

1 State of Arkansas  
2 88th General Assembly  
3 Regular Session, 2011  
4

As Engrossed: H3/8/11 H3/9/11

# A Bill

HOUSE BILL 1495

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

12  
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:

23 Subchapter 24 – Arkansas Small Business Tax Fairness Act  
24

25 26-51-2401. Title.

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

29 26-51-2402. Definitions.

30 As used in this subchapter:

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

1 benefiting from the tax regime;

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

3 (ii) A tax regime lacks transparency if:

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

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

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

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

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

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

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

30  
31 26-51-2403. Combined reporting required – Discretion of director

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

35 (A) The federal consolidated parent corporation; or

36 (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 and multiplying the remainder by the combined apportionment  
16 factors of all members of the combined group.

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

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

23 (1) Share of business income that is apportioned to Arkansas of  
24 each of the combined groups of which it is a member, as determined under §  
25 26-51-2406;

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

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

33 (4) Income sourced to Arkansas from the sale or exchange of  
34 capital or assets;

35 (5) Nonbusiness income or loss allocable to Arkansas, as  
36 determined under the Uniform Division of Income for Tax Purposes Act, § 26-

1 51-701 et seq., and the apportionment and allocation requirements under §§  
2 26-51-1401-26-51-1405; and

3 (6)(A) Net operating loss carryover.

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

7 (ii) A net operating loss of the combined group is  
8 applied as a deduction in a subsequent year only to the extent that the  
9 combined group has Arkansas source positive net income.

10 (C)(i) Only a taxpayer member that joins a combined group  
11 and has a net operating loss from a tax year before the taxpayer member  
12 joined the combined group is subject to the carryover provisions of § 26-51-  
13 427, the net operating loss limitations, and the separate return limitation  
14 year restriction.

15 (ii) Separate return limitation year restrictions  
16 allow the net operating loss of a member that joins a combined return to  
17 offset the combined income of all corporations that were members of the same  
18 federal consolidated group when the net operating loss was created or that  
19 were members of the same Arkansas combined group when the net operating loss  
20 was created.

21 (b)(1) A tax credit earned by a member may be applied against the  
22 total tax liability of the combined group.

23 (2)(A) A charitable contribution made by a taxpayer member of  
24 the combined group is available as a deduction of the combined group subject  
25 to the limitations of 26 U.S.C. § 170, as it existed on January 1, 2011.

26 (B) A charitable contribution under subdivision (b)(2)(A)  
27 of this section is subtracted from the business income of the combined group  
28 before apportionment, and the remaining balance is treated as a nonbusiness  
29 expense allocable to the nonbusiness income of the combined group subject to  
30 the income limitations of 26 U.S.C. § 170, as it existed on January 1, 2011.

31 (C) A charitable contribution under subdivision (b)(2)(A)  
32 of this section that is disallowed under the income limitations of this  
33 subsection is allowed as a carryover deduction for up to five (5) years in  
34 accordance with 26 U.S.C. § 170, as it existed on January 1, 2011.

35  
36 26-51-2406. Determination of share of business income of a combined

1 group.

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

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

6 (2)(A) The taxpayer member's apportionment percentage, as  
7 determined under the Uniform Division of Income for Tax Purposes Act, § 26-  
8 51-701 et seq., and the apportionment and allocation requirements under §§  
9 26-51-1401-26-51-1405, including:

10 (i) In each numerator, the taxpayer's property,  
11 payroll, or sales factor associated with the combined group's unitary  
12 business in this state; and

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

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

23  
24 26-51-2407. Determination of business income of the combined group.

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

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

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

36 (2) The income of each member of the combined group is

1 determined as follows:

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

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

10 (a) A profit and loss statement shall be  
11 prepared for each foreign branch or corporation in the currency in which the  
12 books of account of the branch or corporation are regularly maintained;

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

17 (c) Except as otherwise provided in this  
18 subchapter, the profit and loss statement of each member of the combined  
19 group and the related apportionment factors shall be expressed in United  
20 States dollars.

21 (d) Income apportioned to Arkansas shall be  
22 expressed in United States dollars.

23 (ii)(a) In lieu of the procedures in subdivision  
24 (c)(2)(B)(i) of this section and subject to the determination of the Director  
25 of the Department of Finance and Administration that it reasonably  
26 approximates income as determined under the Income Tax Act of 1929, § 26-51-  
27 101 et seq., a member not included in subdivision (c)(2)(A) of this section  
28 may determine its income on the basis of the consolidated profit and loss  
29 statement that includes the member and that is prepared for filing with the  
30 United States Securities and Exchange Commission by related corporations.

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

35 (c) If the profit and loss statements in this  
36 subdivision (c)(2)(B)(ii) of this section do not reasonably approximate

1 income as determined under this chapter, the director may accept profit and  
2 loss statements with appropriate adjustments to approximate the income as  
3 determined under this chapter.

4 (d) If a unitary business includes income from a partnership, the  
5 income included in the total income of the combined group is the member of  
6 the combined group's direct and indirect distributive share of the  
7 partnership's unitary business income.

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

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

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

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

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

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

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

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

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

34 (g) An expense of a member of the unitary group that is directly or  
35 indirectly attributable to the nonbusiness or exempt income of another member  
36 of the unitary group is allocated to the other member as corresponding

1 nonbusiness or exempt expense as appropriate.

2  
3 26-51-2408. Designation of surety.

4 (a)(1)(A)(i) Members of a combined reporting group shall annually  
5 designate one (1) taxpayer member of the combined group to file a single  
6 return in the form and manner prescribed by the Director of the Department of  
7 Finance and Administration, in lieu of each member filing its own respective  
8 return.

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

11 (a) The federal consolidated parent  
12 corporation; or

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

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

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

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

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

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

29  
30 26-51-2409. Water's-edge election.

31 (a) Taxpayer members of a unitary group that meet the requirements of  
32 § 26-51-2410 may elect to determine each member's apportioned share of the  
33 net business income or loss of the combined group under a water's-edge  
34 election.

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

1 the combined group:

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

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

9 (3) The entire income and apportionment factors of any member  
10 that is a domestic international sales corporation as described in 26 U.S.C.  
11  §§ 991-994, as they existed on January 1, 2011;

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

17 (5)(A) The income of a member that is a controlled foreign  
18 corporation, as defined under 26 U.S.C. § 957, as it existed on January 1,  
19 2011, to the extent the income is described under 26 U.S.C. § 952, as it  
20 existed on January 1, 2011, not excluding lower-tier subsidiaries'  
21 distributions of income that were previously taxed and the apportionment  
22 factors related to the income.

23 (B) An item of income received by a controlled foreign  
24 corporation is excluded if the income was subject to an effective rate of  
25 income tax imposed by a foreign country greater than ninety percent (90%) of  
26 the maximum rate of tax specified in 26 U.S.C. § 11, as it existed on January  
27 1, 2011;

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

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

34 (B) If the member's business activity within a tax haven  
35 is entirely outside the scope of the laws, provisions, and practices that  
36 cause the jurisdiction to be a tax haven under § 26-51-2402, the activity of

1 the member shall be treated as not having been conducted in a tax haven.

2  
3 26-51-2410. Initiation and withdrawal of water's-edge election.

4 (a)(1) A water's-edge election is effective only if made on a timely  
5 filed, original return for the tax year by each member of the unitary  
6 business subject to tax under the Income Tax Act of 1929, § 26-51-101 et seq.

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

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

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

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

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

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

30 (B) If the director grants a withdrawal of election, the  
31 director shall impose reasonable conditions to prevent the evasion of tax or  
32 to clearly reflect income for the election period before or after the  
33 withdrawal.

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

36 (B) Withdrawal under this section shall be made in writing

1 within one (1) year of the expiration of the election.

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

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

8  
9 24-51-2411. Rules.

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

12  
13 *SECTION 2. Arkansas Code § 26-51-419(b), concerning deductions for*  
14 *charitable contributions, is amended to read as follows:*

15 *(b) ~~The provisions of subsection~~ Subsection (a) of this section ~~shall~~*  
16 *~~apply~~ applies to a corporation that files an Arkansas ~~consolidated~~*  
17 *~~corporation~~ combined income tax return pursuant to ~~§ 26-51-805, provided that~~*  
18 *~~each member of the affiliated group shall follow the provisions of § 26-51-~~*  
19 *~~805(f) and calculate its contribution limits separately~~ under the Arkansas*  
20 *Small Business Tax Fairness Act, § 26-51-2401 et seq., in accordance with §*  
21 *26-51-2405.*

22  
23 *SECTION 3. Arkansas Code § 26-51-804(a), concerning income tax returns*  
24 *for corporations, is amended to read as follows:*

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

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

31 *(3) Corporations that are not members of a unitary business*  
32 *under the Arkansas Small Business Tax Fairness Act, § 26-51-2401 et seq.,*  
33 *shall file returns on either a consolidated basis or a separate entity basis.*

34  
35 *SECTION 4. Arkansas Code § 26-51-805(a), concerning consolidated*  
36 *income tax returns for corporations, is amended to read as follows:*

