

TAX ADVISORY COUNCIL

2015 YEAR-ENDING REPORT

(Meetings Chaired by A.W. Bailey, Arkansas Society of Accountants)

Definition

Purpose: The Tax Advisory Council (TAC) was created by Act 998 of 1991. It consists of tax professionals and representatives of interested public and professional groups, including the Arkansas Bar Association Tax Section, the Arkansas Society of Accountants, the Arkansas Society of Certified Public Accountants, and employees of the Department of Finance and Administration's Revenue Division. The Council provides input to the General Assembly during the legislative process by studying and recommending changes to tax laws. It also promotes a better understanding of those tax laws and changes. At the end of every calendar year, a report summarizing discussions and decisions made by the TAC is prepared to inform the chairmen of the Revenue and Taxation Committees and members of the State's House of Representatives and Senate.

Membership **(Arranged by Organization)**

Arkansas Bar Association:

TJ Lawhon, Michael Parker, Matt Boch and Jane Strike

Arkansas Society of Accountants:

A.W. Bailey

Arkansas Society of Certified Public Accountants:

Stan Kozij and Phyllis Holifield

Arkansas Department of Finance and Administration (DFA), Revenue Division:

Walter Anger, Assistant Commissioner of Operations and Administration;

John H. Theis, Assistant Commissioner of Revenue for Policy and Legal;

Paul Gehring, Chief Counsel, Revenue Legal Counsel;

Deanna Munds-Smith, Administrator, Field Audit;

Lynne Reynolds, Administrator, Income Tax;

Roberta Overman, Manager, Sales and Use Tax;

Scott Fryer, Manager, Corporation Income Tax;

Matthew Turner, Division Manager I, Individual Income Tax;

David Rector, Problem Resolution Officer;

Rob Allen, Tax Auditor, Income Tax;

Andrew Smith, Manager, Miscellaneous Tax;

Brian Sansoucie, Division Manager I, Sales and Use Tax;

Kathy Horner, Assistant Manager, Individual Income Tax;

Monica Carmichael, Public Information Specialist.

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Meetings

Members of the TAC met three times during 2015 on the following dates:

<u>Meeting dates</u>	<u>Total Present</u>
May 12, 2015	12
August 11, 2015	13
November 10, 2015	16

These meetings were held in Conference Room 2330 of the Joel Ledbetter Building. Meetings averaged one (1) to one and one-half (1 ½) hours in length and were open to the public and to all representatives of the State Senate and House of Representative Revenue and Taxation Committees.

Summary

Tax Advisory Council Activities: The following is a brief summary of what transpired during the TAC's 2015 meetings.

Office of Revenue Legal Counsel:

Status of Lawsuits Filed:

Gary Sanford et al. v. Weiss, Pulaski County Circuit Court, 5th Division, Case Number: 60CV-10-3462—As discussed in the August 11, 2015 TAC Meeting, this case is a challenge to the interest that is assessed on tax delinquencies after a Certificate of Indebtedness (COI) has been filed. The case was filed as an “illegal exaction” challenge and civil rights claim. The plaintiff alleges the collection of interest violates Article 19, § 13, which is the constitutional usury provision as made applicable by Ark. Code Ann. § 16-65-114 (the statute that governs the interest rates on judgments). The court dismissed the civil rights claim. The plaintiff subsequently amended the complaint, adding back the civil rights claim and continuing the illegal exaction claim. DFA filed a motion to dismiss the amended complaint. The trial on this case was held on June 6, 2014. The court dismissed both claims in the case, holding that the plaintiff did not plead sufficient facts to support either the illegal exaction claim or the claim that plaintiff's civil rights were violated. The plaintiff filed another motion for a new trial that was subsequently denied on October 2, 2014. Three notices of appeals were filed by the plaintiff, and the last notice of appeal was filed on October 7, 2014. The court reporters prepared the record of the proceedings. On May 8, 2015, the court granted the plaintiff's request for oral arguments. Oral arguments are scheduled for June 4, 2015. As of August 11, 2015, the court determined the Tax Procedure Act as well as the judicial relief that is contained in the Tax Procedure Act provides sufficient due process protections to taxpayers.

Weatherford Artificial Lift Systems, Inc. v. Weiss, Pulaski County Circuit Court, 6th Division, Case Number: 60CV-11-3290—As discussed in the August 11, 2015 TAC Meeting, the plaintiff in this case alleges three alternative causes of action, all relating to the purchase of various tangible personal property (including silicon dioxide, silicon dioxide coated with resins, and aluminum silicate and aluminum oxide based ceramics) that were used by the plaintiff in the services it provides to the natural gas extraction industry in areas where the gas is extracted from areas of shale. The issue in the case concerns the taxability of various materials used as proppants in natural gas extraction. The case was tried on February 5, 2013. The circuit court judge ruled from the bench, finding that the proppants are exempt as equipment used in manufacturing. The briefing process concluded on October 16, 2014 in the appellate court. An oral argument was held on May 21, 2015. During the Arkansas Regular 2015 Legislative Session, there were legislative acts passed that made the specific exemptions that are at issue in this case a part of Arkansas state law. When the Arkansas Supreme Court

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makes a ruling, it will ultimately only apply to that specific period that was involved in this case. It is anticipated the written decision would be made before the next TAC Meeting scheduled for August 11, 2015.

During the Arkansas Regular 2015 Legislative Session, there were legislative acts passed that made specific exemptions that are at issue in this case a part of Arkansas state law. As of the date of this TAC Meeting, the Pulaski County Circuit Court invalidated DFA's Gross Receipts Tax Rule GR-57(E)(5), which characterized proppants used in the extraction of natural gas as being not exempt from Arkansas sales and use tax under the manufacturing exemption. A majority of the Arkansas Supreme Court upheld the circuit court decision, although the dissent in the Supreme Court case argued that DFA's rule was valid. The decision in the Weatherford case is limited to the facts in that case since Act 1125 of the 2015 regular session specifically extended the exemption to the sale of proppants.

H & S Maintenance, Inc. v Weiss, Pulaski County Circuit Court, Case Number: 60CV-011-4268—As discussed in the August 11, 2015 TAC Meeting, the issue in this case concerns the taxability of initial installation of lawn sprinkler systems. The taxpayer filed the original lawsuit as an illegal exaction. The complaint has been amended several times by the plaintiff in response to motions to dismiss the illegal exaction claim. A hearing was held on May 7, 2014 on DFA's motion to dismiss. Judge Mary McGowan took it under advisement. As discussed in the May 12, 2015 TAC Meeting, the court granted DFA's motion to dismiss, and the plaintiff had not filed a notice of appeal at that time. As of the date of this meeting, the court agreed with DFA and dismissed the case because the taxpayer did not properly state a cause of action for illegal exaction. The taxpayer in this case is not alleging the sales and use tax is an illegal tax. The taxpayer alleged that DFA's approach to taxing the installation of lawn sprinkler systems should be exempt. The case was dismissed without prejudice which allows the plaintiff to refile the case. In May 2015, the plaintiff refilled the case as an illegal exaction. DFA has again filed another motion to dismiss the illegal exaction claim. In July 2015, the plaintiff's attorney filed a first amended complaint that did not include any illegal exaction claims in the case, and DFA filed the appropriate answer.

L.A. Darling Company v. Weiss, Greene County Circuit Court, Case Number: CV-2012-173—As discussed in the May 12, 2015 TAC Meeting, the plaintiff is a direct pay taxpayer, and one of the issues in the taxpayer's complaint concerns transactions in which the taxpayer paid tax to the vendor by way of a credit card (also called a P-Card) and also accrued and paid tax to the Department as required under its direct pay permit. The Department denied plaintiff's refund request as to these transactions and informed plaintiff that the proper way to have obtained a refund would have been to either request the refund from the vendor or obtain a vendor assignment that would have allowed plaintiff to request the refund directly from the Department. The plaintiff filed suit, and the court held a hearing on the parties' cross motions for summary judgment on August 8, 2014. On April 13, 2015, Judge Pamela Honeycutt issued an order (filed April 27, 2015) granting DFA's motion for summary judgment on the direct pay (P-Card issue). A second issue involved in the complaint was whether machinery and equipment purchased by the plaintiff is exempt as manufacturing machinery and equipment. As of the date of this TAC meeting, the court granted DFA's motion of stating the taxpayer did not follow the specific transaction procedures in a letter opinion dated in March 2015. The letter opinion included a joint order granting DFA's motion that would sufficiently cover all legal and factual issues in the case for appeal purposes. A notice of appeal has not yet been filed, but currently, the plaintiff is still within their timeframe to file an appeal.

Alert Alarm Systems, Inc. v Weiss, Sebastian County Circuit Court, Case Number: CV-13-0323—As discussed in the August 11, 2015 TAC Meeting, the issue in this case concerns the taxability of materials that the plaintiff purchased and installed in connection with its alarm installation and monitoring business. The complaint has been amended three times in response to DFA motions to dismiss. The most recent motion to dismiss was denied, and DFA answered. There have been a number of procedural issues with this case, and the merits have not been reached on this case. As of the date of this meeting, the plaintiff will most likely dismiss this case voluntarily pursuant to a settlement agreement reached by the parties.

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Flis Enterprises, Inc. dba Burger King v. Richard Weiss, Pulaski County Circuit No. 60CV-14-1628—As discussed in the August 11, 2015 TAC Meeting, Burger King was audited, and the audit revealed Burger King was not remitting any tax on the meals they provided free of charge to their managers. The auditors assessed tax on the retail price of the meals which is the same price Burger King would have charged for a meal they would have sold to a customer. Burger King's argument is that they do admit they did not remit any taxes, but Burger King believes they should only remit taxes on the cost of the ingredients. As discussed in the May 12, 2015 TAC Meeting, DFA had filed a motion for summary judgment alleging the facts of the case are not in dispute, but DFA is entitled to judgment as a matter of law. During this discussion, Mr. Parker had a question concerning this case. Mr. Gehring answered by stating that DFA had pending cross motions for summary judgments in this case.

AT&T Mobility Wireless Operations Holding Inc. successor to Pine Bluff Cellular, Inc., Pulaski County Circuit Court, 6th Division, Case Number: 60CV-14-1722—As discussed in the November 10, 2015 TAC Meeting, this case involves a claim by AT&T for refund of taxes that AT&T collected from its customers on internet access charges billed to its customers. AT&T filed the refund claim more than six months ago. DFA has not denied or paid the claim. At any time after the passage of six months if DFA does not respond to the claim, the taxpayer or whoever filed the refund claim can sue. AT&T has sued DFA. This case began in federal court where AT&T was sued by plaintiffs stating AT&T should not have collected sales tax on charges for internet access. DFA was not a party to that federal court case, and was not notified, or otherwise served in the federal lawsuit. A form of service which is a notice regarding a class action lawsuit was given to the Arkansas Attorney General, but the form of service did not give the attorney general any notice that this was a tax case. Since no state agency was a party in the lawsuit, DFA assumed the attorney general thought he was given notice of a class action lawsuit, and the federal court would decide if it was a tax case. If there is a remedy in state court, the Tax Injunction Act states a tax action against a state cannot be brought in federal court. Similar cases such as this in other states were handled in this manner throughout the country and were consolidated in federal court in a multidistrict litigation and transferred to the Northern District of Illinois. The primary question to be litigated is if the refund claim handled in this manner complies with the Arkansas Tax Procedure Act. As of the date of this meeting, the court denied DFA's motion to dismiss on December 3, 2014. The court thought it would be more appropriate that those factual issues be determined within the discovery process, and it is possible once all the facts of the case are known that the case could be decided on a motion of summary judgment either filed by the plaintiff or DFA. Both parties did agree that the refund claims would be limited to November 2007 and going forward. Anything prior to November 2007 would be barred by the statute of limitations. As of the date of this meeting, DFA has come to an agreement in principle with the plaintiffs receiving a refund of sales tax paid which the plaintiffs alleged in the lawsuit that were improperly collected taxes on internet access charges. DFA will refund \$18 million in sales tax. AT&T will receive \$3 million in tax credit per month beginning in April 2016. In case there are sufficient state revenue in the current fiscal year, DFA is reserving the right to extinguish the full amount of the settlement. The settlement is subject to the approval by the Arkansas Legislative Council.

Robert Nunn v. Richard Weiss, Director, Pulaski County Circuit Court, Case Number: 60CV-14-2403—As discussed in the August 11, 2015 TAC Meeting, this is a challenge to the constitutionality Act 300 of the 2014 Fiscal Session. Act 300, DFA's appropriation bill, contains a provision providing a statutory sales tax exemption for the sale of proppants. The plaintiffs in this case alleged the proponents of the bill failed to obtain the required two thirds vote on a non-appropriation measure to be voted on in a fiscal session. Plaintiffs also alleged that Act 300 violates Article 5 § 21 of the Arkansas Constitution, which requires that any amendment to a bill apply to the original purpose of the act. The plaintiffs also alleged an illegal exaction. DFA filed an answer denying the claim of an illegal exaction since the complaint neither states that the tax itself is illegal nor states that the funds resulting from the collection of the tax have been misused. Since DFA took a position consistent with the plaintiff's legal position on the constitutionality of Act 300 in testimony before the General Assembly during the Fiscal Session and at the time of the Governor's veto speech on Act 300, DFA's answer also conceded that Act 300 was unconstitutional. Therefore, DFA alerted the leadership in the Arkansas House of Representatives and Senate, along with the Attorney General, that DFA could not defend the lawsuit. Thereafter, the Attorney General intervened in the case to defend the constitutionality of the Act. The circuit court issued

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an order on September 19, 2014 allowing the Attorney General to intervene. The Attorney General filed a motion to dismiss based upon plaintiff's lack of standing to file the lawsuit. The circuit court has given plaintiff 30 days from the date the Arkansas Supreme Court issues its decision in the *Weatherford v. Weiss* case to file a response to the Attorney General's motion to dismiss. The plaintiffs in this case voluntarily dismissed their case as a result of the *Weatherford Artificial Lift Systems, Inc. v. Walther (formerly Weiss)* decision.

Carrothers Construction Company, LLC v. Walther, Pulaski County Circuit Court, 9th Division, Case Number: 60CV-10-6101—As discussed in the August 11, 2015 TAC meeting, the previous case, *Carrothers Construction Company, LLC v. Richard Weiss*, Pulaski County Circuit Court, 9th Division, Case Number: 60CV-07-15814, focused on whether machinery and equipment used in the water purification plants to generate potable water is machinery and equipment used in manufacturing. During the November 9, 2010 TAC Meeting, Ms. Baker stated the case had been refiled before the passage of one year from the date of dismissal. Mr. Theis also stated the court dismissed the case for failure to prosecute by Judge Mary McGowan on October 28, 2009, and on October 25, 2010, the case was refiled. In 2010, it was assigned to Judge Wendell Griffin. As of today's meeting, Judge Wendell Griffin agreed with the plaintiff in a June 2015 decision by stating they were engaging in a manufacturing activity, and it should be entitled to any exemption provided by machinery and equipment that was used directly in processing. DFA has filed a notice of appeal on July 20, 2015, and Mr. Gehring anticipates that it would most likely be fully briefed and submitted by spring 2016.

New Cases

A+ Government Solutions LLC, Chickasaw Advisory Services LLC, CNI Aviation LLC and CNI Professional Services LLC v. Larry Walther, Director, Department of Finance and Administration of the State of Arkansas, Pulaski County Circuit Court, 6th Division, Case Number: 60CV-15-5023—As discussed in the November 10, 2015 TAC meeting, there are four single member LLCs (A Plus Government Solutions LLC, Chickasaw Advisory Services LLC, CNI Aviation LLC, and CNI Professional Services LLC, and these four single member LLCs are owned by another LLC called Chickasaw Nation Industries Inc. which is a federal chartered tribal corporation organized under Oklahoma law. The issue in the case is the manner of reporting of their Arkansas returns. In the lawsuit, the entities claim they should not have to file federal income tax returns. These four entities file Arkansas corporate income tax returns. At least a portion of these four single member LLCs' income derives from Arkansas.

Tax Acts Adopted in 2015:

- **Act 218**- This act will be effective February 26, 2015. The act added the duties of Arkansas Lottery Commission to the Arkansas Department of Finance's (DFA's) responsibilities. The duties will be handled in the Management Services Section.
- **Act 580**- This act included the Income Tax Technical Corrections Act. Mr. Theis provided TAC members with a handout that explained many points in the 2015 Income Tax Technical Corrections Act. Most items were readopted by Arkansas in 2013. Congress reenacted different items retroactively in December 2014. Mr. Theis stated he received many calls from taxpayers wanting to make sure the Arkansas Tax Deferred Tuition Savings Program was added to the 2015 Income Tax Technical Corrections Act, and he received one call on the IRA charitable donation exemption. Mr. Theis is concerned about next year, 2016, because Congress is beginning to handle tax policy on a year by year basis which affect DFA. Act 580 retroactively went into effect on January 1, 2014.

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- **Act 1202-** This act requires the study of restructuring of various state agencies. Effective immediately.
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Office of Excise Tax Administration:

Sales Tax Changes Effective January 1, 2016 (Passed During 2015 Regular Session)

- **Act 709-** This act concerns sales and use tax on remote sales. After the first \$70,000 per year is collected from remote sellers, any additional tax goes into an account to reduce the four and one and a half percent (4.5%) tax bracket. DFA has to review how much money is in that account and reduce that tax bracket so all taxpayers can get a reduction in the tax rate proposed depending on the amount of money available. The act is effective July 22, 2015.

Arkansas Sales Tax Holiday (August 1, 2015 - August 2, 2015)— As discussed in the August 11, 2015 TAC Meeting, there were not any major complications during the Arkansas Sales Tax Holiday (Sales Tax Holiday). The Sales Tax Section received most of their contact from news media outlets concerning the Sales Tax Holiday, and they did not receive many calls from sellers and customers. Sellers were reminded that it is not optional to participate in the Sales Tax Holiday, and if they sell items that are tax exempt during the Sales Tax Holiday, they must sell the item tax free.

Streamlined Sales Tax Updates— During the calendar year of 2014, almost \$13 million was collected in state and local tax from remote sellers who do not have nexus with Arkansas. As of May 2015, \$5.5 million has been collected in streamlined sales tax.

Sales Tax Changes— As discussed in the November 10, 2015 TAC Meeting, TAC members were given a copy of the *What's New for Sales Tax in 2015* bulletin which included the upcoming sales tax changes.

- **Act 1107-** This act went into effect on April 6, 2015. This act creates a limited direct pay permit for taxpayers who want to claim the benefit of the reduced rate of one percent (1%) on manufacturing repair parts and services. Many taxpayers are not taking advantage of claiming the reduced rate. The limited direct pay permit will only be valid for purchasing repair parts that eligible for the reduced rate. TAC members were urged to inform their clients who are eligible for the reduced rate if they have purchased eligible repair parts but do not want a full direct pay permit. Taxpayers are urged to apply for the reduced rate as soon as possible. Because the sooner they apply, the sooner the reduced rate applies to their account. To apply for the reduced rate, taxpayers may contact the Sales Tax Section at 501-682-7104.
- **Act 1182-** This act went into effect on April 7, 2015. This act creates an exemption for the sale of an aircraft brought into Arkansas only for repairs when the seller and purchaser are both residents of another state, and the aircraft will be based outside of Arkansas.
- **Act 236-** This act will go into effect on July 1, 2015. The act allows DFA to get back in compliance with the Streamline Sales Tax Agreement. In 2013, Act 1001 of the 2013 Regular Session was adopted to allow an out of state winery properly licensed with the

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Arkansas Alcoholic Beverage and Control (ABC) to ship wine into Arkansas if the purchaser had been to the winery and made a purchase to be shipped back to Arkansas. This law failed to require out of state wineries to collect local sales and use taxes which placed DFA out of compliance with the Streamline Sales Tax Agreement. Act 236 clarifies that out of state wineries must collect state and local sales and use tax as well as the beverage excise tax.

- **Act 691**- This act will go into effect on July 22, 2015. This act provides a sales and use tax exemption for the lessee of property located at an intermodal authority on the lessee's purchases of tangible personal property and services. This act relates primarily to warehouse operations.
- **Act 896**- This act will go into effect on October 1, 2015. This act extends the time period for a local tax rebate for eligible business purchases from the current six (6) month time period to a total of twelve (12) months from the date of tax payment to the seller. Purchases made on or after October 1, 2015 will be eligible for the extended time period.
- **Act 1125**- This act will go into effect on October 1, 2015. This act provides an exemption for sand and other proppants used to complete a new oil or gas well or to re-complete, re-drill, or expand an existing well.
- **Act 1126**- This act will go into effect on October 1, 2015. This act creates an exemption for the collection of solid waste for saltwater, drilling fluids, hydraulic fracturing fluids, produced water, pit water, pit mud, and similar materials produced from oil, gas, or other natural resource exploration. Act 1126 excludes the items previously listed from the definition of solid waste for purposes of taxation on the collection and disposal of solid waste provided it does not go to a landfill.

Office of Income Tax Administration:

General Corporate Income Tax Updates for 2016:

- **Act 164 of 2015**- Amends the Equity Investment Incentive Act of 2007 concerning eligibility for the credit.
- **Act 567 of 2015**- Amends the Arkansas Historic Rehabilitation income tax credit.
- **Act 862 of 2015**- Amends the income tax credit for waste reduction.
- **Act 864 of 2015**- Exempts out-of-state businesses from certain taxes and regulatory requirements during disaster response period.
- **Act 896 of 2015**- Amends A.C.A. § 26-18-306(b)(1) to extend the time taxpayers have to report IRS audit to the state from 90 days to 180 days. Extends the amount of time to report an RAR adjustment refund to 180 days. Reduces the time the state has to assess adjustments from an RAR from eight (8) years to three (3).

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- **Act 1254 of 2015-** Amends the law to allow a taxpayer to claim a refund or credit for an overpayment of a state tax during the same period of time that the state may assess overdue taxes.
- AR-KI Form changed to allow the type of entity and allocation of Federal and Arkansas Income.
- As of November 10, 2015, 52% of returns have been e-filed. This will be adjusted as later returns are filed.
- The changes to the Multi State Compact were presented. These changes will not be effective in Arkansas until ratified by the legislature in the next general session.

Update on Individual and Corporation Income Tax Filings—As discussed in the May 12, 2015 TAC Meeting, TAC members were given a copy of the TurboTax Press Release that focused on state tax filing issues. Originally, 7,500 tax returns filed through TurboTax were isolated by the Income Tax Section and processing of TurboTax filed tax returns was stopped for a few days when DFA first became aware of the filing fraud issues.

Arkansas taxpayers were notified that taxpayers in other states were experiencing a problem when attempting to use TurboTax to file their 2014 state income tax returns. These taxpayers received a message stating they had already filed a 2014 state tax return, even though the taxpayers had not filed their 2014 state tax return.

There were not any major issues with TurboTax filings in Arkansas. Only 1,500 returns were reviewed for the TurboTax filing fraud issue. The Income Tax Section has seen an increase in tax filing fraud issues in tax year 2014, but the increase in those issues is not related to the TurboTax fraud issue.

The Income Tax Section received a report from TurboTax requesting that 90 tax returns filed with TurboTax go under a thorough review because those returns were thought to be affected with the filing fraud issue in Arkansas.

After the thorough review, eight returns were affected by the TurboTax fraud filing issue. Seven tax returns were already caught by the Income Tax Section and had a fraud indicators applied to the tax accounts. One tax return was not caught by the Income Tax Section, but it did not generate a refund on the account. Because the taxpayer had a previous balance on the account, the refund went towards that balance. For assistance concerning Arkansas income tax fraud filing issues, taxpayers should call Phil Summers at 501-682-0424 or Robert Pugh at 682-7227. The TurboTax filing fraud issue has affected federal tax returns more than state tax returns.

Act 580-The Income Tax Technical Corrections Act

The following paragraphs include federal laws that DFA retroactively adopted in the Income Tax Technical Corrections Act:

Sections 1 through 8

An amendment to the federal law concerning the Tax Deferred Tuition Savings Program also known as the 529 Plan now allows taxpayers to direct the investment of contributions in an account under the program up to two times per year.

Sections 9

The exclusion of discharge of mortgage debt on a primary residence up to \$2 million from taxable income.

Sections 10

Excludes an employee's taxable income up to \$250 per month in qualifying employer-provided transportation benefits. This adoption relates to the same limitations for transit passes, vanpooling, and parking passes.

Section 11

Allows a Subchapter S Corporation to contribute property to a charity and then reduce the shareholder's share in the Subchapter S Corporation by the shareholder's pro rata share of the adjusted basis in the contributed property. This rule further allows the shareholders to reduce their basis below zero in the Subchapter S Corporation if warranted, in order to claim their share of the charitable contribution.

Arkansas also adopted federal law addressing Subchapter C Corporations that convert to Subchapter S Corporations. For Arkansas income tax purposes, this built-in gain will be recognized if the asset is held less than 10 years after the date of conversion from a C Corporation to S Corporation.

Section 12

Arkansas adopted the federal law allowing taxpayers aged 70 ½ or above to take a tax exempt distribution up to \$100,000 from their IRA if the distribution is donated to charity.

Section 13

Arkansas adopted the federal law that authorizes an itemized deduction for mortgage insurance premiums.

Section 14

Arkansas adopted federal law allowing corporations deductions for contributions of conservation easements, food, and other inventory for charitable purposes. This section also allows C Corporations to donate computer equipment and food to schools and libraries without limiting those deductions to 10% of taxable income, as with other charitable contributions.

Section 15

Federal law allowing accelerated depreciation methods for leasehold improvements, qualified restaurant properties, motorsports facilities, and property on Indian reservations that were set to expire were extended to the end of 2014.

Section 16

Arkansas adopted federal law allowing dividends paid before the 15th day of the 9th month of the year following the current year to be treated as paid in the current year by Regulated

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Investment Companies or a Real Estate Investment Trust. The dividends are taxed as capital gains.

Section 17

The effective date of Act 580 is retroactive for tax years beginning on and after January 1, 2014.

2014 Individual Income Tax Filings to Date and any Issues with Processing

As of May 12, 2015, there was a decrease in overall returns that were processed for tax year 2014. There were 21,000 fewer tax returns processed compared to the same time last year for tax year 2013 with 1.139 million processed for tax year 2014. Paper returns decreased by 46,000 in tax year 2014 compared to the same time last year for tax year 2013, and e-filed tax returns increased by 26,000 compared to the same time last year for tax year 2013. The Income Tax Section continues to see filing of paper tax returns decrease as e-filed tax returns increase every tax year. The final numbers for tax year 2014 will not be available until the end of the tax year.

For tax year 2014, the Income Tax Section received about 100,000 calls to their hotline number which is about the same number they received for tax year 2013. The overall tax season went fairly normal without any significant issues. Early in the tax season, there were some minor issues with the 1099-G Form, but most of those issues have been resolved at this time.

Fraud Question

Mr. Kozij had a question about identity theft. Mr. Turner answered by stating the state e-filed returns usually piggyback off of the IRS the majority of the time to catch errors if the taxpayer filed their state return with their federal return. Mr. Turner agreed that there needs to be more discussion on identity theft. Mr. Kozij wanted more information on if the e-filed returns are piggybacked off of the IRS returns and if there is really protection against identity theft. Mr. Bailey stated there have been instances where a federal return was rejected because of errors, and the state return was accepted; even though it was piggybacked off of the IRS. Mr. Bailey added there still is a problem with identity theft. Mr. Turner stated he would talk with the E-file Section to see why those state tax returns with errors were accepted. Mr. Kozij stated he contacted Ms. Caroline Glover, Tax Examiner Supervisor/Arkansas E-file Support, and she stated he had a software issue. Mr. Kozij stated there really needs to be a serious discussion about identity theft. Mr. Bailey stated there has been a major increase in identity theft, and many academic professionals such as teachers and professors were affected this tax season. Mr. Theis and Mr. Kozij added that many medical professionals were victims of identity theft in tax year 2014 which may be due to the insurance breach.

Depreciation and Section 179 Facts

In Act 580, Arkansas adopted the Internal Revenue Code (IRC) §§ 167 and 168 A through J for depreciation methods that will apply to property purchased in tax years 2014 and went into effect on January 1, 2015.

Section 179 limits did not change, and they will remain the same for tax year 2014 as they were in tax year 2013. The deduction limit is \$25,000.00, and the phase out begins at \$200,000.00.

2013 Non-filer Notices and Exam Operational Automation Database (EOAD)

As of August 11, 2015, the Income Tax Section has processed 12,000 2013 non-filer notices. Taxpayers should receive these notices a week after this meeting. If taxpayers filed their federal tax return late, they could receive a non-filer notice for a tax year other than 2013, but the majority of the non-filer notices will be for tax year 2013.

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Taxpayers who have been audited by the Internal Revenue Service (IRS) are receiving EOAD letters or Revenue Agent Reports (RAR). The taxpayer agreed to the changes being made on their federal tax return but failed to file an amended Arkansas income tax return reporting the change in taxable income. The Income Tax Section started with 61,000 leads or income tax returns to adjust, and they removed 39,000 due to negative income, social security unemployment, or various other factors. The Income Tax Section is currently processing approximately 22,000 total leads. Twelve thousand leads will be automated, and the remaining ten thousand will be reviewed and processed by the Audit Section. The majority of the EOAD letters focus on tax year 2009 and after. There is a slight possibility that some EOAD letters will focus on tax year 2007 and 2008 if the taxpayer filed a late federal tax return. As of the date of this meeting, EOAD letters are already being sent to taxpayers.

General Individual Income Tax Updates for 2016:

- The State of Arkansas retroactively adopted IRC code 163 and 408, as part of the Tax Increase Prevention Act of 2014. For tax year 2014 only, deductions of mortgage insurance premiums (PMI) and tax free distributions from an IRA for charitable purposes are allowed.
- Act 580 of the 2015 Regular Session-Technical Corrections Act- The State is keeping rates in Section 179 at the 2009 level.
- Non-filers will need to file their return or show reason why they are not required to file return.
- **Act 1488 of the 2013-** Regular Session—Increased exemption by \$2,200
- **Act 1173 of the 2015 Regular Session-** Capital gains will get 50% exemption for the month of January and lowered thereafter to 45% for the rest of the year. Capital gains in excess of \$10,000.00 will continue to be exempt.
- **Act 531-** A new set-off applied to debt owed to the Arkansas Highway and Transportation Commission before a refund will be issued.
- **Act 399-** Added checkoff for the Arkansas Game & Fish and removed the U. S. Olympic Committee Tax checkoff.
- For taxpayers with identity theft issues they should contact the Internal Revenue Service and follow those procedures. They should include any Internal Revenue forms with their Arkansas return.
- **Act 22-** This act is Governor Asa Hutchinson's Income Tax Plan. It divided taxpayers into three different group for income tax purposes:
 - Low income taxpayers-making less than \$21,000, effective for tax year 2015 and following, and uses tax brackets of .9%, 2.4%, 3.4%, or 4.4%. These are also the same tax rates that were effective in Act 1488 of 2013 sponsored by Representative Collins which essentially reduced all those brackets by one tenth of a percent (.1%). Governor Hutchinson's Income Tax Plan retained the benefits of Act 1488 of 2013 for low income taxpayers.
 - Middle income taxpayers, making \$21,000 to \$75,000, will continue to pay at same rates for 2015. For 2015, the middle income taxpayers will continue to pay the same rates of 0.9%, 2.5%, 3.5%, 4.5%, 5%, 6%, and 7%. Beginning in tax year 2016, the 6% tax bracket will be reduced to 5%, and the 7% tax bracket will be reduced to 6%.

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- Upper income taxpayers, making more than \$75,000, will now pay the 6.9% bracket for incomes above \$35,100. Beginning in tax year 2016, the 7% tax bracket will be reduced to 6.9%.
- For taxpayers making between \$75,000 and \$80,000, one extra dollar of income could cost a taxpayer a significant amount of additional tax, and to mitigate that situation, the law includes a bracket adjustment as described below:

<u>From</u>	<u>Equal To</u>	<u>Bracket Adjustment Amount</u>
\$75,001	\$76,000	\$440
\$76,001	\$77,000	\$340
\$77,001	\$78,000	\$240
\$78,001	\$79,000	\$140
\$79,001	\$80,000	\$40
\$80,001 and above		\$0

The cost of Governor Hutchinson's Income Tax Plan for FY2016 was just short of 23 million dollars, and for FY2017, it was just short 90 million dollars. This act went into effect on February 1, 2015.

- **Act 864**- This act is an income tax exemption for non-resident disaster responders who come into the state. It eliminates the requirements for non-resident disaster responders to register for various purposes which include items unrelated to tax. It also provides the income that non-resident disaster responders earn is not subject to income or withholding tax. It's basically aimed at making the process easier for people to come to the state for disaster response. Effective March 31, 2015.
- **Act 896**- This act includes significant changes to the Tax Procedure Act. It reduces the time period for DFA to make an assessment if the taxpayer has an IRS adjustment and fails to notify the agency. Since 1979, the Tax Procedure Act of 1979 has provided that DFA had eight years to file an assessment. The time limit has been reduced to three years. The act also allows a refund for any issue for any period if the statute of limitations is open for DFA for assessment. This act also changes the burden of proof. The law now states there is a strict construction of any tax imposition statute and strict construction of any exemption statute. If there is any doubt as to how the law applies, it is strictly construed against the tax if the state is trying to impose a tax. It is strictly construed against the exemption if the taxpayer is trying to claim an exemption. Once you get beyond the strict construction of the statute, the burden of proof with regard to evidence and matters of fact is a preponderance of the evidence. The standards are reduced for factual and evidentiary type issues. Beginning January 1, 2016, legal opinions issued by DFA's Office of Legal Counsel as well as opinions of the Administrative Hearing Board will be published in a redacted format. Since 1979 if a taxpayer wanted to challenge a state tax assessment in court, the law stated that a taxpayer had to pay the tax under protest or pay at least one period. The law has now been removed, and the taxpayer can appeal to the circuit court without payment. It improves access to courts for taxpayers challenging an assessment of tax. The time for taxpayers to claim a local tax rebate on large purchases over \$2,500 has been extended from six (6) months to one (1) year. The act extends the corporate filing period by one month on January 1, 2017. The majority of the other provisions of Act 896 are effective October 1, 2015.
- **Act 1098**- This act provides that non judicial foreclosures are exempt from real estate transfer tax in the same manner as judicial foreclosures. Effective July 22, 2015.

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- **Act 1173-** The act revised the previous capital gains legislation and established a new capital gains exclusion. The capital gains exclusion for the period of January 1, 2015 to January 31, 2015 is 50%. For the period of February 1, 2015 to December 31, 2015, the capital gains exclusion is 45%. For the period of January 1, 2016 through June 30, 2016, the capital gains exclusion is 45%. For all periods after July 1, 2016, the capital gains exclusion is 50%. It reinstated capital gains exemption for gains in excess of 10 million dollars retroactively to January 1, 2014. This act had a revenue cost of 6 million dollars for FYI 2016 and 11.8 million dollars for FYI 2017. Effective July 22, 2015.
 - **Act 1238-** This act addressed an "ABLE account". It is patterned after the federal program. It creates a tax-deferred savings account for persons who are blind or disabled, and their disability is diagnosed before the age of 26. Effective when the Arkansas State Treasurer determines that federal regulations regarding the federal ABLE law have been finalized and provide adequate guidance.
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New Business:

Announcement of Personnel Changes—As discussed in the May 12, 2015 TAC Meeting, effective June 30, 2015, Mr. Rick Pruett retired as the Administrative Law Judge in the Hearing and Appeals Section.

As of June 30, 2015, Mr. Jim Branham retired as Collections Manager in the DFA Revenue Division. While serving as the Collections Manager, Mr. Branham increased the amount of monthly tax collections in the Collections Section from three million dollars to an estimated seven to ten million dollars. Mr. Dale Breshears has been announced as the new Collections Manager. Mr. Breshears will start in that position on August 17, 2015.

Ms. Jessica Duncan has been hired as an Administrative Law Judge in the DFA Revenue's Hearing and Appeals Section.

Mr. Gregory Ivester was introduced as a new attorney on staff in the Office of Revenue Legal Counsel. Mr. Ivester has a background in natural resource law. Ms. Mary Kathryn Williams was also introduced as a new attorney on staff in the Office of Revenue Legal Counsel, and she was employed at the Pulaski County Public Defender's Office. Ms. Williams has also worked as clerk for the Arkansas Supreme Court.

Appointment of New Tax Advisory Council Chairperson (from Arkansas Society of Certified Public Accountants/ASCPA) for 2016/2017

A member of the Arkansas Society of CPAs will be the new chairperson of the committee. That person has not been determined as of November 10, 2015.

Update on Southeastern Association of Tax Administrators (SEATA) Conference

The SEATA Conference was held on July 19th through July 22nd, 2015 in Atlanta, Georgia this year. There was a presentation by Commander Kirk S. Lippold, USN (ret) of the USS Cole, and he discussed the attack on the USS Cole, and the steps that were needed to save lives. The real focus of Commander Lippold's discussion was making sure your staff is properly trained and prepared for any crisis they may face. He felt

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as though his staff was properly trained and that he had given them all the tools they needed in case a crisis arose.

Lynne Reynolds, Income Tax Administrator, spoke at the Commissioner's Roundtable. During the SEATA Conference, some of the discussions focused on how many states are experiencing the same type of budget issues. Since the last election, many states have seen a transition in political parties in their leadership. Tax cuts, methods on balancing their budgets, and improving taxpayer service were some of the issues being addressed by many states at the SEATA Conference.

A presentation called "Security of Our Data Breaches" was given that focused on deterring staff from opening email attachments that may contain viruses.

A breakout session called "Sales and Use Tax Potpourri" dealt with an update on litigation throughout the Southeastern states. There was not much discussion on sales tax, but there was a lot of discussion concerning corporate income tax issues. One lecture dealt with good faith exemptions. DFA has removed the good faith exemption certificate issue in Arkansas, and now the tax is assessed on the purchaser if they present an improper exemption.

Frederick J. Nicely, Senior Tax Counsel of the Council on State Taxation (COST), and Craig Johnson, Executive Director of the Streamlined Sales Tax Governing Board, Inc., led a breakout session called "Streamlined Sales Tax-Fairness in the Marketplace" where they gave an update on streamlined sales tax issues mainly discussing the proposals at the federal level.

Old Business:

Income Tax Fraud and Identity Theft

DFA has worked with Fast Enterprises (Fast) to make sure Arkansas is taking advantage of every security feature with the Fast system. Fast reported that Arkansas was doing a great job with intercepting identity theft and income tax fraud. DFA was not using a specific security item that is available through Fast Enterprises, but it will be incorporated in the upcoming session. DFA has also discussed with Fast and other software vendors concerning enhanced security features. One advantage of using the Fast system is that it allows DFA to work in conjunction with the other states who utilize the Fast system.

Mr. Kozij asked if the IRS was working with DFA on security measures. In October 2015, the IRS and DFA are working on a presentation focused on security measures. As a whole, states are working through the Federal Tax Administrators (FTA) with the IRS as well as the tax preparation software community on security features. The states and the IRS will need assistance from the tax preparation software community because certain security features will need to be implemented to their current software to ensure the taxpayer information DFA receives is more secure on the front-end. The IRS, FTA, and the software developers are currently working on a software proposal.

Mr. Kozij had a question concerning Power of Attorney (POA) cellphone confirmation implementation on Arkansas Taxpayer Access Point (ATAP). Ms. Overman answered by stating cellphone confirmation has been put in place, and she directed Mr. Kozij to contact Brian Fry, DFA Division Manager I, in the Excise Tax Section at 501-682-7131. She further explained that the ATAP cellphone confirmation is a two-step authentication process. Mr. Theis asked Ms. Overman to contact the ATAP Section for the correct process for signing up for the POA ATAP cellphone confirmation, and then email that information to all TAC members.