

1 State of Arkansas  
2 88th General Assembly  
3 Regular Session, 2011

# A Bill

HOUSE BILL 1495

4  
5 By: Representative Nickels  
6

## For An Act To Be Entitled

8 AN ACT TO CREATE THE ARKANSAS SMALL BUSINESS TAX  
9 FAIRNESS ACT; TO REQUIRE COMBINED REPORTING FOR  
10 INCOME TAX PURPOSES; AND FOR OTHER PURPOSES.  
11

## Subtitle

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13  
14 TO CREATE THE ARKANSAS SMALL BUSINESS TAX  
15 FAIRNESS ACT AND TO REQUIRE COMBINED  
16 REPORTING FOR INCOME TAX PURPOSES.  
17

18  
19 BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF ARKANSAS:  
20

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

### Subchapter 24 – Arkansas Small Business Tax Fairness Act

#### 26-51-2401. Title.

25  
26 This subchapter shall be known as the “Arkansas Small Business Tax  
27 Fairness Act”.  
28

#### 26-51-2402. Definitions.

##### As used in this subchapter:

30  
31 (1) “Combined group” means the group of persons whose income and  
32 apportionment factors are required to be taken into account under § 26-51-  
33 2403 in determining the taxpayer member’s share of the net business income or  
34 loss to be apportioned to the state;

35 (2)(A) “Corporation” means an organization of any kind treated  
36 as a corporation for tax purposes under this chapter, wherever located, that



1 if it were doing business in this state, would be a taxpayer.

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

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

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

12 (5) "Person" means:

13 (A) An individual;

14 (B) A firm;

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

16 (D) A limited liability company;

17 (E) A registered limited liability partnership;

18 (F) A foreign limited liability partnership;

19 (G) An association;

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

23 (I) A company;

24 (J) A syndicate;

25 (K) An estate;

26 (L) A trust or trustee;

27 (M) A trustee in bankruptcy;

28 (N) A receiver;

29 (O) An executor or administrator; and

30 (P) An organization of any kind;

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

33 (A) Has no tax or a nominal effective tax on the relevant  
34 income;

35 (B) Has laws or practices that prevent effective exchange  
36 of information for tax purposes with other governments on taxpayers

benefiting from the tax regime;

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

(ii) A tax regime lacks transparency if:

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

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

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

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

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

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

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

26-51-2403. Combined reporting required – Discretion of director

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

(A) The federal consolidated parent corporation; or

(B) A subsidiary with a nexus to Arkansas, if the federal

1 consolidated parent is not a member of the combined group.

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

5 (A) The income determined under § 26-51-2406;

6 (B) The apportionment factors determined under:

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

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

11 (iii) The combined reporting requirements under §  
12 26-51-2405; and

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

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

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

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

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

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

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

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

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

36 (ii) An equitable allocation and apportionment of

1 the taxpayer's income.

2  
3 26-51-2404. Determination of taxable income using combined report.

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

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

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

13 (3) A member's net business income is determined by removing all  
14 but business income, expense, and loss from that member's total income under  
15 this subchapter.

16  
17 26-51-2405. Income subject to tax – Application of tax credits –  
18 Deductions after apportionment.

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

22 (1) Share of business income that is apportioned to Arkansas of  
23 each of the combined groups of which it is a member, as determined under §  
24 26-51-2406;

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

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

32 (4) Income sourced to Arkansas from involuntary conversions and  
33 the sale or exchange of capital or assets, as determined under § 26-51-2407;

34 (5) Nonbusiness income or loss allocable to Arkansas, as  
35 determined under the Uniform Division of Income for Tax Purposes Act, § 26-  
36 51-701 et seq., and the apportionment and allocation requirements under §§

26-51-1401-26-51-1405;

(6) Income or loss, other than a net operating loss, that was allocated or apportioned in an earlier year and is required to be taken into account as Arkansas source income during the income year; and

(7)(A) Net operating loss carryover.

(B)(i) If the taxable income computed under this subchapter results in a loss for a combined group, the combined group has an Arkansas net operating loss.

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

(C) Only taxpayer members that join a combined group and have a net operating loss from a tax year before the taxpayer member joined the combined group are subject to the net operating loss limitations and carryover provisions of § 26-51-427.

(b)(1) A tax credit or post-apportionment deduction earned by a member of the group, but not fully used by or allowed to that member, may be applied against the total income of the combined group.

(2) A post-apportionment deduction carried over into a subsequent year as to the member that incurred it, and available as a deduction to that member or the combined group in a subsequent year, shall be considered in the computation of the income of that member or the combined group in the subsequent year regardless of the composition of that income as apportioned, allocated, or wholly within Arkansas.

26-51-2406. Determination of share of business income of a combined group.

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

(1) The business income of the combined group, as determined under § 26-51-2407; and

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

(i) In each numerator, the taxpayer's property,

payroll, or sales factor associated with the combined group's unitary business in this state; and

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

(B) The property, payroll, and sales factors of a partnership are included in the determination of the partner's apportionment percentage in proportion to a ratio the numerator of which is the amount of the partner's distributive share of partnership's unitary income included in the income of the combined group under § 26-51-2407 and the denominator of which is the amount of the partnership's total unitary income.

26-51-2407. Determination of business income of the combined group.

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

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

(c)(1) Except as otherwise provided in this section, the total income of the combined group is the sum of the income of each member of the combined group, as determined under the Internal Revenue Code of 1986, 26 U.S.C. § 1 et seq., as it existed on January 1, 2011, as if the member were not consolidated for federal purposes.

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

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

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

(a) A profit and loss statement shall be

1 prepared for each foreign branch or corporation in the currency in which the  
2 books of account of the branch or corporation are regularly maintained;

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

7 (c) Adjustments shall be made to the profit  
8 and loss statement to conform it to any tax accounting standards required by  
9 the state;

10 (d) Except as otherwise provided in this  
11 subchapter, the profit and loss statement of each member of the combined  
12 group and the related apportionment factors shall be translated into the  
13 currency in which the parent company maintains its books and records; and

14 (e) Income apportioned to Arkansas shall be  
15 expressed in United States dollars.

16 (ii)(a) In lieu of the procedures in subdivision  
17 (c)(2)(B)(i) of this section and subject to the determination of the Director  
18 of the Department of Finance and Administration that it reasonably  
19 approximates income as determined under the Income Tax Act of 1929, § 26-51-  
20 101 et seq., a member not included in subdivision (c)(2)(A) of this section  
21 may determine its income on the basis of the consolidated profit and loss  
22 statement that includes the member and that is prepared for filing with the  
23 United States Securities and Exchange Commission by related corporations.

24 (b) If the member is not required to file with  
25 the United States Securities and Exchange Commission, the director may allow  
26 the use of a consolidated profit and loss statement prepared for reporting to  
27 shareholders and subject to review by an independent auditor.

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

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



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

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

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

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

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

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

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

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

25           (B) The buyer and seller are no longer members of the same  
26 combined group regardless of whether the members remain unitary.

27       (g)(1) To the extent allowable as a deduction under 26 U.S.C. § 170,  
28 as it existed on January 1, 2011, a charitable expense incurred by a member  
29 of a combined group is subtracted first from the business income of the  
30 combined group, subject to the income limitations of 26 U.S.C. § 170, as it  
31 existed on January 1, 2011, and as it is applied to the entire business  
32 income of the group, and the remaining amount is treated as a nonbusiness  
33 expense allocable to the combined group, subject to the income limitations of  
34 26 U.S.C. § 170, as it existed on January 1, 2011, and as it is applied to  
35 the nonbusiness income of the combined group.

36       (2) A charitable deduction disallowed under this subsection (g)

1 but allowed as a carryover deduction for up to five (5) years is treated as  
 2 originally incurred in the subsequent year by the combined group, and this  
 3 section applies in the subsequent year in determining the allowable deduction  
 4 in that year.

5 (h) Gain or loss from the sale or exchange of capital assets, property  
 6 described in §§ 26-51-411 – 26-51-413, and property subject to an involuntary  
 7 conversion, is removed from the total net income of a combined group and is  
 8 apportioned and allocated as follows:

9 (A) For each class of gain or loss under this chapter, all  
 10 members' business gain and loss for the class are combined without netting  
 11 between the classes, and each class of net business gain or loss is  
 12 separately apportioned to each member using the member's apportionment  
 13 percentage determined under § 26-51-2406;

14 (B) Each taxpayer member shall then net its apportioned  
 15 business gain or loss for all classes against the taxpayer member's  
 16 nonbusiness gain and loss for all classes allocated to Arkansas under §§ 26-  
 17 51-411 – 26-51-413 without regard to the taxpayer member's gains or losses  
 18 from the sale or exchange of capital assets, property under §§ 26-51-411 –  
 19 26-51-413, and involuntary conversions that are nonbusiness items allocated  
 20 to another state;

21 (C) Any resulting Arkansas source income or loss of a  
 22 combined group, if the loss is not subject to the limitations of §§ 26-51-411  
 23 – 26-51-413, that is produced under this section is applied to all other  
 24 Arkansas source income or loss of the combined group; and

25 (D) Any resulting Arkansas source loss of the combined  
 26 group that is subject to the limitations of §§ 26-51-411 – 26-51-413 is  
 27 carried forward by the combined group and is treated as an Arkansas source  
 28 short-term capital loss incurred by the combined group for the year for which  
 29 the carryover applies.

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

34  
 35 26-51-2408. Designation of surety.

36 (a)(1)(A)(i) Members of a combined reporting group shall annually

designate one (1) taxpayer member of the combined group to file a single return in the form and manner prescribed by the Director of the Department of Finance and Administration, in lieu of each member filing its own respective return.

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

(a) The federal consolidated parent corporation; or

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

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

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

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

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

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

#### 26-51-2409. Water's-edge election.

(a) Taxpayer members of a unitary group that meet the requirements of § 26-51-2410 may elect to determine each member's apportioned share of the net business income or loss of the combined group under a water's-edge election.

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

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

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

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

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

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

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

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

(7)(A) The entire income and apportionment factors of any member that is doing business in a tax haven.

(B) If the member's business activity within a tax haven is entirely outside the scope of the laws, provisions, and practices that cause the jurisdiction to be a tax haven under § 26-51-2402, the activity of the member shall be treated as not having been conducted in a tax haven.

26-51-2410. Initiation and withdrawal of water's-edge election.

(a)(1) A water's-edge election is effective only if made on a timely

1 filed, original return for the tax year by each member of the unitary  
2 business subject to tax under the Income Tax Act of 1929, § 26-51-101 et seq.

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

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

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

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

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

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

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

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

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

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

(D) If no withdrawal is properly made, the water's edge election shall be in place for an additional ten-year period subject to the conditions that applied to the original election under this section.

24-51-2411. Rules.

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

SECTION 2. Arkansas Code § 26-51-804(a), concerning income tax returns for corporations, is amended to read as follows:

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

(2) Corporations that are members of a unitary business under the Arkansas Small Business Tax Fairness Act, § 26-51-2401 et seq., shall file a combined return.

SECTION 3. Arkansas Code § 26-51-805(a), concerning consolidated income tax returns for corporations, is amended to read as follows:

(a)(1) All corporations ~~which that~~ are eligible members of an affiliated group, ~~as that term is defined in 26 U.S.C. § 1504(a) and (b), as of it existed on January 1, 1989, which affiliated group files a federal consolidated corporate income tax return pursuant to 26 U.S.C. §§ 1501-1505 as of January 1, 1989, may elect to~~ shall file a consolidated combined Arkansas corporate income tax return under the Arkansas Small Business Tax Fairness Act, § 26-51-2401 et seq., if the affiliated group files a federal consolidated corporate income tax return under 26 U.S.C. §§ 1501-1505, as they existed on January 1, 1989.

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

SECTION 4. EFFECTIVE DATE. This act is effective for tax years beginning on or after January 1, 2012.