitant whether paid by the devisee out of the income of such properties or other sources.

(B) The devisee is not:

(i) Required to return as gross income the amount of the proceeds paid to the donee annuitant; and

(ii) Entitled to deduct from his or her gross income any sums paid to the annuitant.

(3) The amounts received by an insured as a return of premiums paid by him or her under life insurance, endowment, or annuity contracts, such as the so-called "dividend" of a mutual insurance company that may be credited against the current premium, are not subject to tax.

Example: Brown received ten thousand dollars (\$10,000) on a ten-year endowment contract that matured in 1993. He had paid premiums of eight thousand five hundred dollars (\$8,500) and had received dividends of two hundred dollars (\$200) before the contract matured. Brown's cost to be recovered tax free is eight thousand three hundred dollars (\$8,300) (\$8,500 minus \$200).

(4) The annuity starting date is the first day of the first period for which a benefit is received as a payment under the annuity contract or on the fixed date in the contract, whichever is later.

(5) Investment in the contract is the total aggregate premiums paid plus other consideration less amounts received prior to the annuity starting date that were not included in gross income.

(l) Cost basis of divided tract of land — Arkansas Code § 26-51-404(a)(1).

(1) Where a tract of land is purchased with an intent of dividing it into lots or parcels of ground to be sold as such, the cost or other basis shall be equitably apportioned to the several lots or parcels and made a matter of record on the books of the taxpayer, to the extent that any gain derived from the sale of any such lots or parcels that constitutes taxable income may be reported as income for the tax year in which the sale is made.

(2) This subsection contemplates that there must be a measure of gain or loss on every lot or parcel sold and not measured on the entire tract as a whole.

(3) The sale of each lot or parcel must be treated as a separate transaction and gain or loss computed accordingly.

(m) Buildings and lease-hold improvements — Arkansas Code § 26-51-404(a)(1).

(1) When buildings are erected or improvements made by a lessee in pursuance of an agreement with the lessor and such buildings or improvements are not subject to removal by the lessee, the lessor may at his or her option report the income therefrom upon either of the following basis:

(A) The lessor may report as income, at the time when such buildings or improvements are completed, the fair market value of such buildings or improvements subject to the lease; or

(B) The lessor may spread over the life of the lease the estimated depreciated value of such buildings or improvements at the termination of the lease and report as income for each tax year of the lease an allocated part thereof.

(2)(A) If, for any other reason than a bona fide purchase from the lessee by lessor the lease is terminated, so that the lessor comes into possession or control of the property prior to the time originally fixed for the termination of the lease, the lessor receives additional income for the tax year in which the lease is so terminated to the extent that the value of such buildings or improvements when he or she became entitled to such possession exceeds the amount already reported as income on account of the erection of such buildings or improvements.

(B) No appreciation in value due to causes other than the premature termination of the lease shall be included.

(3) Conversely, if the buildings or improvements are destroyed prior to the expiration of the lease, the lessor is entitled to deduct as a loss for the tax year when such destruction takes place the amount previously reported as income because of the erection of such buildings or improvements, less any salvage value subject to the lease to the extent that such loss was not compensated for by insurance.

(n) Long-term contracts — Arkansas Code § 26-51-404(a)(1).

(1) Income from long-term contracts is taxable for the period in which the income is determined, such determination depending upon the nature and terms of the particular contract.

(2) Arkansas taxpayers must use the same accounting method as that used for federal income tax purposes.

(o) Stock dividends and distributions from regulated investment companies — Arkansas Code § 26-51-404(a)(1).

(1) The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders but the gain so derived or loss sustained from the sale of such stock, or from the sale of the stock in respect to which it is issued.

(2) Distributions received by shareholders from regulated investment companies are, by reason of the shareholder's option to receive the equivalent of cash or new stock, deemed to be a cash dividend and therefore taxable.

(p) Interest — Arkansas Code § 26-51-404(a)(1).

(1)(A) When interest coupons have matured and are payable but have not been cashed, such interest, though not collected when due and payable, shall be included in gross income for the year during which the coupons mature, unless it can be shown that there are no funds available for payment of the interest during such year.

(B) The interest shall be included in gross income even though the coupons are exchanged for other property instead of eventually being cashed.

(C) Defaulted coupons are income for the year in which paid.

(2) Dividends on corporate stock are subject to tax when unqualifiedly made subject to the demand of the shareholder.

(3) As for the distributive share of the profits in a partnership, see 26 CAR § 100-123(d).

(4) Interest credited on savings bank deposits, even though the bank has a rule, seldom or never enforced, that it may require so many days' notice before withdrawals are permitted, is income to the depositor when credited.

(5)(A) An amount credited to shareholders of a building and loan association, when such credit passes without restriction to the shareholder, shall be included in taxable income for the year of the credit.

(B) Where the amount of such accumulations does not become available to the shareholder until the maturity of a share, the amount of any share in excess of the aggregate amount paid in by the shareholder is income for the year of the maturity of the share.

(q) Installment sales — Personal property — Arkansas Code § 26-51-404(a)(2).

(1)(A) Dealers who sell personal property on the installment plan may elect to report the income on installment sales over the life of the installment contract provided the initial payment is thirty percent (30%) or less.

(B) The rule prescribed is that a person who regularly sells or otherwise disposes of personal property on the installment plan, whether or not title remains in the vendor until the property is fully paid for, may report as income therefrom, in any tax year, the portion of the installment payments actually received in that tax year which the total or gross profit (i.e., payments less cost of goods sold) realized or to be realized when the property is paid for bears to the total contract price.

(C) Thus, the income of a dealer in personal property on the installment plan may be ascertained by taking as income that proportion of the total payments received in the tax year from installment sales (such payments being allocated to the tax year against the sales to which they apply) that the total or gross profit realized or to be realized on the total installment sales made during each tax year bears to the total contract price of all such sales made during that respective tax year.

(D) A dealer who desires to compute his or her income on the installment basis shall maintain books of account in such a manner as to enable an accurate computation to be made on such basis in accordance with the provisions of this part.

(2)(A) In the case of a casual sale or other casual disposition of personal property other than property of any kind that would properly be included in the inventory of a taxpayer if on hand at the close of the tax year, income may be reported on the installment basis.

(B) This method of reporting sales may be utilized provided the payments received in cash or property other than evidences of indebtedness of the purchaser

during the tax year in which the sale or other disposition is made do not exceed thirty percent (30%) of the sale price.

(3) If for any reason the purchaser defaults on any of his or her payments and the vendor reporting income on the installment basis repossesses the property, the entire amount received in installment payments and retained by the vendor less the sum of the profits previously reported as income and an amount representing proper allowance for damage and use, if any, will be income of the vendor for the tax year in which the property is repossessed, and the property repossessed must be carried on the books of the vendor at its original cost less proper allowance for damage and use, if any.

(4) If the vendor chooses, as a matter of consistent practice to report the income from installment sales on the straight accrual or cash receipts and disbursement basis such a course is permissible.

(5)(A) Arkansas did not adopt the federal treatment of installment sales contained in I.R.C. § 453(c) referred to as installment receivables until January 1, 1995.

(B) This subsection refers only to tax years beginning before January 1, 1995.

(r) Installment sales — Real estate — Arkansas Code § 26-51-404(a)(2).

(1)(A) Sales of real estate in which thirty percent (30%) or less of the sale price is received in the year the sale is consummated may be reported on the installment basis.

(B) The vendor may report as income from such transaction in any tax year that proportion of the installment payment actually received in that tax year which the total profit realized, or to be realized when the property is paid for, bears to the total contract price.

(2)(A) In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall be included as a part of the selling price.

(B) However, the amount of the mortgage to the extent it does not exceed the price to the vendor of the property sold, shall not be considered as a part of

the initial payments or of the total contract price in determining the application of installment basis in the reporting of income.

(C) Commissions and other selling expenses paid or incurred by the vendor are not to be deducted or taken into account in determining the amount of the:

- (i) Initial payment;
- (ii) Total contract price; or
- (iii) Selling price.

(3)(A) If for any reason the purchaser defaults in any of his or her payments and the vendor, reporting income on the installment basis, repossesses the property, the entire amount received in installment payments and reported by the vendor less the sum of the profits previously reported as income and an amount representing proper adjustment for exhaustion, wear and tear, obsolescence, amortization, and depletion of the property while in the hands of the purchaser, will be income of the vendor for the tax year in which the property is repossessed.

(B) The basis of the property in the hands of the vendor will be the original basis at the time of the installment sale.

(4) If the vendor consistently chooses to report the income from installment sales on the accrual or cash receipt and disbursement basis, the sales will not be treated as being on an installment plan.

(5) Where real property is sold and the seller accepts indebtedness secured by the real property in return and later repossesses the property, the gain is limited and no loss shall result to the seller because of the repossession of the property.

(6) Gain on repossession shall be limited to the lesser of:

(A) Total payments received before repossession less the amount of the gain from original sale reported as income before repossession; or

(B)(i) The gain on the original sale (selling price less adjusted basis) reduced by income reported before repossession and by repossession costs.

(ii) Repossession costs include money or fair market value of property paid or transferred by seller in connection with repossession.

Example: In 1990, Brown sold property for sixty thousand dollars (\$60,000) having an adjusted basis of forty-eight thousand dollars (\$48,000). Brown qualifies for reporting the twelve-thousand-dollar gain (twenty percent (20%) of selling price) by accepting an initial payment of ten thousand dollars (\$10,000) and evidence of fifty thousand dollars (\$50,000) liability secured by the property to be paid in five (5) annual payments of ten thousand dollars (\$10,000). In 1994, the purchaser defaulted and Brown, at a cost of five hundred dollars (\$500), repossessed the property. Prior to repossession, Brown had received payments amounting to forty thousand dollars (\$40,000) and had reported eight thousand dollars (\$8,000) as taxable gain. Brown's recognized gain on repossession is as follows:

Gain on original sale (selling price less adjusted basis)	\$12,000
Less: Gain previously reported	<u>- 8,000</u>
	\$ 4,000
Less: Recognized expense	<u>- 500</u>
Recognized gain	<u>\$ 3,500</u>

The basis of the repossessed property is \$20,000.

Defaulted obligation	\$20,000
Less: 20% gain included	<u>- 4,000</u>
Adjusted obligation	\$16,000
Plus: Repossession gain	+ 3,500
Plus: Repossession cost	<u>500</u>

Basis of repossessed property

\$20,000

(7) This subsection only applies to tax years beginning before January 1, 1995.

(s) Gain on sale — Involuntary conversion — Arkansas Code § 26-51-404(b)(1).

(1) Section 1033 of the Internal Revenue Code of 1986, as in effect on January 1, 1999, relating to the exclusion from gross income of gain resulting from the involuntary conversion of a taxpayer's property, has been adopted for the purpose of computing Arkansas income tax liability.

(2) In any case where the taxpayer elects to replace or restore the converted property, but it is not practical to do so immediately, see 26 CAR § 100-127(d) for procedure.

(3) The special rules for property damaged in a presidentially declared disaster are found at I.R.C. § 1033(h).

(t) Gain on sale or exchange of principal residence — Arkansas Code § 26-51-404(b)(2).

(1) Gross income shall not include the gain resulting from the sale or exchange of real estate located within Arkansas when all of the following conditions are met:

(A) The real estate sold or exchanged by the taxpayer was the taxpayer's principal residence;

(B)(i) The taxpayer uses the gain within a four-year period, beginning two (2) years prior to the date of sale or exchange and ending two (2) years after that date, to purchase, build, or restore a new parcel of real estate.

(ii) This exclusion from gross income shall only apply to that portion of the "gain" actually used to purchase, build, or restore the new parcel of real estate;

(C) The new parcel of real estate is located within Arkansas; and

(D) The new parcel of real estate is used or will be used by the taxpayer as his or her principal place of residence.

(2) Gain shall be computed as set forth in Arkansas Code § 26-51-411(d).

(u) Life insurance proceeds — Arkansas Code § 26-51-404(b)(3).

(1)(A) Section 101 of the Internal Revenue Code of 1986, as in effect on January 1, 1997, has been adopted for the purpose of excluding from gross income the proceeds paid under life insurance policies on behalf of a chronically ill, terminally ill, or deceased insured.

(B) For treatment of accelerated death benefits, see I.R.C. § 101(g)(1).

(2)(A) The proceeds of life insurance policies paid by reason of the illness or death of an insured to his or her estate or to any beneficiary (individual, partnership, or corporation but not to a transferee for valuable consideration), directly or in trust, are excluded from the gross income of the beneficiary.

(B) It is immaterial whether the proceeds are received in a single sum or in installments.

(C) If, however, such proceeds are held by the insurer under an agreement to pay interest thereon, the interest payments must be included in gross income.

(3) Amounts received (other than amounts paid by reason of the illness or death of the insured and interest payments on such amounts) under a life insurance, endowment, or annuity contract are excluded from gross income, but if such amounts (when added to amounts received before the tax year under such contract) exceed the aggregate premium or consideration paid (whether or not paid during the tax year) then the excess shall be included in gross income.

Example 1: Life insurance, endowment contracts, amounts paid other than by reason of the death of the insured.

Received in 1994	\$ 5,000
------------------	----------

Received in prior years	<u>5,000</u>
-------------------------	--------------

Total	\$10,000
-------	----------

Aggregate premiums paid	<u>\$ 4,000</u>
-------------------------	-----------------

Example 4: Life insurance, endowment contracts, or annuities may be transferred for a consideration and the proceeds of the contract payable to a transferee for reasons other than the death of the insured. In 1994, transferee realized on maturity of the contract seventy-five thousand dollars (\$75,000). At time of transfer, transferee paid forty thousand dollars (\$40,000) for the contract and paid subsequent premiums totaling twenty thousand dollars (\$20,000).

Transferee's Gain	
Amount realized	\$75,000
Paid for contract	\$40,000
Total premiums paid	<u>20,000</u>
	<u>60,000</u>
Taxable Gain	<u>\$15,000</u>

If the proceeds are received as an annuity over a fixed number of years, the annual payment is excludable from income until the aggregate payments equal the cost of the contract of sixty thousand dollars (\$60,000).

(v) Gifts — Arkansas Code § 26-51-404(b)(4).

(1) A gift is where a capable donor with the intention of making a gift completes delivery of a property to a donee who, in turn, accepts the property.

(2) Property received as a gift is exempt from income tax, although the income therefrom derived from investment, sale, or otherwise, is taxable.

(w) Bequests, devise, or descent — Arkansas Code § 26-51-404(b)(5).

(1) A bequest is a gift by will of personal property.

(2) A devise is a gift of real property by the last will and testament of the donor.

(3) A bequest or devise received by a legatee under the provisions of a will or by an heir in accordance with the statutes of descent and distribution is tax exempt, but not the income therefrom.

(x) Interest — Obligations of the United States or its possessions — Arkansas Code § 26-51-404(b)(5).

(1) Interest earned on obligations of the United States or its possessions is not included in gross income.

(2) "Obligations of the United States" means any United States Government obligation used to finance the national debt, e.g., United States Treasury bills or any other instrument acknowledged by the United States Secretary of the Treasury as an obligation of the United States Government.

(3) These obligations must:

(A) Be specifically exempt from state taxation by United States laws; or

(B)(i) Meet the four (4) criteria established by *Smith v. Davis*, 323 U.S. 111, 114 (1944).

(ii) The requirements are that the obligations must:

(a) Be in writing;

(b) Bear specific interest;

(c) Bind the United States to pay specific sums at specific dates;

and

(d) Have congressional authority to pledge the full faith and credit of the United States in support of the promise to pay.

(iii)(a) As an example, interest received from the Federal National Mortgage Association, Government National Mortgage Association, and Federal Home Loan Mortgage Corporation does not meet all four (4) of the above stated requirements and is not tax exempt.

(b) This is not intended to be an all-inclusive list.

(y) Interest — Obligations of the State of Arkansas — Arkansas Code § 26-51-404(b)(5).

(1) Interest earned on obligations of the State of Arkansas or any political subdivision thereof is not included in gross income.

(2) "Obligations of the State of Arkansas" means any obligation backed by credit of the State of Arkansas.

(3) "Any political subdivision" means any county, city, or town obligations, including special assessment districts such as:

- (A) Road;
- (B) Water;
- (C) Sewer;
- (D) Reclamation;
- (E) Drainage;
- (F) Levee;
- (G) School; or
- (H) Similar districts.

(z) Social Security benefits — Arkansas Code § 26-51-404(b)(6).

(1) Social Security benefits are excluded from gross income for state income tax purposes.

(2) Thus, amounts received as pensions or annuities under the Social Security Act of 1935, 42 U.S.C. § 301 et seq., or the Railroad Retirement Act are excluded from gross income.

(aa) Unemployment benefits paid by organized union — Arkansas Code § 26-51-404(b)(6).

(1) Amounts paid by an organized union as unemployment benefits to its unemployed members are taxable where the benefits are paid through union dues.

(2)(A) Where union members make special payments to a fund, unemployment benefits that they receive from the fund are includible in gross income only to the extent they exceed the recipient's contributions.

(B) The amounts contributed to the fund are not deductible.

(bb) Unemployment benefits paid by state or federal agency — Arkansas Code § 26-51-404(b)(6).

(1) Unemployment insurance benefits received from a state agency from funds received from the federal Unemployment Trust Fund are not taxable.

(2) Unemployment insurance benefits received from the United States Railroad Retirement Board are not includible in gross income.

(3) Unemployment compensation paid to federal employees by state or federal agencies is excludable from gross income.

(cc) Cancellation or forgiveness of debt — Arkansas Code § 26-51-404(b)(10).

(1) The cancellation and forgiveness of indebtedness may amount to a payment of income, to a gift, or to a capital transaction, dependent upon the circumstances.

(2) If, for example, an individual performs services for a creditor who in consideration thereof cancels the debt, income to that amount is realized by the debtor as compensation for his or her services.

(3) If, however, a creditor merely desires to benefit a debtor and, without any consideration therefore, cancels the debt, the amount of the debt:

(A) Is a gift from the creditor to the debtor; and

(B) Need not be included in the latter's gross income.

(4) If a shareholder in a corporation that is indebted to him or her gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation.

(dd) Cafeteria plan and flexible spending arrangements — Taxability of benefits — Arkansas Code § 26-51-404(b)(11).

(1)(A) "Qualified benefits", as defined in I.R.C. § 125(f), received through a cafeteria plan or flexible spending arrangement (FSA) are excluded from the taxpayer's gross income.

(B) However, the term "qualified benefits" does not include benefits paid by an employer towards long-term care insurance premiums or long-term care services.

(C) Such benefits paid on behalf of the employee/taxpayer through a cafeteria plan or FSA are includable in the taxpayer's gross income.

(2)(A) It should be noted that under certain circumstances, expenses incurred by a taxpayer for qualified long-term care services and eligible long-term care insurance premiums may be taken as an itemized deduction.

(B) This deduction for unreimbursed medical expenses can be taken only to the extent such expenses exceed seven and one-half percent (7.5%) of the taxpayer's AGI.

(C) I.R.C. § 213(d)(1)(C) and (D).

(3)(A) "Qualified long-term care services" are necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services, as well as maintenance or personal care services that are:

(i) Required by a chronically ill individual; and

(ii) Provided under a plan of care prescribed by a licensed healthcare practitioner.

(B) I.R.C. § 7702B(c)(1).

(4)(A) Eligible long-term care insurance premiums may be deductible as medical expenses when such premiums are paid towards qualified long-term care insurance.

(B) The definition of "qualified long-term care insurance" is set forth in I.R.C. § 7702B(b)(1).

(ee) **Lawsuit damages — Arkansas Code § 26-51-404(b)(15).**

(1) Compensatory and punitive damages are includable in gross income unless the damages are received on account of a personal physical injury or physical sickness.

(2) If an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow from that injury or sickness are treated as payments received on account of physical injury or physical sickness, whether or not the recipient of the damages is the injured party.

(3)(A) However, punitive damages are includable in gross income even if they are received on account of a personal physical injury or physical sickness.

(B) I.R.C. § 104(a)(2).

(5) The taxability of damages remains the same whether the damages are received as a settlement or jury award.

Example: Damages (other than punitive damages) received by an individual on account of a claim for loss of consortium due to the physical injury or physical sickness of that individual's spouse are excludable from gross income.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. "AGI" means adjusted gross income.

I.R.C. § 453(c) is codified at 26 U.S.C. § 453(c).

I.R.C. § 1033(h) is codified at 26 U.S.C. § 1033(h).

I.R.C. § 101(g)(1) is codified at 26 U.S.C. § 101(g)(1).

I.R.C. § 213(d)(1)(C) and (D) is codified at 26 U.S.C. § 213(d)(1)(C) and (D).

I.R.C. § 7702B(c)(1) is codified at 26 U.S.C. § 7702B(c)(1).

I.R.C. § 7702B(b)(1) is codified at 26 U.S.C. § 7702B(b)(1).

I.R.C. § 104(a)(2) is codified at 26 U.S.C. § 104(a)(2).

26 CAR § 100-123. Partnership income — Arkansas Code § 26-51-405.

(a) Partnership income generally — Arkansas Code § 26-51-405.

(1) Partnership income must be allocated to the state where it was actually earned.

(2) All partnership income from activities carried on within Arkansas shall be allocated to Arkansas.

Example: A partnership composed of two (2) partners earned one hundred thousand dollars (\$100,000) during the tax year. One (1) partner resides in Arkansas and the other in Louisiana. Thirty thousand dollars (\$30,000) of the partnership's income is allocable to activity carried on in Arkansas by, or on behalf of, the partnership. Each partner's distributive share of the partnership's income is fifty percent (50%). Therefore, the Arkansas-based partner would report fifteen thousand dollars (\$15,000) in gross income on his or her resident Arkansas individual income tax return and the Louisiana-based partner would report fifteen thousand dollars (\$15,000) in gross income on his or her nonresident Arkansas individual income tax return. Because a portion of the partnership's income was allocable to Arkansas, the partners will need to file a partnership tax return (AR1050) with the State of Arkansas.

(b) Partnership composite return — Arkansas Code § 26-51-405.

(1) Before the Department of Finance and Administration will allow a composite individual income tax return ("block filing"), certain conditions must be agreed to.

(2) Those conditions are as follows:

(A) The Revenue Division of the Department of Finance and Administration must be provided with the names of all relevant partners;

(B)(i) Each composite or block return must be filed in the name of the partnership, and the partner that signs the return will be responsible for any assessments or deficiencies incurred by the return.

(ii) This requirement does not relieve any of the partners from their personal liability in any way;

(C)(i) The total net taxable income in Arkansas must be reported on form AR1000.

(ii) Tax will be computed at a flat seven percent (7%) tax rate;

(D)(i) Partners who become or are residents of Arkansas, or who have income or losses from Arkansas sources other than from the partnership, will be excluded from the block filing.

(ii) Only those partners who must file Arkansas nonresident individual income tax returns as a result of their interest in the partnership will be included in the proposed block filing; and

(E)(i) The agreement to allow composite or block filing will be reviewed annually, and the agreement is revocable at the option of the division.

(ii) Permission to file a composite return must be obtained from an Individual Income Tax Section Manager before such a return is filed.

(c) Partnerships — Arkansas Code § 26-51-405(a).

(1) A partnership must keep records showing the participation of the partners, the interest owned by them, duties performed, and services rendered in the operation of the business.

(2) A partnership as such is not subject to taxation but it must make a return of income, which return properly reflects the net income for each partner.

(3) Individuals carrying on business in partnership are:

(A) Taxable upon their distributive shares of the net income of such partnerships, whether distributed or not; and

(B) Required to include such distributive shares in their individual returns.

(d) Distributive share of partnership income — Arkansas Code § 26-51-405(a).

(1) The distributive share of the net income of the partnership that a partner is required to include in his or her return is his or her proportionate share of the net income of the partnership, either:

(A) For the taxable year upon the basis of which the partner's net income is computed; or

(B) If the partner's net income is computed upon the basis of a taxable year different from that upon the basis of which the net income of the partnership is computed, for the taxable year of the partnership ending within the taxable year upon the basis of which the partner's net income is computed.

(2) Amounts earned and distributed to a partner by a partnership after the end of its taxable year and before the end of his or her corresponding taxable year should be accounted for both by the partnership and by the partner in their returns for their next succeeding taxable year.

(3) Where the results of partnership operation is a net loss, the loss:

(A) Will be divisible by the partners in the same proportion as net income would have been divisible or, if the partnership agreement provides for the division of a loss in a manner different from the division of a gain, in the manner so provided; and

(B) May be taken by the individual partners in their returns of income.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-124. Federal Subchapter S adopted — Arkansas Code § 26-51-409.

(a) **I.R.C. Subchapter S adopted — Arkansas Code § 26-51-409.** Subchapter S of the Internal Revenue Code of 1986, as in effect on January 1, 1997, regarding small business corporations, has been adopted for the purpose of computing Arkansas income tax liability.

(b) **Corporations that must file as a Subchapter S corporation — Arkansas Code § 26-51-409.**

(1) Corporations incorporated in Arkansas, registered to conduct business within Arkansas, or having income from Arkansas sources must file an income tax return with the State of Arkansas.

(2) Such corporations must file a Subchapter S corporation income tax return (AR1100S) with the State of Arkansas if the:

(A) Corporation elected, by filing Form AR1103, to be taxed as a Subchapter S corporation within seventy-five (75) days of incorporation;

(B) Election was accepted by the State of Arkansas; and

(C) Election remains in effect.

(3) Having "income from Arkansas sources" means income derived from property located within Arkansas or from business activity carried on within Arkansas.

(c) **Applicable rules — Generally — Arkansas Code § 26-51-409.** The rules of Subchapter C (corporate distributions, liquidations, contributions, and reorganizations) apply to Subchapter S corporations, unless the Internal Revenue Code or Arkansas law otherwise provides or a Subchapter C rule is inconsistent with a Subchapter S rule.

(d) **Subchapter S corporation — Auditing — Arkansas Code § 26-51-409.**

(1) Subchapter S corporations are generally audited on a shareholder-by-shareholder basis.

(2) The general rule is that a Subchapter S corporation's taxable income is computed under the rules that apply to individuals.

(e) **Consistency between Subchapter S corporation returns and shareholders' returns — Arkansas Code § 26-51-409.**

(1) A Subchapter S corporation shareholder should generally treat a Subchapter S item on his or her own individual income tax return consistently with the treatment of that item on the Subchapter S corporation's return.

(2)(A) If the shareholder treats an item or items inconsistently between his or her return and the corporation's return, the shareholder must notify the Individual Income Tax Section of the Department of Finance and Administration (as well as the Internal Revenue Service) of the inconsistency.

(B) This notification should be provided on IRS Form 8082.

(f) **Reporting Subchapter S corporation income, loss, deductions, and credits — Arkansas Code § 26-51-409(c)(1).**

(1) All resident and nonresident shareholders of corporations that have elected to be taxed by Arkansas as Subchapter S corporations and who receive a share of the

corporation's income, loss, deductions, or credits must file an Arkansas individual income tax return reporting the share so received.

(2)(A) However, a nonresident shareholder of such a corporation shall only be required to file an Arkansas individual income tax return if some or all of his or her share of the corporation's income, loss, credits, or deductions are attributable to Arkansas sources.

(B) When an Arkansas return is required to be filed, the nonresident must report all of his or her gross income on his or her Arkansas nonresident return pursuant to Arkansas Code §§ 26-51-435 and 26-51-504.

(3) Moreover, a shareholder's share of Subchapter S corporation income attributable to Arkansas is subject to Arkansas income tax whether or not it is actually distributed to the shareholder.

(g) Reporting Subchapter S corporation income, loss, deductions, and credits — Shareholder termination — Arkansas Code § 26-51-409(c)(1).

(1) A Subchapter S corporation's items of income, loss, deduction, and credit for its tax year are usually allocated to its shareholders on a per-share, per-day basis.

(2) An equal part of a tax year's items is:

(A) Assigned to each day of the tax year; and

(B) Divided pro rata among the shares outstanding on the day to which it's assigned.

(3)(A) However, if the corporation and all affected shareholders agree, an election could be made to terminate the Subchapter S corporation's tax year when a shareholder terminated his or her interest in the corporation.

(B)(i) The effect of the election is that the tax year of the corporation is treated as if it consists of two (2) tax years, with the first tax year ending on the date on which the shareholder's interest was terminated.

(ii) I.R.C. § 1377(a)(2)(A).

(C) The items of income, loss, deduction, and credit, determined for each separate tax year by closing the books, are allocated on a per-share, per-day basis to shareholders who were shareholders during the separate tax year.

(D)(i) Affected shareholders include:

- (a) The shareholders who terminate their interests; and
- (b) All shareholders to whom the terminating shareholders

transfer their shares during the tax year.

(ii) If shares are transferred to the corporation, all persons who were shareholders during the tax year are treated as affected shareholders.

(iii) I.R.C. § 1377(a)(2)(B).

(h) Subchapter S corporation shareholder basis — Arkansas Code § 26-51-409(c)(1).

(1) A Subchapter S corporation shareholder's basis is significant because:

(A) Distributions in excess of his or her basis may result in gain to the shareholder; and

(B) The shareholder can deduct his or her pro rata share of the corporation's losses only to the extent of his or her adjusted basis in the Subchapter S corporation's stock and debt.

(2)(A) The adjusted basis of the shareholder's stock for purposes of computing the limitation on the amount of the Subchapter S corporation's losses he or she can deduct (the loss limitation) is computed after the basis is reduced by the year's nontaxable distributions made to the shareholder.

(B) I.R.C. § 1366(d).

(3)(A) The adjusted basis of the shareholder's stock for determining the tax effects of the Subchapter S corporation distributions to him or her is determined by increasing the basis for his or her share of the Subchapter S corporation's income items for the year, but without decreasing the basis for his or her share of the Subchapter S corporation's losses for the year.

(B) I.R.C. § 1368.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. I.R.C. § 1377(a)(2)(A) is codified at 26 U.S.C. § 1377(a)(2)(A).

I.R.C. § 1377(a)(2)(B) is codified at 26 U.S.C. § 1377(a)(2)(B).

I.R.C. § 1366(d) is codified at 26 U.S.C. § 1366(d).

I.R.C. § 1368 is codified at 26 U.S.C. § 1368.

26 CAR § 100-125. Inventory — What constitutes inventory — Arkansas Code § 26-51-410.

(a) In order to reflect the net income correctly, inventories at the beginning and end of each year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor.

(b)(1) The inventory should include raw materials and supplies on hand that have been acquired for sale, consumption, or use in productive processes, together with all finished or partly finished goods.

(2) Only merchandise, title to which is vested in taxpayer, should be included in the inventory.

(3) Accordingly, the seller should include in his or her inventory goods under contract for sale but not yet segregated and applied to the contract and goods out upon consignment but should exclude from inventory goods sold, title to which has passed to the purchaser.

(4) A purchaser should include in inventory merchandise purchased, title to which has passed to him or her, although such merchandise is in transit or for other reasons has not been reduced to physical possession, but should not include goods ordered for future delivery, transfer of title to which has not yet been affected.

(c) There are two (2) tests to which each inventory must conform:

(1) It must conform as nearly as may be to the best accounting practice in the trade or business; and

(2) It must clearly reflect the income.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-126. Gain or loss — Sales of property — Arkansas Code § 26-51-411.

(a) Amount realized on disposition of property — Arkansas Code § 26-51-411(a).

(1)(A) The amount realized from the sale or other disposition of property is the sum of any money received plus the fair market value of the property (other than money) received.

(B) The fair market value of the property is a question of fact, but only in rare and extraordinary cases does the property have no fair market value.

(2)(A) In computing the amount of gain or loss, however, the cost or other basis of the property shall be properly adjusted for any expenditure, receipt, loss, or other item properly chargeable to capital account, including:

(i) The cost of improvements and betterment made to the property since the basic date; and

(ii) Carrying charges such as taxes on nonproductive property.

(B) Where the taxpayer has elected to deduct carrying charges in computing net income or used such charges in determining his or her liability for filing returns of income for prior years, the cost or other basis may not be increased by such items in computing the gain or loss from the subsequent sale of such property.

(C) The cost or other basis of the property must also be decreased by the amount of the deductions for exhaustion, wear and tear, obsolescence, and depletion that have, since the acquisition of the property, been allowable in respect of such property whether or not such deductions were claimed by the taxpayer or formally allowed.

(D) Adjustments to the cost or other basis on account of such allowable deductions as distinguished from the deductions actually taken in prior years will be made only on the basis of explicit and convincing evidence (calculations based upon a theoretical formula are not such evidence) that the deductions taken were insufficient

or excessive, as the case may be, due regard being given to the expenditures made by the taxpayer to maintain the effective usefulness of the property.

(3) In no case shall the amount of the diminution in respect to depletion exceed a depletion deduction computed without reference to discovery in the case of mines, oil, and gas wells.

(4)(A) In the case of stock, the basis must be diminished by the amount of distributions previously made in respect of such stock to the extent that they have been a return of capital.

(B) The provisions of Arkansas Code § 26-51-411 shall not be construed so as to conflict with the provisions of Arkansas Code § 26-51-404(a)(2), which make special provisions for the reporting of income from the sale of property on the installment plan where the initial payment is thirty percent (30%) or less.

(b) Sale of shares of stock — Arkansas Code § 26-51-411(a).

(1)(A) When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots cannot be determined, the stock sold shall be charged against the earliest purchases of such stock.

(B) The excess of the amount realized on the sale over the cost or other basis of the stock will constitute gain.

(2) In the case of stock in respect of which any stock dividend was paid, the basis for determining gain or loss from a sale of a share of such stock shall be the difference between the sale price and the quotient of the cost or other basis of the original shares of stock divided by the total number of the old and new shares.

(3) Where common stock is received as a bonus with a purchase of preferred stock or bonds, the total purchase price shall be fairly apportioned between such common stock and the securities purchased for the purpose of determining the portion of the cost attributable to each class of stock or securities, but if that should be impracticable in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until out of the proceeds of sales shall have been recovered the total cost.

(4)(A) Where a corporation issues to its shareholders rights to subscribe to its stock, the value of the rights does not constitute taxable income to the shareholder, although gain may be derived or loss sustained by the shareholder from the sale of such rights.

(B) In this connection, the following rules may be stated:

(i) If the shareholder does not exercise, but sells, his or her rights to subscribe, the cost or other basis of the stock in respect of which the rights are issues, shall be apportioned between the rights and the stock in proportion to the respective values thereof at the time the rights are issued and the basis for determining gain or loss from the sale of a right on one (1) hand or a share of stock on the other will be the quotient of the cost or other basis assigned to the right or the stock divided, as the case may be, by the number of:

(a) Rights issued; or

(b) Shares held;

(ii)(a) If the shareholder exercises his or her rights to subscribe, the basis for determining gain or loss from a subsequent sale of a share of the stock in respect of which the rights were issued shall be determined as in subdivision (b)(4)(B)(i) of this section.

(b) The basis for determining gain or loss from a subsequent sale of a share of the stock obtained through exercising the rights shall be determined by dividing the part of the cost or other basis of the old shares assigned to the rights plus the subscription price of the new shares by the number of new shares obtained; and

(iii) If the stock in respect of which the rights are issued was purchased at different times and at different prices and the identity of the lots cannot be determined, or if the stock in respect of which the rights are issued was purchased at different times and at different prices and the stock rights issued in respect of such stock cannot be identified as having been issued in respect of any particular lot of such stock, the basis for determining the gain or loss from the sale of the old share or the rights in cases where the rights are sold or from the sale of the old or new shares in

cases where the rights are exercised shall be ascertained by applying the cost or ascertained value of the rights from the earliest purchased stock.

(5) The taxpayer may at his or her option include the entire proceeds from the sale of stock rights in gross income in which the basis for determining gain or loss, from the subsequent sale of stock in respect of which the rights were issued, shall be the same as though the rights had not been issued.

(c) **Sale of real estate or personal property — Arkansas Code § 26-51-411(a).** Sales of real estate or personal property in which more than thirty percent (30%) of the sales price is received in the year in which the sales are consummated will be handled as provided in Arkansas Code § 26-51-411.

(d) **Sale of property acquired by gift — Arkansas Code § 26-51-411(a).**

(1) If the property was acquired by gift, even though the gift was made in contemplation of or was intended to take effect in possession or enjoyment at or after the donor's death, the basis is the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift.

(2)(A) If the donee is unable to ascertain the facts necessary to determine the basis, he or she shall so state upon his or her return and the Income Tax Director will, if possible, obtain such facts from the donor or last preceding owner or any other person cognizant therefore.

(B) If the Income Tax Director finds it impossible to obtain such facts, the basis shall be the last assessed valuation of the property while in the hands of the donor.

(e) **Basis of property acquired on or before March 9, 1929 — Arkansas Code § 26-51-411(a).** In computing the gain or loss from the sale or other disposition of property acquired by gift on or before March 9, 1929, the basis shall be the assessed valuation of the property.

(f) **Patents and copyrights — Arkansas Code § 26-51-411(a).** A taxpayer disposing of patents or copyrights by sale should determine the gain or loss arising therefrom by computing the difference between the selling price and the cost or other

basis, with property adjustment for depreciation as provided in Arkansas Code § 26-51-411(d).

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-127. Gain or loss — Exchange of property — Arkansas Code § 26-51-412.

(a) Exchange of property for like property — Arkansas Code § 26-51-412(a).

(1) For purposes of the Income Tax Act of 1929, Arkansas Code § 26-51-101 et seq., no gain or loss shall be recognized in an exchange of property for like property of a similar value.

(2) If property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, certificates of trust or beneficial interest, or other securities or evidence of indebtedness) is exchanged solely for property of like kind to be held either for productive use in trade or business or for investment, no gain or loss is recognized.

(3)(A) The words "like kind" have reference to the nature or character of the property and not its grade or quality.

(B) Therefore, under subdivision (a)(3) of this section, no gain or loss is realized by one, other than a dealer, from the exchange of real estate for other real estate.

(C) One (1) kind or class of property may not, under this subdivision (a)(3), be exchanged for property of a different kind or class, as real estate for personal property.

(4) If property, real, personal, or mixed, is transferred to a corporation by one (1) person solely in exchange for stock or securities in such corporation and, immediately after the exchange, such person is in control of the corporation, or by two (2) or more persons solely in exchange for stock or securities in such corporation, and if, immediately after the exchange, such persons are in control of the corporation, and

the amount of stock and securities received by each is substantially in proportion to his or her interest in the property prior to the exchange, no gain or loss will be recognized.

(5) If common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation by one (1) person solely in exchange for stock or securities in such corporation and, immediately after the exchange, such person is in control of the corporation, or by two (2) or more persons solely in exchange for stock or securities in such corporation, and if, immediately after the exchange, such persons are in control of the corporation, and the amount of stock and securities received by each is substantially in proportion to his or her interest in the property prior to the exchange, no gain or loss will be recognized.

(b) Exchange of property for property not of like kind — Arkansas Code § 26-51-412(a).

(1) When property is exchanged for other property not of a like kind, the property received in exchange shall, for the purpose of determining gain or loss, be treated as the equivalent of cash to the amount of its fair market value.

(2) If no market exists in which all of the property so received can be disposed of at the time of exchange for a reasonably certain and definite price in cash:

(A) The exchange shall be considered as a conversion of assets from one (1) form to another from which no gain or loss shall be deemed to arise; and

(B) The property received in exchange shall be taken into the records of the taxpayers at the same cost or assessed value, plus additions and minus depreciation and depletion allowable, as the property that he or she exchanged.

(c) Dividends paid in securities or other property — Arkansas Code § 26-51-412(a).

(1) Dividends paid in securities or other property (other than its own stock) in which the earnings of a corporation have been invested are income to the recipients in the amount of the market value of such property when receivable by the shareholders.

(2) Where a corporation declared a dividend payable in stock of another corporation, setting aside the stock to be so distributed and notifying the shareholders

of its action, the income arising to the recipients of such stock is its market value at the time the dividends become payable.

(3) Scrip dividends are subject to tax in the year in which the warrants are issued.

(d) Property acquired as a result of an involuntary conversion — Arkansas Code § 26-51-412(a).

(1)(A) In the case of property acquired as a result of an involuntary conversion, the basis of the property shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer that was not expended, and increased in the amount of the gain or decreased in the amount of loss to the taxpayer recognized upon such conversion applicable to the year in which the conversion was made.

(B) Refer to 26 CAR § 100-122(s).

(2)(A) In any case where the taxpayer elects to replace or restore the converted property, but it is not practicable to do so immediately, he or she may obtain permission to establish a replacement fund in his or her accounts in which part or all of the compensation so received shall be held, without deduction for the payment of any mortgage.

(B) In such a case the taxpayer should make application to the Secretary of the Department of Finance and Administration for permission to establish such a replacement fund, and in his or her application should:

(i) Recite all the facts relating to the transaction; and

(ii) Declare that he or she will proceed as expeditiously as possible to replace or restore such property.

(C) The taxpayer will be required to furnish a bond with such surety as the secretary may require in an amount not in excess of double the estimated additional income taxes that would be payable if no replacement fund were established.

(D) The estimated additional taxes, for the amount of which the claimant is required to furnish security, should be computed at the rates at which the claimant would have been obliged to pay, taking into consideration the remainder of his or her

net income and resolving against him or her all matters in dispute affecting the amount of the tax.

(E) Only surety companies will be approved as sureties.

(F) The application should be executed in triplicate, so that the secretary, the applicant, and the surety or depository may each have a copy.

(e) Basis of stock received for property — Real, personal, or mixed — Arkansas Code § 26-51-412(b).

(1) In the case of the organization of a corporation, the stock or securities of the corporation received for property, real, personal, or mixed, transferred to the corporation, shall be deemed to have the same value or cost as the property so transferred, and no gain or loss shall arise from the transaction.

(2)(A) The cost or value of the property transferred (adjusted as to depreciation and depletion) shall be entered in the records of the taxpayer as the cost of his or her stock in the corporation, and a record of such cost must be maintained.

(B) Gain or loss in future sales of such stock shall be measured by the difference between the individual cost per share determined as above applied to the selling price of such stock.

(f) Stock or securities exchanged in a reorganization — Arkansas Code § 26-51-412(c).

(1) If stock or securities in a corporation, a party to a reorganization, are, in pursuance to the plan of reorganization, exchanged for stock or securities in such corporation, or in another corporation, a party to the reorganization, and other property or money, the gain, if any, to the recipient shall be recognized in an amount not in excess of the sum of the money and the fair market value of other property.

(2) No loss from such an exchange will be recognized.

(g) Stock or securities received in a reorganization — Arkansas Code § 26-51-412(c). If without any surrender of his or her stock or securities, a shareholder in a corporation, a party to a reorganization, receives in pursuance of the plan of reorganization, stock or securities in such corporation or in another corporation, a party to the reorganization, no gain to the shareholder will be recognized.

(h) Basis of stock or securities received in a reorganization — Arkansas Code § 26-51-412(c).

(1)(A) In the case of stock or securities acquired by a shareholder in connection with the transactions described in subsection (f) of this section, the cost or assessed value of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder.

(B) The basis of each share will be the quotient of the cost or assessed value of the old shares of stock divided by the total number of the old and new shares.

(2) Where the stock distributed in reorganization is materially different from the stock in respect of which the distribution is made:

(A) The cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion as nearly as may be to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed; and

(B) The basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class.

(3) Where the stock in respect of which a distribution in reorganization is made was purchased at different times and prices, and the identity of the lots cannot be determined:

(A) Any sale of the original stock will be charged to the earliest purchases of such stock (see 26 CAR § 100-126(b)); and

(B) Any sale of the stock distributed in reorganization will be presumed to have been made from the stock distributed in respect of the earliest purchased stock.

(4) Where the stock in respect of which a distribution in reorganization is made was purchased at different times and prices, and the stock distributed in reorganization cannot be identified as having been distributed in respect of any particular lot of such stock, then any sale of the stock distributed in reorganization will

be presumed to have been made from the stock distributed in respect of the earliest purchased stock.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-128. Corporate liquidations — Arkansas Code § 26-51-413.

(a) Amounts distributed in complete liquidation — Arkansas Code § 26-51-413.

(1)(A) Amounts distributed in complete liquidation of a corporation are to be treated as in full payment in exchange for the stock, and the amounts distributed in partial liquidation are to be treated as in part or full payment in exchange for the stock so canceled or redeemed.

(B) The phrase "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of all of its stock, or one (1) of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

(2)(A) The gain or loss to a shareholder from a distribution in liquidation is to be determined by comparing the amount of the distribution with the cost or other basis of the stock.

(B) In the case of amounts distributed in partial liquidation, other than a distribution in pursuance of a plan of reorganization as described in Arkansas Code § 26-51-412, the part of such distribution that is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of Arkansas Code § 26-51-411 for the purpose of determining the taxability of subsequent distribution by the corporation.

(b) Corporate liquidation — Stock purchase treated as asset acquisition — Arkansas Code § 26-51-413.

(1)(A) A taxpayer who has elected to be treated as a Subchapter S corporation for federal income tax purposes but not for state income tax purposes (therefore retaining its Subchapter C corporation status) must file an I.R.C. § 338 election with the

Individual Income Tax Section of the Department of Finance and Administration stating that it desires to be taxed in accordance with I.R.C. § 338.

(B) This is so despite the fact that the taxpayer may already have an I.R.C. § 338 election on file with the Internal Revenue Service.

(2)(A) If the taxpayer has elected to be treated as a Subchapter S corporation for both federal and state income tax purposes, and the taxpayer has also filed an I.R.C. § 338 election with the Internal Revenue Service, the taxpayer need not file a separate I.R.C. § 338 election with the Department of Finance and Administration.

(B) The taxpayer will automatically receive I.R.C. § 338 treatment by the department for state income tax purposes as well.

(3)(A) If the taxpayer has elected to be treated as a Subchapter C corporation for both federal and state income tax purposes, and the taxpayer has also filed an I.R.C. § 338 election with the Internal Revenue Service, the taxpayer need not file a separate I.R.C. § 338 election with the department.

(B) The taxpayer will automatically receive I.R.C. § 338 treatment by the department for state income tax purposes as well.

(4) Under I.R.C. § 338, certain stock purchases will be treated as asset acquisitions for purposes of income taxation.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. I.R.C. § 338 is codified at 26 U.S.C. § 338.

26 CAR § 100-129. Deferred compensation plans — Arkansas Code § 26-51-414.

(a) Deferred compensation plans — IRAs — Arkansas Code § 26-51-414.

(1)(A) A nonworking spouse can open up his or her own IRA and contribute up to two thousand dollars (\$2,000) per year to the IRA.

(B) Under prior law, a nonworking spouse did not have the option of owning his or her own "spousal" IRA.

(2)(A) To determine the deductibility of the contributions made to a married couple's IRAs, refer to I.R.C. § 219(c).

(B) The requirement of filing a joint return under I.R.C. § 219(c)(2)(A) in order to deduct contributions shall not apply.

(b) Deferred compensation plans — Lump-sum distributions — Arkansas Code § 26-51-414.

(1) Lump-sum distributions from qualified retirement plans will no longer be eligible for special five-year income averaging beginning with the 2000 tax year.

(2) Except for older taxpayers eligible for the Tax Reform Act of 1986, Pub. L. No. 99-514, transition rules (i.e., ten-year averaging and capital gains treatment for the pre-1974 portion of the distribution), distributions from qualified plans will be taxed in the same manner as other income, regardless of the form of distribution.

(3) I.R.C. § 402(e)(4)(D).

(c) Deferred compensation plans — Self-employed ministers — Arkansas Code § 26-51-414.

(1) A "church plan" is a retirement plan established and maintained by a tax-exempt church or association of churches for its employees.

(2) These plans can cover ministers, regardless of the source of the ministers' compensation.

(3)(A) A self-employed minister covered under a church plan is treated as his or her own employer.

(B) I.R.C. § 414(e)(5).

(4)(A) Therefore, the minister can deduct his or her contributions to the church plan.

(B) I.R.C. § 404(a)(10).

(5) Prior to the 1997 tax year, self-employed ministers could participate in church plans, but their contributions were not deductible because the contributions were treated as made by the church itself, rather than the ministers.

(d) Deferred compensation plans — Section 457 plan distributions — Arkansas Code § 26-51-414.

(1) Amounts that a participant defers under an eligible deferred compensation plan of a tax-exempt or state or local governmental employer (i.e., an I.R.C. § 457 plan) are includible in gross income after the participant separates from service only in the tax year in which the amounts are actually paid or otherwise made available to the participant.

(2) Amounts deferred under an I.R.C. § 457 plan generally may not be made available to an employee before the earlier of:

(A) The calendar year in which the participant attains age seventy and one-half (70 1/2);

(B) When the participant is separated from service with the employer; or

(C) When the participant is faced with an unforeseeable emergency.

(3)(A) Amounts payable are not treated as made available and thus will neither be includible in a participant's gross income under the constructive receipt rules nor run afoul of the I.R.C. § 457 distribution rules, in the following circumstances.

(B) In-service I.R.C. § 457 plan distributions are not treated as "made available" if:

(i) The total amount payable does not exceed three thousand five hundred dollars (\$3,500); and

(ii) There has been no prior distribution from the I.R.C. § 457 plan to the participant.

(C) I.R.C. § 457(e)(9)(A).

(e) Penalty-free withdrawals from IRAs and qualified retirement plans — Arkansas Code § 26-51-414. A taxpayer may make an early withdrawal of funds from an IRA or other qualified retirement plan free of the ten percent (10%) penalty normally associated with such early withdrawals under the following two (2) circumstances:

(1)(A) Payment of medical expenses in excess of seven and one-half percent (7.5%) of the taxpayer's adjusted gross income (AGI).

Example: A taxpayer's AGI is forty thousand dollars (\$40,000). Seven and one-half percent (7.5%) of forty thousand dollars (\$40,000) is three thousand dollars (\$3,000). The taxpayer incurs medical expenses of ten thousand dollars (\$10,000) and makes an early withdrawal of ten thousand dollars (\$10,000) from his IRA to pay the expenses in full. The first three thousand dollars (\$3,000) of the withdrawal would be subject to the ten percent (10%) penalty. However, the remaining seven thousand dollars (\$7,000) would not be subject to the ten percent (10%) penalty.

(B) I.R.C. § 72(t)(2)(B); or

(2)(A) The taxpayer is unemployed at the time the withdrawal is made and meets the following criteria:

(i) The taxpayer has received unemployment compensation for at least twelve (12) consecutive weeks;

(ii) The withdrawal does not exceed the total amount paid during the tax year by the taxpayer for premiums for health insurance coverage for the:

(a) Taxpayer;

(b) Taxpayer's spouse; and

(c) Taxpayer's children; and

(iii)(a) The withdrawal must be made in the year the unemployment compensation is actually received or the following year.

(b) I.R.C. § 72(t)(2)(D).

(B) The actual retirement funds withdrawn do not have to be paid towards the health insurance premiums to qualify for the break from the ten percent (10%) penalty.

(f) **Savings Incentive Match Plan for Employees (SIMPLE) — Arkansas Code § 26-51-414.**

(1)(A) Beginning in tax years after 1996, eligible employers may maintain SIMPLE retirement plans to provide a tax-favored means of providing for employees' retirement.

(B) An eligible employer is an employer that:

(i) Employs no more than one hundred (100) employees who each received at least five thousand dollars (\$5,000) of compensation from the employer the preceding year; and

(ii) Does not maintain another employer-sponsored retirement plan to which contributions were made or benefits accrued.

(2) An eligible employer who establishes and maintains a SIMPLE plan for at least one (1) year, but thereafter fails to qualify, continues to be treated as an eligible employer for the two (2) years following the last year in which it did qualify.

(3)(A) An employee is eligible to participate in any calendar year if he or she:

(i) Received at least five thousand dollars (\$5,000) of compensation from the employer during each of the two (2) preceding calendar years; and

(ii) Is reasonably expected to receive at least five thousand dollars (\$5,000) in compensation during the current calendar year.

(B) A self-employed individual is treated as an employee and may participate in a SIMPLE plan if the compensation threshold is met.

(4) There are two (2) types of SIMPLE plans:

(A) Cash or deferred arrangement (CODA) incorporated in a qualified plan (I.R.C. § 401(k)(11)(C)); or

(B) An IRA established for each participating employee.

(5)(A) A SIMPLE plan must permit each eligible employee to elect to have the employer make payments either:

(i) Directly to the employee in cash; or

(ii) As a contribution to the SIMPLE account.

(B)(i) No contribution, other than elective contributions, employer matching contributions, and nonelective employer contributions may be made to a SIMPLE account.

(ii) However, a rollover from another SIMPLE account may be received.

(6)(A) Elective contributions are limited to six thousand dollars (\$6,000) for any calendar year.

(B) The employer must match the elective contribution of an employee in an amount not exceeding three percent (3%) of the employee's compensation.

(C)(i) However, the employer may elect to limit its match, for all eligible employees, to a smaller percentage of compensation not less than one percent (1%).

(ii) The election may not be made in more than two (2) out of every five (5) years.

(7)(A) Nonelective contributions may be made as an alternative to matching contributions.

(B) The employer may elect to make nonelective contributions of two percent (2%) of compensation for each employee who:

(i) Is eligible to participate; and

(ii) Has at least five thousand dollars (\$5,000) of compensation from the employer for the calendar year.

(B)(i) The compensation that may be taken into account in determining the two percent (2%) nonelective contribution may not exceed an indexed dollar amount.

(ii) For 1996, this amount is one hundred fifty thousand dollars (\$150,000) for most plans.

(8)(A) Elective contributions of employees are not includable in gross income when made.

(B)(i) They are taxed only under the distribution rules that govern distributions from conventional IRAs.

(ii) I.R.C. § 408(p)(1)(A).

(C)(i) Any elective contributions under this plan are included in the sum of elective deferrals, subject to an annual limit on the amount that can be excluded from income.

(ii) I.R.C. § 402(g)(3)(D).

(9)(A) The employer is entitled to a deduction for its contributions to a SIMPLE account.

(B) For deduction purposes, the employer contributions to a SIMPLE account are treated as if they were made to a plan subject to the requirements of I.R.C. § 404(m).

(10)(A) For self-employed persons, the contribution is not a business expense, therefore it is not deductible on the Schedule C.

(B) In the case of a sole proprietorship, the contribution may only be claimed as an adjustment to income.

Example: XYZ Company maintains a SIMPLE retirement plan for its eligible employees. Melinda Jones earns thirty thousand dollars (\$30,000) from XYZ Company. The company matches the elective contribution in the amount of three percent (3%) of the employee's compensation. Ms. Jones elects to contribute six thousand dollars (\$6,000) to her SIMPLE account. Ms. Jones has no other income deferrals. XYZ Company makes a matching contribution of seven hundred twenty dollars (\$720) to Ms. Jones' SIMPLE account $((\$30,000 - \$6,000) \times 3\%)$. Ms. Jones' wages reported on her W-2 are twenty-four thousand dollars (\$24,000), and XYZ Company may deduct the seven hundred twenty dollars (\$720) as an expense.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. I.R.C. § 219(c) is codified at 26 U.S.C. § 219(c).

I.R.C. § 219(c)(2)(A) is codified at 26 U.S.C. § 219(c)(2)(A).

I.R.C. § 402(e)(4)(D) is codified at 26 U.S.C. § 402(e)(4)(D).

I.R.C. § 414(e)(5) is codified at 26 U.S.C. § 414(e)(5).

I.R.C. § 404(a)(10) is codified at 26 U.S.C. § 404(a)(10).

I.R.C. § 457(e)(9)(A) is codified at 26 U.S.C. § 457(e)(9)(A).

I.R.C. § 72(t)(2)(B) is codified at 26 U.S.C. § 72(t)(2)(B).

I.R.C. § 72(t)(2)(D) is codified at 26 U.S.C. § 72(t)(2)(D).

I.R.C. § 401(k)(11)(C) is codified at 26 U.S.C. § 401(k)(11)(C).

I.R.C. § 408(p)(1)(A) is codified at 26 U.S.C. § 408(p)(1)(A).

I.R.C. § 402(g)(3)(D) is codified at 26 U.S.C. § 402(g)(3)(D).

I.R.C. § 404(m) is codified at 26 U.S.C. § 404(m).

26 CAR § 100-130. Deductions — State income taxes — Arkansas Code § 26-51-416.

(a) No deduction will be allowed for Arkansas state income taxes in the computation of net income.

(b) All other states' income taxes are deductible as a miscellaneous deduction not subject to the two percent (2%) of AGI reduction unless said taxes are taken as a credit.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. "AGI" means adjusted gross income.

26 CAR § 100-131. Deductions — Charitable contributions — Arkansas Code § 26-51-419.

(a) Arkansas has adopted I.R.C. § 170 as referenced in Arkansas Code § 26-51-419.

(b)(1) I.R.C. § 170(d)(2)(B) does not allow unused contributions to increase NOL carry forward.

(2) It merely decreases net taxable income by accumulated contributions carry forward first up to ten percent (10%), therefore decreasing the amount of NOL used, and thus results in an increase of NOL for future years.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. "NOL" means net operating loss.

26 CAR § 100-132. Deductions — Expenses — Arkansas Code § 26-51-423.

(a) Types of deductions — Arkansas Code § 26-51-423(a).

(1)(A) In computing an individual's taxable income, the individual is permitted to claim certain deductions.

(B) Some of these deductions may be subtracted from gross income, while other types of deductions must be claimed as itemized deductions and subtracted from the individual's adjusted gross income.

(C) A deduction from adjusted gross income is generally referred to as an itemized deduction.

(D) To be deductible as a trade or business expense, an expense must be:

(i) An ordinary and necessary expense of the taxpayer's trade or business;

(ii) Paid or incurred during the tax year in which it is deducted; and

(iii) Connected with a trade or business conducted by the taxpayer.

(2) The business expenses of a sole proprietorship or a statutory employee are claimed on Schedule C of Internal Revenue Service Form 1040.

(3) A "trade or business", although not defined in the tax law, has been characterized as an activity carried on for a livelihood or for profit.

(4)(A) A profit motive must be present, and some type of economic activity must be conducted.

(B) With respect to the profit motive, an activity is considered a business if it is entered into and carried on in good faith for the purpose of making profit.

(C) Moreover, a trade or business is characterized by:

- (i) Regularity of activities and transactions; and
- (ii) The production of income.

(b) Business expenses — Long-term care insurance premiums — Arkansas Code § 26-51-423(a)(1).

(1) A self-employed taxpayer can deduct as a business expense on Internal Revenue Service Form 1040, Schedule C, a percentage of the premiums paid during the tax year for qualified long-term care insurance.

(2) The definition of "qualified long-term care insurance" is set forth in I.R.C. § 7702B(b)(1).

(3) The applicable percentage begins with forty percent (40%) for the 1997 tax year and increases up to a maximum of eighty percent (80%) in 2006.

(4) The percentages are as follows:

1997	40%	2004	60%
1998 through 2002	45%	2005	70%
2003	50%	2006 or thereafter	80%

(c) Medical expenses — Long-term care insurance premiums — Arkansas Code § 26-51-423(a)(2).

(1)(A) Under certain circumstances, expenses incurred by a taxpayer for eligible long-term care insurance premiums may be taken as an itemized deduction.

(B) This deduction for unreimbursed medical expenses can be taken only to the extent such expenses exceed seven and one-half percent (7.5%) of the taxpayer's AGI.

(C) I.R.C. § 213(d)(1)(D).

(2)(A) Eligible long-term care insurance premiums may be deductible as medical expenses when such premiums are paid towards qualified long-term care insurance.

(B) The definition of "qualified long-term care insurance" is set forth in I.R.C. § 7702B(b)(1).

(d) Travel and entertainment — Arkansas Code § 26-51-423(b).

(1) For tax years beginning before January 1, 1995, I.R.C. § 274 as in effect January 1, 1989, shall apply.

(2) For tax years 1995 and 1996, I.R.C. § 274 as in effect on January 1, 1995, shall apply.

(3) Beginning with the 1997 tax year, I.R.C. § 274 as in effect on January 1, 1997, shall apply.

(4) Eighty percent (80%) of qualified expenses will be allowed for tax years beginning before January 1, 1995, and fifty percent (50%) of qualified expenses will be allowed for tax years beginning on or after January 1, 1995.

(e) Business expenses — Medical care insurance premiums — Arkansas Code § 26-51-423(c)(1).

(1) A self-employed taxpayer can deduct as a business expense on Internal Revenue Service Form 1040, Schedule C, a percentage of the premiums paid during the tax year for insurance that constitutes medical care for:

(A) The taxpayer; or

(B) His or her spouse and dependents.

(2)(A) The applicable percentage begins with forty percent (40%) in 1997 and increases up to a maximum of eighty percent (80%) in 2006.

(B) I.R.C. § 162(l).

(3) The percentages are as follows:

1997	40%	2004	60%
1998 through 2002	45%	2005	70%
2003	50%	2006 or thereafter	80%

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. “AGI” means adjusted gross income.

I.R.C. § 7702B(b)(1) is codified at 26 U.S.C. § 7702B(b)(1).

I.R.C. § 213(d)(1)(D) is codified at 26 U.S.C. § 213(d)(1)(D).

I.R.C. § 274 is codified at 26 U.S.C. § 274.

I.R.C. § 162(l) is codified at 26 U.S.C. § 162(l).

26 CAR § 100-133. Deductions — Losses — Arkansas Code § 26-51-424.

(a) Losses — Arkansas Code § 26-51-424(a)(1).

(1) Losses sustained during the tax year and not compensated for by insurance or otherwise are fully deductible if:

(A) Incurred in a trade or business;

(B) Incurred in any transaction entered into for profit; or

(C) Losses of property not connected with a trade or business if:

(i) These losses arise from fires, storms, shipwrecks, other casualty, or theft, only to the extent that the amount of the loss from each casualty or theft shall exceed one hundred dollars (\$100); and

(ii) The aggregate amount of all such losses sustained by an individual during any one (1) income year exceeds ten percent (10%) of the net income of the individual for that income year.

(2)(A) There shall be allowed any loss attributable to a disaster occurring in an area subsequently determined by the President of the United States to warrant assistance by the United States Government under the Disaster Relief Act of 1974, Pub. L. No. 93-288.

(B) A taxpayer may elect to deduct this loss, less one hundred dollars (\$100), for the year immediately preceding the tax year of the disaster.

(C) For example, if a taxpayer experiences a loss in 1993 and elects to carry the loss back to 1992, the loss is deductible only to the extent that it exceeds ten percent (10%) of the adjusted gross income for 1992.

(b) Transfer of property to a related person — Arkansas Code § 26-51-424(a)(1). No loss is realized by the transfer of property by gift, by death, or by sale to any person related by blood or marriage at less than the fair market value.

(c) Voluntary removal or demolition — Arkansas Code § 26-51-424(a)(1).

(1) Losses due to the voluntary removal or demolition of old buildings, scrapping of old machinery, equipment, etc., incident to renewals and replacements, are deductible from gross income.

(2) When a taxpayer buys real estate upon which is located a building that he or she proceeds to raze with the intent of erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building and no deductible expense on account of the cost of such removal, the value of the real estate, exclusive of old improvements, which is presumed equal to the purchase price of the land and building plus the cost of removing the useless building.

(d) Obsolescence — Arkansas Code § 26-51-424(a)(1).

(1) When, through some change in business conditions, the usefulness in the business of some or all of the capital assets is suddenly terminated so that the taxpayer discontinues the building or discards such assets permanently from use in such business, he or she may claim as a loss for the year in which he or she takes such action the difference between the cost of the assets less depreciation, etc., and the salvage value thereof.

(2) This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized, nor does it apply to inventories or to other than capital assets.

(3) The exception applies to:

(A) Buildings only when they are permanently abandoned; and

(B) Machinery only when its use as such is permanently abandoned.

(4) Any loss to be deductible under this exception must be fully explained in the return of income.

(e) Shrinkage in value of stock — Arkansas Code § 26-51-424(a)(1).

(1) A person possessing stock of a corporation cannot deduct from gross income any amount claimed as a loss merely on account of shrinkage in the value of such stock through fluctuation of the market or otherwise.

(2) The loss allowable in such cases is that actually suffered when the stock is disposed of.

(3) If such stock of a corporation becomes worthless, its cost or other basis may be deducted by the owner in the tax year in which the stock became worthless.

(f) Farm losses — Arkansas Code § 26-51-424(a)(1).

(1) Losses incurred in the operation of farms as business enterprises are deductible from gross income.

(2) If farm products are held for favorable markets, no deductions for shrinkage in weight or physical value or by reason of deterioration in storage shall be allowed except as such shrinkage may be reflected in an inventory, if used to determine profits.

(3) The total loss by frosts, storm, flood, or fire of a prospective crop is not a deductible loss in computing net income.

(4) A farmer engaged in raising or selling stock, cattle, sheep, horses, etc., is not entitled to claim as a loss the value of animals that perish from among these animals that were raised on the farm, except as such loss is reflected if an inventory is used.

(5) The cost of any feed, pasture, or care that has been deducted as an expense of operation shall not be included as part of the cost of the stock for the purpose of ascertaining the amount of deductible loss.

(6) If gross income is ascertained by inventories, no deduction can be made for livestock or products lost during the tax year, whether purchased for resale or produced on the farm, as such losses will be reflected in the inventory by reducing the amount of livestock or products on hand at the close of the tax year.

(7) If any individual owns and operates a farm, in addition to being engaged in another trade, business, or calling, and sustains a loss from such operation of the farm, then the amount of loss sustained may be deducted from gross income received from all sources, provided the farm is not operated for recreation or pleasure.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-134. Deductions — Worthless debts — Arkansas Code § 26-51-425.

(a) Worthless debts — Arkansas Code § 26-51-425.

(1)(A) Worthless debts shall be allowed as deductions from income after being ascertained as such.

(B) There are two (2) types of bad debts an individual may incur, business and nonbusiness.

(C) A business bad debt is created and deductible from the taxpayer's ordinary net income computation.

(D)(i) A nonbusiness bad debt is:

(a) Listed on a federal Schedule D with documents; and

(b) Deducted as a short-term capital loss.

(ii) There shall accompany the return a statement showing the propriety of any deduction claimed for bad debts.

(iii) Before a taxpayer may charge off and deduct a debt in part, he or she must ascertain and be able to demonstrate with a reasonable degree of certainty the amount thereof that is uncollectible.

(iv) An amount subsequently received on account of a bad debt, or on account of a part of such debt previously charged off and allowed as a deduction for income tax purposes, must be included in gross income in the tax year in which received.

(2)(A) Bankruptcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt.

(B) Actual determination of worthlessness in bankruptcy cases is sometimes possible before and, at other times, only when settlement in bankruptcy shall have been made.

(C) Where a taxpayer ascertained a debt to be worthless and charged it off in one (1) tax year, the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later tax year, confirming the conclusion that the debt is worthless, will not authorize shifting the deduction to such later tax year.

(D) If a taxpayer computes his or her income upon the basis of valuing his or her notes or accounts receivable at their fair market value when received, which may be less than their face value, the amount deductible for bad debts in any case is limited to such original valuation.

(3)(A) Worthless debts arising from unpaid wages, salaries, rents, and similar items of taxable income, will not be allowed as a deduction unless such items have been entered as income in the books of the taxpayer in a prior tax year or in the tax year in which the deduction was made.

(B) Only the difference between the amount received in distribution of the assets of a bankruptcy and the amount of the claim may be deducted as a bad debt.

(C) The difference between the amount received by a creditor of a decedent in distribution of the assets of the decedent's estate and the amount of his or her claim may be considered a worthless debt.

(D) A purchaser of accounts receivable that cannot be collected and are subsequently charged off the books as bad debts is entitled to deduct them, the amount of the deductions to be based upon the price he or she paid for them and not upon their face value.

(b) Mortgaged or pledged property sold for less than the amount of the debt — Arkansas Code § 26-51-425.

(1) Where mortgaged or pledged property is lawfully sold (whether to the creditor or another purchaser) for less than the amount of the debt and the mortgagee or pledgee ascertains that the portion of the indebtedness remaining unsatisfied after such sale is wholly or partially uncollectible and charges it off, he or she may deduct such amount (to the extent that it constitutes capital or represents an item the income from which has been reported by him or her) as a bad debt for the tax year in which it is ascertained to be wholly or partially worthless and charged off.

(2)(A) In addition, where the creditor buys in the mortgaged or pledged property, loss or gain is realized, measured by the difference between the:

(i) Amount of those obligations of the debtor that are applied to the purchase or bid price of the property (to the extent that such obligations constitute capital or represent an item the income from which has been returned by him or her); and

(ii) Fair market value of the property.

(B) The fair market value of the property shall be presumed to be the amount for which it is bid in by the taxpayer, in the absence of clear and convincing proof to the contrary.

(3) If the creditor subsequently sells the property so acquired, the basis for determining gain or loss is the fair market value of the property at the date of acquisition.

(4) Accrued interest may be included as part of the deduction only when it has previously been reported as income.

(c) Bonds or other similar obligations — Arkansas Code § 26-51-425.

(1)(A) Bonds, when ascertained to be worthless, may be treated as bad debts to the amount actually paid for them.

(B) Bonds of an insolvent corporation secured only by a mortgage from which, on foreclosure, nothing is realized for the bondholders, are regarded as ascertained to be worthless not later than the tax year of the foreclosure sale, and no deduction for a bad debt is allowable in computing a bondholder's income for a subsequent tax year.

(2)(A) A taxpayer (other than a dealer in securities) possessing debts evidenced by bonds or other similar obligations cannot deduct from gross income any amount merely on account of market fluctuations.

(B) When a taxpayer ascertains, however, that due to the financial condition of the debtor or conditions other than market fluctuations, he or she will recover upon maturity none or only a part of the debt evidenced by the bonds or other similar obligations and so demonstrates to the satisfaction of the Secretary of the Department of Finance and Administration, he or she may deduct, in computing net income, the uncollectible part of the debt evidenced by the bonds or other similar obligations.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-135. Deductions — Net operating loss carryover — Arkansas Code § 26-51-427.

(a) Net operating loss carryover — Arkansas Code § 26-51-427.

(1)(A) The net operating loss carryover (NOL) is the excess of allowable deductions over gross income derived from a trade or business for the taxable year.

(B) This loss may be carried over to the next succeeding taxable year and annually thereafter for a total period of three (3) years succeeding the year of the net operating loss if the loss occurred in an income year before January 1, 1987, and five (5) years if the loss occurred on or before January 1, 1987, or if the loss has been

exhausted or absorbed by the taxable income of any succeeding year, whichever is earlier.

(C) The NOL must be carried forward in the order named above.

(2)(A) Taxable income as used in subdivision (a)(1) of this section, above, is the amount realized after the deduction of personal itemized deductions from the adjusted gross income (AGI), and if no itemized deductions, then taxable income will be the same as the AGI.

(B) The NOL calculated from a qualified previous year may be exhausted or absorbed in part by this amount.

(3) The NOL must be reduced by all nontaxable income, less any expenses properly and reasonably incurred in earning nontaxable income not required to be reported as gross income.

(4) Nontaxable income includes, but is not limited to:

(A) The first six thousand dollars (\$6,000) of military pay or retirement;

(B) The first six thousand dollars (\$6,000) of a public or private employment-related retirement or disability system; and

(C) Any other income that is exempt under Arkansas Code § 26-15-404.

(5) Gross income is the total income of all items listed, except an NOL, on the lines of the individual returns and before any adjustments are considered.

(6)(A) Gross income not derived from a trade or business is also known as nonbusiness income.

(B) Nonbusiness income includes, but is not limited to:

(i) Personal savings interest;

(ii) Dividends;

(iii) Annuity distributions;

(iv) Endowments; and

(v) Nontaxable income not required to be reported.

(C) Nonbusiness deductions are those expenses incurred during the year and reported on the itemized deduction schedule with the exception of unreimbursed employee expenses.

(7)(A) In the case of a taxpayer other than a corporation, nonbusiness deductions shall be eliminated from the deduction otherwise allowable for the taxable year to the extent that they exceed nonbusiness income.

(B) Personal exemptions and credit for dependents shall not be a deduction for the purpose of computing a net operating loss.

Example 1: Mr. Smith reported the following income items on his 1995 tax return:

Wages	\$ 5,000.00
Interest	\$ 500.00
Business (Sch. C)	(\$ 25,000.00)
Capital Gain	\$ 2,000.00
Farm (Sch. F)	(\$ 15,000.00)
Pension	\$ 6,000.00
IRA Distribution	\$ 2,500.00

Other items on Mr. Smith's tax return include forfeited interest penalty on premature IRA withdrawal of fifty dollars (\$50.00) and itemized deductions consisting of mortgage interest, contributions, and miscellaneous deductions totaling eight thousand dollars (\$8,000). Adjusted gross income (AGI) for Mr. Smith is (\$30,000) and taxable income is (\$38,050) calculated as follows:

INCOME:

Wages	\$ 5,000.00
Interest	\$ 500.00
Sch C Loss	(\$ 25,000.00)
Capital Gain	\$ 2,000.00
IRA	\$ 2,500.00

Sch F Loss		(\$ 15,000.00)
Pension	\$ 6,000.00	
<i>Less Exemption (\$ 6,000.00)</i>		<u>\$ 0.00</u>

Total Income		(\$ 30,000.00)
--------------	--	----------------

ADJUSTMENTS:

Forfeited Interest Penalty		<u>(\$ 50.00)</u>
AGI:		(\$ 30,050.00)
Itemized Deductions:		<u>(\$ 8,000.00)</u>

Taxable Income		(\$ 38,050.00)
----------------	--	----------------

NOL CALCULATION:

NON-BUSINESS INCOME:

Interest	\$ 500.00
Capital Gain	\$ 2,000.00
IRA	\$ 2,500.00
Pension	<u>\$ 6,000.00</u>

Total Non-Business Income	\$ 11,000.00
---------------------------	--------------

NON-BUSINESS DEDUCTIONS:

Itemized Deductions	(\$ 8,000.00)
Forfeited Interest	<u>(\$ 50.00)</u>
Total Non-Business Deductions	(\$ 8,050.00)

Net Non-Business Income (Non Bus Income - Non Bus Deductions) \$ 2,950.00

BUSINESS INCOME:

Wages	\$ 5,000.00
Schedule C	(\$ 25,000.00)
Schedule F	<u>(\$ 15,000.00)</u>
Total Business Income	(\$ 35,000.00)

BUSINESS DEDUCTIONS:

None	\$ 0.00
Total Business Deductions	<u>\$ 0.00</u>

Net Business Loss (Bus Income - Bus Deductions) (\$ 35,000.00)

NET OPERATING LOSS (Net Non-Business Income - Net Business Loss) (\$ 32,050.00)

Example 2: Same information as Example 1 except itemized deductions are ten thousand dollars (\$10,000) and includes a two-thousand-dollar-deduction for unreimbursed employee expenses. AGI equals (\$30,050) and taxable income equals (\$40,050) computed as follows:

INCOME:

Wages	\$	5,000.00
Interest	\$	500.00
Sch C Loss	(\$	25,000.00)
Capital Gain	\$	2,000.00
IRA	\$	2,500.00
Sch F Loss	(\$	15,000.00)
Pension	\$	6,000.00
<i>Less Exemption</i>	<i>(\$ 6,000.00)</i>	<i>\$ 0.00</i>
Total Income	(\$	30,000.00)

ADJUSTMENTS:

Forfeited Interest Penalty	(\$	50.00)
AGI:	(\$	30,050.00)
Itemized Deductions:	(\$	10,000.00)
Taxable Income	(\$	40,050.00)

NOL CALCULATION:**NON-BUSINESS INCOME:**

Interest	\$	500.00
Capital Gain	\$	2,000.00
IRA	\$	2,500.00
Pension	\$	6,000.00

(b) Net operating loss carryover — Adjustments — Arkansas Code § 26-51-427.

(1) The fact that the statutory period for assessment of income taxes for the year in which the loss was sustained has expired does not preclude the making of such adjustments as may be necessary to correct the net operating loss deduction.

(2) The net operating loss may be increased or decreased by any such adjustment.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. “IRA” means individual retirement account.

26 CAR § 100-136. Deductions — Depreciation — Expensing of property — Arkansas Code § 26-51-428.

(a) Depreciation — Arkansas Code § 26-51-428(a).

(1)(A) For property placed in service during tax years beginning before January 1, 1995, I.R.C. §§ 167, 168, and 179 as in effect on January 1, 1991, shall apply.

(B) The I.R.C. § 179 deduction is limited to ten thousand dollars (\$10,000).

(C) Any I.R.C. § 179 expense disallowed because of the limitation:

(i) May be depreciated by regular depreciation methods appropriate for that property; or

(ii) Can be carried forward.

(2)(A) Property placed in service during tax years beginning before January 1, 1995, will have a useful life as determined by I.R.C. § 168 as in effect on January 1, 1991.

(B) Property placed in service during tax years beginning on or after January 1, 1995, will have a useful life as determined by I.R.C. § 168 as in effect on January 1, 1995.

(3) Any differences in basis because of depreciation differences must be included in the determination of gain or loss upon disposition of the property.

(b) Amortization of intangibles — Arkansas Code § 26-51-428(c).

(1) For tax years beginning before January 1, 1995, I.R.C. § 197 regarding amortization of intangibles shall apply.

(2) For tax years beginning on or after January 1, 1995, I.R.C. § 197 shall apply.

(3) Any differences in Arkansas and federal basis must be considered in calculating gain or loss upon disposition of the intangibles.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. I.R.C. § 167 is codified at 26 U.S.C. § 167.

I.R.C. § 168 is codified at 26 U.S.C. § 168.

I.R.C. § 179 is codified at 26 U.S.C. § 179.

I.R.C. § 197 is codified at 26 U.S.C. § 197.

26 CAR § 100-137. Nonresidents or part-year residents — Arkansas Code § 26-51-435.

(a) Computing taxable income — Arkansas Code § 26-51-435(a) and (b).

(1) Nonresidents or part-year residents of Arkansas shall compute their taxable income as if all their income was earned in Arkansas, despite the fact that a portion of their income may have been earned in another state or foreign country.

(2) Nonresident or part-year residents of Arkansas shall use Arkansas income tax rates to compute their Arkansas tax liability on their taxable income.

(3) The computed tax liability is then prorated to Arkansas based on a percentage calculated according to subsection (c) of this section.

(b) Credit for income tax paid to another state — Arkansas Code § 26-51-435(c).

(1) After a nonresident or part-year resident's Arkansas tax liability has been computed as set forth in subsection (a) of this section, all allowable tax credits should be deducted to determine the amount of income tax due the State of Arkansas.

(2) However, credit may not be taken for individual income taxes paid to another state (or states) during the tax year at issue unless:

(A) The taxpayer is a resident of Arkansas; and

(B) Can clearly prove that he or she would be subject to double taxation if the other state tax credit was not allowed.

(c) Computing percentage of AGI attributable to Arkansas — Arkansas Code § 26-51-435(d). The percentage that Arkansas adjusted gross income (AGI) represents of all AGI received by a nonresident or part-year resident during the tax year shall be computed as follows:

$$\div \frac{\text{AGI from Arkansas Sources}}{\text{AGI from All Sources}} = \%$$

(d) Calculating Arkansas income tax due — Arkansas Code § 26-51-435(e). In order to determine the proper amount of income tax that must be paid to the State of Arkansas by a nonresident or part-year resident, the tax shall be computed as follows:

Tax liability minus		Percentage (%)
allowable credits as	X	as determined in = Tax

set forth in subsection (b) of
this section

Due,
subsection (c) of this
section

(e) Deductions — Passive activity loss — Arkansas Code § 26-51-436(2).

(1)(A) If all gain or loss realized on the disposition of an entire interest in a passive activity is recognized, then the excess of any loss from the activity for the tax year of disposition (including losses carried over from earlier years) over any net income or gain for the tax year from all other passive activities (including losses carried over from earlier years) is treated as a loss that is not from a passive activity.

(B) I.R.C. § 469(g)(1)(A).

(2) As such, any gain from disposing of a passive activity would offset any loss from the activity for the tax year of the disposition.

(3) The balance of the loss would then be applied first against any net income or gain from other passive activities, and finally against nonpassive income.

(f) Passive activity credits — Oil and gas properties — Arkansas Code § 26-51-436(2).

(1)(A) Passive activity credits can only be used to offset taxes allocable to income from passive activities.

(B) A working interest in oil or gas property that the taxpayer holds either directly or through an entity that does not limit his or her liability is not a passive activity.

(C) However, if the taxpayer has any loss for any tax year from such an interest, then any net income from the property for any later tax year is treated as income that is not from a passive activity, notwithstanding that the activity may otherwise have become passive with respect to the taxpayer.

(D) I.R.C. § 469(c)(3)(B).

(2) The 1996 act provides that if, under the above rule, the net income from a working interest in an oil or gas property is treated as income that is not from a passive

activity for any tax year, then any credits attributable to the property for that year are not treated as credits from a passive activity.

(3) The credits are treated as not from a passive activity even for a tax year in which the activity is no longer treated as not being a passive activity (i.e., the activity has become passive with respect to the taxpayer).

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. I.R.C. § 469(g)(1)(A) is codified at 26 U.S.C. § 469(g)(1)(A).

I.R.C. § 469(c)(3)(B) is codified at 26 U.S.C. § 469(c)(3)(B).

26 CAR § 100-138. Medical savings accounts — Arkansas Code § 26-51-436.

(a) Medical savings account (MSA) — Defined — Arkansas Code § 26-51-436(5).

(1)(A) An MSA is a trust or custodial account that is created or organized in the United States exclusively for the purpose of paying the qualified medical expenses of an account holder (i.e., taxpayer) as well as the taxpayer's spouse and/or dependents.

(B) I.R.C. § 220(d)(1).

(2) The Internal Revenue Service has an MSA pilot program for employees of small businesses and self-employed persons.

(3) The accounts must be used in conjunction with high-deductible health insurance.

(4) Participation is limited to the first seven hundred fifty thousand (750,000) taxpayers utilizing MSAs each year for the tax years 1997 through 2000.

(b) Medical savings account — Eligibility — Arkansas Code § 26-51-436(5).

(1) In order to be eligible, a taxpayer must have insurance coverage only under a high-deductible health plan.

(2) An "eligible individual" is more specifically defined at I.R.C. § 220(c)(1)(A).

(3) "High-deductible health plan" is defined at I.R.C. § 220(c)(2)(A).

(c) Medical savings account (MSA) — Deductibility from income — Arkansas Code § 26-51-436(5).

(1) The amount of MSA contributions made by a taxpayer should be broken down on a month-by-month basis.

(2) For any given month, the limitation on the deduction that can be taken for that particular month is set forth at I.R.C. § 220(b)(1) and (2).

(3) Other key points regarding deductibility of contributions include:

(A) The annual contribution limit is the sum of the limits determined separately for each month, based on the individual's status and health plan coverage as of the first day of the month;

(B)(i) The deduction for MSA contributions cannot exceed the taxpayer's compensation.

(ii) For employees, see I.R.C. § 220(b)(4)(A).

(iii) For self-employed individuals, see I.R.C. § 220(b)(4)(B);

(C) No deduction is allowed to an individual if any other person is entitled to a personal exemption on account of the individual, whether or not the personal exemption is actually taken;

(D)(i) Contributions to an MSA for a tax year can be made until the due date for filing the individual's tax return for the year (determined without regard to extensions).

(ii) For example, with respect to Arkansas individual income tax returns, the deadline for contributions that a taxpayer wishes to deduct on his or her 1997 return would be May 15, 1998; and

(E)(i) MSA contributions are taken into account in arriving at AGI (i.e., they are taken above the line).

(ii) As such, MSA contributions can be deducted even if the taxpayer does not itemize deductions.

(d) Medical savings account (MSA) — Exclusion from income — Arkansas Code § 26-51-436(5).

(1) Employer contributions to an MSA on behalf of an eligible individual are excludable from gross income.

(2)(A) The amount excludable from gross income cannot exceed the MSA deduction limit applicable to the individual.

(B) See subsection (c) of this section and I.R.C. § 106(a) and (b).

(3) However, employer contributions to an MSA are not excludable from gross income if made at the election of the employee under a salary reduction arrangement under a cafeteria plan.

(4) Other key points regarding excludability of contributions include:

(A) Any employer contribution to an MSA (if otherwise allowable as a deduction) is allowed only for the tax year in which it is actually made; and

(B) Every individual required to file an income tax return for the tax year must include on the return the aggregate amount contributed by employers to the MSAs of the individual or the individual's spouse for the tax year.

(e) Medical savings account (MSA) — Taxability of account earnings — Arkansas Code § 26-51-436(6).

(1) MSA earnings are exempt from income taxation.

(2)(A) However, if an MSA ceases to be an MSA, the account's subsequent earnings would be subject to taxation.

(B) I.R.C. § 220(e).

(f) Medical savings account (MSA) — Taxability of account distributions — Arkansas Code § 26-51-436(7).

(1)(A) Distributions from an MSA that are used to pay the qualified medical expenses of an individual or the individual's spouse or dependents are excludable from gross income.

(B) I.R.C. § 220(f)(1).

(2)(A) "Qualified medical expenses" are any expenses for medical care as defined under the rules relating to the itemized deduction for medical expenses.

(B) See I.R.C. § 220(d)(2)(A).

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. I.R.C. § 220(d)(1) is codified at 26 U.S.C. § 220(d)(1).

I.R.C. § 220(c)(1)(A) is codified at 26 U.S.C. § 220(c)(1)(A).

I.R.C. § 220(c)(2)(A) is codified at 26 U.S.C. § 220(c)(2)(A).

I.R.C. § 220(b)(1) and (2) is codified at 26 U.S.C. § 220(b)(1) and (2).

I.R.C. § 220(b)(4)(A) is codified at 26 U.S.C. § 220(b)(4)(A).

I.R.C. § 220(b)(4)(B) is codified at 26 U.S.C. § 220(b)(4)(B).

I.R.C. § 106(a) and (b) is codified at 26 U.S.C. § 106(a) and (b).

I.R.C. § 220(e) is codified at 26 U.S.C. § 220(e).

I.R.C. § 220(f)(1) is codified at 26 U.S.C. § 220(f)(1).

I.R.C. § 220(d)(2)(A) is codified at 26 U.S.C. § 220(d)(2)(A).

26 CAR § 100-139. FASITs — Arkansas Code § 26-51-440.

(a) **Subchapter M — Arkansas Code § 26-51-440.** Subchapter M of the Internal Revenue Code of 1986, 26 U.S.C. § 851 et seq., as in effect on January 1,

1997, has been adopted for the purpose of computing Arkansas income tax liability with respect to:

- (1) Regulated investment companies (RICs);
- (2) Real estate investment trusts (REITs); and
- (3) Financial asset securitization investment trusts (FASITs).

(b) Subchapter M — FASITs — Definition — Arkansas Code § 26-51-440.

(1) A new type of statutory entity called a financial asset securitization investment trust (FASIT) has been created to facilitate the securitization of debt obligations such as:

- (A) Credit card receivables;
- (B) Home equity loans; and
- (C) Auto loans.

(2) An entity that qualifies as a FASIT can issue instruments that are treated as debt for federal income tax purposes (and interest on which is therefore deductible) whether or not they would be so treated under normal tax principles.

(3) In addition, a FASIT itself generally is not taxable, and any taxable income or net loss that it has (after taking into account deductions for interest on the debt) flows through to the equity owner of the FASIT.

(c) Subchapter M — FASITs — Qualification requirements — Arkansas Code § 26-51-440.

(1)(A) To qualify for status as a FASIT, an entity must meet several requirements, which are specifically set forth at I.R.C. § 860L(a)(1) [repealed].

(B) Any entity, including a corporation, partnership, or trust may be treated as a FASIT.

(2)(A) The ownership of a FASIT (i.e., the "ownership interest") must be held directly by an eligible corporation.

(B) I.R.C. § 860L(a)(1)(C) [repealed].

(C) An eligible corporation is a nonexempt domestic Subchapter C corporation that does not qualify as a:

- (i) RIC;

- (ii) REIT;
- (iii) REMIC; or
- (iv) Cooperative.

(D)(i) Moreover, the ownership interest of a FASIT must generally be entirely held by a single domestic Subchapter C corporation.

(ii) I.R.C. § 860L(a)(2) [repealed].

(3)(A) The FASIT issues debt instruments called "regular interests", which are in the nature of bonds.

(B) These regular interests would normally be purchased by investors and feature the following characteristics:

(i) The investor is unconditionally entitled to receive a specified amount of principal;

(ii) Interest is paid on the principal;

(iii) A stated term to maturity of usually no more than thirty (30) years; and

(iv)(a) In some cases, a FASIT may issue a high-yield interest rather than a regular interest.

(b) The tax treatment to investors of a high-yield interest is different from a regular interest.

(c) I.R.C. § 860L(b)(1)(B) [repealed].

(4)(A) For an entity to qualify as a FASIT, substantially all of its assets must consist of "permitted assets" as defined at I.R.C. § 860L(c)(1) [repealed].

(B) The assets of a FASIT are considered to be owned directly by the holder of the ownership interest.

(d) Subchapter M — FASITs — Taxation of FASITs — Arkansas Code § 26-51-440.

(1)(A) A FASIT is not subject to income tax and is not treated as a:

- (i) Trust;
- (ii) Partnership; or
- (iii) Corporation.

(B) Instead, all of the FASIT's assets and liabilities are treated as the assets and liabilities of the FASIT's owner.

(C) Any income, gain, deduction, credit, or loss of the FASIT is allocable directly to its owner.

(2)(A) Any FASIT income subject to Arkansas income tax shall be taxed at the corporate rates set forth in Arkansas Code § 26-51-205.

(B) No special Arkansas income tax return has been created specifically for FASITs that are located within Arkansas.

(C) As noted above, FASIT income passes through to the FASIT's owner.

(D) The FASIT's owner is responsible for:

(i) Reporting any such income on the owner's return; and

(ii) Paying any Arkansas individual income tax due.

(E) Once an election to be a FASIT is made, the election applies for that tax year and all subsequent years until such time that the election is revoked with the consent of the Internal Revenue Service.

(3)(A) All members of an affiliated group filing a consolidated return are to be treated as one (1) taxpayer.

(B) I.R.C. § 860J(d) [repealed].

(C) Specifically, the provision that the taxable income of a holder of a FASIT ownership interest cannot be less than the taxable income with respect to the FASIT interest applies to any consolidated group of corporations of which the holder is a member as if the group were a single taxpayer.

(4)(A) The holder of a FASIT ownership interest cannot offset income or gain from the FASIT ownership interest with non-FASIT losses.

(B) I.R.C. § 860J [repealed].

(5)(A) The taxable income of a FASIT (in determining the taxable income of the holder of an ownership interest) should be calculated using an accrual method of accounting.

(B) I.R.C. § 860H(b)(2) [repealed].

(e) Subchapter M — FASITs — Taxation of regular interests — Arkansas Code § 26-51-440.

(1) The holder of a regular or high-yield interest in a FASIT (normally an investor) is generally taxed in the same manner as a holder of any other debt instrument.

(2) I.R.C. § 860H(c)(1) [repealed].

(f) Subchapter M — FASITs — Prohibited transactions — Arkansas Code § 26-51-440.

(1) In order to ensure that FASITs are not used for purposes other than securitization, a one hundred percent (100%) federal excise tax is imposed on any income not related to securitization (that is, income derived from prohibited transactions).

(2) Prohibited transactions are specifically set forth at I.R.C. § 860L(e)(1) and (2) [repealed].

(g) Subchapter M — FASITs — Transfers of assets to FASITs — Arkansas Code § 26-51-440.

(1)(A) Where the holder of the ownership interest in a financial asset securitization investment trust (FASIT) or a related person sells or contributes property to the FASIT, gain is recognized immediately in an amount equal to the excess (if any) of the property's value on the date of the contribution over its adjusted basis on that date.

(B) This gain is recognized notwithstanding any other income tax code provision, and the basis of any property is increased by the amount of gain recognized.

(C) I.R.C. § 860I [repealed].

(2) Losses on assets contributed to the FASIT are not allowed upon their contribution but may be allowed to the FASIT owner upon their disposition by the FASIT.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. I.R.C. § 860L was repealed by Pub. Law. No. 108-357.

I.R.C. § 860J was repealed by Pub. Law. No. 108-357.

I.R.C. § 860H was repealed by Pub. Law. No. 108-357.

I.R.C. § 860I was repealed by Pub. Law. No. 108-357.

**26 CAR § 100-140. Deduction — College and technical school tuition —
Arkansas Code § 26-51-447.**

(a) An itemized deduction from the taxpayer's AGI shall be allowed for a portion of the tuition paid by the taxpayer for the taxpayer, the taxpayer's spouse, or the taxpayer's dependent or dependents to attend post-secondary educational institutions that fall into the following classifications:

- (1) Four-year colleges and universities;
- (2) Two-year community colleges; and
- (3) Technical institutes and colleges.

(b)(1) The deduction shall be limited to the lesser of:

- (A) Fifty percent (50%) of the amount actually paid for tuition; or
- (B) Fifty percent (50%) of a weighted average tuition for post-secondary

educational institutions within the same classification.

(2) On or before November 30 of each year (beginning with November 30, 1998), the Office of Income Tax Administration of the Department of Finance and Administration shall obtain and make available the weighted average tuition for each of the three (3) classifications.

(c) This deduction includes tuition paid to qualifying post-secondary educational institutions located both inside and outside of Arkansas.

(d) The deduction will be allowable for tax years beginning on or after January 1, 1998.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. "AGI" means adjusted gross income.

26 CAR § 100-141. Household and dependent care services — Arkansas Code § 26-51-502.

(a) General requirements for the credit — Arkansas Code § 26-51-502(a) and (b)(1).

(1)(A) A credit against individual income tax owed to the State of Arkansas is allowed for expenses associated with household and dependent care services that are necessary for the taxpayer to obtain or hold gainful employment.

(B) Section 21 of the Internal Revenue Code of 1986, as amended and in effect on January 1, 1997, has been adopted for purposes of calculating this credit.

(C) The corresponding Treasury Regulation, as of January 1, 1993, remains I.R.C. Reg. 1.44A-1 [removed].

(2) As set forth in I.R.C. Reg. 1.44A-1 (1993) [removed], five (5) general requirements must be satisfied before the credit can be taken:

(A)(i) The taxpayer must maintain a household.

(ii) I.R.C. Reg. 1.44A-1(a)(2) and (d) [removed];

(B)(i) One (1) or more "qualifying individuals" must be a member of the taxpayer's household.

(ii) I.R.C. Reg. 1.44A-1(a)(2) and (b) [removed];

(C)(i) The household and dependent care expenses must be necessary for the taxpayer to obtain or hold gainful employment.

(ii) I.R.C. Reg. 1.44A-1(a)(2) and (c) [removed];

(D)(i) The services provided, whether they are provided inside the household or outside the household (including services provided by dependent care centers), must meet the specific requirements of I.R.C. § 21.

(ii) I.R.C. Reg. 1.44A-1(c)(2), (c)(3), (c)(4), and (c)(5) [removed];

and

(E)(i) The household and dependent care expenses must actually be paid during the tax year for which the credit is being claimed.

(ii) I.R.C. Reg. 1.44A-1(a)(3) [removed].

(b) **Ten percent standard credit — Arkansas Code § 26-51-502(b)(2).** The amount of the credit shall be ten percent (10%) of the total federal credit allowable under I.R.C. § 21 as in effect on January 1, 1997.

(c) **Twenty percent approved childcare facility credit — Arkansas Code § 26-51-502(c)(1).**

(1) A credit against individual income tax owed to the State of Arkansas is allowed for expenses incurred by a qualified individual for childcare services provided by an approved childcare facility.

(2) The amount of this credit shall be twenty percent (20%) of the total federal household and dependent care credit allowed under Section 21 of the Internal Revenue Code as in effect on January 1, 1993.

(3) Three (3) general requirements must be satisfied before the credit can be taken:

(A) A federal household and dependent care credit must be allowable under I.R.C. § 21 as in effect on January 1, 1993;

(B) A "qualified individual" is a taxpayer who:

(i) Has a dependent child with respect to whom the taxpayer is entitled to a credit under Arkansas Code § 26-51-501(a)(3); and

(ii) Incurs childcare expenses necessary to obtain or hold gainful employment at an approved childcare facility; and

(C) An "approved childcare facility" is a childcare facility that:

(i)(a) Provides an appropriate early childhood program.

(b) Such programs are:

(1) Developmentally appropriate for young children ages three (3) through five (5); and

(2) Approved by the Division of Elementary and Secondary Education; and

(ii)(a) Has been certified by the Division of Child Care and Early Childhood Education.

(b) Arkansas Code § 6-45-109.

(d) Refundability — Arkansas Code § 26-51-502(c)(1).

(1) The twenty percent (20%) Arkansas approved childcare facility credit is refundable.

(2) The excess of this credit over the taxpayer's Arkansas tax liability will be returned to the taxpayer as an overpayment of tax.

(e) Election of credits — Arkansas Code § 26-51-502(c)(2).

(1) A taxpayer cannot claim both the ten percent (10%) and the twenty percent (20%) childcare credit on the same expenses.

(2) If an individual has a federal childcare credit that includes expenses from a facility that qualifies for the twenty percent (20%) credit and expenses from a facility that only qualifies for the ten percent (10%) credit, the credit must be prorated based on the number of days the child attended each facility.

(f) Tax credit — Child with developmental disability — Arkansas Code § 26-51-503.

(1)(A) A taxpayer who is maintaining, supporting, and caring for a child with a developmental disability shall be entitled to a five-hundred-dollar credit per tax year for the child.

(B) If the taxpayer is caring for more than one (1) child with a developmental disability, the taxpayer shall be entitled to one (1) five-hundred-dollar credit per child.

(2) **Requirements.** The following criteria must be satisfied in order to properly claim the exemption:

(A)(i) A physician (medical doctor) must certify in writing that the child has a developmental disability.

(ii) Such certification shall be valid for state income tax purposes for five (5) years;

(B) The individual must meet the eligibility requirements for admission to a human development center (Arkansas Code § 20-48-404), which are:

(i) The taxpayer has resided in the State of Arkansas for at least three (3) years prior to the claim for credit;

(ii) Due to developmental disability, the child is incapable of managing himself or herself or his or her affairs, and his or her welfare requires the special care, training, and education provided at a center; and

(iii) The child's physician has used standard tests and examinations in determining that the child has a developmental disability and is in need of the special training provided at a human development center;

(C) The child with a developmental disability must be:

(i) The taxpayer's biological child;

(ii) The taxpayer's adopted child; or

(iii) Clearly related by blood to the taxpayer; and

(D) The taxpayer must be caring for the child with a developmental disability in the taxpayer's home.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. I.R.C. Reg. 1.44A-1 was removed by 72 FR 45338, 45346.

I.R.C. § 21 is codified at 26 U.S.C. § 21.

26 CAR § 100-142. Income from sources outside Arkansas — Arkansas Code § 26-51-504.

(a) Calculating the credit — Arkansas Code § 26-51-504(a).

(1)(A) When the gross income of an Arkansas resident includes income derived from sources outside the State of Arkansas, such as property or business activity, the Arkansas income tax liability shall first be computed as if all of the Arkansas resident's income was derived from sources within the State of Arkansas.

(B) However, a credit shall be allowed against the resident's Arkansas income tax liability in the amount of any income tax actually owed by the resident for the tax year at issue to any other state or territory.

(2)(A) Any credit given shall not be allowed to exceed what the tax would be on all the Arkansas resident's income, from wherever derived, if such tax was calculated using Arkansas income tax rates.

(B) No credit shall be allowed against the resident's Arkansas income tax liability unless the resident can clearly show that he or she would be subject to double taxation on a portion of his or her income unless the credit is allowed.

Example: Mr. and Mrs. Jones file a full-year resident return in the State of Arkansas. Mr. Jones works in Arkansas and earns thirty thousand dollars (\$30,000). Mrs. Jones works in Oklahoma and also earns thirty thousand dollars (\$30,000). Mrs. Jones paid one thousand five hundred dollars (\$1,500) tax to Oklahoma. The Joneses file as status 4, married filing separate on same return.

	<u>Mr. Jones</u>	<u>Mrs. Jones</u>
Income	\$30,000.00	\$30,000.00
Arkansas Tax	\$1,364.00	\$1,364.00
Total Tax		\$2,728.00
Personal Credits		(\$40.00)
Other State Tax Credit		*(\$1,364.00)
Tax Liability		\$1,324.00

*The other state tax credit is limited to what the amount of Arkansas tax would be if the Oklahoma income was earned in Arkansas.

The Joneses must attach a copy of their Oklahoma tax return to their Arkansas tax return in order to receive this credit.

(b) Prerequisites to claiming the credit — Arkansas Code § 26-51-504(b).

Before a resident of Arkansas may properly claim a credit for income tax paid to another state or territory, he or she shall include with their Arkansas income tax return the following information:

- (1) The amount of income tax owed to any other state or territory; and
- (2) If so requested by the Individual Income Tax Section of the Department of Finance and Administration, information that shows in detail the amount of gross and net income derived by the Arkansas resident from sources outside the State of Arkansas.

(c) Restriction of credit — Arkansas Code § 26-51-504(c).

(1)(A) The credit against Arkansas individual income tax liability for income taxes actually owed to another state or territory shall only be available to Arkansas residents or part-year residents.

(B) Nonresidents are not eligible for this credit.

(2) The credit shall also be available to fiduciaries and partnerships residing or domiciled in Arkansas that either:

(A) Are subject to Arkansas income tax; or

(B) Have to report income for purposes of Arkansas income tax.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-143. Returns by individuals — Arkansas Code § 26-51-801.

(a) Who should file — Arkansas Code § 26-51-801(a).

(1) Every person receiving gross income from Arkansas sources shall file an Arkansas individual income tax return for the tax year such gross income was received with the Revenue Division of the Department of Finance and Administration.

(2) Arkansas sources shall include:

(A) Real or personal property located within Arkansas; and

(B) Business or personal activity carried on within Arkansas.

(3)(A) However, gross income received by nonresident individuals from entirely passive sources within Arkansas is not subject to Arkansas individual income tax and thus need not be reported by such individuals to the Department of Finance and Administration.

(B) Examples of gross income derived entirely from passive sources would be:

- (i) Interest earned on a bank account located within Arkansas; or
- (ii) Dividends from stocks held by an investment firm located within Arkansas as part of its client's investment portfolio.

(b) Filing status 4 — Married filing separately on the same return — Arkansas Code § 26-51-801(a).

(1) Married taxpayers who both have a net taxable income for the tax year may find that this method of tax computation will provide the greatest reduction in their tax liability over any other filing statuses that are available.

(2) The net result will be either a combined refund or a combined tax due.

(3) If there is tax due, both spouses will be considered jointly liable for it even though they are filing separately.

(c) Completing and signing returns — Arkansas Code § 26-51-801(c).

(1) If, for whatever reason, a taxpayer does not complete his or her own Arkansas individual income tax return, the return should be completed by an authorized agent or by a guardian or other court appointed person charged with caring for:

- (A) The taxpayer;
- (B) The taxpayer's estate; or
- (C) Both.

(2) An authorized agent may be designated by power of attorney, will, or any other form of authorization made by the taxpayer that:

- (A) Is clear and unambiguous; and
- (B) Was made by the taxpayer while of sound mind and without duress or coercion.

(3) If the authorized agent is merely a paid tax return preparer hired by the taxpayer, both the tax return preparer and the taxpayer must sign the return.

(d) **Head of household — Arkansas Code § 26-51-801(d)(2).** A taxpayer shall be considered the head of a household if, and only if, the following three (3) conditions are met:

(1) The taxpayer is not married at the close of his or her tax year;

(2) The taxpayer is not a surviving spouse as defined by I.R.C. Reg. 1.2-2(a);

and

(3) The taxpayer either:

(A) Maintains as his or her home a household that constitutes (for the tax year at issue) the principal place of abode, as a member of such household, of at least one (1) of the individuals described in I.R.C. Reg. 1.2-2(b)(3)(i) or (ii); or

(B) Maintains, whether or not as his or her home, a household that constitutes (for the tax year at issue) the principal place of abode of at least one (1) of the individuals described in I.R.C. Reg. 1.2-2(b)(4).

(e) **Surviving spouse — Arkansas Code § 26-51-801(d)(4).**

(1) The term "qualifying widow or widower with dependent child" shall mean the same thing as the term "surviving spouse".

(2) A surviving spouse's Arkansas individual income tax return for each of the next two (2) tax years following the tax year in which the other spouse died shall be treated as a joint return and therefore taxed at the joint return rate if the surviving spouse:

(A) Has not remarried at any time before the close of the tax year;

(B) Maintains (pays more than fifty percent (50%) of the costs of) a household as his or her home that is the principal place of abode of a:

(i) Son or daughter (including adopted or foster children); or

(ii) Stepson or stepdaughter;

(C) Is entitled to a dependency deduction for at least one (1) child; and

(D) Was entitled to file a joint return with the deceased spouse for the year of death.

(3) This surviving spouse rule does not apply to the tax year in which the spouse died.

(4)(A) A joint return may be filed for a husband and wife (thus using a joint return tax rate) where their tax years start on the same day and end on different days because of the death of either or both.

(B) However, if the surviving spouse remarries before the close of his or her tax year, he or she cannot file a joint return for himself or herself and his or her deceased husband or wife.

(f) Dependent defined — Arkansas Code § 26-51-801(d)(1).

(1) A person qualifies as a taxpayer's dependent only if all of the following provisions are met:

(A) Relationship test.

(i) The person is:

(a) Related to the taxpayer; or

(b) A member of the taxpayer's household.

(ii) The person will be considered a member of the taxpayer's household if, for the taxpayer's entire tax year, the person had as his or her principal place of abode the home of the taxpayer;

(B)(i) The person's gross income does not equal or exceed the exemption amount.

(ii) However, this gross income test does not apply to a child of the taxpayer who either:

(a) Has not reached the age of nineteen (19) at the end of the calendar year in which the taxpayer's tax year begins; or

(b) Is a student who has not reached the age of twenty-four (24) at the close of the calendar year;

(C) Support test.

(i) Except for a divorced or separated parent claiming his or her child as a dependent, a taxpayer can claim a person as a dependent only if he or she

furnishes more than fifty percent (50%) of such person's support during the calendar year in which the taxpayer's tax year begins.

(ii)(a) A taxpayer who provides at least ten percent (10%) of a person's support under a multiple support agreement may also meet the support test.

(b) Refer to I.R.C. Reg. 1.152-3.

(iii) The support test for a child of divorced or separated parents is set forth in I.R.C. Reg. 1.152-4 and I.R.C. Reg. 1.152-4T [removed].

(iv)(a) Support funds can take many forms.

(b) However, where the claimed dependent is in an institution supported by a state, charity, etc., the amount spent by the institution on the claimed dependent is:

(1) Part of support; and

(2) Treated as furnished by the institution;

(D)(i) The person does not file a joint return under certain conditions.

(ii) A taxpayer cannot take a dependency exemption for a married person who files a joint return with his or her spouse for a tax year beginning in the same calendar year that the taxpayer's tax year begins.

(iii) However, an exemption may be claimed for a married dependent if neither the dependent nor his or her spouse is required to file a return but they file only to claim a refund of all tax withheld; and

(E) To qualify as a dependent, at some time during the calendar year in which the tax year of the taxpayer begins, a person must be a:

(i) Citizen or resident of the United States;

(ii) Resident of the Canal Zone, Panama, Canada, or Mexico; or

(iii) National of the United States.

(2) **Relationship test.**

(A) A person meets the relationship test only if he or she has one (1) of the following relationships to the taxpayer:

(i) Child or descendant of child;

(ii) Stepchild;

(iii) Brother or sister, whether by whole or half blood;
(iv) Stepbrother or stepsister;
(v) Father, mother, or ancestor of either (grandparent, great-grandparent, etc.);
(vi) Stepfather or stepmother;
(vii) Nephew or niece;
(viii) Brother or sister of father or mother (uncle or aunt);
(ix) Brother-in-law, sister-in-law, father-in-law, mother-in-law, son-in-law, or daughter-in-law.

(B) I.R.C. Reg. 1.151-3(a).

(C) A child born alive qualifies for the full dependency exemption (if other tests are met) even if the child lives only momentarily.

(D) A person is treated as the taxpayer's child if the person is:

(i)(a) Legally adopted by the taxpayer.

(b) I.R.C. Reg. 1.152-2(c);

(ii)(a) A member of the taxpayer's household and is placed with the taxpayer by an authorized placement agency for legal adoption by the taxpayer under a formal application filed with the agency.

(b) The agency must be authorized to place children for adoption by a government or governmental subdivision (state, foreign country, etc.).

(c) I.R.C. Reg. 1.152-2(c)(2); or

(iii)(a) A foster child if he or she meets the member of household test.

(b) I.R.C. Reg. 1.152-2(c)(4).

(E)(i) The relationship must exist with respect to the taxpayer claiming the dependency exemption on the taxpayer's separate return.

(ii) On a joint return, the relationship need exist with respect to only one (1) spouse, and it does not matter which spouse furnished the dependent's support.

(F) These individuals do not meet the relationship test:

- (i) Taxpayer's grandnephew or grandniece;
- (ii) Stepchild's descendant;
- (iii) Aunt's husband; or
- (iv) Foster parent.

(3) Support test — Definition of support. Support includes:

- (A) Food, school lunches, toilet articles, and haircuts;
- (B) Clothing;
- (C) Recreation, including toys, summer camp, horseback riding, entertainment, and vacation expenses;
- (D) Medical and dental care, including premiums on accident and health insurance;
- (E) Childcare expenses, even though a credit is also allowed for these expenses;
- (F) Allowances and gifts;
- (G) Son's or daughter's wedding costs;
- (H)(i) Lodging.
 - (ii) When furnished in kind, it is measured by its fair market value rather than actual cost.
 - (iii) I.R.C. Reg. 1.152-1(a)(2);
- (I)(i) Education.
 - (ii) These costs include board, uniforms at military schools, and tuition, even where free schooling is available.
 - (iii)(a) Scholarship payments received by a dependent are treated as support furnished by someone other than the taxpayer.
 - (b) However, scholarships are not counted in determining whether the taxpayer furnished more than fifty percent (50%) of the dependent's support if these tests are met:
 - (1) The dependent is a child (including stepchild, foster child, or child adopted or placed for adoption) of the taxpayer; and

(2) The dependent is a full-time student at an educational institution.

(c) I.R.C. Reg. 1.152-1(c);

(J)(i) Social Security benefits received by a child and used for his or her support are considered provided by the child.

(ii) I.R.C. Reg. 1.152-1(a)(2)(ii); and

(K)(i) United States Armed Forces dependency allotments.

(ii) The amount contributed by the government and the amount withheld from the pay of the member of the United States Armed Forces are treated as contributed by the member.

(g) Withholding for low-income employees — Arkansas Code § 26-51-801(e).

(1) If a person's gross income is not high enough to subject the person to Arkansas's individual income tax, such person must complete and submit to his or her employer Form AR4ECSP.

(2) This form, also known as the employee's special withholding exemption certificate, must be signed and dated by the employee.

(3) This form allows an employer that would normally withhold Arkansas income tax from the wages of such an employee to refrain from doing so.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. I.R.C. Reg. 1.2-2(a) is codified at 26 C.F.R. § 1.2-2(a).

I.R.C. Reg. 1.2-2(b)(3)(i) or (ii) is codified at 26 C.F.R. § 1.2-2(b)(3)(i) or (ii).

I.R.C. Reg. 1.2-2(b)(4) is codified at 26 C.F.R. § 1.2-2(b)(4)

I.R.C. Reg. 1.152-3 is codified at 26 C.F.R. § 1.152-3.

I.R.C. Reg. 1.152-4 is codified at 26 C.F.R. § 1.152-4.

I.R.C. Reg. 1.152-4T was removed by 73 FR 37797, 37804.

I.R.C. Reg. 1.151-3(a) is codified at 26 C.F.R. § 1.151-3(a).

I.R.C. Reg. 1.152-2(c) is codified at 26 C.F.R. § 1.152-2(c).

I.R.C. Reg. 1.152-2(c)(2) is codified at 26 C.F.R. § 1.152-2(c)(2).

I.R.C. Reg. 1.152-2(c)(4) is codified at 26 C.F.R. § 1.152-2(c)(4).

I.R.C. Reg. 1.152-1(a)(2) is codified at 26 C.F.R. § 1.152-1(a)(2).

I.R.C. Reg. 1.152-1(c) is codified at 26 C.F.R. § 1.152-1(c).

I.R.C. Reg. 1.152-1(a)(2)(ii) is codified at 26 C.F.R. § 1.152-1(a)(2)(ii).

26 CAR § 100-144. Partnership returns — Arkansas Code § 26-51-802.

(a) Partnership returns — Generally — Arkansas Code § 26-51-802(a).

(1) For a tax year in which a partnership receives any income from Arkansas sources, a partnership return (AR1050) must be:

- (A) Filed on behalf of the partnership; and
- (B) Signed by at least one (1) of the partners.

(2) The partnership return must include the:

(A) Names and addresses of all partners of whatever nature who are entitled to a share of the partnership's income; and

- (B) Percentage or amount of each such partner's share.

(b) **Partnership income from Arkansas sources — Arkansas Code § 26-51-802(b).** All partnership income from activities carried on within Arkansas or from real or personal property located within Arkansas must be allocated to Arkansas.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-145. Fiduciary returns — Arkansas Code § 26-51-803.

(a)(1) A fiduciary return (AR1002F) is used to report the income of an estate or trust.

(2) The income received by an estate or trust will be considered attributable to Arkansas when the estate or trust's trustee, administrator, executor, or personal representative is a resident of Arkansas.

(3) Likewise, the income received by an estate or trust shall be attributable to Arkansas when the estate or trust is physically located within Arkansas.

(4) As such, a fiduciary return must be filed by every resident (AR1002) and nonresident (AR1002NR) fiduciary under the following circumstances:

(A) Any income of such estate or trust is currently distributable;

(B) The tax is payable by the beneficiaries or by the grantor;

(C) The net income of such estate or trust is three thousand dollars (\$3,000) or over; or

(D) Any beneficiary of such estate or trust is a nonresident.

(b) Pursuant to Arkansas Code § 26-51-201(b) and (c), a limited exemption from Arkansas income tax has been established for resident fiduciaries under the following circumstances:

(1) The trust or estate was created by a nonresident individual; or

(2) The beneficiary of a trust is a nonresident.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-146. Filing returns — Time and place — Forms — Arkansas Code § 26-51-806.

(a) Due date and what constitutes filing — Arkansas Code § 26-51-806(a).

(1) The due date for the filing of Arkansas individual income tax returns shall be as follows:

(A) May 15 for tax years based on a calendar year; or

(B) Four and one-half (4 1/2) months from the closing date of the period covered for tax years based on a fiscal year.

(2)(A) A tax return is filed with the Department of Finance and Administration at the time and date it is actually received by the department.

(B)(i) However, there is one (1) exception to this rule for tax returns mailed to the department through the United States Postal Service, Arkansas Code § 26-18-105.

(ii) This statute states that the postmark date on the envelope containing the tax return (or returns) shall be considered the return's filing date with the department.

(iii) Only tax returns mailed through the United States Postal Service qualify for this filing break.

(C) Tax returns sent through private carriers such as United Parcel Service or Federal Express will be considered filed when such returns are actually received by the department.

(3) If the due date falls on a Saturday, Sunday, or legal holiday for which the department is closed in observance of, the due date shall be the next working day that the department is open for business.

(b) Responsibility for obtaining and filing returns — Arkansas Code § 26-51-806(b)(1).

(1) When a taxpayer requests that the department send the taxpayer a tax return or related form, such as through the mail or via facsimile transmission, the department must make a good-faith effort to comply with all such requests that are

reasonable, even though the department has no legal obligation or duty to deliver tax returns or forms to taxpayers via public or private carrier.

(2) However, it is ultimately the taxpayer's responsibility to obtain, properly complete, and file all Arkansas individual income tax returns and related forms required by Arkansas law to be completed and filed.

(3) A taxpayer may not avoid responsibility for any tax, penalty, or interest properly due the State of Arkansas merely because the department did not send the taxpayer the appropriate return or forms, even where personnel of the department advised the taxpayer that such return or forms would be sent by the department to the taxpayer.

(c) Signing returns — Arkansas Code § 26-51-806(c).

(1)(A) Every taxpayer filing an Arkansas individual income tax return must sign and date the return.

(B) Where a married couple files a joint return or files separately on the same return, both taxpayers must sign the return.

(C) Tax returns that have not been signed will not be processed although otherwise complete.

(D) If the taxpayer paid someone else to complete the return, the paid preparer must also sign and date the return (in addition to the taxpayer).

(2)(A) Arkansas individual income tax returns that are filed electronically by computer or by telephone must still be signed by the taxpayer.

(B) However, the signature can be entered electronically by keystroke or spoken over the telephone for such alternative filing options.

(3)(A) Any taxpayer who files an Arkansas individual income tax return that has been fraudulently prepared is guilty of a Class D felony.

(B) Arkansas Code § 26-18-203.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-147. Filing returns — Extensions of time — Arkansas Code § 26-51-807.

(a) Extension of time — Generally — Arkansas Code § 26-51-807(a).

(1)(A) A taxpayer who requests an automatic extension of time for filing his or her federal income tax return (by filing Form 4868 with the Internal Revenue Service) shall be entitled to receive the same extension of time to file the taxpayer's corresponding Arkansas income tax return.

(B) However, in order to take advantage of the federal automatic extension for state purposes, the taxpayer must check the appropriate box on the corresponding Arkansas return indicating that he or she has already requested an automatic federal extension.

(C) Beginning with the 1997 tax year, the Department of Finance and Administration will no longer require that a copy of Form 4868 be attached to a taxpayer's state return.

(2)(A) The federal extension provided by Form 4868 extends the due date for filing a federal individual income tax return by four (4) months from April 15 to August 15 (for a calendar-year taxpayer).

(B) This federal extension is provided automatically and need not be approved by the Internal Revenue Service provided Form 4868 is properly completed and filed.

(C) Assuming the box on the taxpayer's Arkansas income tax return indicating that the taxpayer has already requested an automatic federal extension has been checked, the return must be filed with the department on or before August 15 (for a calendar-year taxpayer).

(3)(A) "Corresponding" means the same type of state and federal income tax return.

(B) For example, a properly completed Form 4868 for a federal individual income tax return will also apply to an Arkansas individual income tax return.

(C) However, this automatic extension cannot be used to obtain an extension of time to file a noncorresponding Arkansas income tax return, such as a fiduciary or partnership return.

(4)(A) A taxpayer who requests and is granted an extension of time for filing his or her federal income tax return beyond the automatic four-month extension period and who attaches a copy of the document granting the additional federal extension to the taxpayer's corresponding Arkansas income tax return, shall automatically receive an additional extension of time until the due date of the federal income tax return to file the corresponding Arkansas income tax return.

(B) Federal Form 2688 is used to request an extension beyond the four-month period that is automatically available.

(C)(i) In undue hardship cases, an extension of up to six (6) months from the original due date of the return will be granted.

(ii) For a calendar-year taxpayer, a six-month extension would push the filing due date for the taxpayer's federal and Arkansas individual income tax returns to October 15.

(5)(A) As set forth in 26 CAR § 100-109, a taxpayer who does not obtain any type of federal extension may nonetheless request an extension of the due date for filing his or her Arkansas individual income tax return.

(B)(i) Moreover, an extension can be requested from the department even when a federal extension (four (4) or six (6) months) has been taken.

(ii) However, such a request must be submitted before the federal extension period expires.

(C) Arkansas Form AR1055 must be properly completed for such requests and filed with the department.

(D) When no federal extension has been taken, Form AR1055 must be filed before the due date for filing Arkansas individual income tax returns, which is May 15 for calendar-year taxpayers.

(6) The extension request (up to ninety (90) days), will be granted for good cause shown.

(7)(A) An additional extension of up to another ninety (90) days may be granted under extraordinary circumstances.

(B) The request for an additional extension of time must be requested in the form of a letter setting forth in detail the reasons why the additional extension is needed, along with a copy of the approved initial (i.e., good cause) extension.

(C) The request for an additional extension of time, along with a copy of the approved initial extension and any other supporting documentation, should be sent to:

Individual Income Tax Section
Department of Finance & Administration
P. O. Box 3628
Little Rock, AR 72203-3628

(8) Arkansas individual income tax returns filed after the original due date (i.e., late) without the appropriate box checked or without the appropriate state or federal extension documents will be considered delinquent and thus subject to a failure-to-file penalty.

(b) Payment of tax, penalty, and interest — Arkansas Code § 26-51-807(b).

(1) Although an Arkansas taxpayer receives an extension of time to file his or her Arkansas individual income tax return, this extension does not extend to the payment of any income tax due the State of Arkansas.

(2) A taxpayer should:

(A) File a tentative return in the form of estimated tax voucher #5 on or before the original due date for filing the return (May 15 for calendar-year taxpayers); and

(B) Include with the return payment in full of any tax estimated to be due the State of Arkansas.

(3) Interest at the rate of ten percent (10%) per annum will be assessed on all unpaid tax due the State of Arkansas from the original due date for filing the return (May 15 for calendar-year taxpayers).

(4)(A) A failure-to-pay penalty will also be assessed on all unpaid tax due the State of Arkansas from the original due date for filing the return.

(B) However, no failure-to-file penalty will be assessed where the taxpayer has properly requested an extension of time to file his or her Arkansas individual income tax return.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-148. Failure to file return or include income — Arkansas Code § 26-51-808.

(a) Taxpayer required to file return or amended return — Arkansas Code § 26-51-808(a) and (b).

(1) The Department of Finance and Administration shall have the authority to require a taxpayer to file an Arkansas income tax return or an amended Arkansas income tax return under the following circumstances:

(A) The taxpayer has failed to file a return;

(B) The taxpayer has failed, through error, to include items of taxable income in the taxpayer's return; or

(C) The taxpayer has intentionally failed to include items of taxable income in the taxpayer's return.

(2) A return or amended return filed under such circumstances must include all items of income received by the taxpayer during the tax year, whether or not such income is subject to Arkansas individual income tax.

(b) Penalties, prosecution, and jeopardy assessments — Arkansas Code § 26-51-808(c).

(1)(A) Even though a taxpayer fully complies with a request by the department to file a return or amended return, any penalties justifiable under Arkansas Code § 26-18-208 may be assessed against the taxpayer.

(B) Moreover, in the case of intentional failure to disclose taxable income (i.e., fraud), a referral to the appropriate prosecuting attorney for criminal prosecution may be appropriate.

(C) Arkansas Code § 26-18-201 et seq.

(2) Where a taxpayer refuses to promptly comply with a request by the department to properly prepare and file a return or amended return, the department may make a jeopardy assessment against the taxpayer as set forth in Arkansas Code § 26-18-402.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-149. Receipts for taxes — Arkansas Code § 26-51-809.

The Department of Finance and Administration shall provide, upon request, to any taxpayer making a tax payment a written or printed receipt containing the following information:

- (1) The amount paid;
- (2) The account to which the payment will be credited; and
- (3) If applicable, the installment period to which the payment will be credited.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-150. Forms for tax practitioners — Fee charged by department — Arkansas Code § 26-51-810.

The Department of Finance and Administration may charge a postage fee for blank tax returns and related forms mailed to any person, partnership, limited liability company, or corporation that prepares tax returns for a fee.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

**26 CAR § 100-151. Information at source as to recipients of income —
Arkansas Code § 26-51-811.**

(a) Recipients of income — Generally — Arkansas Code § 26-51-811(a).

(b) Every individual, fiduciary, and business entity of whatever type or nature (payor) located within Arkansas shall report to the Department of Finance and Administration, on Form 1099, all payments totaling two thousand five hundred dollars (\$2,500) or more made to taxpayers (payees, such as individuals, fiduciaries, or business entities) during the tax year.

(c) Such payments shall include:

- (1) Interest;
- (2) Rent;
- (3) Salaries;
- (4) Wages;
- (5) Premiums;
- (6) Annuities;
- (7) Compensation;
- (8) Remuneration;
- (9) Gains;
- (10) Profits; and
- (11) Other income.

(d)(1) When such payments are not properly reported to the department, the department can disallow the payments as deductions or credits in computing the payor's Arkansas income tax liability.

(2) Moreover, the department can require payors making payments as described above to withhold Arkansas income tax from such payments and remit the tax directly to the department.

(3) Arkansas Code § 26-51-812 and the Arkansas Income Tax Withholding Act of 1965, Arkansas Code § 26-51-901 et seq.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-152. Confidentiality of reports and returns — Arkansas Code § 26-51-813.

(a) Confidentiality — Generally — Arkansas Code § 26-51-813.

(1) All employees of the Department of Finance and Administration must keep all taxpayer information strictly confidential.

(2) This includes:

(A) Information gained through an audit or investigation conducted by:

- (i) The State of Arkansas;
- (ii) Any other state; or
- (iii) The United States Government;

(B) Information from any tax returns, reports, forms, or other related documents filed with:

- (i) The State of Arkansas;
- (ii) Any other state; or
- (iii) The United States Government; and

(C) Tax-related information provided in any other form from any other source whatsoever.

(3) The provisions of Arkansas Code § 26-51-813 shall complement and be read in conjunction with those of Arkansas Code § 26-18-303, which is the confidentiality statute of the Arkansas Tax Procedure Act, Arkansas Code § 26-18-101 et seq.

(4) The provisions of both Arkansas Code §§ 26-18-303 and 26-51-813 shall be strictly interpreted to ensure the highest degree of taxpayer confidentiality.

(b) Confidentiality — Exceptions — Arkansas Code § 26-51-813. Taxpayer information may be disclosed, but only to the extent necessary, under the following circumstances:

(1) The taxpayer and the department are involved in a proceeding, either administratively or judicially, involving any issue related to Arkansas's individual income tax;

(2) To income tax officials of any other state or the United States Government if:

(A) The taxpayer is required by the law of the other state or the United States Government to file an income tax return; and

(B) The other state or the United States Government has substantially the same confidentiality laws as the State of Arkansas;

(3) To the Attorney General or any other legal representatives of the State of Arkansas when the taxpayer and the department are involved in an administrative or judicial proceeding (or such a proceeding is at least necessary and/or pending) involving any issue related to Arkansas's individual income tax;

(4)(A) To the Office of Child Support Enforcement of the Revenue Division of the Department of Finance and Administration with respect to a parent from whom the Office of Child Support Enforcement is charged with collecting child support.

(B) However, only the following information may be disclosed:

(i) Last known address;

(ii) Last known whereabouts; and

(iii) Last known employer.

(C) The department will only allow the Office of Child Support Enforcement to examine the parent's tax return (both personal and business) and will only provide any other tax-related information regarding the parent when specifically compelled to do so by order of the Supreme Court or any Arkansas Chancery Court;

(5)(A) To the Student Loan Authority Division of the Arkansas Development Finance Authority or the Student Loan Guarantee Foundation of Arkansas with respect to any person from whom these agencies are charged with collecting a student loan indebtedness.

(B) However, only the following information may be disclosed:

(i) Last known address;

- (ii) Last known whereabouts; and
- (iii) Last known employer.

(C) These agencies shall not be allowed to examine any tax returns or related documents filed with the department; or

(6)(A) To the Division of Higher Education or any Arkansas public institution of higher education with respect to any person from whom these institutions are charged with collecting student indebtedness.

(B) However, only the following information may be disclosed:

- (i) Last known address;
- (ii) Last known whereabouts; and
- (iii) Last known employer.

(C) These institutions shall not be allowed to examine any tax returns or related documents filed with the department.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-153. Computing capital gains and losses — Arkansas Code § 26-51-815.

(a) Computing capital gains and losses — Generally — Arkansas Code § 26-51-815(a).

(1) With respect to capital gains and losses realized or incurred during tax years beginning after December 31, 1990, the following Internal Revenue Code and regulations shall apply:

(A) I.R.C. §§ 1211 – 1237 and 1239 – 1257, as in effect on January 1, 1997;

(B) Corresponding regulations promulgated by the United States Secretary of the Treasury as in effect on January 1, 1997; and

(C) Any other provisions of the Internal Revenue Code and regulations necessary for interpreting and implementing the above cited code sections as in effect on January 1, 1997.

(2) However, the provisions of this subsection shall not apply to Subchapter C corporations as defined in I.R.C. § 1361 as in effect on January 1, 1997.

(b) Computation of tax — Arkansas Code § 26-51-815(b).

(1) If a taxpayer has a net capital gain for a given tax year, the tax on such capital gain shall not exceed the sum of:

(A) A tax computed at the rates and in the same manner as if this subsection had not been enacted on the greater of:

(i) Taxable income reduced by the amount of the net capital gain; or

(ii) The amount of taxable income taxed at a rate below six percent (6%); plus

(B) A tax of six percent (6%) on the amount of taxable income in excess of the amount determined under subdivision (b)(1)(A) of this section, above.

(2) I.R.C. § 1222 defines "net capital gain" as the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year.

Example 1: Mr. Jones, a single taxpayer with no dependents, reported a net taxable income of forty thousand dollars (\$40,000) after itemized deductions. The income and deductions comprised the following:

Wages	\$	30,000.00
Interest	\$	500.00
Net Capital Gain	\$	15,000.00
Total Income	\$	45,500.00
Less Itemized Deductions		<u>(\$ 5,500.00)</u>
Net Taxable Income	\$	40,000.00

Mr. Jones' tax liability is calculated as follows:

ORDINARY INCOME: Wages	\$ 30,000.00
Interest	<u>\$ 500.00</u>
Total Ordinary Income	\$ 30,500.00
Less Itemized Deductions	<u>(\$ 5,500.00)</u>
Subtotal #1	\$ 25,000.00
Tax on Subtotal #1 (Using the Itemized Deduction Tax Table)	\$ 1,084.00
Net Capital Gain Income	\$ 15,000.00
Tax on Net Capital Gains (Maximum tax rate of 6%)	\$ 900.00
TOTAL TAX LIABILITY	\$ 1,984.00

(3) Reminder.

(A) Normal Arkansas tax rates are graduated from one percent (1%) to six percent (6%) up to twenty-five thousand dollars (\$25,000) and seven percent (7%) for income twenty-five thousand dollars (\$25,000) and above.

(B) The maximum tax rate for net capital gains cannot exceed six percent (6%).

Example 2: Same as Example 1 but the wages equal fifteen thousand dollars (\$15,000) and net taxable income equals twenty-five thousand dollars (\$25,000).

Mr. Jones' tax liability is calculated as follows:

ORDINARY INCOME: Wages	\$ 15,000.00
Interest	<u>\$ 500.00</u>
Total Ordinary Income	\$ 15,500.00
Less Itemized Deductions	<u>(\$ 5,500.00)</u>
Subtotal #1	\$ 10,000.00

Since Subtotal #1 is less than twenty-five thousand dollars (\$25,000), add the capital gain up to this amount.

Capital Gains	\$ 15,000.00
TOTAL TAX LIABILITY	\$ 1,984.00

Example 3: Same as Example 1 but wages equal fifty thousand dollars (\$50,000) and net taxable income equals sixty thousand dollars (\$60,000).

Mr. Jones' tax liability is calculated as follows:

ORDINARY INCOME: Wages	\$ 50,000.00
Interest	<u>\$ 500.00</u>
Total Ordinary Income	\$ 50,500.00
Less Itemized Deductions	<u>(\$ 5,500.00)</u>
Subtotal #1	\$ 45,000.00

Tax on Subtotal #1
(Using the Itemized Deduction Tax Table) \$ 2,484.00

Capital Gains	\$ 15,000.00
---------------	--------------

Tax on Long Term Capital Gains (Maximum tax rate of 6%)	\$ 900.00
 TOTAL TAX LIABILITY	 \$ 3,384.00

(c) **Exclusion of small business stock from gain — Arkansas Code § 26-51-815(c).** I.R.C. § 1202, as in effect on January 1, 1995, regarding the exclusion from gain of certain small business stock, is adopted for the purpose of computing Arkansas income tax liability.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. I.R.C. §§ 1211 – 1237 are codified at 26 U.S.C. §§ 1211 – 1237.

I.R.C. 1239 – 1257 are codified at 26 U.S.C. §§ 1239 – 1257.

I.R.C. § 1361 is codified at 26 U.S.C. § 1361.

I.R.C. § 1222 is codified at 26 U.S.C. § 1222.

I.R.C. § 1202 is codified at 26 U.S.C. § 1202.

26 CAR § 100-154. Definitions — Arkansas Code § 26-51-902.

(a) **Agricultural labor — Federal definition — Arkansas Code § 26-51-902(1).** "Agricultural labor" shall be as defined in I.R.C. § 3121(g), as in effect on January 1, 1993.

(b) **Agricultural labor — When nonagricultural labor is also performed — Arkansas Code § 26-51-902(1).**

(1) Where an employee performs duties consisting of both agricultural and nonagricultural labor, the agricultural exemption applies only if the employee in question performs services that constitute valid agricultural labor for at least one-half (1/2) of any pay period (a period of not more than thirty-one (31) consecutive days).

(2) When this requirement has been met, all wages paid by the employer to the employee for the given pay period will be exempt from withholding.

(3) See *Ragland v. Pittman Garden Center*, 293 Ark. 533, 739 S.W.2d 671 (1987).

(c) Agricultural labor — Landscaping services — Arkansas Code § 26-51-902(1).

(1) Landscaping services do not fall within the scope of agricultural labor.

(2)(A) Services performed at nurseries or garden centers operated primarily for the raising of horticultural commodities do fall within the scope of agricultural labor.

(B) However, a nursery or garden center employee is no longer considered to be engaged in agricultural labor at the moment the employee leaves the nursery or garden center to engage in nonagricultural labor.

(3) See *Ragland v. Pittman Garden Center*, 299 Ark. 293, 772 S.W.2d 331 (1989).

(d) Employer — Arkansas Code § 26-51-902(5).

(1) An "employer" is any employer, whether a resident or nonresident of Arkansas, who:

(A) Is carrying on business activity within Arkansas or is receiving income from sources located within Arkansas; and

(B) Has control, either directly or through an officer or agent, over the payment of wages to an individual for services performed by such individual within Arkansas.

(2) Nonresident employers include both:

(A) Transient employers; and

(B) Those employers carrying on business activity within Arkansas or receiving income from sources within Arkansas on a long-term (nontransient) basis.

(e) Transient employer — Arkansas Code § 26-51-902(11).

(1) A "transient employer" is an employer who:

(A) Is not a resident of Arkansas; and

(B) Temporarily engages in any activity within Arkansas for the purpose of producing income for the employer.

(2) A temporary engagement is one that, as of any date, cannot reasonably be expected to continue for a period of eighteen (18) consecutive months.

(3) See also 26 CAR § 100-155(b).

(f) Wages for agricultural labor — Cash remuneration — Arkansas Code § 26-51-902(12)(B). Pursuant to I.R.C. § 3121(a), cash remuneration paid by an employer in any calendar year to an employee for agricultural labor shall not be considered wages subject to withholding unless:

(1) The cash remuneration paid in such year by the employer to the employee for such labor is one hundred fifty dollars (\$150) or more; or

(2)(A) The employer's expenditures for agricultural labor in such year equal or exceed two thousand five hundred dollars (\$2,500).

(B) However, subdivision (f)(2) of this section shall not apply in determining whether remuneration paid to an employee constitutes wages if such employee:

(i) Is employed as a hand-harvest laborer and is paid on a piece-rate basis in an operation that has been, and is customarily and generally recognized as having been, paid on a piece-rate basis in the region of employment;

(ii) Commutes daily from his or her permanent residence to the farm on which he or she is employed; and

(iii) Has been employed in agriculture less than thirteen (13) weeks during the prior calendar year.

(g) Wages for agricultural labor — Noncash remuneration — Arkansas Code § 26-51-902(13)(B). Remuneration paid in any medium other than cash for agricultural labor shall not be considered wages, regardless of the amount or quantity paid.

(h) Withholding of income tax on agricultural wages — Arkansas Code § 26-51-902(13)(B)(i) and (ii).

(1) When cash remuneration paid for agricultural labor is considered wages according to the criteria set forth above, if the agricultural employer pays wages to four (4) or more employees during any reporting period, the employer shall be required to withhold Arkansas income taxes for any such reporting periods.

(2) However, if the agricultural employer pays wages to three (3) or fewer employees during a reporting period, the employer shall have the option to withhold Arkansas income taxes for any such reporting periods if the employer so chooses.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. I.R.C. § 3121(g) is codified at 26 U.S.C. § 3121(g).

I.R.C. § 3121(a) is codified at 26 U.S.C. § 3121(a).

26 CAR § 100-155. Filing of employer's withholding return and payment of income taxes withheld — Arkansas Code § 26-51-908.

(a) Filing schedule for employer's withholding returns — Arkansas Code § 26-51-908.

(1)(A) All employers, resident or nonresident, are initially set up as monthly filers when their registration for a withholding account (via Form AR4ER) is first processed.

(B) Monthly withholding returns:

(i) Are to be filed on or before the fifteenth day of each month; and

(ii) Should include with the return payment in full of all income tax withheld for the preceding (i.e., prior) month.

(2)(A) All employers will remain on a monthly filing schedule regardless of the amount of Arkansas income tax they are withholding.

(B) At the request of the employer or on the Department of Finance and Administration's own initiative, the department can change the employer's filing

schedule from once each month to once each year if the full amount of Arkansas income tax that the employer was required to withhold for the preceding (i.e., prior) year was one hundred ninety-nine dollars (\$199) or less.

(C) Yearly withholding returns must be filed on or before January 31 for the preceding year.

(3)(A) Withholding returns are no longer processed on a quarterly basis by the department.

(B) Therefore, employers should not attempt to file withholding returns on a quarterly basis.

(b) Transient employer — Arkansas Code § 26-51-908(b).

(1)(A) All transient employers shall complete and submit a withholding return (AR941M) to the Individual Income Tax Section of the Department of Finance and Administration once each month.

(B) The full amount of Arkansas income tax required to be deducted and withheld from the employee's wages for the preceding (i.e., prior) calendar month shall be submitted along with the withholding return for such month.

(2) Transient employers shall file their withholding returns (along with payment in full of all income tax due) with the Department of Finance and Administration on or before the last day of the month following the month for which the income taxes were deducted and withheld from the wages of the employees.

(3) See also 26 CAR § 100-154(e).

(c) Employers engaged in a seasonal business — Arkansas Code § 26-51-908(c).

(1) All employers engaged in any business that is seasonal in nature shall nonetheless be required to complete and file a withholding return on or before the last day of each month for wages paid to employees the preceding (i.e., prior) calendar month.

(2) The employer shall remit payment in full of all income taxes required to be deducted and withheld along with the withholding return.

(d) **Filing requirements when employer no longer withholds income tax — Arkansas Code § 26-51-908(g).** An employer on a monthly or annual filing schedule who correctly no longer withholds and remits income tax to the department must continue to file monthly or annual reports until such time that the employer gives the department written notice that the employer:

- (1) No longer has any employees; or
- (2) Has no employees based within or regularly working within Arkansas.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-156. Annual withholding statement — Arkansas Code § 26-51-909.

(a) **Filing requirement — Arkansas Code § 26-51-909(a).**

(1) Every employer shall file with the Secretary of the Department of Finance and Administration an annual statement of withholding (federal Form W-2) for each employee along with an Arkansas Annual Withholding Tax Reconciliation (Form AR-3MAR).

(2)(A) Every employer shall also file with the secretary a copy of all federal Form 1099s issued during the year.

(B) The 1099s must be accompanied by a copy of the federal transmittal (federal Form 1096).

(b) **Filing requirement — Due date — Arkansas Code § 26-51-909(b).**

(1) The annual withholding tax reconciliation statement with attached W-2s shall be filed with the Department of Finance and Administration on or before February 28 following the close of the income year.

(2)(A) The statement from the employer for the employee (Form W-2) shall be provided to the employee on or before January 31 following the close of the income year.

(B) However, if the employment of the employee is terminated during the calendar year, the employer shall furnish the W-2 to the employee at the time of termination of the employment.

(3) The Form 1096 transmittal with attached Form 1099s shall be filed with the department on or before February 28 following the close of the income year.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

26 CAR § 100-157. Acts 1997, No. 1309.

(a) Tuition savings program — Generally.

(1)(A) The Arkansas Tax-Deferred Tuition Savings Program Act of 1997, Arkansas Code § 6-83-101 et seq. [repealed], became effective on August 1, 1997.

(B) The Arkansas Tax-Deferred Tuition Savings Program Act of 1997 is based closely upon the federal law regarding qualified state tuition programs found at I.R.C. § 529.

(C) For purposes of administering the Arkansas Tax-Deferred Tuition Savings Program Act of 1997, the provisions of I.R.C. § 529 regarding qualified state tuition programs should be considered to have been adopted as Arkansas law.

(2)(A) Arkansas residents or nonresidents may make cash contributions to a special tax-deferred account for the purpose of accumulating funds to pay the expenses of attending a post-secondary institution of higher education located either inside or outside of Arkansas.

(B) The contributions will be held, invested, and accounted for by the Arkansas Teacher Retirement System.

(3) "Expenses" shall be limited to tuition, fees, books, supplies, and equipment required for enrollment or attendance at the post-secondary institution.

(4)(A) "Post-secondary institutions of higher education" shall include two-year and four-year:

- (i) Colleges;
- (ii) Universities;

- (iii) Technical schools; and
- (iv) Institutes.

(B) Institutions that meet all of the following criteria would also qualify:

- (i) The institution provides not less than a six-month program of training to prepare students for gainful employment in a recognized occupation;
- (ii) The institution is:
 - (a) Licensed by the State Board of Private Career Education; or
 - (b) Accredited by a nationally recognized accrediting agency;
- (iii) The institution has been in existence for at least two (2) years;

and

(iv) The institution admits as regular students persons who are beyond the age of compulsory school attendance within the State of Arkansas.

(C) I.R.C. § 135(c)(3), 20 U.S.C. § 1201a(10) [repealed], 20 U.S.C. § 1088.

(5)(A) The account must have a designated beneficiary, who must be either the contributor to the account or a member of the contributor's family.

(B) Qualifying family members are limited to the following:

- (i) An ancestor of the contributor;
- (ii) A contributor's spouse;
- (iii) A lineal descendant of:
 - (a) The contributor;
 - (b) The contributor's spouse; or
 - (c) A parent of the contributor; or

(iv) The spouse of any lineal descendant falling within the scope of subdivision (a)(5)(B)(iii) of this section, above.

(C) I.R.C. § 2032A(e)(2).

(b) Acts 1997, No. 1309 [repealed] — Tuition savings program — Tax consequences.

Contributor's Gross Income	Beneficiary's Gross Income
Contributions **Nondeductible	Excluded To Program

Earnings on	Excluded	Excluded Contributions
*Distributions	Excluded	Excluded From Program

*Any distributions made to the contributor or beneficiary that are not used as qualifying expenses at a qualifying post-secondary institution of higher education must be included in the taxpayer's taxable income.

**Contributions to a tax-deferred tuition savings program account are not deductible "above the line" as an adjustment to the contributor's gross income. Arkansas' tuition savings program is based upon IRC Sec. 529 which does not allow contributions to such programs to be taken as deductions.

Authority. Arkansas Code §§ 26-18-301, 26-51-104.

Codification Notes. The Arkansas Tax-Deferred Tuition Savings Program Act of 1997 was repealed by Acts 1999, No. 996, § 15.

I.R.C. § 529 is codified at 26 U.S.C. § 529.

I.R.C. § 135(c)(3) is codified at 26 U.S.C. § 135(c)(3).

20 U.S.C. § 1201a was repealed by Pub. L. No. 105-220.

Appendix A. Individual Income Tax Regulations

Link:

<https://CodeOfARRules.arkansas.gov/docs/CARCodeAppendices/Appendices/217/26CARpt.100Appendix.pdf>