

Arkansas Tax Reform Brief

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DDH SALT Tax Team



Matthew C. Boch

Matt Boch helps clients navigate state and local tax issues and leverage economic development incentives. He is deeply involved in the world of Arkansas taxes and incentives, and he also practices on a multistate basis. He is a member and former Chair of the Arkansas Tax Advisory Council and assists the Arkansas State Chamber of Commerce in tax policy as an *ex officio* Board Member. Matt also authors or coauthors the Arkansas chapters of Bloomberg BNA's *Corporate Income Tax Navigator* and *Pass-Through Entity Navigator* and the ABA *Sales & Use Tax Deskbook*. At the multistate level, Matt is a member of the SALT Executive Committee for the American Bar Association as well as the Independent SALT Alliance, and he is active in COST and IPT.

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Thane J. Lawhon

T.J. Lawhon concentrates his practice in business related matters including taxation, commercial transactions, agriculture law and regulatory issues. He received his B.S. degree from the University of Arkansas at Fayetteville, his M.B.A. degree from the University of Arkansas at Little Rock, and his J.D. degree, with honors, from the William H. Bowen School of Law. He is a participating member of the Arkansas Tax Advisory Council and a board member of the Agriculture Council of Arkansas. He is co-author of the Arkansas chapter of the American Bar Association's Sales and Use Tax Deskbook, the Council on State Taxation State Tax Update, and is a frequent contributor to articles, updates and materials regarding state and local tax issues.

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Michael O. Parker

Mike Parker concentrates his practice in the areas of state and local tax and litigation, business law and regulatory issues. He received his B.A. degree from Vanderbilt University, his J.D. degree with honors from the University of Arkansas at Fayetteville, and has been a practicing attorney for over 40 years. For many of those years, Mike has advocated for changes to the Arkansas state tax code as tax counsel for the Arkansas State Chamber of Commerce and Associated Industries of Arkansas, and on behalf of individual clients; and has had a hand in writing and passing many of the more business-friendly tax bills adopted in recent years. Mike has been recognized as a Best Lawyers' Lawyer of the Year in Tax Litigation and Controversy and as a Mid-South Super Lawyer for several years.

Arkansas Tax Reform & 2019 Legislation

- Overview of Arkansas Tax Reform Context & Process
- 2019 Acts and Bills
 - Task Force legislation
 - Other legislation

The Big Picture: *Regnat Populus* Tax Policy

- Arkansas's populist tax structure:
 - Very high sales taxes, with complex rules
 - Average-to-high, steeply progressive income tax
 - Very low property taxes, esp. w/ homestead credit
- With shift to “red” state:
 - Broad desire to cut income taxes
 - Some interest in making state more competitive
 - Strong resistance to raising taxes

Tax Reform & Relief Legislative Task Force

- Governor Hutchinson's income tax cuts
 - 2015 \$100m middle class tax cut
 - 2017 \$50m low-income tax cut disappointed some legislators
 - Task Force included in 2017 package as a chance for legislative leadership
- Tax Reform & Relief Legislative Task Force
 - 16 legislators
 - Met from May 2017 – December 2018

Task Force's Recommendations

1. Regularly review credits and exemptions
2. Use sales tax exemption repeals to pay for income tax cuts
3. Cap local sales taxes at 7%
4. Expand car wash exemption and impose water use fee
5. Replace farm ATV exemption with rebate
6. Reform charitable exemptions
7. Online sales tax collection
8. Exempt bus advertising
9. Cut individual income tax rate
10. Consolidate bracket schedules
11. Cut corporate rate
12. Repeal throwback rule
13. Single sales factor apportionment
14. Extend NOL carryforward
15. Repeal capital gain exclusion
16. Repeal political contribution credit
17. Passthrough entity tax
18. Business inventory tax credit
19. Franchise tax admin. to DFA
20. ACD guidelines for prop. tax exemptions
21. Index fuel taxes to constr. cost inflation
22. Annual user fees for electric and hybrid

Upper Income Tax Reform: Act 182

- Task Force ultimately recommended “2-4-5.9 plan”
 - Consolidate bracket schedules
 - Increase standard deduction to match feds
 - Reduce top rate to 5.9%
 - Problem: middle-class, high-itemizers get small tax increase
- Act 182 is the 2-4-5.9 plan for high-earners
 - Top rate reductions to 6.6% for 2020 and 5.9% for 2021 and after
 - Almost-flat tax for high-earners: 5.9% rate kicks in at \$8k
 - Bracket adjustment on the high end of the middle income table
 - Inflation adjustments through the 2018 tax year

Major Business Tax Reforms: Act 822

- Uses revenue from remote sales tax collection to pay for business tax reforms
- Overview:
 - Remote sales tax collection
 - Single sales factor apportionment
 - Reduce top corporate rate to 5.9%
 - Extend NOL carryforward to 10 years
 - Car wash exemption and water fee

Act 822 – Online Sales Tax Collection

- Requiring remote sales tax collection is constitutional after *South Dakota v. Wayfair* (U.S. June 2018)
 - Reversed *Quill v. North Dakota* (U.S. 1992)
 - 40 states (of 45 that levy sales tax) now have remote seller laws or regulations
 - Proposed legislation pending in other states
- Would require remote sellers over *Wayfair* thresholds to collect tax:
 - \$100,000 sales or 200 transactions in previous *or current* calendar year
- Marketplace facilitators also required to collect tax:
 - Marketplace facilitator lists item and processes payment
 - Same thresholds of \$100,000 sales or 200 transactions
 - Remote seller does not have to collect tax if marketplace facilitator is required to collect
- Effective July 1, 2019

Act 822 – Business Income Tax Reforms

- Single sales factor apportionment eff. 2021
 - No throwback repeal
 - Significant generally for manufacturers, wholesalers, retailers, and banks
- Rate cut from 6.5% to 5.9% phased in 2021-2022
- NOL carryforward extended to 8 years for losses in 2020 and 10 years for losses in 2021 and thereafter

Act 822 – Car Washes

- Status quo: hand-washes taxable; coin-op exempt; automatic & tunnel with service attendants taxable; machine only exempt
- Task Force recommended exempting all car washes and substituting a water usage fee
 - Benefits hand washes
 - Hurts machine only washes (mostly automatic vs tunnel)
- Act as Amended
 - Fee applies to 80% of water used
 - Tunnel wash usage fee of 0.4¢/gallon
 - Automatic wash usage fee of 0.2¢/gallon
 - Self service bay no water usage fee, but overall taxation unclear (late drafting error)
 - Manual hand-washes & related purchases continue taxable (shaft)
 - Effective October 1, 2019

Act 819 – Tax Administration Changes

- **Biennial cycle to review all credits and exemptions**
 - 1st report likely in late 2022
- Franchise tax administration to DFA
 - Also penalty waiver for terminating abandoned corporations
- ACD rules and guidelines for
 - Property tax exemption determinations
 - Business inventory assessment
- Farm ATV sales tax exemption claim detail
- Bus advertising sales tax exemption

HB1714 – Passthrough Entity Tax

- Federal TCJA SALT deduction cap impacts many Arkansans
- Idea: convert nondeductible individual-level deduction into deductible entity-level tax
- Stalled in House Revenue & Tax Committee
- Recommended for interim study
- Oklahoma just passed a passthrough entity tax

Act 910 - Government Transformation

- Assessment Coordination Department (ACD) to DFA
- AEDC to Department of Commerce

Act 512 – Unemployment Insurance Reforms

- Arkansas UI fund has \$700m+ surplus
 - Not a deficit!
- Provides a sliding-scale wage base for Arkansas unemployment insurance contributions
- Can reduce the wage base to as low as \$7,000 (from current \$10,000), depending on the unemployment rate and funding level of trust fund
- Effective 2020

Act 1055 – Worker Classification

- Empower Independent Contractors Act
- Generally adopts the IRS twenty-factor test for determining whether a person is an employee or independent contractor for various purposes, including unemployment insurance, taxation, and workers' compensation.
- Effective July 24, 2019

IRC Conformity (TCJA)

- Act 870
 - Section 118 contributions to capital limitations
 - Section 162 business expense changes
 - Sections 167 and 168(a)-(j) depreciation methods
 - Section 172 charitable contribution deductions
 - Deductibility of R&D costs under sections 174 and 280C
 - Section 274 meal and entertainment changes
 - 280F luxury automobile limitations
 - Sections 1361-1374 S corporations
 - Also conforms depletion allowances, below-market loans, expense capitalization, discharge of indebtedness, payments to foreign affiliates and Subchapter M
- Act 201: QOZ conformity (AR only)
- No section 199A or most other TCJA benefits

Act 327 – Consolidated Incentive Act Revisions

- Consolidated Incentive Act provides main state-level incentives
- Numerous changes in comprehensive revision, including the following
 - Reduced Create Rebate thresholds
 - High-wage extra 1% “kicker” for Advantage Arkansas and Create Rebate
 - Increased minimum investment for Tax Back
 - Broadening eligible business definition
- Bottom line – check back to the statute for new projects

Highway Funding – Act 416 and HJR1018

- Act 416
 - New wholesale sales tax on fuel (6¢/gal diesel and 3¢/gal gasoline)
 - \$35+m from general revenue and/or new casino gaming revenue
 - Annual fees of \$200 for electric vehicles and \$100 for hybrids
- HJR1018
 - Refer constitutional amendment to extend 0.5% Amendment 91 sales tax to fund roads indefinitely

SB560 - Independent Tax Commission

- Ongoing concern that DFA Office of Hearings and Appeals is tilted against taxpayers
- SB560 would have created a 3-person independent tax commission
 - Potentially a positive development for taxpayers
 - Potential concern – too formal too fast?
 - Potential concern – non-lawyers deciding legal issues?
- Passed Senate; stalled in House
- Possible subject for working group attention between sessions

Outlook for 2019: Sales Tax Rules

- DFA sales tax rules last updated in 2008
- Comprehensive rewrite almost released before 2019 session
- Likely to be forthcoming this summer / fall
- Likely to codify positions in DFA opinions and rulings
- Carefully review changes to rules of interest to your business

Unfinished Business for 2021?

- Task Force proposals can come back in 2021
 - More income tax cuts
 - Rate cuts vs. bracket reforms
 - Repeal of throwback rule
 - Inventory property tax relief
 - Passthrough tax
- Other ideas
 - Increase used car sales tax exemption
 - Tax tribunal
 - ???

Questions?

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