

SUMMARY OF PROPOSAL #3
for consideration by the
ARKANSAS TAX REFORM AND RELIEF LEGISLATIVE TASK FORCE

TOPIC: Corporate Franchise Tax

Summary of Proposal for Consideration

To repeal the Arkansas corporate franchise tax under Arkansas Code § 26-54-101 et seq., effective for tax years beginning January 1, 2019.

Fiscal Analysis

According to the Arkansas Secretary of State, the following chart provides an overview of the corporate franchise tax collections since 2009:¹

2009 - \$22.8 million	2012 - \$23.1 million	2015 - \$26.3 million
2010 - \$24.0 million	2013 - \$26.5 million	2016 - \$25.6 million
2011 - \$23.2 million	2014 - \$25.8 million	2017 - \$26.1 million

Under Arkansas Code § 26-54-113(b), the first eight million dollars (\$8,000,000) of revenues collected under the corporate franchise tax are deposited into general revenues, and the remaining revenues are deposited to the credit of the Educational Adequacy Trust Fund.

According to the Arkansas Secretary of State, it is anticipated that collections from the franchise tax will exceed thirty million dollars (\$30,000,000) in fiscal year 2018. Repeal of the corporate franchise tax may result in an estimated loss of eight million dollars (\$8,000,000) in general revenues and a loss of twenty-two million dollars (\$22,000,000) in revenues for the Educational Adequacy Trust Fund, based on the Secretary of State's estimated revenue amounts for fiscal year 2018.

Legal Analysis

Background

The Arkansas Secretary of State is responsible for the collection and administration of Arkansas's corporate franchise tax. Companies who conduct business in Arkansas are required to pay the corporate franchise tax on an annual basis. The following chart provided by the Arkansas Secretary of State² lists the current corporate franchise tax rates under Arkansas Code § 26-54-104:

¹ Source: Arkansas Secretary of State: <https://www.sos.arkansas.gov/business-commercial-services-bcs/franchise-tax/>

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Franchise Tax Type	Current Rate
Corporation/Bank with Stock	0.3% of the outstanding capital stock; \$150 minimum
Corporation/Bank without Stock	\$300 annual fee
Limited Liability Company	\$150 annual fee
Insurance Corporation Legal Reserve Mutual, Assets Less Than \$100 million	\$300 annual fee
Insurance Corporation Legal Reserve Mutual, Assets Greater Than \$100 million	\$400 annual fee
Insurance Company Outstanding Capital Stock Less Than \$500,000	\$300 annual fee
Insurance Company Outstanding Capital Stock Greater Than \$500,000	\$400 annual fee
Mortgage Loan Corporation	0.3% of the outstanding capital stock; \$300 minimum
Mutual Assessment Insurance Corporation	\$300 annual fee

ACT 443 of 1907 created the first corporate franchise tax, which was an annual tax of either ten dollars (\$10.00), twenty-five dollars (\$25.00), fifty dollars (\$50.00), or one hundred dollars (\$100), depending on the amount of the corporation's authorized capital stock.

ACT 260 of 1909 added an annual corporate franchise tax of one hundred dollars (\$100) for corporations with more than one million dollars (\$1,000,000) in authorized stock. The act further added an annual franchise tax of fifty dollars (\$50.00) for corporations without any authorized stock. The act also exempted fraternal orders that write insurance and any agricultural corporation organized only for agricultural purposes from the annual corporate franchise tax.

ACT 112 of 1911 repealed Act 260 of 1909 and established a new system for the corporate franchise tax. The act required each corporation to pay an annual corporate franchise tax of five hundredths percent (0.05%) on outstanding capital stock for property owned and used in business transacted in Arkansas. The act also required an annual tax between twenty dollars (\$20.00) and one hundred dollars (\$100), depending on the type of corporation.

ACT 85 of 1917 amended the corporate franchise tax to impose a tax of one-tenth percent (0.1%) on the part of a domestic or foreign corporation's outstanding capital stock employed in Arkansas.

ACT 278 of 1923 levied an annual corporate franchise tax of ten dollars (\$10.00) on mortgage loan companies that have capital stock of ten thousand dollars (\$10,000) or less employed in Arkansas.

ACT 236 of 1925 required foreign corporations doing business in Arkansas to pay the same corporate franchise tax as domestic corporations and added an annual corporate franchise tax for

legal reserve mutual insurance companies. The act also increased the corporate franchise tax for mutual assessment corporations and building and loan associations.

ACT 271 of 1925 increased the corporate franchise tax on outstanding capital stock to eleven hundredths percent (0.11%).

ACT 220 of 1931 required a domestic corporation doing business entirely outside of Arkansas to pay an annual corporate franchise tax of five dollars (\$5.00).

ACT 304 of 1953 raised the annual corporate franchise tax on insurance companies and mortgage loan companies. The act also required corporations in the process of liquidation to pay a tax of eleven hundredths percent (0.11%) of the value of their real and tangible personal property in Arkansas, and it required mortgage loan companies and corporations in the process of liquidation to pay a minimum tax of eleven dollars (\$11.00).

ACT 889 of 1979 created the Arkansas Corporate Franchise Tax Act of 1979. The act defined "corporation" to mean any corporation that is organized under the laws of Arkansas. However, the act exempted non-profit organizations, corporations exempt from federal income tax, and organizations formed under the Uniform Partnership Act or the Uniform Limited Partnership Act from the corporate franchise tax. The act retained the existing tax structure but increased the tax on insurance companies and legal reserve mutual insurance companies. The act also levied a tax of twenty-five dollars (\$25.00) to one hundred dollars (\$100) on non-insurance corporations without capital stock based on the value of the assets held by the corporation. These provisions are codified under Arkansas Code § 26-54-102.

ACT 863 of 1983 increased the minimum annual corporate franchise tax to seventeen dollars (\$17.00).

ACT 19 of 1987 removed the Commissioner of Revenues of the State as the administrator of the corporate franchise tax and made the Secretary of State the administrator of the corporate franchise tax.

ACT 29 of 1987 (1st Ex. Sess.) established a maximum corporate franchise tax of one million seventy-five thousand dollars (\$1,075,000) and raised the rate of the corporate franchise tax to twenty-seven hundredths percent (0.27%) on corporations with outstanding capital stock and corporations in the process of liquidation. The act also established a minimum tax of one hundred dollars (\$100) for mortgage loan companies. The act required corporations that are not legal reserve mutual insurance corporations, mutual assessment insurance corporations, or mortgage loan corporations, without authorized capital stock, to pay a tax of one hundred dollars (\$100). The minimum corporate franchise tax was also raised to fifty dollars (\$50.00).

ACT 1285 of 1993 added an additional levy of three dollars (\$3.00) for each corporation to pay under the annual corporate franchise tax. The revenues from this levy were designated as special revenues credited to the Signature Imaging System Fund. The act also increased the franchise tax on mutual assessment insurance corporations to one hundred dollars (\$100).

ACT 479 of 1997 required organizations formed under to the Small Business Entity Tax Pass Through Act to pay the minimum annual corporate franchise tax.

ACT 1104 of 1997 provided that the special revenues received by the three-dollar levy would be credited to the Voter Registration Signature Imaging System.

ACT 94 of 2003 (2nd Ex. Sess.) repealed the three-dollar levy and created the corporate franchise tax rates that are currently in use. This act also eliminated the maximum amount of annual corporate franchise tax and provided that the first eight million dollars (\$8,000,000) of revenues collected under the corporate franchise tax would be placed into general revenues, and the remaining revenues would be credited to the Educational Adequacy Trust Fund. The corporate franchise tax has not been amended since.

Potential Legal Issues

Under Arkansas Constitution, art. 14, § 1, and as held by the court in *Lake View School District No. 25 v. Huckabee*, 91 S.W.3d (2002), the State of Arkansas is required to provide an equal opportunity for an adequate education for all students. The majority of the funds received by the corporate franchise tax are used to fund the Educational Adequacy Trust Fund, which is used to help ensure compliance with the educational adequacy requirements of the Arkansas Constitution and Lake View. Repeal of the corporate franchise tax would reduce the funding available for educational adequacy.

Other States

- Iowa: Iowa imposes a franchise tax on financial institutions for the privilege of doing business in Iowa, regardless of how the financial institution is treated under federal law. (IA St. §§ 422.60(1) and 422.61(3)(g), and Iowa Admin. Code § 701-59.21). To calculate the financial institution's franchise tax, the financial institution multiplies its net taxable income in Iowa by five percent (5%). (IA St. § 422.63).
- Louisiana: Louisiana imposes a franchise tax on every domestic and foreign corporation conducting business in Louisiana. Louisiana's annual franchise tax is levied at a rate of one dollar and fifty cents (\$1.50) for each one thousand dollars (\$1,000) on the first three hundred thousand dollars (\$300,000) of taxable capital and at a rate of three dollars (\$3.00) for each one thousand dollars (\$1,000) on taxable capital that exceeds three hundred thousand dollars (\$300,000). (LA St. § 47:601). Taxable capital includes the amount of a corporation's issued and outstanding capital stock, surplus, and undivided profits.

Louisiana allows holding corporations that hold at least eighty percent (80%) of the stock or voting power of a banking subsidiary or a public water utility subsidiary, domestic corporations that hold at least eighty percent (80%) of a subsidiary, and public utility holding corporations to deduct investments and advances made to a subsidiary from its taxable capital. Any corporation in a controlled group that has a telephone corporation regulated by the Louisiana Public Service Commission as

a member of the group is also permitted to deduct investments made to any member of the controlled group from its taxable capital. (LA St. § 47:602).

Louisiana law also exempts several types of corporations from the franchise tax, including without limitation labor unions, certain agricultural corporations, fraternal beneficiary societies, nonprofit and charitable organizations, insurance corporations paying a premium tax, and teachers' retirement fund associations. (LA St. § 47:608).

- Mississippi: Mississippi imposes a franchise tax on corporations for the privilege of doing business in the State of Mississippi. Mississippi's franchise tax is due annually as long as the corporation remains incorporated, domesticated, or continues to do business in Mississippi. However, Mississippi's franchise tax is being systematically reduced and beginning January 1, 2028, Mississippi will no longer have a franchise tax. (MS St. §§ 27-13-5 and 27-13-7).

However, for 2018, Mississippi's franchise tax is levied at the rate of two dollars and fifty cents (\$2.50) per one thousand dollars (\$1,000) of the value of the capital used, invested, or employed in Mississippi. Mississippi also has a minimum franchise tax of twenty-five dollars (\$25.00). For 2019, Mississippi's franchise tax will be levied at the rate of two dollars and twenty-five cents (\$2.25) per one thousand dollars (\$1,000) in excess of one hundred thousand dollars (\$100,000) of the value of capital used, invested, or employed in Mississippi. (MS St. §§ 27-13-5 and 27-13-7). When determining the value of the capital subject to the franchise tax, the amount of capital cannot be less than the assessed value of the real estate and tangible personal property in Mississippi from the preceding year. (MS. St. § 27-13-9).

Mississippi also exempts several types of organizations from the Mississippi franchise tax, including without limitation a corporation that has negotiated a fee in lieu of franchise tax payments, approved business enterprises as defined in Mississippi's Growth and Prosperity Act, clean energy generation enterprises, aerospace enterprises, fraternal beneficiary societies, nonprofit and charitable organizations, insurance companies regulated by the Commissioner of Insurance, state, county, or community fair associations, and corporations whose sole function is to own and operate a grammar school, junior high school, high school, or military school within Mississippi. (MS St. §§ 27-13-5(3), 27-13-7(3), and 27-13-63).

- Missouri: Missouri repealed its corporate franchise tax beginning on January 1, 2016. (Mo St. § 147.010(5)).
- Oklahoma: Oklahoma imposes an annual corporate franchise tax on all corporations that do business in Oklahoma. (68 OK St. § 1201). Every domestic and foreign corporation, association, joint-stock company, and business trust is assessed an annual corporate franchise tax of one dollar and twenty-five cents (\$1.25) for each one thousand dollars (\$1,000) of capital invested or used in

Oklahoma. (68 OK St. §§ 1203 and 1204). If the amount of franchise tax is two hundred and fifty dollars (\$250) or less, no franchise tax is due, and the maximum franchise tax due is twenty thousand dollars (\$20,000). (68 OK St. § 1205). However, the franchise tax will not apply during the fiscal year where a corporation, association, or organization has paid an incorporating, filing, or qualifying fee to the Oklahoma Secretary of State. (68 OK St. § 1207).

The franchise tax also does not apply to savings and loan associations; small business investment companies licensed under the Federal Small Business Act of 1958; credit unions; trust companies; real estate trusts operating under the Federal Real Estate Trust Act of 1960; insurance companies, including surety and bond companies; retirement or pension funds; savings banks and savings fund societies; and nonprofit organizations. (68 OK St. § 1206).

- Tennessee: Tennessee imposes a franchise tax on any person, taxpayer, or corporate franchise doing business in Tennessee and having a substantial nexus in Tennessee. (TN St. § 67-4-2104). Substantial nexus means that the taxpayer has a direct or indirect connection to the state such that the taxpayer can be legally required to pay the franchise tax. (TN St. § 67-4-2004(49)). A direct or indirect connection to the state includes without limitation the taxpayer being organized or commercially domiciled in the state, the taxpayer owning or using capital in the state, or the taxpayer having systematic and continuous business activity in the state that has produced gross receipts attributable to customers in the state. (TN St. 67-4-2004(49)). Doing business in the state is any activity that a person purposely engages in within Tennessee with the objective to gain or benefit from the activity in Tennessee. (TN St.67-4-2004(14)(A)). Financial institutions with assets above five million dollars (\$5,000,000) in Tennessee are presumed to be doing business in the state and to be subject to the franchise tax; however, such institutions may challenge this presumption. (TN St. § 67-4-2105(d)(1)). Financial institutions may be exempt from the franchise tax if the only property the entity owns in Tennessee relates to an interest in property, security, or other similar assets in Tennessee. (TN St. § 67-4-2105).

The franchise tax is levied at a rate of twenty-five cents (25¢) per one hundred dollars (\$100) of the greater of a taxpayer's net worth at the close of the tax year or the value of real and tangible property owned or used in Tennessee, excluding exempt inventory and exempt required capital investments. (TN St. §§ 67-4-2106 and 67-4-2108). Tennessee has a minimum franchise tax of one hundred dollars (\$100). (TN St. § 67-4-2119).

Tennessee exempts several types of businesses from the franchise tax, including without limitation:

- Any corporation organized under the laws of Tennessee with the sole purpose of furthering industrial development throughout the state;

- Corporations organized for the purpose of erecting, owning, or operating a common meeting place for more than one (1) Masonic lodge, more than one (1) Lodge of Odd Fellows, or similar lodges, except on income received by such corporations as rentals for use for commercial purposes;
- Federal credit unions and credit unions organized under the laws of other taxing jurisdictions;
- Limited liability companies where at least two-thirds (2/3) of the activities of the company are organized for farming and personal residences; and
- Family owned non-corporate entities created for the production of passive income.

(TN St. §§ 67-4-2008 and 67-4-2105(a)).

- Texas: Texas imposes a franchise tax on entities formed in Texas or doing business in Texas. (TX St. Tax Code §§ 171.001 and 171.0002). The entities subject to the tax include corporations, certain limited liability companies, banks, state limited banking associations, savings and loan associations, S corporations, certain professional corporations, partnerships (not including general partnerships or certain passive entities), certain trusts, professional associations, business associations, joint ventures, and other legal entities. (TX St. Tax Code § 171.0002). An additional franchise tax is imposed on a taxable entity that is no longer subject to the franchise tax, which is equal to the appropriate rate of the franchise tax of the taxable entity's taxable margin determined by the date the previous franchise tax was imposed and the date the entity is no longer subject to the franchise tax. (TX St. Tax Code § 171.0011(b)).

The rate of the franchise tax is seventy-five hundredths percent (0.75%) of the taxpayers taxable margin or a rate of three hundred seventy-five thousandths percent (0.375%) for taxable entities primarily engaged in retail or wholesale trade. (TX St. Tax Code § 171.002). A taxable entity with total revenue that is not more than twenty million dollars (\$20,000,000) may elect to pay a franchise tax that is three hundred thirty-one thousandths percent (0.331%) of the entities taxable margin; however, the entity will not be permitted to take a credit, deduction, or other adjustment against franchise tax liability. (TX St. Tax Code § 171.1016).

Several types of businesses are exempt from the franchise tax, including without limitation:

- An insurance organization, title insurance company, or title insurance agent authorized to engage in insurance business in Texas that is required to pay an annual tax measured by its gross premium receipts;
- A farm mutual, local mutual aid association, and burial association;
- A corporation organized as a railway terminal corporation and having no annual net income;
- A corporation engaged solely in the business of manufacturing, selling, or installing solar energy devices;
- A nonprofit organization;

- A marketing association incorporated under the Texas Agricultural Code;
 - A housing finance corporation incorporated under the Texas Housing Finance Corporations Act;
 - A hospital laundry cooperative association;
 - A credit union organized and existing under the laws of Texas;
 - An electric cooperative corporation;
 - A telephone cooperative corporation;
 - A corporation engaged solely in the business of recycling sludge; and
 - A political subdivision corporation.
- (TX St. Tax Code §§ 171.052 – 171.088).