

SUMMARY OF PROPOSAL #1-A
for consideration by the
ARKANSAS TAX REFORM AND RELIEF LEGISLATIVE TASK FORCE

TOPIC: To Amend the Carry-Forward Period for Net Operating Losses

Summary of Proposal for Consideration

To incrementally increase the net operating loss carry-forward period to ten (10) years under Arkansas Code § 26-51-427, effective for tax years beginning January 1, 2019.

Fiscal Analysis

According to the Department of Finance and Administration, a phased-in increase of the net operating loss (NOL) carry forward from the current five-year carry forward to a ten-year carry forward would have the following methodology and fiscal impact:

- Year 1 – Phase in six-year carry forward
- Year 2 – Phase in seven-year carry forward
- Year 3 – Phase in eight-year carry forward
- Year 4 - Phase in nine-year carry forward
- Year 5 – Phase in ten-year carry forward
- Years 6 & 7
- Year 8 **\$16,700,000**
- Year 9 **\$16,700,000**
- Year 10 **\$31,500,000**
- Year 11 **\$31,500,000**
- Year 12 **\$44,400,000**
- Year 13 **\$44,400,000**
- Year 14 **\$55,500,000**
- Year 15 **\$55,500,000**
- Year 16+ Full Implementation **\$64,800,000**

The fiscal impact would begin in the sixth year after enactment because the existing revenue expectations include the current five-year carry forward.

Legal Analysis

Background

Net operating losses are the excess of allowable deductions over gross income for the taxable year, subject to certain adjustments, including that nontaxable income is included in determining gross income (less any expenses incurred in earning the nontaxable income). Arkansas tax law states that net operating losses may be carried forward for a maximum of five (5) years. Arkansas does not permit net operating losses to be carried backward. If the taxpayer is not a C corporation, the amount deductible for losses from sales or exchanges of capital assets cannot exceed the amount includible for gains from sales or exchanges of capital assets.

ACT 118 of 1929 created the Income Tax Act of 1929 and established the first definitions of net operating loss for the purposes of Arkansas income tax, allowing a corporation to deduct “[l]osses sustained during the income year and not compensated for by insurance or otherwise, if incurred in trade or business and such losses incurred in any transaction entered into for profit, though not connected with the trade of business; and such losses arising from fires, storms, shipwrecks, or other casualty, or from theft, and not compensated for by insurance or otherwise.”

ACT 147 of 1957 provided that net operating losses after 1957 could be carried over to the next succeeding taxable year and annually thereafter for a total period of three (3) years, or until the net operating loss was exhausted or absorbed by the taxable income of any succeeding year, whichever was earlier.

ACT 382 of 1987 provided that net operating losses after 1987 may be carried over to the next succeeding taxable year and annually thereafter for a total period of five (5) years, or until the net operating loss has been exhausted or absorbed by the taxable income of any succeeding year, whichever is earlier. The provisions relating to net operating losses have not been materially amended since 1987.

The Tax Cuts and Jobs Act (TCJA) allows for an indefinite carry forward of net operating losses and prohibits a carry back of net operating losses. The TCJA also limits the amount of net operating losses that may be deducted in a single tax year to the lesser of the NOL carryover or eighty percent (80%) of the taxpayer’s pre-NOL taxable income.

Potential Legal Issues

None.

Other States

- Iowa: Is a static conformity state, which means that the state adopts federal tax law as of a specific date, and changes in federal law are not automatically incorporated into state law. Iowa currently allows for a carry-forward period of a net operating loss deduction for twenty (20) years. Iowa allows a net operating loss deduction to be carried back for two (2) years. Iowa limits this deduction to only the portion of the loss that is fairly and equitably allocable to Iowa. Iowa has not adopted the federal law changes with regard to net operating losses from the TCJA. (IA St. § 422.35)
- Louisiana: Is a rolling conformity state, which means that when federal law provisions are adopted by the state, any changes in federal law are automatically incorporated into state law. However, Louisiana appears to have decoupled from federal law with respect to its net operating loss deduction. Instead, Louisiana allows a deduction in an amount equal to seventy-two percent (72%) of the net operating loss for the taxable year, but the deduction cannot exceed seventy-two percent (72%) of net income. Louisiana allows a twenty-year carry forward of net

operating loss deductions. Louisiana does not have a carryback provision for net operating loss deductions. (LA St. §47:287.86)

- Mississippi: Is a non-conformity state, which means that the state adopts only selective parts of federal tax law; any future changes in federal law, even for the parts selectively adopted, are not automatically incorporated into state law. Mississippi has not adopted federal law with respect to its net operating loss deduction. Instead, Mississippi allows net operating loss deductions to be carried forward for a maximum of twenty (20) years. Mississippi allows net operating loss deductions to be carried back a maximum of two (2) years. Mississippi does not limit the amount of net operating losses that may be deducted. (MS St. § 27-7-17)
- Missouri: Is a rolling conformity state, which means that when federal law provisions are adopted by the state, any changes in federal law are automatically incorporated into state law. Missouri conforms to the federal law with respect to net operating loss deductions, except with respect to the special rules for insurance companies. As a result of the TCJA, unless Missouri decouples from this provision, Missouri will permit an unlimited carry-forward period for net operating loss deductions, subject to the eighty percent (80%) cap, and will no longer permit a carry back period for net operating losses. (MO St. § 143.121)
- Oklahoma: Is a rolling conformity state, which means that when federal law provisions are adopted by the state, any changes in federal law are automatically incorporated into state law. Oklahoma conforms to the federal law with respect to net operating loss deductions, except that the state uses “Oklahoma net operating loss” and “Oklahoma taxable income” instead of the federal definitions. As a result of the TCJA, unless Oklahoma decouples from the provision, Oklahoma will permit an unlimited carry-forward period for Oklahoma net operating loss deductions, subject to the eighty percent (80%) cap, and will no longer permit a carry back period for net operating losses. (OK St. 68 § 2358)
- Tennessee: Is a rolling conformity state, which means that when federal law provisions are adopted by the state, any changes in federal law are automatically incorporated into state law. However, Tennessee has decoupled from federal law with respect to its net operating loss deduction from excise tax. Tennessee currently allows for a fifteen-year carry-forward period but, does not allow for a carry-back period. Tennessee does not limit the amount of net operating losses that may be deducted. (TN St. § 67-4-2006)
- Texas: Texas does not have a corporate income tax, and there is no net operating loss deduction from the franchise tax.