Agency 006.05

DEPARTMENT OF FINANCE & ADMINISTRATION

REVENUE DIVISION

Comprehensive

INDIVIDUAL

INCOME TAX

REGULATIONS

Regulation 1997-4

ARKANSAS INDIVIDUAL INCOME TAX REGULATIONS

Pursuant to the authority vested in the Commissioner of Revenues and in compliance with Ark. Code Ann. §26-18-301 and §26-51-104, the Commissioner of Revenues of the Department of Finance and Administration, with the approval of the Governor, does hereby promulgate the following rules and regulations for the enforcement and administration of Ark. Code Ann. §26-51-101 et seq.

EFFECTIVE DATE: All regulations previously promulgated by the Commissioner of Revenues for purposes of enforcing or implementing the Arkansas Income Tax Act of 1929 (as amended) are hereby specifically repealed as of the effective date of these regulations.

PURPOSE OF THE REGULATIONS: The following regulations are promulgated to implement and clarify the Arkansas Income Tax Act of 1929 (§26-51-101 et seq.), as amended. All persons affected by or relying upon these regulations are advised to read them in their entirety, as the meaning of the provisions of one regulation may depend upon the provisions contained in another regulation.

INTERPRETATION: In those instances where Arkansas has adopted a section of the Internal Revenue Code (IRC) as its own law, the regulations promulgated by the Treasury Department to aid in interpreting the IRC section should be used for guidance in applying the law. Moreover, when an IRC section is adopted, that section is adopted in its entirety, despite language in the Arkansas adoption statute such as "regarding" which could be construed to limit the scope of the adoption.

INDEX

INDIVIDUAL INCOME TAX REGULATIONS

	REGULATION NUMBER	PAGE NUMBER
ADDITIONAL PENALTIES AND TAX		
Failure to File and Failure to Pay Penalties	1.26-18-208(3)(B)	12
Underestimated Tax Penalty	1.26-18-208(6)(A)	12
ADOPTED INTERNAL REVENUE CODES		
Alpha Listing		3
Numeric Listing		8
ANNUAL WITHHOLDING STATEMENT		
Filing Requirement	1.26-51-909(a)	98
Filing Requirement -- Due Date	1.26-51-909(b)	98
ASSEMBLING YOUR ARKANSAS RETURN		2
CLAIMS FOR REFUNDS OF OVERPAYMENTS		
Grounds for Refund Claim	1.26-18-507(a)	15
Form and Procedure for Refund Claims	1.26-18-507(i)(1)	15
Judicial Relief	1.26-18-507(e)(2)	15
COMPENSATION AND BENEFITS FROM MILITARY SERVICE		
Exemption Amount	1.26-51-306	26
Combat Pay	1.26-51-306(a)(4)	27
Service Allowances	2.26-51-306	27
United States Armed Services Defined	3.26-51-306	27
COMPUTING CAPITAL GAINS AND LOSSES		
Computing Capital Gains and Losses -- Generally	1.26-51-815(a)	91
Computation of Tax	1.26-51-815(b)	92
Exclusion of Small Business Stock from Gain	1.26-51-815(c)	94

INDEX

INDIVIDUAL INCOME TAX REGULATIONS

	REGULATION NUMBER	PAGE NUMBER
CONFIDENTIALITY OF REPORTS AND RETURNS		
Confidentiality -- Generally	1.26-51-813	90
Confidentiality - Exceptions	2.26-51-813	90
CORPORATE LIQUIDATIONS		
Amounts Distributed in Complete Liquidation	1.26-51-413	55
Stock Purchase Treated as Asset Acquisition	2.26-51-413	56
DATE OF PERFORMANCE		
U.S. Postal Service Postmark	1.26-18-105(a)(2)	12
When Last Day is a Saturday, Sunday or Legal Holiday	1.26-18-105(b)	12
DEDUCTIONS - CHARITABLE CONTRIBUTIONS		
Charitable Contributions	1.26-51-419	60
DEDUCTIONS - COLLEGE AND TECHNICAL SCHOOL TUITION	1.26-51-447	76
DEDUCTIONS - DEPRECIATION; EXPENSING OF PROPERTY		
Depreciation	1.26-51-428(a)	70
Amortization of Intangibles	1.26-51-428(c)	70
DEDUCTIONS - EXPENSES		
Types of Deductions	1.26-51-423(a)	60
Long-Term Care Insurance Premiums (Business Expenses)	1.26-51-423(a)(1)	61
Long-Term Care Insurance Premiums (Medical Expenses)	1.26-51-423(a)(2)	61
Travel and Entertainment	1.26-51-423(b)	61
Medical Care Insurance Premiums (Business Expenses)	1.26-51-423(c)(1)	61

INDEX

INDIVIDUAL INCOME TAX REGULATIONS

	REGULATION NUMBER	PAGE NUMBER
DEDUCTIONS - LOSSES		
Losses	1.26-51-424(a)(1)	62
Transfer of Property to Related Person	2.26-51-424(a)(1)	62
Voluntary Removal or Demolition	3.26-51-424(a)(1)	62
Obsolescence	4.26-51-424(a)(1)	63
Shrinkage in Value of Stock	5.26-51-424(a)(1)	63
Farm Losses	6.26-51-424(a)(1)	63
DEDUCTIONS -- NET OPERATING LOSS CARRYOVER		
Net Operating Loss Carryover	1.26-51-427	65
Net Operating Loss Carryover - Adjustments	2.26-51-427	69
DEDUCTIONS -- PASSIVE ACTIVITY LOSS	1.26-51-436(2)	71
DEDUCTIONS - TAXES		
State Income Taxes	1.26-51-416	60
DEDUCTIONS - WORTHLESS DEBTS		
Worthless Debts	1.26-51-425	64
Mortgaged or Pledged Property Sold for Less Than the Amount of the Debt	2.26-51-425	64
Bonds or Other Similar Obligations	3.26-51-425	64
DEFERRED COMPENSATION PLANS		
IRA's	1.26-51-414	56
Lump-Sum Distributions	2.26-51-414	56
Self-Employed Ministers	3.26-51-414	57
Section 457 Plan Distributions	4.26-51-414	57
Penalty-Free Withdrawals	5.26-51-414	57

INDEX

INDIVIDUAL INCOME TAX REGULATIONS

	REGULATION NUMBER	PAGE NUMBER
DEFINITIONS		
Administrator	1.26-51-102(8)	18
Charitable Trust	1.26-51-102	18
Corporate Characteristics	1.26-51-102(5)	18
Estate	2.26-51-102	18
Estate Taxability	3.26-51-102	18
Executor	2.26-51-102(8)	19
Fiduciary	3.26-51-102(8)	19
Grantor Trust	4.26-51-102	19
Irrevocable Trust	5.26-51-102	20
Limited Liability Company	6.26-51-102	20
Limited Partnership	1.26-51-102(4)	20
Partnership	2.26-51-102(4)	21
Publicly Traded Partnership (PTP)	3.26-51-102(4)	21
Resident	1.26-51-102(9)	21
Residency Determination	2.26-51-102(9)	21
Revocable Trust	7.26-51-102	23
Trust	8.26-51-102	23
Trust Taxability	9.26-51-102	23
Trustee	4.26-51-102(8)	23
WITHHOLDING DEFINITIONS		
Agricultural Labor -- Federal Definition	1.26-51-902(1)	94
Agricultural Labor -- When Nonagricultural Labor is also Performed	2.26-51-902(1)	94
Agricultural Labor -- Landscaping Services	3.26-51-902(1)	95
Employer	1.26-51-902(6)	95
Transient Employer	1.26-51-902(12)	95
Wages for Agricultural Labor -- Cash Remuneration	1.26-51-902(13)(B)	96
Wages for Agricultural Labor -- Noncash Remuneration	2.26-51-902(13)(B)	96
Withholding of Income Tax on Agricultural Wages	1.26-51-902 (13)(B)(i)&(ii)	96

INDEX

INDIVIDUAL INCOME TAX REGULATIONS

	REGULATION NUMBER	PAGE NUMBER
EXTENSION OF TIME FOR FILING RETURNS		
First Ninety Day Extension	1.26-18-505(a)(3)(A)	14
Second Ninety Day Extension	1.26-18-505(a)(3)(B)	14
Federal Extension Recognized	1.26-18-505(a)(4)	14
FAILURE TO FILE RETURN OR INCLUDE INCOME		
Taxpayer Required to File Return or Amended Return	1.26-51-808(a)&(b)	88
Penalties, Prosecution, Jeopardy Assessments	1.26-51-808(c)	89
FASITs		
Defined	2.26-51-440	74
Qualification Requirements	3.26-51-440	74
Taxation of FASITs	4.26-51-440	75
Taxation of Regular Interests	5.26-51-440	75
Prohibited Transactions	6.26-51-440	75
Transfers of Assets to FASITs	7.26-51-440	75
FEDERAL SUBCHAPTER S ADOPTED		
IRC Subchapter S Adopted	1.26-51-409	47
Corporations That Must File as an S Corporation	2.26-51-409	47
Applicable Rules - Generally	3.26-51-409	48
Auditing	4.26-51-409	48
Consistency Between Returns	5.26-51-409	48
Reporting S Corporation Income, Loss, Deductions and Credits	1.26-51-409(c)(1)	48
S Corporation Reporting; Shareholder Termination	2.26-51-409(c)(1)	48
Shareholder Basis	3.26-51-409(c)(1)	49
FIDUCIARIES		
Fiduciaries -- Generally	1.26-51-203	25

INDEX

INDIVIDUAL INCOME TAX REGULATIONS

	REGULATION NUMBER	PAGE NUMBER
FIDUCIARY RETURNS		
Fiduciary Returns -- Generally	1.26-51-803	85
FILING RETURNS -- EXTENSIONS OF TIME		
Extension of Time -- Generally	1.26-51-807(a)	87
Payment of Tax, Penalty and Interest	1.26-51-807(b)	88
FILING RETURNS -- TIME AND PLACE -- FORMS		
Due Date and What Constitutes Filing	1.26-51-806(a)	86
Responsibility for Obtaining and Filing Returns	1.26-51-806(b)(1)	86
Signing Returns	1.26-51-806(c)	86
FILING OF EMPLOYER'S WITHHOLDING RETURN AND PAYMENT OF INCOME TAXES WITHHELD		
Filing Schedule for Employer's Withholding Returns	1.26-51-908(a)	97
Transient Employer	1.26-51-908(b)	97
Employers Engaged in a Seasonal Business	1.26-51-908(c)	97
Filing Requirements when Employer no Longer Withholds Income Tax	1.26-51-908(g)	98
FORMS FOR TAX PRACTITIONERS		
Fee Charged by Department	1.26-51-810	89
FORMS INDEX FOR INDIVIDUAL INCOME TAX		1
GAIN OR LOSS - EXCHANGE OF PROPERTY		
Exchange of Property for Like Property	1.26-51-412(a)	52
Exchange of Property for Property Not of Like Kind	2.26-51-412(a)	53
Dividends Paid In Securities or Other Property	3.26-51-412(a)	53
Property Acquired as a Result of an Involuntary Conversion	4.26-51-412(a)	54

INDEX

INDIVIDUAL INCOME TAX REGULATIONS

	REGULATION NUMBER	PAGE NUMBER
Basis of Stock Received for Property - Real, Personal or Mixed	1.26-51-412(b)	54
Stock or Securities Exchanged in a Reorganization	1.26-51-412(c)	54
Stock or Securities Received in a Reorganization	2.26-51-412(c)	55
Basis of Stock or Securities Received in a Reorganization	3.26-51-412(c)	55
GAIN OR LOSS - SALES OF PROPERTY		
Amount Realized on Disposition of Property	1.26-51-411(a)	50
Sale of Shares of Stock	2.26-51-411(a)	50
Sale of Real Estate or Personal Property	3.26-51-411(a)	52
Sale of Property Acquired by Gift	4.26-51-411(a)	52
Basis of Property Acquired On or Before March 9, 1929	5.26-51-411(**a)**	52
Patents and Copyrights	6.26-51-411(a)	52
GROSS INCOME GENERALLY		
Classes of Income	1.26-51-404(a)(1)	33
Income Credited to an Account	2.26-51-404(a)(1)	34
Gross Income -- Manufacturing, Merchandising and Mining	3.26-51-404(a)(1)	34
Gross Income -- Independent Contractor	4.26-51-404(a)(1)	34
Services Paid For With Other Than Money	5.26-51-404(a)(1)	34
Notes of Indebtedness Used in Payment	6.26-51-404(a)(1)	35
Scholarships, Fellowships, Grants and Stipends	7.26-51-404(a)(1)	35
Commissions, Tips and Other Types of Compensation	8.26-51-404(a)(1)	35
Farm - Defined	9.26-51-404(a)(1)	35
Gain on Sale of Property or Capital Assets	10.26-51-404(a)(1)	36
Annuities and Endowment Contracts	11.26-51-404(a)(1)	36
Cost Basis of Divided Tract of Land	12.26-51-404(a)(1)	36
Buildings and Lease Hold Improvements	13.26-51-404(a)(1)	37
Long-Term Contracts	14.26-51-404(a)(1)	37
Stock Dividends and Distributions from Regulated Investment Companies	15.26-51-404(a)(1)	37
Interest	16.26-51-404(a)(1)	37
Installment Sales - Personal Property	1.26-51-404(a)(2)	38
Installment Sales - Real Estate	2.26-51-404(a)(2)	39
Gain on Sale - Involuntary Conversion	1.26-51-404(b)(1)	40
Gain from Sale or Exchange of Principal Residence	1.26-51-404(b)(2)	41

INDEX

INDIVIDUAL INCOME TAX REGULATIONS

	REGULATION NUMBER	PAGE NUMBER
Life Insurance Proceeds	1.26-51-404(b)(3)	41
Gifts	1.26-51-404(b)(5)	43
Bequests, Devise or Descent	2.26-51-404(b)(5)	43
Interest - Obligations of The United States or its Possessions	1.26-51-404(b)(6)	43
Interest - Obligations of the State of Arkansas	2.26-51-404(b)(6)	43
Social Security Benefits	1.26-51-404(b)(7)	44
Unemployment Benefits Paid by Organized Union	2.26-51-404(b)(7)	44
Unemployment Benefits Paid by State or Federal Agency	3.26-51-404(b)(7)	44
Cancellation or Forgiveness of Debt	1.26-51-404(b)(11)	44
Cafeteria Plan and FSA's	1.26-51-404(b)(12)	44
Lawsuit Damages	1.26-51-404(b)(15)	45
Tuition Savings Program (Act 1309 of 1997)		
-- Generally	1.26-51-	98
-- Tax Consequences	2.26-51-	100
HEARING ON PROPOSED ASSESSMENTS		
Hearing on Proposed Assessments	1.26-18-405(d)(4)(A)	13
HOUSEHOLD AND DEPENDENT CARE SERVICES		
General Requirements for the Credit	1.26-51-502(a)&(b)(1)	76
Ten Percent (10%) Standard Credit	1.26-51-502(b)(2)	77
Twenty Percent (20%) Approved Child Care Facility Credit	1.26-51-502(c)(1)	77
Refundability	2.26-51-502(c)(1)	78
Election of Credits	1.26-51-502(c)(2)	78
INCOME FROM SALE OF HOME		
One Time Exclusion of Gain from Gross Income	1.26-51-305(a)	25
One Time Exclusion of Gain from Gross Income Amount Excludable	1.26-51-305(b)	25
One Time Exclusion of Gain from Gross Income Example	1.26-51-305(c)	26
One Time Exclusion of Gain from Gross Income Husband & Wife	1.26-51-305(d)(1)	26

INDEX

INDIVIDUAL INCOME TAX REGULATIONS

	REGULATION NUMBER	PAGE NUMBER
INCOME FROM SOURCES OUTSIDE ARKANSAS		
Calculating the Credit	1.26-51-504(a)	79
Prerequisites to Claiming the Credit	1.26-51-504(b)	80
Restriction of Credit	1.26-51-504(c)	80
INCOME GENERALLY		
Income Generally	1.26-51-403(b)	30
Long-Term Intergenerational Trusts	2.26-51-403(b)	31
Border City Tax Exemption -- Texarkana	1.26-51-403(b)(13)	31
INFORMATION AT SOURCE AS TO RECIPIENTS OF INCOME		
Recipients of Income -- Generally	1.26-51-811(a)	89
INVENTORY		
What Constitutes Inventory	1.26-51-410	49
JUDICIAL RELIEF		
Judicial Relief	1.26-18-406(a)	14
MEDICAL SAVINGS ACCOUNTS		
Defined	1.26-51-436(5)	72
Eligibility	2.26-51-436(5)	72
Deductibility from Income	3.26-51-436(5)	72
Exclusion from Income	4.26-51-436(5)	73
Taxability of Account Earnings	1.26-51-436(6)	73
Taxability of Account Distributions	1.26-51-436(7)	73
NONRESIDENTS OR PART-YEAR RESIDENTS		
Computing Taxable Income	1.26-51-435(a)&(b)	70
Credit for Income Tax Paid to Another State	1.26-51-435(c)	70

INDEX

INDIVIDUAL INCOME TAX REGULATIONS

	REGULATION NUMBER	PAGE NUMBER
Computing Percentage of AGI Attributable to Arkansas	1.26-51-435(d)	71
Calculating Arkansas Income Tax Due	1.26-51-435(e)	71
NONRESIDENTS		
Income Producing Property	1.26-51-202(a)	24
Income Producing Property - Intangible	2.26-51-202(a)	24
Nonresident Generally	1.26-51-202(b)(1)	24
Income from Trust or Estate	1.26-51-202(d)	24
Allocation of Income to Arkansas Sources	1.26-51-202(c)	24
PARTNERSHIP INCOME		
Partnership Income Generally -- Example	1.26-51-405	45
Partnership Composite Return	2.26-51-405	45
Partnerships	1.26-51-405(a)	45
Distributive Share of Partnership Income	2.26-51-405(a)	46
PARTNERSHIP RETURNS		
Partnership Returns -- Generally	1.26-51-802(a)	85
Partnership Income From Arkansas Sources	1.26-51-802(b)	85
PASSIVE ACTIVITIES		
Loss	1.26-51-436(2)	71
Credit (Oil & Gas Properties)	2.26-51-436(2)	71
PRESERVATION OF RECORDS BY TAXPAYER		
Type of Records and Time Period	1.26-18-506(b)	15
Insufficient Records and Estimated Assessment	1.26-18-506(d)	15
RECEIPTS FOR TAXES		
Receipts -- Generally	1.26-51-809	89
RETARDED CHILD		
Tax Credit – Mentally Retarded Child	1.26-51-503	78

INDEX

INDIVIDUAL INCOME TAX REGULATIONS

	REGULATION NUMBER	PAGE NUMBER
RETIREMENT PLANS AND DISABILITY BENEFITS		
Retirement or Disability Benefits	1.26-51-307	27
Premature Distribution	2.26-51-307	28
Divorce	3.26-51-307	28
Military Related Benefits	4.26-51-307	28
RETURNS BY INDIVIDUALS		
Who Should File	1.26-51-801(a)	80
Filing Status "4" -- Married Filing Separately on the Same Return	2.26-51-801(a)	81
Completing and Signing Returns	1.26-51-801(c)	81
Head of Household	1.26-51-801(d)(1)	81
Surviving Spouse	1.26-51-801(d)(2)	81
Dependent Defined	1.26-51-801(d)(4)	82
Withholding for Low Income Employees	1.26-51-801(e)	84
SIMPLE PLANS		
SIMPLE Retirement Saving Plans	6.26-51-414	58
SUBCHAPTER M		
Adopted	1.26-51-440	73
SUBCHAPTER S		
Adopted	1.26-51-409	52
TAX YEAR - ACCOUNTING METHOD		
Method of Accounting	1.26-51-401(a)	29
Method of Accounting	2.26-51-401(a)	29
Change in Method of Accounting	1.26-51-401(b)	30

INDEX

INDIVIDUAL INCOME TAX REGULATIONS

	REGULATION NUMBER	PAGE NUMBER
TAX YEAR - BASIS FOR DETERMINING LIABILITY		
Tax Year - Calendar vs Fiscal Year	1.26-51-402(a)	30
TAXPAYER BILL OF RIGHTS		
Your Rights as a Taxpayer	1.26-18-801	16
TAXPAYER RELIEF		
Protest of Proposed Assessment	1.26-18-404(c)	13
TIME LIMITATIONS FOR ASSESSMENTS, COLLECTION, REFUNDS AND PROSECUTION		
Adjustment to Federal Return - Duty to Amend State Return	1.26-18-306(b)	13
Time Limitation on Refunds and "Verified Claim" for Credit	1.26-18-306(i)(2)	13
TUITION SAVINGS PROGRAM (Act 1309 of 1997)		
Generally	1.26-51-	98
Tax Consequences	2.26-51-	100

Forms Index for Individual Income Tax

Form No.	Form Description
AR3	Itemized Deductions
AR4	Interest & Dividend Income
AR1000 AR1000NR AR1000DGW	Individual Income Tax Forms and Instructions (includes resident and nonresident forms, instructions and tax tables, and capital gains and losses adjustment schedule)
AR1000S	Short Individual Income Tax Form and Instructions
AR1000PTR	Arkansas Property Tax Refund Forms and Instructions
AR1000A	Arkansas Amended Forms and Instructions (includes resident and nonresident forms and instructions)
AR1100S	Sub-Chapter S Forms and Instructions
AR1002	Fiduciary Forms and Instructions (includes resident and nonresident forms and instructions)
AR1050	Arkansas Partnership Return and Partnership Instructions
AR1055	Extension of Time Request (Individual, Sub-Chapter S, Fiduciary, Partnership and Corporation)
AR1103	Election by Small Business Corporation
AR1000RC5	Retarded Child Certificate
AR1000AC	Adoption Expense Income Tax Credit
AR1000DC	Disabled Child Certificate
AR1000EC	Arkansas Early Childhood Certification
AR1000TD	Lump Sum Distribution Averaging
AR2210	Individual Estimated Tax Penalty
AR1000ES	Individual Estimated Tax Vouchers and Estimated Tax Instructions
AR8453	Declaration for Electronic Filing
AY321	Estate Tax Return and Instructions
AY321E	Estate Tax Extension

Forms may be obtained from any state revenue office. They may also be obtained through the mail by writing or calling:

Arkansas State Income Tax Forms
P. O. Box 3628
Little Rock, AR 72203-3628

(501) 682-1100
(501) 682-4795 (hearing impaired/deaf access only)

Assembling Your Arkansas Return

In order to assist the Income Tax Section in processing returns as quickly as possible, the forms should be assembled in the order shown below beginning with AR1000, AR1000NR or AR1000S. Federal attachment sequence numbers are shown in the upper right hand corner of the Federal Forms; Arkansas forms do not have sequence numbers.

AR1000	Arkansas Individual Returns (with W-2s and check attached on front)
AR1000NR	
AR1000S	
AR1000DGW	Arkansas Capital Gains and Losses Schedule and Worksheet
AR2210	Arkansas Underpayment of Estimated Tax
AR3	Itemized Deductions
AR4	Interest & Dividend Income
AR1000TD	Arkansas Lump Sum Distribution Averaging
Federal 5329	Additional Tax Due to Qualified Retirement Plans
Federal 2441 or 1040A	Child Care Credits
AR1000EC	Arkansas Early Childhood Certification
AR1000AC	Arkansas Adoption Expense Income Tax Credit
	Arkansas Business Tax Credit Schedules
AR1000RC5	Arkansas Certificate for Retarded Child
AR1000DC	Arkansas Disabled Child Certificate

Other State Returns
Federal 1040, 1040EZ or 1040A
Other Federal Forms and Schedules in Federal Sequence Order**
All Other Attachments not included in above.

****Federal Attachment Sequence Number**
of Forms Generally Included with Arkansas Returns
(As shown on the Federal Form, upper right-hand corner)

FORM	NUMBER	SEQUENCE
Schedule A	Itemized Deductions	07
Schedule B	Interest and Dividend Income	08
Schedule C	Profit and Loss from Business	09
Schedule C-EZ	Net Profit from Business	09A
Schedule D	Capital Gains and Losses	12
Form 4952	Investment Interest Expense Deductions	12A
Schedule E	Supplemental Income and Loss	13
Schedule F	Profit or Loss from Farming	14
Form 2119	Sale of Your Home	20
Form 4684	Casualties and Thefts	26
Form 4797	Sale of Business Property	27
Form 6198	At Risk Limitations	31
Form 2555	Foreign Earned Income	34
Form 4835	Farm and Rental Income and Expense	37
Form 8606	Nondeductible IRAs	47
Form 2106	Employee Business Expense	54
Form 2106-EZ	Unreimbursed Employee Business Expense	54A
Form 8283	NonCash Charitable Contributions	55
Form 3903	Moving Expense	62
Form 8829	Expense for Business Use of Home	66
Form 4562	Depreciation and Amortization	67
Form 6252	Installment Sale Income	79
Form 8582	Passive Activity Loss Limitations	88

ADOPTED INTERNAL REVENUE CODES (1)

SUBJECT	IRC	DATE	ACA
Accident and Health Plans,			
. amounts received	105	1-1-97	26-51-404(b)(15)
. contributions by employer	106	1-1-97	26-51-404(b)(15)
Accounting, **(2)**			
. methods **(2)**	446-483 **(2)**	**(2)**	26-51-401
. periods **(2)**	441-444 **(2)**	**(2)**	26-51-402
Agricultural Labor	3121(g)	1-1-93	26-51-902(1)
Alimony and Separate Maintenance,			
. deductions from gross income	215	1-1-87	26-51-417(b)
. income to recipient	71	1-1-87	26-51-417(a)
Amortization	197	1-1-95	26-51-428(c)
Amount of Credit			
. qualified person	46(c)(8)(D)	1-1-89	26-51-404(b)(11)
At Risk	465	1-1-87	26-51-436(1)
Bad Debt, Losses and Gains with Respect to Securities Held by Financial Institutions	582	1-1-97	26-51-426
Business Expense **(3)**	162 **(3)**	1-1-97	26-51-423(a)(1)
Cafeteria Plan	125	1-1-97	26-51-404(b)(12)
Capital Gains **(6)**			
. limitations on capital losses	1211	1-1-97	26-51-815
. capital loss carrybacks and carryovers	1212	1-1-97	26-51-815
. capital assets defined	1221	1-1-97	26-51-815
. other terms relating to capital gains and losses	1222	1-1-97	26-51-815
. holding period of property	1223	1-1-97	26-51-815
. property used in the trade or business and involuntary conversions	1231	1-1-97	26-51-815
. gains and losses from short sales	1233	1-1-97	26-51-815
. options to buy or sell	1234	1-1-97	26-51-815
. gains and losses from certain terminations	1234A	1-1-97	26-51-815
. sale or exchange of patents	1235	1-1-97	26-51-815
. dealers in securities	1236	1-1-97	26-51-815
. real property subdivided for sale	1237	1-1-97	26-51-815
. gain from sale of depreciable property between certain related taxpayers	1239	1-1-97	26-51-815
. cancellation of lease or distributor's agreement	1241	1-1-97	26-51-815
. losses on small business investment company stock	1242	1-1-97	26-51-815
. loss of small business investment company	1243	1-1-97	26-51-815
. losses on small business stock	1244	1-1-97	26-51-815
. gain from dispositions of certain depreciable property	1245	1-1-97	26-51-815

ADOPTED INTERNAL REVENUE CODES (1)

SUBJECT	IRC	DATE	ACA
Capital Gains (cont.)			
. gain on foreign investment company stock	1246	1-1-97	26-51-815
. election by foreign investment companies to distribute income currently	1247	1-1-97	26-51-815
. gain from certain sales or exchanges of stock in certain foreign corporations	1248	1-1-97	26-51-815
. gain from certain sales or exchanges of patents, etc., to foreign corporations	1249	1-1-97	26-51-815
. gain from dispositions of certain depreciable realty	1250	1-1-97	26-51-815
. gain from disposition of farm land	1252	1-1-97	26-51-815
. transfers of franchises, trademarks, and trade names	1253	1-1-97	26-51-815
. gain from disposition of interest in oil, gas, geothermal, or other mineral properties	1254	1-1-97	26-51-815
. gain from disposition of section 126 property	1255	1-1-97	26-51-815
. section 1256 contracts marked to market	1256	1-1-97	26-51-815
. disposition of converted wetlands on highly erodible croplands	1257	1-1-97	26-51-815
Capitalization Rules	263(a-h)	1-1-89	26-51-439
Child Care Credit	21	1-1-97	26-51-502(b)(1)
Charitable Contributions	170	1-1-97	26-51-419
Combat Pay	112	1-1-97	26-51-306(a)(4)
Corporate Liquidations,			
. basis of property	334	1-1-97	26-51-413
. complete liquidation of subsidiaries	332	1-1-97	26-51-413
. gain or loss to liquidating corporation	336	1-1-97	26-51-413
. nonrecognition for property distributed	337	1-1-97	26-51-413
. purchase of stock as purchase of assets	338	1-1-97	26-51-413
Cost-Sharing Payments	126	1-1-97	26-51-404(b)(18)
Credit for Adoption Expenses	23	1-1-97	26-51-445
Deferred Compensation Plans,			
. annuities	72	1-1-97	26-51-414
. collectively bargained plans	413	1-1-97	26-51-414
. deduction for employer's contributions	404	1-1-97	26-51-414
. definitions and special rules	414	1-1-97	26-51-414
. employee plans-domestic subsidiaries in foreign operations	407	1-1-97	26-51-414
. employee plans-foreign affiliates	406	1-1-97	26-51-414
. employee plans-taxation of annuities	403	1-1-97	26-51-414
. foreign deferred compensation plans	404A	1-1-97	26-51-414
. individual retirement accounts(IRA)	408	1-1-97	26-51-414
. limitations on benefits and contributions under qualified plan	415	1-1-97	26-51-414

. ADOPTED INTERNAL REVENUE CODES (1)

SUBJECT	IRC	DATE	ACA
Deferred Compensation Plans (cont.)			
minimum funding standards	412	1-1-97	26-51-414
. minimum participation standards	410	1-1-97	26-51-414
. minimum vesting standards	411	1-1-97	26-51-414
. qualification for tax credits employee stock ownership plans(PAYSOPS)	409	1-1-97	26-51-414
. qualified pension, profit sharing and stock bonus plans	401	1-1-97	26-51-414
. retirement savings	219	1-1-97	26-51-414
. special rules for top-heavy plans	416	1-1-97	26-51-414
. state/local govt. & tax exempt org.	457	1-1-97	26-51-414
. taxability of beneficiary of employee's trust	402	1-1-97	26-51-414
Definitions and Special Rules,			
. head of household	2(b)	1-1-91	26-51-301(c)(1)
. surviving spouse	2(a)	1-1-91	26-51-801(d)(1)
Depletion,			
. allowance of deduction for depletion	611	1-1-91	26-51-429
. basis for cost depletion	612	1-1-91	26-51-429
. deduction and recapture of certain mining exploration expenditures	617	1-1-91	26-51-429
. definition of property	614	1-1-91	26-51-429
. development expenditures	616	1-1-91	26-51-429
. percentage depletion	613	1-1-91	26-51-429
Dependent Defined	152	1-1-91	26-51-801(d)(4)
Dependent Care	129	1-1-97	26-51-404(b)(13)
Depreciation			
. accelerated cost recovery system	168	1-1-97	26-51-428(a)
. depreciation	167	1-1-97	26-51-428(a)
. election to expense certain business assets	179, 179A	1-1-97	26-51-428(a)
Depreciation Limitation,			
. investment tax credit and depreciation for luxury automobiles	280F(a-d)	1-1-91	26-51-436(3)
Discharge of Indebtedness	108	1-1-95	26-51-404(b)(11)
Discharge of Indebtedness	1017	1-1-95	26-51-404(b)(11)
Entertainment Expenses	274	1-1-97	26-51-423(b)
Estate Tax,			26-51-201
. deferral of payments	6166	1-1-89	26-51-203
Farming 464(e)(1)	464(e)(1)	1-1-89	26-51-427(1)
Foreign Income,			
. citizens or residents of the United States living abroad	911	1-1-89	26-51-310
. exemption for certain allowances	912	1-1-89	26-51-310
Foster Care Payments	131	1-1-95	26-51-404(b)(19)
Fringe Benefits	132	1-1-97	26-51-404(b)(20)
FASITS **(5)**	851-860 **(5)**	1-1-97	26-51-440
Gross Income	61	AR SIMILAR*	26-51-404
Group-Term Life Insurance,			
. purchased for employees	79	1-1-89	26-51-404(b)(14)
Individual Retirement Account **(4)**	219 **(4)**	1-1-97	26-51-414

ADOPTED INTERNAL REVENUE CODES (1)

SUBJECT	IRC	DATE	ACA
Income Tax Forgiveness for Armed Forces			
and Government Personnel Injured Overseas	692	1-1-97	26-51-306(a)(4)
Injuries or Sickness,			
. compensation for	104	1-1-97	26-51-404(b)(15)
Installment Method	453(a-b)	1-1-95	26-51-411(e)
Interest	163	1-1-97	26-51-415
. on certain deferred payments	483	1-1-93	26-51-443(a)
. on loans with below-market interest rates	7872	1-1-97	26-51-443(b)
Itemized Deduction			
. limitations	68	1-1-95	26-51-436(4)
Involuntary Conversion	1033	1-1-97	26-51-404(b)(1)
Life Insurance Proceeds			
. exclusion from income	101	1-1-97	26-51-404(b)(3)
Long Term Care Insurance Premiums	7702	1-1-97	26-51-423
Meals & Lodging	119	1-1-97	26-51-404(b)(17)
Medical and Dental	213	1-1-97	26-51-423(a)(2)
Medical Savings Accounts	220	1-1-97	26-51-436
Moving Expenses	217	1-1-95	26-51-423(a)(4)
. reimbursements	82	1-1-95	26-51-404(b)(16)
Offers in Compromise	7122	AR SIMILAR*	26-18-705
Passive Activity	469	1-1-97	26-51-436(2)
. at risk limitations	465	1-1-87	26-51-436(1)
Railroad Retirement Benefits (tier 2)	72	1-1-97	26-51-414
Regulated Investment Companies **(5)**	851-860 **(5)**	1-1-97	26-51-440
. Subchapter M	851-860 **(5)**	1-1-97	26-51-440
Reserves for Losses on Loans of Bank	585	1-1-97	26-51-426
Reserves for Losses on Loans	593	1-1-97	26-51-426
Retirement			
. Individual Retirement Account **(4)**	219 **(4)**	1-1-97	26-51-414
. SIMPLE Retirement Account	408	1-1-97	26-51-414
Sale of Home	121	AR SIMILAR*	26-51-305
Sale of Home	121	AR SIMILAR*	26-51-404(b)(2)
Sale of Property to Comply with			
Conflict-of-Interest Requirements	1043	1-1-93	26-51-442
Self-Employed Health Insurance Cost	162	1-1-97	26-51-423(c)(1)
Severance Pay	61	AR SIMILAR*	26-51-404
SIMPLE Retirement Account	408	1-1-97	26-51-414
Small Business Stock	1202	1-1-95	26-51-815(c)
Soil & Water Conservation	175	1-1-95	26-51-404(b)
Subchapter M **(5)**	851-860 **(5)**	1-1-97	26-51-440
. regulated investment companies	851-860 **(5)**	1-1-97	26-51-440
. FASITS	851-860 **(5)**	1-1-97	26-51-440
Subchapter S corporation,			
. adjustments to basis of stock	1367	1-1-97	26-51-409
. coordination with subchapter C	1371	1-1-97	26-51-409
. defined	1361	1-1-97	26-51-409
. definitions and special rules	1377	1-1-97	26-51-409

ADOPTED INTERNAL REVENUE CODES (1)

SUBJECT	IRC	DATE	ACA
Subchapter S (Cont)			
distributions	1368	1-1-97	26-51-409
. coordination with subchapter C	1371	1-1-97	26-51-409
. defined	1361	1-1-97	26-51-409
. definitions and special rules	1377	1-1-97	26-51-409
. distributions	1368	1-1-97	26-51-409
. effect of election on corporation	1363	1-1-97	26-51-409
. election; revocation; termination	1362	1-1-97	26-51-409
. foreign income	1373	1-1-97	26-51-409
. partnership rules	1372	1-1-97	26-51-409
. pass-thru of items to shareholders	1366	1-1-97	26-51-409
. taxable year of S corporation	1378	1-1-97	26-51-409
. tax imposed on certain built-in gains	1374	1-1-97	26-51-409
. tax imposed when passive investment income	1375	1-1-97	26-51-409
. transitional rules of enactment	1379	1-1-97	26-51-409
Tax Deferred Tuition Savings Plan	529	1-1-97	6-84-102
Tax-Exempt Income, Relating to Expenses and Interest	265(a)	1-1-97	26-51-431(b)
Trade or Business Expenses (5)	162(**5**)	1-1-97(**5**)	26-51-423(a)(1)

Notes:

(1) **In those instances where Arkansas has adopted a section of the Internal Revenue Code (IRC) as its own law, the regulations promulgated by the Treasury Department to aid in interpreting the IRC section should be used for guidance in applying the law. For example, at ACA 26-51-306(a)(4) Arkansas adopted IRC Sec. 112 as in effect on January 1, 1991 regarding tax treatment of combat pay. The tax practitioner would refer to the corresponding regulation (IRC Reg. 1.112-1) when working on a combat pay issue under ACA 26-51-306(a)(4).**

(2) Internal Revenue Code sections 441 - 444, dealing with accounting periods, and sections 446 - 483, dealing with accounting methods, have not been officially adopted by the State of Arkansas. The corresponding Arkansas codes do require the taxpayer to file his/her Arkansas return using the same accounting period and the same accounting method as used for Federal purposes.

(3) Subsection "n" of IRC Sec. 162 has not been adopted by Arkansas.

(4) Requirements for filing a joint return under 219(c)(a)(A) of the Internal Revenue code of 1986 shall not apply.

(5) Provisions of Subchapter M of the Internal Revenue code addressing tax rates are not adopted.

(6) The capital gain provisions of ACA 26-51-815 do not apply to C corporations.

* Arkansas has not adopted the cited Internal Revenue Code (IRC) section as its own law. However, the language of Arkansas' statute is similar to that of the federal statute.

ADOPTED INTERNAL REVENUE CODES (1)

IRC	SUBJECT	DATE	ACA
2(a)	Surviving Spouse	1-1-91	26-51-801(d)(1)
2(b)	Head of Household	1-1-91	26-51-301(c)(1)
21	Child Care Credit	1-1-97	26-51-502(b)(1)
23	Credit for Adoption Expenses	1-1-97	26-51-445
46(c)(8)(D)	Qualified Person	1-1-89	26-51-404(b)(11)
61	Gross Income	AR SIMILAR*	26-51-404
61	Severance Pay	AR SIMILAR*	26-51-404
68	Itemized Deduction Limit	1-1-95	26-51-436(4)
71	Alimony Income	1-1-87	26-51-417(a)
72	Railroad Retirement	1-1-97	26-51-414(a)
79	Group Term Insurance	1-1-89	26-51-404(b)(14)
82	Moving Exp. Reimb.	1-1-95	26-51-404
101	Exclusions of Proceeds Paid Upon Illness or Death of Insured	1-1-97	26-51-404(b)(3)
104	Injury or Sickness	1-1-97	26-51-404(b)(15)
105	Accident/Health	1-1-97	26-51-404(b)(15)
106	Accident/Health	1-1-95	26-51-404(b)(15)
108	Discharge Indebt.	1-1-97	26-51-404
112	Combat Pay	1-1-97	26-51-306(a)(4)
119	Meals & Lodging	1-1-97	26-51-404
121	Sale of Home	AR SIMILAR*	26-51-305
121	Sale of Home	AR SIMILAR*	26-51-404(b)(2)
125	Cafeteria Plan	1-1-97	26-51-404(b)(12)
126	Cost-Sharing Payments	1-1-95	26-51-404(b)(18)
129	Dependent Care	1-1-97	26-51-404(b)(13)
131	Foster Care Payments	1-1-95	26-51-404
132	Fringe Benefits	1-1-95	26-51-404
152	Dependent Defined	1-1-91	26-51-801(d)(4)
162	S/E Health Insurance	1-1-97	26-51-403(b)(14)
162	S/E Health Insurance	1-1-97	26-51-423(c)(1)
162 **(3)**	Business Expenses **(3)**	1-1-97	26-51-423(a)(1)
163	Interest	1-1-97	26-51-415
167	Depreciation	1-1-97	26-51-428(a)
168	Depreciation-ACRS	1-1-97	26-51-428(a)
170	Charitable Contributions	1-1-97	26-51-419
175	Soil & Water Conserv.	1-1-95	26-51-404(b)
179	Election to Expense Certain Business Assets	1-1-97	26-51-428(a)
194	Reforestation Amort.		**NO AR CODE**
197	Amortization	1-1-95	26-51-428
213	Medical	1-1-97	26-51-423(a)(2)
215	Alimony Deduction	1-1-87	26-51-417(b)
217	Moving Expenses	1-1-95	26-51-423(a)(4)
219 **(4)**	Individual Retirement Account **(4)**	1-1-97	26-51-414
220	Medical Savings Accounts	1-1-97	26-51-436
221	Interest on Education Loans	1-1-97	26-51-423(d)
263A(a)-(h)	Cap. Rules	1-1-89	26-51-439

ADOPTED INTERNAL REVENUE CODES (1)

265(a)	Tax Exempt Interest	1-1-93	26-51-431(b)
274	Entertainment Expenses	1-1-97	26-51-423(b)
280F(a)-(d)	Dep. Lux. Autos	1-1-91	26-51-436(3)
332	Corp. Liquidations	1-1-97	26-51-413
334	Corp. Basis of Prop.	1-1-97	26-51-413
336	Corp. Gain & Loss	1-1-97	26-51-413
337	Corp. Nonrecognition	1-1-97	26-51-413
338	Corp. Purchase Stock	1-1-97	26-51-413
401	Qualified Pension	1-1-97	26-51-414
402	Emp. Beneficiary	1-1-97	26-51-414
403	Annuities	1-1-97	26-51-414
404	Employer's Contr.	1-1-97	26-51-414
404A	Foreign Deferred Comp.	1-1-97	26-51-414
406	Foreign Affiliates	1-1-97	26-51-414
407	Domestic Deferred Comp.	1-1-97	26-51-414
408	IRA'S, SIMPLE Retirement Acct	1-1-97	26-51-414
409	Tax Credit Employees	1-1-97	26-51-414
410	Participation Stds.	1-1-97	26-51-414
411	Minimum Vesting Stds.	1-1-97	26-51-414
412	Minimum Funding Stds.	1-1-97	26-51-414
413	Collect. Bargain Pls.	1-1-97	26-51-414
414	Definitions and Rules	1-1-97	26-51-414
415	Benefits & Contrib.	1-1-97	26-51-414
416	Top-Heavy Plans	1-1-97	26-51-414
441-444 **(2)**	Accounting Periods **(2)**	**(2)**	26-51-402
446-483 **(2)**	Accounting Methods **(2)**	**(2)**	26-51-401
453	Install Method	1-1-95	26-51-411
453A	"	"	"
453B	"	"	"
457	Def. Comp. Tax Exempt	1-1-97	26-51-414
464(e)(1)	Farming	1-1-89	26-51-427(1)
465	At Risk	1-1-87	26-51-436(1)
469	Passive Activities	1-1-97	26-51-436(2)
483	Interest on Def. Pay.	1-1-97	26-51-441(a)
529	Tax Deferred Tuition Savings Plan	1-1-97	
582	Bad Debts	1-1-97	26-51-426
585	Reserve for Losses	1-1-97	26-51-426
593	Reserve for Losses	1-1-97	26-51-426
611	Depletion	1-1-91	26-51-429
612	Cost Depletion	1-1-91	26-51-429
613	Percent Depletion	1-1-91	26-51-429
614	Definition/Property	1-1-91	26-51-429
616	Development Expense	1-1-91	26-51-429
617	Mining Expenses	1-1-91	26-51-429
664	Charitable Remainder Trusts	1-1-93	26-51-309
692	Tax Forgiveness for Armed Forces & Govt. Employees Injured Overseas	1-1-97	26-51-306(a)(4)
851-860 **(5)**	Sub. M/Reg.Invest.Co./FASIT **(5)**	1-1-95	26-51-440
911	Foreign Income Exclusion	1-1-89	26-51-310

ADOPTED INTERNAL REVENUE CODES (1)

912	Foreign Income Exclusion	1-1-89	26-51-310
1017	Discharge Indebt.	1-1-95	26-51-404
1033	Involuntary Conver.	1-1-97	26-51-404(b)(1)
1043	Sale of Prop/Conflict	1-1-93	26-51-442
1202	Small Bus. Stock	1-1-95	26-51-815
1211	Cap. Gains Limits	1-1-97	26-51-815
1212	Carryovers/Carrybacks	1-1-97	26-51-815
1221	Cap. Assets/Defined	1-1-97	26-51-815
1222	Other Terms/Cap. Gains	1-1-97	26-51-815
1223	Holding Period	1-1-97	26-51-815
1231	Involuntary Conversion	1-1-97	26-51-815
1233	Short Sales	1-1-97	26-51-815
1234	Options	1-1-97	26-51-815
1234A	Certain Terminations	1-1-97	26-51-815
1235	Sale of Patents	1-1-97	26-51-815
1236	Dealers in Securities	1-1-97	26-51-815
1237	Subdivided Property	1-1-97	26-51-815
1239	Sale of Deprec. Prop.	1-1-97	26-51-815
1241	Lease/Distr. Agree.	1-1-97	26-51-815
1242	Small Business Stock	1-1-97	26-51-815
1243	Small Business Co.	1-1-97	26-51-815
1244	Small Business Stock	1-1-97	26-51-815
1245	Gain from Disposition	1-1-97	26-51-815
1246	Foreign Inv. Stock	1-1-97	26-51-815
1247	Election to Distribute	1-1-97	26-51-815
1248	Gains from Exchanges	1-1-97	26-51-815
1249	Gains from Exchanges	1-1-97	26-51-815
1250	Gain from Disp.	1-1-97	26-51-815
1252	Gain from Disp/Farm	1-1-97	26-51-815
1253	Trf of Franchises, Etc.	1-1-97	26-51-815
1254	Gain/Mineral Prop.	1-1-97	26-51-815
1255	Gain/Section 126 Prop.	1-1-97	26-51-815
1256	Section 1256 Contract	1-1-97	26-51-815
1257	Wetlands	1-1-97	26-51-815
1361	Sub S. Corporation	1-1-97	26-51-409
1362	Election	1-1-97	26-51-409
1363	Corp. Election	1-1-97	26-51-409
1366	Pass-thru	1-1-97	26-51-409
1367	Basis of Stock	1-1-97	26-51-409
1368	Distributions	1-1-97	26-51-409
1371	Coordination W/C	1-1-97	26-51-409
1372	Partnership Rules	1-1-97	26-51-409
1373	Foreign Income	1-1-97	26-51-409
1374	Built-In Gains	1-1-97	26-51-409
1375	Passive Investment	1-1-97	26-51-409
1377	Special Rules	1-1-97	26-51-409
1378	Taxable Year	1-1-97	26-51-409
1379	Rules of Enactment	1-1-97	26-51-409
3121(g)	Agricultural Labor	1-1-89	26-51-902(1)
6166	Estate Tax	AR SIMILAR*	26-51-201/03

ADOPTED INTERNAL REVENUE CODES (1)

7122	Compromise	AR SIMILAR*	26-18-705
7872	Loans/Below-Mkt. Int.	1-1-99	26-51-443(b)
7702	Long Term Care Ins. Premiums	1-1-97	26-51-423

Notes:

(1) **In those instances where Arkansas has adopted a section of the Internal Revenue Code (IRC) as its own law, the regulations promulgated by the Treasury Department to aid in interpreting the IRC section should be used for guidance in applying the law. For example, at ACA 26-51-306(a)(4) Arkansas adopted IRC Sec. 112 as in effect on January 1, 1997 regarding tax treatment of combat pay. The tax practitioner would refer to the corresponding regulation (IRC Reg. 1.112-1) when working on a combat pay issue under ACA 26-51-306(a)(4).**

(2) Internal Revenue Code sections 441 - 444, dealing with accounting periods, and sections 446 - 483, dealing with accounting methods, have not been officially adopted by the State of Arkansas. The corresponding Arkansas codes do require the taxpayer to file his/her Arkansas return using the same accounting period and the same accounting method as used for Federal purposes.

(3) Subsection "n" of IRC Sec. 162 has not been adopted by Arkansas.

(4) Requirements for filing a joint return under 219(c)(1)(A) of the Internal Revenue Code of 1986 shall not apply.

(5) Provisions of Subchapter M of the Internal Revenue Code addressing tax rates are not adopted.

* Arkansas has not adopted the cited Internal Revenue Code (IRC) section as its own law. However, the language of Arkansas' statute is similar to that of the federal statute.

26-18-105 DATE OF PERFORMANCE

1.26-18-105(a)(2) U.S. Postal Service Postmark

Only the postmark of the United States Postal Service shall qualify for the provisions of this act for the filing of a return, claim, statement or other documents beyond a prescribed due date.

1.26-18-105(b) When Last Day is a Saturday, Sunday or Legal Holiday

When the last day prescribed under the authority of state tax laws for performing any act or instituting any suit falls on Saturday, Sunday, or a legal holiday, the performance of the act shall be considered timely if it is performed on the next succeeding business day which is not Saturday, Sunday, or a legal holiday.

26-18-208 ADDITIONAL PENALTIES AND TAX

1.26-18-208(3)(B) Failure to File and Failure to Pay Penalties

For individual income tax purposes only, failure to file penalties of five percent (5%) per month and failure to pay penalties of one percent (1%) per month are assessed simultaneously, not to exceed thirty-five percent (35%).

1.26-18-208(6) Underestimated Tax Penalty

The underestimated tax penalty shall not be imposed if the tax liability for the current tax year is one thousand dollars ($250.00) or less.

The underestimated tax penalty shall not be imposed if the current year payments made equal or exceed ninety percent (90%) of the current year tax liability or one hundred percent (100%) of the preceding tax year liability and the preceding tax year was twelve (12) months.

The underestimated tax penalty is calculated by multiplying the underpayment for each quarter by .00027397, then multiplying this product by the number of days from the date the estimate payment was due to:

a) the date estimate was paid, or

b) the date the return is filed, or

c) the due date of the return, **whichever is earlier.**

For purposes of this regulation, payments include taxes withheld from the taxpayer’s wages and estimated tax payments. Estimated tax payments must be made by the required due dates. Payments made with an extension of time to file individual income tax returns do not constitute estimated tax payments.

26-18-306 TIME LIMITATIONS FOR ASSESSMENTS, COLLECTION, REFUNDS AND PROSECUTION

1.26-18-306(b) Adjustment to Federal Return -- Duty to Amend State Return

For any given tax year, if the IRS changes and corrects the taxable income, taxable estate and/or income tax due on an Arkansas taxpayer's federal income tax return, the taxpayer must file an amended Arkansas income tax return within thirty (30) days of receiving such notice from the IRS.

This provision applies to any taxpayer who is required to file an Arkansas individual income tax return, whether the individual is a resident, part-year resident or nonresident of Arkansas.

1.26-18-306(i)(2) Time Limitation on Refunds and "Verified Claim" for Credit

In the case of a taxpayer who fails to file a return, underreports his income by twenty five percent (25%) or more, or fails to notify the director of any change or correction by the Internal Revenue Service, no amended return or verified claim for credit or refund will be allowed after 3 years from the date the original return or the notification of change by the Internal Revenue Service was originally due.

26-18-404 TAXPAYER RELIEF

1.26-18-404(c) Protest of Proposed Assessment

A taxpayer cannot file a protest based upon a notice of tax adjustment, but must wait until a proposed assessment is received.

The taxpayer must protest a proposed assessment in writing, within thirty (30) days of service of the notice. The protest must include the taxpayer’s grounds for protesting the assessment. If the thirtieth (30th) day falls on a Saturday, Sunday or legal holiday, the next succeeding day which is not a Saturday, Sunday, or legal holiday would be within the prescribed time period in which to file the protest.

26-18-405 HEARING ON PROPOSED ASSESSMENTS

1.26-18-405(d)(4)(A) Hearing on Proposed Assessments

If a proposed assessment is sustained, in whole or part by the Office of Hearing and Appeals, the taxpayer may request in writing, within twenty (20) days of the mailing of the decision, that the director revise the decision of the hearing officer. If the director refuses to make a revision, then a final assessment shall be made upon the final determination of the hearing officer.

26-18-406 JUDICIAL RELIEF

1.26-18-406(a) Judicial Relief

A taxpayer may seek further relief from the final decision of the hearing officer or the director on a final assessment of a tax deficiency through the courts within thirty (30) days of the issuance of the final assessment. The taxpayer may pay the full deficiency, interest and penalty under protest and file suit for recovery within one (1) year from the date of payment, or file a bond with the director in double the amount of the tax deficiency and file suit within thirty (30) days thereafter to stay the effect of the director's determination. A taxpayer's failure to file suit, diligently prosecute the suit, or pay any tax deficiency and court costs, shall result in the forfeiture of the bond in the amount of the assessment and court costs.

Jurisdiction for suit shall be in Pulaski County Chancery Court or the Chancery court of the county in which the taxpayer resides or has his principle place of business.

26-18-505 EXTENSION OF TIME FOR FILING RETURNS

1.26-18-505(a)(3)(A) First Ninety Day Extension

Taxpayers may request a ninety (90) day state extension past the original due date of the state individual income tax return. This request shall be made on or before the original due date of the return. Upon receipt, the extension will be approved or denied and a copy sent back to the taxpayer. If approved, attach a copy of the extension to the return when filed. An approved extension only extends the filing due date and does not postpone the due date of payment of taxes. If any tax due is reflected on the filed return and is not paid on or before the original due date, interest as provided by law sill be assessed from the original due date until the tax is paid. Failure to file or pay penalties under ACA 26-18-208 will apply to any tax not paid on or before the extended date.

1.26-18-505(a)(3)(B) Second Ninety Day Extension

The director may issue a second ninety (90) day extension for extraordinary circumstances. This additional extension will run consecutively with the first extension. This request shall be made on or before the expiration of the first ninety (90) day extended due date.

1.26-18-505(a)(4) Federal Extension Recognized

The director will recognize an automatic extension afforded the taxpayer by the Internal Revenue Service. This extension will be granted to the Federal extended due date. The taxpayer must attach a copy of the request to the state return in order to receive the automatic extension.

26-18-506 PRESERVATION OF RECORDS BY TAXPAYER

1.26-18-506(b) Type of Records and Time Period

The taxpayer is required to keep and maintain all records that are necessary to reconcile the amount of tax due or to prove the accuracy of any return. These records must be preserved for six (6) years after a return is filed and are subject to examination by the director at any reasonable time.

1.26-18-506(d) Insufficient Records and Estimated Assessment

If the taxpayer cannot produce sufficient records to reconcile the amount of tax due or to prove the accuracy of any return, the director may make an estimated assessment based upon information available to him. The burden of proof of refuting this assessment is upon the taxpayer.

26-18-507 CLAIMS FOR REFUNDS OF OVERPAYMENTS

1.26-18-507(a) Grounds for Refund Claim

A taxpayer who has paid any tax to the State of Arkansas through error of fact, computation or mistake or law, in excess of the taxes lawfully due, shall be refunded the overpayment of the tax determined by the director to be erroneously paid upon the filing of an amended return or a verified claim for refund. These claims shall be subjected to certain requirements and other information relative to the overpayment.

If a refund is determined, the director shall certify that the claim is to be paid to the taxpayer as provided by law or credited against taxes due or to become due.

1.26-18-507(i)(1) Form and Procedure for Refund Claims

A "verified claim" for credit or a refund may be the signed copy of a previously filed return accompanied by a letter of explanation as to the reason the refund or credit request is being made. Upon request by the Department, it shall be the burden of the taxpayer to prove that all claimed prior income tax or estimated tax payments that are reflected on an amended return or verified claim for credit or refund were made. The Department will accept legible copies of the front and back of canceled checks as proof of prior payments.

1.26-18-507(e)(2) Judicial Relief

The taxpayer may seek judicial relief, according to ACA 26-18-406, if the written decision of the director denies the claim in whole or part.

A taxpayer must file suit within ninety (90) days after the issuance of the director's written decision. The suit may be filed in Pulaski County Chancery Court or the chancery court of the county in which the taxpayer resides or has his principal place of business. A written decision of the director on a refund becomes final and not subject to suit ninety-one (91) days after it is issued.

If the director fails to issue a written decision, and has not acted on the claim after at least six (6) months have expired from the date of the filing of the claim for refund, the taxpayer may file suit in either Pulaski County Chancery Court or the county in which he lives.

26-18-801 TAXPAYER BILL OF RIGHTS

1.26-18-801 Your Rights as a Taxpayer

You have the right to full explanation of all actions by any agent of the Commissioner of Revenue both during an audit and during collection activities.

All tax information contained in the records and files of the Commissioner of Revenue pertaining to you or your business is confidential.

You may represent yourself in any proceeding or interview before the Commissioner or you may be represented by anyone whom you authorize in writing to be your representative.

You have the right to consult with a lawyer, accountant or other representative at any time during an interview with an agent of the Commissioner. The Commissioner shall terminate the interview to allow you to consult with your representative.

You may record any interview with the Commissioner or his agent at your own expense. You should let the Commissioner or his agent know in advance of your intention to record the interview. The Commissioner may likewise record an interview provided that the Commissioner provides you with a copy at your expense.

You may request an administrative review of any Proposed Assessment of tax. You must request this review within 30 days of your receipt of a Proposed Assessment. The administrative review may be based on either an in-person hearing or a consideration of written documents.

If you receive an unfavorable decision from your administrative review, then you may request a review of the decision by the Commissioner. This review should be requested within 20 days of your receipt of the administrative decision.

If you receive an unfavorable decision from the Commissioner, you may appeal it to Chancery Court. To pursue your appeal to Chancery Court you must, within 30 days of the issuance of the final assessment and demand for payment, pay the amount of tax, interest and penalty under protest or file a bond double the tax deficiency amount. You must file your lawsuit within one year from the date of paying under protest or within 30 days of filing a bond.

A taxpayer may file an amended return or verified claim for credit or refund of an overpayment of any state tax within three years of the time the return was filed or two years from the date the tax was paid, whichever is later. Any amended return or claim for refund should be filed with the office of the Revenue Division which administers the tax in issue.

Any taxpayer who wishes to file a complaint regarding any activity concerning the administration or collection of any State tax by the Revenue Division should make the complaint in writing to:

COMMISSIONER OF REVENUE
LEDBETTER BUILDING, ROOM 215
P. O. BOX 1272
LITTLE ROCK, AR 72203

In administering the State Tax Laws, the Commissioner is authorized by law to make an examination or investigation of the business, books and records of the taxpayer. If the Commissioner determines that an additional amount of tax is due, then a proposed assessment shall be issued to the taxpayers. The taxpayer may seek relief from the proposed assessment as outlined above. If the taxpayer fails to preserve and maintain records suitable to determine the amount of tax due or to prove accuracy of any return, the Commissioner may make an estimated assessment based upon the best information available as to the amount of tax due by the taxpayer.

The Commissioner may issue a jeopardy assessment against any taxpayer for whom the tax liability of that taxpayer exceeds any bond on file indemnifying the State for the payment of a State tax, against any taxpayer who intends to leave the State or remove his property or conceal himself or his property, any taxpayer who intends to discontinue his business without making adequate provisions for payment of State taxes or any taxpayer who does any other act tending to prejudice or jeopardize the Commissioner's ability to compute, assess or collect any State tax. Any taxpayer seeking relief from a jeopardy assessment must request an administrative hearing within five days from the receipt of the notice of jeopardy assessment.

When collecting any State tax due from a taxpayer, the Commissioner is authorized to issue a Certificate of Indebtedness to the Circuit Clerk of any county of this State certifying that the person named there is indebted to the State for the amount of tax established by the Commissioner as due. The Certificate of Indebtedness shall have the same force and effect as the entry of a judgement rendered by a Circuit Court and shall constitute a lien upon the title of any real and personal property of the taxpayer in the county where the Certificate of Indebtedness is recorded.

After the entry of the Certificate of Indebtedness, the Commissioner may take all steps authorized by law for the collection of the tax, including the issuance of a Writ of Execution, garnishment, and cancellation of any State tax permits or registrations.

Any court or sheriff's fees or costs which result from the Commissioner's attempt to collect delinquent taxes shall be collected from the taxpayer in addition to the tax, interest and penalties included in the Certificate of Indebtedness.

26-51-102 DEFINITIONS

1.26-51-102(8) Administrator

A person appointed by the court to administer (that is, manage or take charge of) the estate, including liabilities, of a decedent.

1.26-51-102 Charitable Trust

A trust designed for the benefit of a class or the public generally. Charitable trusts are essentially different from private trusts in that the beneficiaries of a charitable trust are uncertain. A charitable remainder trust consists of assets which are paid over to the trust **after** the expiration of a life estate or intermediate estates and designated for charitable purposes.

1.26-51-102(5) Corporate Characteristics

Whether an organization (including an unincorporated entity like a partnership, LLC, or trust) will be taxed as a corporation depends on how many of these corporate characteristics it has:

- associates,
- an objective to carry on a business and divide the gain from it,
- continuity of life,
- centralized management,
- liability limited to the organization's assets, and
- free transferability of interests. IRC Reg. 301.7701-2(a)(1)

If an entity has more corporate than noncorporate characteristics, it is treated as a corporation (association taxable as a corporation). IRC Reg. 301.7701-2(a)(3)

2.26-51-102 Estate

The degree, quantity, nature and extent of interest which a person has in real estate and all other personal property of whatever kind. With respect to a decedent, the total property of whatever kind that is owned by a decedent prior to the distribution of that property in accordance with the terms of a will, or, when there is no will, by the laws of inheritance in the state of domicile of the decedent.

3.26-51-102 Estate Taxability

Estate Tax Extension -- AY321E
Estate Tax Return -- AY321
Fiduciary Return -- AR1002

Estate income is normally taxed to the estate **itself** if retained by the estate, or to the distributee, if distributed. Thus, if the fiduciary (that is, executor or administrator) passes on income to the distributee, the estate deducts the distributed income which then becomes taxable to the distributee. What would be gross income in the hands of an individual is gross income when received by an estate -- dividends, interest, rents, royalties, capital gains, ordinary gains, etc. IRC Reg. 1.641(a)-2. Gross income includes income accumulated or held for future distribution under the terms of a will or trust, income that is currently distributable, income received by a deceased's estate during administration or settlement, and income that, in the fiduciary's discretion, may be either accumulated or distributed. IRC Sec. 641(a). Deductions and credits allowed to estates are basically those allowed to individuals. An estate's status as a separate taxpayer exists only during the period of administration and settlement of the estate. IRC Sec. 641(a)(3). This period starts with the deceased's death and generally extends for the entire time actually required to perform the ordinary duties of administration, such as collecting assets and paying legacies and debts. If estate administration is unduly prolonged, the IRS considers the estate terminated for tax purposes after expiration of a reasonable period (considering the estate's assets) for performance by the executor of all the duties of administration. IRC Reg. 1.641(b)-3(a).

2.26-51-102(8) Executor

A person appointed by a testator to carry out the directions and requests in his will, and to dispose of the property according to his testamentary provisions after his death. The executor would also be responsible for disposing of the estate's debts and other liabilities.

3.26-51-102(8) Fiduciary

Fiduciary Return -- AR1002
Extension of Time -- AR1055

A person having a duty, created by his undertaking, to act primarily for another's benefit in matters connected with such undertaking. A fiduciary relationship is considered one of trust and confidence. A fiduciary has a legal responsibility to act in the beneficiary's (or beneficiaries') best interest. The term "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any other person. IRC Sec. 7701(a)(6). A trustee, for example, possesses a fiduciary responsibility to the beneficiaries of a trust to follow the terms of the trust and the requirements of applicable state law.

4.26-51-102 Grantor Trust

A trust whereby the grantor retains control over the income or corpus (trust property) or both, **to such an extent** that the grantor will be treated as the owner of the property and its income for income tax purposes. The general result is that the income from a grantor trust is taxable to the grantor, as "owner" of the trust, and not to the fiduciary. In determining whether a trust is a grantor trust, the grantor's degree of control over the trust must be analyzed.

If a grantor is considered to be the owner of the **entire** trust, the grantor computes his own personal income tax by taking into account all trust income, deductions and credits as though the trust did not exist. However, where a grantor is treated as owner solely because of his interest in trust **income**, the grantor takes into account only his share of trust items that would be reported by a current income beneficiary. IRC Reg. 1.671-3.

The grantor of a trust is treated as its "owner" and is generally taxed on its income if:

a) The grantor reserves the power to take back title to (that is, revoke) trust funds for himself **where** the grantor can exercise this power alone, or it can be exercised only by another who is regarded as a nonadverse party or it can be exercised by both the grantor and nonadverse party together;

*b) The trust income is distributed actually or constructively to the grantor or the grantor's spouse;

*c) The trust income is held or accumulated for future distribution to the grantor or the grantor's spouse;

*d) The trust income is applied to pay premiums on life insurance policies taken out on the life of the grantor or the grantor's spouse.

See IRC Sec. 671 et seq.

*The income is not taxable to the grantor if the application of the income to any of these purposes requires the approval of an adverse party (such as a beneficiary).

5.26-51-102 Irrevocable Trust

A trust which the settlor may not revoke after it has been created.

6.26-51-102 Limited Liability Company

Limited Liability Companies (LLC's) are owned and in some cases managed by members who are not personally liable for the LLC's debts or obligations. The IRS may classify an LLC as a partnership if it lacks a preponderance of "corporate characteristics" (see definition), resulting in the flow-through of tax attributes to the LLC's members under the partnership tax rules. In Arkansas, LLC's are created and governed pursuant to the Small Business Entity Tax Pass Through Act, ACA 4-32-101 et seq. An LLC can be created by one or more persons by filing Articles of Organization with the Arkansas Secretary of State. Property may be acquired, held and conveyed in the name of the LLC and such property would belong to the LLC, not its members. Pursuant to ACA 4-32-1313, every LLC having two (2) or more members must file an income tax return for each taxable year as required for every partnership by ACA 26-51-802. The income and expenses of every LLC having **only** one (1) member must be reported on the member's individual income tax return.

1.26-51-102(4) Limited Partnership

A limited partnership is a partnership with two classes of partners: general partners, who may participate in the management of the partnership's business and who have unlimited liability for the partnership's obligations; and limited partners, who may not participate in management, and whose liability is limited to the amount of their capital contribution.

2.26-51-102(4) Partnership

Partnership Return -- AR1050
Extension of Time -- AR1055

A "partnership" includes a syndicate, group, pool, joint venture or other unincorporated organization through, or by means of which, any business, financial operation or venture is carried on if it is not, within the meaning of the IRC, a corporation, trust or estate. IRC Sec. 761(a). A partnership exists when two or more persons join in carrying on a trade or business, with each person contributing either money, property, labor or skill. The partnership agreement doesn't have to be written, it can be oral. IRC Sec. 761(c); Reg. 1.761-1(c). A joint undertaking merely to share expenses isn't a partnership. IRC Reg. 1.761-1(a). Partnerships are treated as a conduit or "pass-through entity" and are, therefore, not subject to taxation. The various items of partnership income, gains and losses, etc. flow through to the individual partners and are reported on their individual income tax returns. Moreover, every domestic or foreign partnership doing business within Arkansas or which has received income from sources within Arkansas (regardless of the amount), shall file an Arkansas partnership return.

3.26-51-102(4) Publicly Traded Partnership (PTP)

A publicly traded partnership (PTP) is taxable as a corporation. IRC Sec. 7704(a). A partnership is a publicly traded partnership if interests in the partnership either: (1) are traded on an established securities market, or (2) are readily tradable on a secondary market or its substantial equivalent. IRC Sec. 7704(b). However, a publicly traded partnership won't be treated as a corporation if, for each tax year beginning after 1987, at least 90% of its gross income is specified passive-type income, and certain other requirements are met. IRC Sec. 7704(c). Certain existing partnerships that were publicly traded partnerships on December 17, 1987, won't be treated as corporations until tax years beginning after 1997.

1.26-51-102(9) Resident

Any natural person domiciled in the State of Arkansas **or** any other person who maintains a permanent place of abode within Arkansas and spends in the aggregate more than six (6) months of the tax year within Arkansas.

2.26-51-102(9) Residency Determination

A three pronged test, as set forth below, is used to determine whether or not a person is a resident of Arkansas. Satisfaction of any one prong is sufficient to establish residency.

a) <u>any person **domiciled** in the state of Arkansas</u>. Domicile is comprised of an act coupled with an intent. A domicile is acquired by (1) physical presence at a place coinciding with (2) the state of mind (that is, intent) of regarding the place as a permanent home. A domicile arises instantaneously when these two facts occur. Every person must have one domicile but can have no more than one domicile, regardless of how many residences a person may have at any given time. A domicile, once established, continues until a new domicile of choice is legally established. An established domicile does not end by lack of physical presence alone nor by mental intent alone. The old domicile must be abandoned with the intention not to return to it. If one moves to a new location but intends to stay there only for a limited period of time (no matter how long), the domicile does not become the new location but rather remains unchanged.

b) any person who maintains a permanent **place of abode** within Arkansas **and** spends in the aggregate more than six (6) months of the year within Arkansas. Place of abode means a place where a person has established a permanent home, even though such person may be absent therefrom[sic] for a long period of time. A temporary home or residence would not be considered a place of abode, as there must be at least some degree of permanence. In addition, a person must actually spend **more** than six months of the tax year in Arkansas to fall within the scope of this provision. A person who has spent either less than six months or exactly six months in Arkansas would not fall within the scope of this provision.

Place of abode and residence are considered to mean roughly the same thing. However, domicile and residence are not considered to be synonymous. Residence denotes only an act (the act of residing), while domicile denotes an act (the act of residing) coupled with the intent that the residence be a permanent home. The distinction between domicile and place of abode is that although a person can have several homes (or places of abode) at one time, only one of those homes can be the person's domicile. The home that the person **intends** or **considers** to be their permanent home (as in home base) would be the domicile.

c) In situations where it is not clear if the requirements of either domicile (a) or place of abode (b) have been met, a residency determination can only be made after thoroughly reviewing the facts on a case by case basis. When reviewing the facts, the Supreme Court of Arkansas has held that we are not bound to accept a taxpayer's claims of intent when the circumstances point to a contrary conclusion. Furthermore, when acts are inconsistent with a taxpayer's declarations, the acts will control, and our conclusions regarding residency should be based on the facts and circumstances proved. The following factors should be reviewed in making a residency determination:

* Address used on federal income tax returns;
* Address used on telephone, utility and commercial documents;
* Address used on voter registration;
* Address used on driver's license, hunting and fishing license;
* Address used on motor vehicle, boat and trailer registration;
* Address used on real and personal property tax documents;
* Address used on county and other tax assessments;
* Address on governmental documents, such as military records. With respect to military records, the Leave and Earning Statement is a very important document;
* If the Taxpayer has a spouse, the spouse's address on such things as drivers license, voter registration, vehicle registration, etc. should be checked out;
* Employer and withholding information, nature of Taxpayer's employment (traveling salesperson, etc);
* Location of Taxpayer. How often and for how long is Taxpayer present at the locations at issue;
* Location of immediate family, such as spouse and children;

* Length of time in Arkansas of Taxpayer and immediate family;
* Community affiliations, such as club memberships, church, bank accounts, etc.;
* Absence of factors in other states.

7.26-51-102 Revocable Trust

A trust in which the settlor (that is, grantor or creator of the trust) reserves the right to revoke the trust. The settlor would be considered to be the "owner" of such a trust. Therefore, revocable trusts may be treated as grantor trusts under certain circumstances. IRC Sec. 671 et seq.; Reg. 1.676(a).

8.26-51-102 Trust

Any arrangement whereby property is transferred with the intention that it be administered by a trustee for anothers benefit. A trust can be created for any purpose which is not illegal and which is not against public policy. The essential elements of a trust are a designated beneficiary and trustee, a fund or other property sufficiently identified to enable title to pass to the trustee, and actual delivery to the trustee with the intention of passing title to the trustee. A fiduciary relationship exists between the trustee and beneficiary.

9.26-51-102 Trust Taxability

Fiduciary Return -- AR1002
Extension of Time -- AR1055

Trust income is normally taxed to the trust **itself** if retained by the trust, or to the beneficiary, if distributed. Thus, if the fiduciary (that is, trustee) passes on income to the beneficiary, the trust deducts the distributed income which then becomes taxable to the beneficiary. What would be gross income in the hands of an individual is gross income when received by a trust -- dividends, interest, rents, royalties, capital gains, ordinary gains, etc. IRC Reg. 1.641(a)-2. Gross income includes income accumulated or held for future distribution under the terms of a trust, income that is currently distributable, and income that, in the fiduciary's discretion, may be either accumulated or distributed. IRC Sec. 641(a). A "trust" is taxed as a corporation if it has been created or used during the tax period to carry on a business and it has corporate characteristics such as centralized management, continuity of existence, limited liability, etc. IRC Reg. 301.7701-4(b). Deductions and credits allowed to trusts are basically those allowed to individuals. When a trust terminates, it ends as a separate tax entity and no longer reports gross income or claims deductions, credits, etc. IRC Reg. 1.641(b)-3(d). Though the duration of a trust may depend on the occurrence of a particular event under the trust instrument, e.g., the life beneficiary reaching a specified age, for tax purposes the trust will nevertheless continue for a reasonable period beyond this time to allow for the orderly completion of administration. IRC Reg. 1.641(b)-3(b).

4.26-51-102(8) Trustee

Person who holds legal title to property in trust for the benefit of another person or people (that is, the beneficiaries). A trustee is one who is appointed, or required by law, to execute a trust.

26-51-202 NONRESIDENTS

1.26-51-202(a) Income Producing Property

A nonresident individual, partnership, trust or estate who earns income from property (real property or tangible personal property) located within Arkansas or from a business, trade or occupation carried on within Arkansas shall pay Arkansas income tax at the rates set forth in ACA 26-51-201.

2.26-51-202(a) Income Producing Property - Intangible

Income derived by a nonresident from **intangible** personal property located within Arkansas is not subject to Arkansas income tax. For example, the interest income earned on a savings account with a bank located in Arkansas by a nonresident account holder would not be subject to Arkansas income tax.

1.26-51-202(b)(1) Nonresident Generally

A nonresident who earns income attributable to Arkansas must timely file an Arkansas income tax return and remit with the return the full amount of Arkansas income tax due. The filing of an Arkansas income tax return and the payment of Arkansas income tax by a nonresident shall be done without regard to the income tax laws of the nonresident's resident state.

1.26-51-202(d) Income from Trust or Estate

A nonresident beneficiary of a trust or estate administered by a resident trustee, executor or administrator shall not be subject to Arkansas income tax **unless** the beneficiary's income has been derived by the trust or estate from:

a) Any interest in real property (real estate) located within Arkansas, including but not limited to the following: lease and rental income; income from crops, timber, mining and other land uses; and the **gain** from any sale of such real property.

b) The use of tangible personal property located within Arkansas, including any **gain** realized from the sale thereof.

c) Any unincorporated business located within Arkansas, such as an association, sole proprietorship, partnership and limited liability company (LLC).

1.26-51-202(c) Allocation of Income to Arkansas Sources

Where a nonresident individual is paid a salary, lump sum payment or some other form of payment which encompasses work performed both inside and outside of Arkansas, Arkansas income tax should be paid only on that portion of the individual's income that can be reasonably **allocated** to work performed in Arkansas.

26-51-203 FIDUCIARIES

1.26-51-203 Fiduciaries - Generally

Arkansas income tax shall be levied against and paid by resident fiduciaries on the **net income** of:

a) Estates and trusts which has not been distributed (or become distributable) to beneficiaries during the tax year;

b) deceased individuals received during the tax year who at the time of their death were residents and who died during the tax year without having made a return;

c) resident insolvent or incompetent individuals, whether or not any portion thereof is held for the future use of such individuals, where the fiduciary has complete charge of the net income.

Where there are two (2) or more joint fiduciaries, part of whom are nonresidents of Arkansas, the net income taxable to the fiduciaries shall be allocated equally. The income tax imposed upon a fiduciary shall be a charge against the estate or trust, as opposed to a charge against the fiduciary personally.

26-51-305 INCOME FROM SALE OF HOME

1.26-51-305(a) One Time Exclusion of Gain from Gross Income

A taxpayer may make a one time (i.e., once-in-a-lifetime) election to exclude from his gross income the gain realized from the sale or exchange of a home if the following conditions are met:

1 The taxpayer has reached the age of fifty-five (55) before the date of the sale or exchange; and

2 During the five (5) year period **ending** on the date of the sale or exchange, the home was owned and used by the taxpayer as his principal residence for a period of (or periods aggregating) three (3) years or more.

1.26-51-305(b) One Time Exclusion of Gain from Gross Income -- Amount Excludable

The maximum amount of gain excludable from gross income under this section is one hundred twenty-five thousand dollars ($125,000.00). In the case of a separate return filed by a married taxpayer, the maximum amount allowable shall be sixty-two thousand five hundred dollars ($62,500.00) for such taxpayer.

The exclusion from gross income provided by this section can only be taken once by a taxpayer after reaching the age of fifty-five (55). After this election has been properly taken by a taxpayer, it shall not be available to the taxpayer again. However, refer to 1.26-51-305(c) regarding revocation of the election.

1.26-51-305(c) One Time Exclusion of Gain from Gross Income – Example

An election to exclude from gross income the gain realized from the sale or exchange of a home may be **made** or **revoked** at any time before the period expires for filing a claim for credit or a refund of income tax paid for the tax year in which the sale or exchange occurred. If the taxpayer making the election or revocation is married, the taxpayer's spouse must join in the election or revocation.

For example, a taxpayer well above the age of fifty-five (55) sold his long-time principal place of residence in 1994. The taxpayer realized fifty-five thousand dollars ($55,000.00) in gain from the sale. In 1995, the taxpayer made his once-in-a-lifetime election to exclude the $55,000.00 of gain from his gross income. The taxpayer now wishes to revoke this election, as he anticipates realizing a larger gain on the pending sale of his current residence. Pursuant to ACA 26-18-306(i)(1), the taxpayer must file his revocation with the Department within three (3) years from the date his 1994 Arkansas income tax return was filed or two (2) years from the time his 1994 Arkansas income tax due was paid, whichever period expires later.

1.26-51-305(d)(1) One Time Exclusion of Gain from Gross Income -- Husband & Wife

With respect to excluding from gross income the gain realized from the sale or exchange of a home, **both** a husband and wife shall be treated as satisfying the age, holding and use requirements of 1.26-51-305(a) if all of the following requirements are met:

a) The home is held by the husband and wife as either:
    i. joint tenants; or
    ii. tenants by the entirety;

b) The husband and wife file an Arkansas joint return or "separate on same" return for the tax year in which the home was sold or exchanged; and

c) At least one (1) of the spouses satisfies the age, holding and use requirements of 1.26-51-305(a) with respect to the home.

26-51-306 COMPENSATION AND BENEFITS FROM MILITARY SERVICE

1.26-51-306 Exemption Amount

The first $6,000.00 of **service pay** or **service allowances** received by any active duty member of the United States armed services shall be exempt from Arkansas income tax. All such service pay or allowances received above and beyond $6,000.00 for any given tax year shall be subject to Arkansas income tax.

1.26-51-306(a)(4) Combat Pay

For enlisted personnel, gross income shall not include compensation received while on active service in a combat zone or while hospitalized as a result of serving in a combat zone. IRC Sec. 112(a). With respect to commissioned officers, gross income shall not include *compensation received while on active service in a combat zone or while hospitalized as a result of serving in a combat zone. IRC Sec. 112(b).

> *The amount of compensation for a commissioned officer that is excludable from gross income is limited to the "maximum enlisted amount." The term "maximum enlisted amount" is defined as the highest rate of basic pay payable during the period of combat zone service to any enlisted member of the U.S. Armed Forces at the highest pay grade applicable to enlisted members.

2.26-51-306 Service Allowances

Service allowances shall include, but not be limited to, the following: veteran's benefits; medical benefits; disability benefits; professional education; moving and storage; group-term life insurance; survivor and retirement protection plan premiums; subsistence; uniform; housing; overseas cost-of-living; evacuation; family separation allowances; death gratuities; interment (burial) allowance; various travel allowances; dependent benefits; and, when provided in connection with a **permanent** change of station, allowances for dislocation, temporary lodging and move-in housing.

3.26-51-306 United States Armed Services Defined

United States armed services shall include the following; Army; Navy; Air Force; Marine Corps; Coast Guard; National Guard; Reserve units; and U.S. Public Health Service.

26-51-307 RETIREMENT PLANS AND DISABILITY BENEFITS

1.26-51-307 Retirement or Disability Benefits

The first $6,000.00 of retirement or disability benefits received by a resident of Arkansas from an in-state or out-of-state retirement plan or program will be exempt from Arkansas income tax if:

a) the retirement plan or program is directly related to either public or private employment;
b) the Arkansas resident is the employee or former employee owner of the plan or the employee or former employee's spouse.

Plans or programs that could fall within the scope of this exemption are: pension plans; profit sharing plans; stock bonus plans; employee stock ownership plans (ESOPs); annuity plans; thrift and savings plans; cash or deferred arrangements (CODAs, also known as 401(k) plans); and simplified employee pension (SEP) plans. An individual retirement account (IRA) will fall outside the scope of this exemption unless it is established by an employer as a SEP.

2.26-51-307 Premature Distribution

A **premature distribution** taken by an Arkansas resident from a retirement plan or program that meets all of the criteria set forth above would qualify for the exemption.

3.26-51-307 Divorce

A taxpayer's interest in an ex-spouse's employment-related retirement plan or program acquired through a divorce is eligible for this exemption only if the interest was awarded pursuant to a qualified domestic relations order (QDRO). IRC Sec. 402(e)(1)(A) requires that an alternate payee (i.e. taxpayer), who is a former spouse of a retirement plan participant, be treated just like the participant with respect to any payments made to the alternate payee **under a QDRO.** Note that Arkansas has adopted Sections 72, 219, 401-404, 406-416 inclusive, and 457 of the Internal Revenue Code of 1986.

Example:

1. Mary was divorced from James by a Decree dated May 4, 1993.

2. As a part of the property settlement contained in the Decree, Mary was awarded an interest in James' 401(k) retirement plan pursuant to a qualified domestic relations order (IRC Sec. 414(p)).

3. Mary received $7,000.00 from James' 401(k) retirement plan in 1994.

4. Although Mary would report $7,000.00 in the gross income section of her Arkansas individual income tax return for 1994, she would be entitled to the $6,000.00 exemption and would pay income tax only on the $1,000.00 balance of the distribution.

4.26-51-307 Military Related Benefits

Only the first $6,000.00 of military retirement pay based on length of service is exempt from Arkansas income tax. However, pursuant to IRC Sec. 104(a)(4), the full amount of a military disability pension (with no $6,000.00 cap) is exempt from Arkansas income tax so long as the pension is for personal injuries or sickness resulting from active service in the armed forces. Likewise, military retirement pay, **to the extent** that it is based upon a military related disability, would be exempt above and beyond the first $6,000.00 received.

26-51-401 TAX YEAR - ACCOUNTING METHOD

1.26-51-401(a) Method of Accounting

It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Arkansas taxpayers must use the same accounting method as that used for federal income tax purposes.

Each taxpayer is required by law to make an income tax return reflecting his true and correct income. Therefore, adequate accounting records and source documents must be retained to justify that the filed income tax returns are a true and correct accounting of the taxpayers transactions for each tax year. As a general rule, the accounting records and source documents should be retained for a minimum of six (6) years.

The essential elements are as follows:

(1) In all cases in which the production, purchase or sale of merchandise of any kind is an income-producing factor, inventories of the merchandise on hand (including finished goods, work in process, raw materials, and supplies) should be taken at the beginning and end of the year and used in computing the net income for the tax year.

(2) Expenditures made during the tax year should be properly classified as between capital and expense; that is to say, expenditures for items of plant, equipment, etc., which have a useful life extending substantially beyond the tax year should be charged to a capital account and not to an expense account; and

(3) In any case in which the cost of capital assets is being recovered through deductions for wear and tear, depletion or obsolescence, any expenditure (other than ordinary repairs) made to restore the property or prolong its useful life should be added to the property account or charged against the appropriate reserve and not to current expenses.

2.26-51-401(a) Method of Accounting

Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. All items of gross income subject to taxation shall be included in the gross income for the tax year in which they are received by the taxpayer, and deductions taken accordingly, unless in order to clearly reflect income such amounts are to be properly accounted for as of a different period. Refer to 1.26-51-403(b). For instance, in a case where it is necessary to use an inventory, no other accounting method in regard to purchases and sales will correctly reflect income except the accrual method. A taxpayer is deemed to have received items of gross income which have been credited to or set apart for him without restriction. On the other hand, appreciation in value of property is not an accrual of income to a taxpayer prior to the realization of such appreciation through sale or conversion of the property.

The true income, computed under the Income Tax Act of 1929, and where the taxpayer keeps books of account, in accordance with the method of accounting regularly employed in keeping such books (provided the method so used is properly applicable in determining the net income of the taxpayer for purposes of taxation) shall in all cases be entered on the income tax return.

1.26-51-401(b) Change in Method of Accounting

If for any reason the basis of reporting income subject to tax is changed, the taxpayer shall attach to his income tax return a copy of the Internal Revenue Service certification or approval of the change in accounting method.

26-51-402 TAX YEAR - BASIS FOR DETERMINING LIABILITY

1.26-51-402(a) Tax Year - Calendar vs Fiscal Year

Taxable income is computed on the basis of a period of time called a tax year. A tax year generally is the annual period on the basis of which the taxpayer regularly computes income in keeping its books and records. The annual period is usually a calendar year or a fiscal year. A calendar year is a period of twelve (12) months ending on December 31. A fiscal year is a period of Twelve (12) months ending on the last day of any month other than December.

A taxpayer must calculate income using the same tax year as that used on the federal income tax return. A change of the tax year must be approved by the Internal Revenue Service and a copy of the approval letter must be attached to the Arkansas income tax return

26-51-403 INCOME GENERALLY

1.26-51-403(b) Income Generally

Each year's return should be completed in itself and taxpayer's are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. The expenses of one year can not be used to reduce the income of a subsequent year. A taxpayer has the right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes or other charges, he can not deduct them from the income of the next or any succeeding year. It is recognized, however, that particularly in a going business of any magnitude, there are certain overlapping items of both income and deductions, and so long as these overlapping items do not materially distort the income they may be included in the year in which the taxpayer, pursuant to a consistent policy, takes them into his accounts. Judgements[sic] or other binding adjudications, such as decisions of referees and boards of review under workman's compensation laws, on account of damages for patent infringement, personal injuries, or other causes, are deductible from gross income when the claim is so adjudicated or paid, unless taken under other methods of accounting which clearly reflects, the correct deduction, less any amount of such damages as may have been compensated for by insurance or otherwise. If, subsequent to its occurrence, however, a taxpayer first ascertains the amount of a loss sustained during a prior taxable year which has not been deducted from gross income, he may render an amended return for such preceding taxable year including such amount of loss in the deductions from gross income and may file a claim for refund of the excess tax paid by reason of the failure to deduct such loss on the original return. A loss from theft or embezzlement occurring in one year and discovered in another year is ordinarily deductible for the year in which sustained.

2.26-51-403(b) - Long-Term Intergenerational Trusts

A long-term intergenerational trust is a trust established for an individual under the age of 18. The purpose of the trust is to provide tax-deferred growth of funds for the minor's retirement. The trustee must be a resident of Arkansas and cannot distribute any of the trust's funds to the beneficiary until the beneficiary reaches the age of 55. Up to $4,000.00 per year can be contributed to the trust.

CONTRIBUTIONS

Contributions to the trust are taken as an adjustment (that is, subtracted) from the contributor's gross income for purposes of calculating the contributor's adjusted gross income.

EARNINGS

Income tax on trust earnings is deferred until such time that the earnings are distributed to the trust's beneficiaries.

DISTRIBUTIONS

*All distributions from the trust, whether principal, earnings or a combination thereof, are taxable to the beneficiary who receives them. Prior to August 1, 1997, distributions of trust principal were not taxable, while distributions of trust earnings were taxable.

> *All distributions from long-term intergenerational security trusts are taxable pursuant to ACA 28-72-505(a)(1).

1.26-51-403(b)(13) Border City Tax Exemption -- Texarkana

Under certain circumstances, as set forth below in Income Tax Regulation 1977-5, the income of **residents** of Texarkana, Arkansas and Texarkana, Texas, which would normally be subject to Arkansas income tax, will be exempt from Arkansas income tax due to Arkansas' "border city tax exemption" as established by ACA 26-52-602.

The Commissioner of Revenues of the State of Arkansas, pursuant to the authority vested in him by Act 118 of 1929, and Act 132 of 1965, with the approval of the Governor, does hereby promulgate the following regulations and rules for the orderly administration of Act 48 of 1977, as amended by Act 177 of 1977.

Definitions. The following words shall have, when used in this regulation, the following meaning:

Texarkana, Arkansas, Resident -- Shall mean an individual who maintains a place of abode within the city limits of Texarkana, Arkansas.

Texarkana, Texas, Resident -- Shall mean an individual who maintains a place of bode within the city limits of Texarkana, Texas.

Individual Taxpayer -- Shall mean a natural person.

1. Texarkana, Arkansas residents are exempt from the Arkansas Income Tax on income received while a bona fide resident of Texarkana, Arkansas, but they shall be required to file an Arkansas Income Tax return.

2. Texarkana, Texas residents are subject to the Arkansas Income Tax on taxable income earned in Arkansas, other than income earned in Texarkana, Arkansas.

3. All other residents of Texas, other than those residents of Texarkana, Texas are subject to the Arkansas Income Tax on taxable income earned in Arkansas, including Texarkana, Arkansas.

4. Texarkana, Arkansas residents are subject to the Arkansas Income Tax on taxable income earned in Arkansas while a resident of any city other than Texarkana, Arkansas.

*5. Employers shall verify to the State of Arkansas the residency of those employees on whom they do not withhold Arkansas Income Tax. Employees shall file the Employee's Withholding Exemption Certificate with the employer if the employee is claiming a Texarkana, Arkansas, residency exemption or a Texarkana, Texas, residency exemption for income earned in Texarkana, Arkansas. The employer shall keep this certificate with his records, under the penalty of being liable for any taxes not properly withheld on his employees. Employers shall also list the names and addresses of all employees during the course of the quarterly tax period or at the time a report is due from the employer.

6. Information furnished by the employee to the employer shall include the physical location of the employee if his mailing address is different from his residence address.

7. An individual taxpayer who is claiming an exemption from Arkansas Income Tax because of a Texarkana, Arkansas, or a Texarkana, Texas residence shall verify to the State of Arkansas that he is indeed a bona fide resident of Texarkana, Arkansas or Texarkana, Texas in a manner that is acceptable to the State of Arkansas.

The effective date of this regulation shall be January 1, 1978.

* Withholding forms associated with this exemption are:

AR-4EC (TX) -- Texarkana employee's withholding exemption certificate.

AR-TX -- Completed by employer and provided to employee, shows wages paid during the preceding tax year that are exempt from Arkansas income tax because of the border city exemption.

AR-3Q-Tex -- Completed by employer. All of the employees' Form AR-TXs (a copy of one for each employee) are attached to the AR-3Q-Tex form and sent in to the Withholding Unit.

26-51-404 GROSS INCOME GENERALLY

1.26-51-404(a)(1) Classes of Income

The tax imposed by the Income Tax Act is upon net income. In the computation of the tax, various classes of income must be considered.

(a) Income, meaning all wealth which flows into the taxpayer other than a mere return of capital, includes the forms of income specifically described as gains and profits including gains derived from the sale or other disposition of capital assets. Many factors must be taken into consideration in accurately determining income, among which are inventories, accounts receivable, property exhaustion and accounts payable for expenses incurred.

(b) Gross income is all wealth other than a return of capital received during a tax year less income which is, by statutory provisions or otherwise, exempt from the tax imposed by the Act.

(c) Net income is gross income less statutory deductions. The statutory deductions are in general, though not exclusively, expenditures other than capital expenditures connected with the production of income.

2.26-51-404(a)(1) Income Credited to an Account

Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition. A book entry, if made, should indicate an absolute transfer from one account to another. Where a corporation contingently credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt.

3.26-51-404(a)(1) Gross Income -- Manufacturing, Merchandising and Mining

In the case of a manufacturing, merchandising or mining business, "gross income" means the total sales less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources. In determining the gross income, subtractions should not be made for depreciation, depletion, selling expenses, losses or for items not ordinarily allowable in computing the cost of goods sold.

4.26-51-404(a)(1) Gross Income -- Independent Contractor

The profit of an independent contractor from a contract with the United States Government must be included in gross income.

5.26-51-404(a)(1) Services Paid For With Other Than Money

Where services are paid for with something other than money, the fair market value for the item taken in payment is the amount to be included as income. If the services were rendered at the stipulated prices, in the absence of evidence to the contrary, such price will be presumed to be the fair value of the compensation received.

Compensation paid an employee of a corporation in its stock is to be treated as if the corporation sold the stock for its market value and paid the employee in cash. When living quarters are furnished the employees for the convenience of the employer, the ratable value need not be added to the cash compensation of the employee; but where a person receives as compensation for services rendered a salary and in addition thereto living quarters, the value to such person of the quarters furnished constitutes income subject to tax.

Premiums paid by an employer on policies of group life insurance covering the life of its employees, beneficiaries of which are designated by the employees, are not taxable to the extent that these premiums cover the first $50,000.00 worth of coverage. premiums paid by an employer to purchase group life insurance in excess of $50,000.00 are reportable as excess compensation to the covered employee with the exception of:

(1) the employee is disabled,

(2) the employer is directly or indirectly the beneficiary, or

(3) a charitable organization is the sole beneficiary.

6.26-51-404(a)(1) Notes of Indebtedness Used in Payment

Notes or other evidence of indebtedness received in payment for services and not merely as security for such payment constitutes income to the amount of their fair market value. The taxpayer receiving as compensation a note regarded as good for its face value at maturity, but not bearing interest, shall treat as income as of the time of receipt the fair discounted value of the note at such time. Thus, if it appears that such a note is or could be discounted on a six percent basis, the recipient shall include such note in his gross income as to the amount of its face value less discount computed at the prevailing rate for such transactions. If the payments due on a note so accounted for are made as they become due, they should be included as income in respect of such payment so much thereof as represent recovery of the discount originally deducted.

7.26-51-404(a)(1) Scholarships, Fellowships, Grants and Stipends

A scholarship is a grant of money to further the undergraduate education of the recipient without a quid pro quo to the University or the donor. A fellowship is a grant of money for the primary purpose of furthering the education and training of the recipient toward a higher degree or for independent research with no corresponding benefit to the donor. Stipend means wages, salary, or the equivalent thereof, where the context shows that it refers to something given as compensation for services, as for example, where a student for an advanced degree performs services of some type for a school or organization in return for room, board, tuition or other equivalent compensation. Grants made to students for scholarships and fellowships are gifts and therefore not included in taxable income, but stipends are fully taxable. The Director reserves the right to examine the substance of the transaction rather than the name given to it.

8.26-51-404(a)(1) Commissions, Tips and Other Types of Compensation

Commissions paid salesmen, compensation for services on the basis of percentage of profit, commissions on insurance premiums, tips, and pay of persons in the service of the State of Arkansas are income to the recipients. Marriage fees, baptismal offerings, sums paid for saying masses for the dead, and other contributions received by clergymen, evangelists or religious workers for services rendered, are also income to the recipient.

9.26-51-404(a)(1) Farm - Defined

The term farm includes stock, dairy, poultry, fruit and truck farms, plantations, ranches and all land used for farming operations. The term farm does not include tree farms except those farms that have trees bearing fruit or nuts.

10.26-51-404(a)(1) Gain on Sale of Property or Capital Assets

When property is acquired and later sold for an amount in excess of the cost or other basis, the gain on the sale is income. When a corporation sells its capital assets in whole or in part it shall include in its gross income for the tax year in which the sale was made the gain from such sale computed as provided in ACA 26-51-411 through ACA 26-51-413. If the purchaser takes over all of the assets and assumes the liability the amount so assumed is part of the selling price.

11.26-51-404(a)(1) Annuities and Endowment Contracts

Amounts received as an annuity under an annuity or endowment contract are in general subject to tax to the extent that the aggregate amounts received by the annuitant exceed the amounts paid as a consideration of the contract.

An annuity contract charged upon devised property is taxable income to the annuitant whether paid by the devisee out of the income of such properties or other sources. The devisee is not required to return as gross income the amount of the proceeds paid to the donee annuitant and he is not entitled to deduct from his gross income any sums paid to the annuitant. The amounts received by an insured as a return of premiums paid by him under life insurance, endowment or annuity contracts, such as the so-called "dividend" of a mutual insurance company which may be credited against the current premium, are not subject to tax.

Example: Brown received $10,000.00 on a 10-year endowment contract which matured in 1993. He had paid premiums of $8,500.00 and had received dividends of $200.00 before the contract matured. Brown's cost to be recovered tax free is $8,300.00 ($8,500.00 minus $200.00).

The annuity starting date is the first day of the first period for which a benefit is received as a payment under the annuity contract or on the fixed date in the contract whichever is later.

Investment in the contract is the total aggregate premiums paid plus other consideration less amounts received prior to the annuity starting date which were not included in gross income.

12.26-51-404(a)(1) Cost Basis of Divided Tract of Land

Where a tract of land is purchased with an intent of dividing it into lots or parcels of ground to be sold as such, the cost or other basis shall be equitably apportioned to the several lots or parcels and made a matter of record on the books of the taxpayer, to the extent that any gain derived from the sale of any such lots or parcels which constitutes taxable income may be reported as income for the tax year in which the sale is made. This rule contemplates that there must be a measure of gain or loss on every lot or parcel sold, and not measured on the entire tract as a whole. The sale of each lot or parcel must be treated as a separate transaction and gain or loss computed accordingly.

13.26-51-404(a)(1) Buildings and Lease Hold Improvements

When buildings are erected or improvements made by a lessee in pursuance of an agreement with the lessor and such buildings or improvements are not subject to removal by the lessee, the lessor may at his option report the income therefrom upon either of the following basis:

(a) The lessor may report as income, at the time when such buildings or improvements are completed, the fair market value of such buildings or improvements subject to the lease.

(b) The lessor may spread over the life of the lease the estimated depreciated value of such buildings or improvements at the termination of the lease and report as income for each tax year of the lease an allocated part thereof.

If, for any other reason than a bona fide purchase from the lessee by lessor the lease is terminated, so that the lessor comes into possession or control of the property prior to the time originally fixed for the termination of the lease, the lessor receives additional income for the tax year in which the lease is so terminated to the extent that the value of such buildings or improvements when he became entitled to such possession exceeds the amount already reported as income on account of the erection of such buildings or improvements. No appreciation in value due to causes other than the premature termination of the lease shall be included. Conversely, if the buildings or improvements are destroyed prior to the expiration of the lease, the lessor is entitled to deduct as a loss for the tax year when such destruction takes place the amount previously reported as income because of the erection of such buildings or improvements, less any salvage value subject to the lease to the extent that such loss was not compensated for by insurance.

14.26-51-404(a)(1) Long-Term Contracts

Income from long-term contracts is taxable for the period in which the income is determined, such determination depending upon the nature and terms of the particular contract. Arkansas taxpayers must use the same accounting method as that used for federal income tax purposes.

15.26-51-404(a)(1) Stock Dividends and Distributions from Regulated Investment Companies

The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders but the gain so derived or loss sustained from the sale of such stock, or from the sale of the stock in respect to which it is issued. Distributions received by shareholders from regulated investment companies are, by reason of the shareholder's option to receive the equivalent of cash or new stock, deemed to be a cash dividend and therefore taxable.

16.26-51-404(a)(1) Interest

When interest coupons have matured and are payable but have not been cashed, such interest, though not collected when due and payable, shall be included in gross income for the year during which the coupons mature, unless it can be shown that there are no funds available for payment of the interest during such year. The interest shall be included in gross income even though the coupons are exchanged for other property instead of eventually being cashed. Defaulted coupons are income for the year in which paid. Dividends on corporate stock are subject to tax when unqualifiedly made subject to the demand of the shareholder. As for the distributive share of the profits in a partnership, see 2.26-51-405(a). Interest credited on savings bank deposits, even though the bank has a rule, seldom or never enforced, that it may require so many days notice before withdrawals are permitted is income to the depositor when credited. An amount credited to shareholders of a building and loan association, when such credit passes without restriction to the shareholder, shall be included in taxable income for the year of the credit. Where the amount of such accumulations does not become available to the shareholder until the maturity of a share, the amount of any share in excess of the aggregate amount paid in by the shareholder is income for the year of the maturity of the share.

1.26-51-404(a)(2) Installment Sales - Personal Property

Dealers who sell personal property on the installment plan may elect to report the income on installment sales over the life of the installment contract provided the initial payment is thirty per cent (30%) or less. The rule prescribed is that a person who regularly sells or otherwise disposes of personal property on the installment plan, whether or not title remains in the vendor until the property is fully paid for, may report as income therefrom, in any tax year, the portion of the installment payments actually received in that tax year which the total or gross profit (i.e., payments less cost of goods sold) realized or to be realized when the property is paid for bears to the total contract price. Thus, the income of a dealer in personal property on the installment plan may be ascertained by taking as income that proportion of the total payments received in the tax year from installment sales (such payments being allocated to the tax year against the sales to which they apply) which the total or gross profit realized or to be realized on the total installment sales made during each tax year bears to the total contract price of all such sales made during that respective tax year. A dealer who desires to compute his income on the installment basis shall maintain books of account in such a manner as to enable an accurate computation to be made on such basis in accordance with the provisions of this regulation.

In the case of a casual sale or other casual disposition of personal property other than property of any kind which would properly be included in the inventory of a taxpayer if on hand at the close of the tax year, income may be reported on the installment basis. This method of reporting sales may be utilized provided the payments received in cash or property other than evidences of indebtedness of the purchaser during the tax year in which the sale or other disposition is made do not exceed thirty per cent (30%) of the sale price.

If for any reason the purchaser defaults in any of his payments and the vendor reporting income on the installment basis repossesses the property, the entire amount received in installment payments and retained by the vendor less the sum of the profits previously reported as income and an amount representing proper allowance for damage and use, if any, will be income of the vendor for the tax year in which the property is repossessed and the property repossessed must be carried on the books of the vendor at its original cost less proper allowance for damage and use, if any.

If the vendor chooses, as a matter of consistent practice to report the income from installment sales on the straight accrual or cash receipts and disbursement basis such a course is permissible.

Arkansas did not adopt the federal treatment of installment sales contained in IRC Sec. 453(c) referred to as installment receivables until 01/01/95. This regulation refers only to tax years beginning before 01/01/95.

2.26-51-404(a)(2) Installment Sales - Real Estate

Sales of real estate in which thirty per cent (30%) or less of the sale price is received in the year the sale is consummated may be reported on the installment basis. The vendor may report as income from such transaction in any tax year that proportion of the installment payment actually received in that tax year which the total profit realized, or to be realized when the property is paid for, bears to the total contract price.

In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall be included as a part of the selling price. However, the amount of the mortgage to the extent it does not exceed the price to the vendor of the property sold, shall not be considered as a part of the initial payments or of the total contract price in determining the application of installment basis in the reporting of income. Commissions and other selling expenses paid, or incurred by the vendor, are not to be deducted or taken into account in determining the amount of the initial payment, total contract price or selling price.

If for any reason the purchaser defaults in any of his payments and the vendor, reporting income on the installment basis, repossesses the property, the entire amount received in installment payments and reported by the vendor less the sum of the profits previously reported as income and an amount representing proper adjustment for exhaustion, wear and tear, obsolescence, amortization and depletion of the property while in the hands of the purchaser, will be income of the vendor for the tax year in which the property is repossessed. The basis of the property in the hands of the vendor will be the original basis at the time of the installment sale.

If the vendor consistently chooses to report the income from installment sales on the accrual or cash receipt and disbursement basis, the sales will not be treated as being on an installment plan.

Where real property is sold and the seller accepts indebtedness secured by the real property in return and later repossesses the property, the gain is limited and no loss shall result to the seller because of the repossession of the property.

Gain on repossession shall be limited to the lesser of:

(1) Total payments received before repossession less the amount of the gain from original sale reported as income before repossession; or

(2) The gain on the original sale (selling price less adjusted basis) reduced by income reported before repossession and by repossession costs. Repossession costs include money or fair market value of property paid or transferred by seller in connection with repossession.

Example: In 1990, Brown sold property for $60,000.00 having an adjusted basis of $48,000.00. Brown qualifies for reporting the $12,000.00 gain (20% of selling price) by accepting an initial payment of $10,000.00 and evidence of $50,000.00 liability secured by the property to be paid in five (5) annual payments of $10,000.00. In 1994, the purchaser defaulted and Brown, at a cost of $500.00, repossessed the property.

Prior to repossession, Brown had received payments amounting to $40,000.00 and had reported $8,000.00 as taxable gain.

Brown's recognized gain on repossession is as follows:

Gain on original sale (selling price less adjusted basis)	$12,000.00
Less: Gain previously reported	- 8,000.00
	$ 4,000.00
Less: Recognized expense	- 500.00
Recognized gain	$ 3,500.00

The basis of the repossessed property is $20,000.00.

Defaulted obligation	$20,000.00
Less: 20% gain included	- 4,000.00
Adjusted obligation	$16,000.00
Plus: Repossession gain	+ 3,500.00
Plus: Repossession cost	500.00
Basis of repossessed property	$20,000.00

This regulation only applies to tax years beginning before 01/01/95.

1.26-51-404(b)(1) Gain on Sale - Involuntary Conversion

Section 1033 of the Internal Revenue Code of 1986, as in effect on January 1, 1999 relating to the exclusion from gross income of gain resulting from the involuntary conversion of a taxpayer's property, has been adopted for the purpose of computing Arkansas income tax liability.

In any case where the taxpayer elects to replace or restore the converted property, but it is not practical to do so immediately, see 4.26-51-412(a) for procedure.

The special rules for property damaged in a Presidentially declared disaster are found at IRC Sec. 1033(h).

1.26-51-404(b)(2) Gain on Sale or Exchange of Principal Residence

Gross income shall not include the **gain** resulting from the sale **or** exchange of real estate located within Arkansas when **all** of the following conditions are met:

a) the real estate sold or exchanged by the taxpayer was the taxpayer's principal residence;

b) the taxpayer uses the *gain within a four (4) year period, beginning two (2) years prior to the date of sale or exchange and ending two (2) years after that date, to purchase, build or restore a new parcel of real estate;

c) the new parcel of real estate is located within Arkansas; and

d) the new parcel of real estate is used or will be used by the taxpayer as his principal place of residence.

*This exclusion from gross income shall only apply to that portion of the "gain" actually used to purchase, build or restore the new parcel of real estate.

Gain shall be computed as set forth in ACA 26-51-411(d).

1.26-51-404(b)(3) Life Insurance Proceeds

Section 101 of the Internal Revenue Code of 1986, as in effect on January 1, 1997 has been adopted for the purpose of excluding from gross income the proceeds paid under life insurance policies on behalf of a chronically ill, terminally ill or deceased insured. For treatment of accelerated death benefits, see IRC Sec. 101(g)(1).

The proceeds of life insurance policies paid by reason of the illness or death of an insured to his estate or to any beneficiary (individual, partnership or corporation but not to a transferee for valuable consideration), directly or in trust, are excluded from the gross income of the beneficiary. It is immaterial whether the proceeds are received in a single sum or in installments. If, however, such proceeds are held by the insurer under an agreement to pay interest thereon, the interest payments must be included in gross income. Amounts received (other than amounts paid by reason of the illness or death of the insured and interest payments on such amounts) under a life insurance, endowment or annuity contract are excluded from gross income, but if such amounts (when added to amounts received before the tax year under such contract) exceed the aggregate premium or consideration paid (whether or not paid during the tax year) then the excess shall be included in gross income.

Example 1: Life insurance, endowment contracts, amounts paid other than by reason of the death of the insured.

Received in 1994	$ 5,000.00
Received in prior years	5,000.00
Total	$10,000.00
Aggregate premiums paid	$ 4,000.00
Taxable income	$ 6,000.00

Example 2: Under the terms of a life insurance policy, the beneficiary had an option of receiving $10,000.00 in a lump sum upon the death of the insured, or of receiving four (4) annual installments of $2,630.00 based on a certain guaranteed interest rate. The beneficiary elected to receive the installment method. During the first three (3) years, the beneficiary will have received tax-free $7,890.00. The beneficiary, at the end of the fourth year, will include in gross income the excess of amounts received plus amounts received tax-free in previous years over the lump sum option or $520.00 ($10,520.00 minus $10,000.00).

However, in the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein, only the actual value of such consideration and the amount of premium and other sums subsequently paid by the transferee are exempt from taxation.

Example 3: A taxpayer takes out a $20,000.00 life insurance policy. Six years later the surrender value of the policy is $7,000.00, and at that time the taxpayer assigns the policy to Mr. Doe, a creditor, for a consideration of $7,000.00. Mr. Doe pays $4,000.00 thereafter in premiums as they come due. The taxpayer dies. Mr. Doe receives the $20,000.00 insurance proceeds and has taxable income of $9,000.00 ($20,000.00 minus $7,000.00 and $4,000.00).

Example 4: Life insurance, endowment contract or annuities may be transferred for a consideration and the proceeds of the contract payable to a transferee for reasons other than the death of the insured. In 1994, transferee realized on maturity of the contract $75,000.00. At time of transfer, transferee paid $40,000.00 for the contract and paid subsequent premiums totaling $20,000.00.

Transferee's Gain	
Amount realized	$75,000.00
Paid for contract	$40,000.00
Total premiums paid	20,000.00
	60,000.00
Taxable Gain	$15,000.00

If the proceeds are received as an annuity over a fixed number of years, the annual payment is excludable from income until the aggregate payments equal the cost of the contract of $60,000.00.

1.26-51-404(b)(5) Gifts

A gift is where a capable donor with the intention of making a gift completes delivery of a property to a donee who, in turn, accepts the property. Property received as a gift is exempt from income tax although the income therefrom derived from investment, sale or otherwise, is taxable.

2.26-51-404(b)(5) Bequests, Devise or Descent

A bequest is a gift by will of personal property. A devise is a gift of real property by the last will and testament of the donor. A bequest or devise received by a legatee under the provisions of a will or by an heir in accordance with the statutes of descent and distribution is tax exempt, but not the income therefrom.

1.26-51-404(b)(6) Interest - Obligations of The United States or its Possessions

Interest earned on obligations of the United States or its possessions is not included in gross income.

"Obligations of the United States" means any U.S. Government obligation used to finance the national debt, e.g., U.S. Treasury bills, or any other instrument acknowledged by the U.S. Secretary of Treasury as an obligation of the United States.

These obligations must be specifically exempt from state taxation by United States Laws <u>or</u> must meet the four criteria established by <u>Smith v. Davis</u>, 323 U.S. 111, 114 (1944). The requirements are that the obligations must:

1) be in writing;
2) bear specific interest;
3) bind the U.S. to pay specific sums at specific dates; and
4) have congressional authority to pledge the full faith and credit of the United States in support of the promise to pay.

As an example, interest received from the Federal National Mortgage, Government National Mortgage and Federal Home Loan Mortgage Corporation do not meet all four of the above stated requirements and <u>is not</u> tax exempt. This is not intended to be an all inclusive list.

2.26-51-404(b)(6) Interest - Obligations of the State of Arkansas

Interest earned on obligations of the State of Arkansas or any political subdivision thereof, is not included in gross income.

"Obligations of the State of Arkansas" means any obligation backed by credit of the State of Arkansas.

"Any political subdivision" means any county, city or town obligations, including special assessment districts such as road, water, sewer, reclamation, drainage, levee, school or similar districts.

1.26-51-404(b)(7) Social Security Benefits

Social security benefits are excluded from gross income for state income tax purposes. Thus, amounts received as pensions or annuities under the Social Security Act or the Railroad Retirement Act are excluded from gross income.

2.26-51-404(b)(7) Unemployment Benefits Paid by Organized Union

Amounts paid by an organized union as unemployment benefits to its unemployed members are taxable where the benefits are paid through union dues. Where union members make special payments to a fund, unemployment benefits which they receive from the fund are includible in gross income only to the extent they exceed the recipient's contributions. The amounts contributed to the fund are not deductible.

3.26-51-404(b)(7) Unemployment Benefits Paid by State or Federal Agency

Unemployment insurance benefits received from a state agency from funds received from the Federal Unemployment Trust Fund are not taxable. Unemployment insurance benefits received from the Railroad Retirement Board are not includible in gross income. Unemployment compensation paid to federal employees by state or federal agencies is excludable from gross income.

1.26-51-404(b)(11) Cancellation or Forgiveness of Debt

The cancellation and forgiveness of indebtedness may amount to a payment of income, to a gift or to a capital transaction, dependent upon the circumstances. If, for example, an individual performs services for a creditor who in consideration thereof cancels the debt, income to that amount is realized by the debtor as compensation for his services. If, however, a creditor merely desires to benefit a debtor, and, without any consideration therefore, cancels the debt, the amount of the debt is a gift from the creditor to the debtor and need not be included in the latter's gross income. If a shareholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation.

1.26-51-404(b)(12) Cafeteria Plan and Flexible Spending Arrangements -- Taxability of Benefits

"Qualified benefits," as defined in IRC Sec. 125(f), received through a cafeteria plan or flexible spending arrangement (FSA) are excluded from the taxpayer's gross income. However, the term "qualified benefits" does not include benefits paid by an employer towards long-term care insurance premiums or long-term care services. Such benefits paid on behalf of the employee/taxpayer through a cafeteria plan or FSA are includable in the taxpayer's gross income.

It should be noted that under certain circumstances, expenses incurred by a taxpayer for qualified long-term care services and eligible long-term care insurance premiums may be taken as an itemized deduction. This deduction for unreimbursed medical expenses can be taken only to the extent such expenses exceed 7.5% of the taxpayer's AGI. IRC Sec. 213(d)(1)(C) & (D).

"Qualified" long-term care services are necessary diagnostic, preventive, therapeutic, curing, treating, mitigating and rehabilitative services, as well as maintenance or personal care services which:

1. Are required by a chronically ill individual; and

2. Are provided under a plan of care prescribed by a licensed health care practitioner. IRC Sec. 7702B(c)(1).

"Eligible" long-term care insurance premiums may be deductible as medical expenses when such premiums are paid towards "qualified" long-term care insurance. The definition of "qualified" long-term care insurance is set forth in IRC Sec. 7702B(b)(1).

1.26-51-404(b)(15) Lawsuit Damages

Compensatory and punitive damages are includable in gross income unless the damages are received on account of a personal **physical** injury or **physical** sickness. If an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow from that injury or sickness are treated as payments received on account of physical injury or physical sickness, whether or not the recipient of the damages is the injured party. However, punitive damages are includable in gross income even if they are received on account of a personal physical injury or physical sickness. IRC Sec. 104(a)(2).

The taxability of damages remains the same whether the damages are received as a settlement or jury award.

Example: damages (other than punitive damages) received by an individual on account of a claim for loss of consortium due to the physical injury or physical sickness of that individual's spouse are excludable from gross income.

26-51-405 PARTNERSHIP INCOME

1.26-51-405 Partnership Income Generally -- Example

Partnership income must be allocated to the state where it was actually earned. All partnership income from activities carried on within Arkansas shall be allocated to Arkansas. For example, a partnership comprised of two (2) partners earned $100,000.00 during the tax year. One partner resides in Arkansas and the other in Louisiana. $30,000.00 of the partnership's income is allocable to activity carried on in Arkansas by, or on behalf of, the partnership. Each partner's distributive share of the partnership's income is 50%. Therefore, the Arkansas based partner would report $15,000.00 in gross income on his resident Arkansas individual income tax return and the Louisiana based partner would report $15,00.00 in gross income on his nonresident Arkansas individual income tax return.

Because a portion of the partnership's income was allocable to Arkansas, the partners will need to file a partnership tax return (AR1050) with the State of Arkansas.

2.26-51-405 Partnership Composite Return

Before the Department will allow a composite individual income tax return ("block filing"), certain conditions must be agreed to. Those conditions are as follows:

1. The Revenue Division must be provided with the names of all relevant partners.

2. Each composite or block return must be filed in the name of the partnership and the partner that signs the return will be responsible for any assessments or deficiencies incurred by the return. This requirement does not relieve any of the partners from their personal liability in any way.

3. The total net taxable income in Arkansas must be reported on form AR1000. Tax will be computed at a flat 7% tax rate.

4. Partners who become or are residents of Arkansas, or who have income or losses from Arkansas sources other than from the partnership, will be excluded from the block filing. Only those partners who must file Arkansas non-resident individual income tax returns as a result of their interest in the partnership will be included in the proposed block filing.

5. The agreement to allow composite or block filing will be reviewed annually and the agreement is revocable at the option of the Revenue Division. Permission to file a composite return must be obtained from an Individual Income Tax Section Manager **before** such a return is filed.

1.26-51-405(a) Partnerships

A partnership must keep records showing the participation of the partners, the interest owned by them, duties performed and services rendered in the operation of the business. A partnership as such is not subject to taxation but it must make a return of income, which return properly reflects the net income for each partner. Individuals carrying on business in partnership are taxable upon their distributive shares of the net income of such partnerships, whether distributed or not, and are required to include such distributive shares in their individual returns.

2.26-51-405(a) Distributive Share of Partnership Income

The distributive share of the net income of the partnership which a partner is required to include in his return is his proportionate share of the net income of the partnership, either:

(a) For the taxable year upon the basis of which the partner's net income is computed, or

(b) If the partner's net income is computed upon the basis of a taxable year different from that upon the basis of which the net income of the partnership is computed, for the taxable year of the partnership ending within the taxable year upon the basis of which the partner's net income is computed.

Amounts earned and distributed to a partner by a partnership after the end of its taxable year and before the end of his corresponding taxable year should be accounted for both by the partnership and by the partner in their returns for their next succeeding taxable year. Where the results of partnership operation is a net loss, the loss will be divisible by the partners in the same proportion as net income would have been divisible (or, if the partnership agreement provides for the division of a loss in a manner different from the division of a gain, in the manner so provided), and may be taken by the individual partners in their returns of income.

26-51-409 FEDERAL SUBCHAPTER S ADOPTED

1.26-51-409 IRC Subchapter S Adopted

Subchapter S of the Internal Revenue Code of 1986, as in effect on January 1, 1997, regarding small business corporations, has been adopted for the purpose of computing Arkansas income tax liability.

2.26-51-409 Corporations That Must File as an S Corporation

Corporations incorporated in Arkansas, or registered to conduct business within Arkansas or having income from Arkansas *sources, must file an income tax return with the State of Arkansas. Such corporations must file an S Corporation income tax return (AR1100S) with the State of Arkansas if:

a) the corporation elected, by filing Form AR1103, to be taxed as an S Corporation within seventy-five (75) days of incorporation;

b) the election was accepted by the State of Arkansas; and

c) the election remains in effect.

* Having income from Arkansas "sources" means income derived from property located

within Arkansas or from business activity carried on within Arkansas.

3.26-51-409 Applicable Rules -- Generally

The rules of Subchapter C (corporate distributions, liquidations, contributions and reorganizations) apply to S corporations, unless the Internal Revenue Code or Arkansas law otherwise provides or a Subchapter C rule is inconsistent with a Subchapter S rule.

4.26-51-409 S Corporation -- Auditing

S corporations are generally audited on a shareholder-by-shareholder basis. The general rule is that an S corporation's taxable income is computed under the rules that apply to individuals.

5.26-51-409 Consistency Between S Corporation Returns and Shareholders' Returns

An S corporation shareholder should generally treat a Subchapter S item on his own individual income tax return consistently with the treatment of that item on the S corporation's return. If the shareholder treats an item or items inconsistently between his return and the corporation's return, the shareholder must notify the Department's Individual Income Tax Section (as well as the IRS) of the inconsistency. This notification should be provided on IRS Form 8082.

1.26-51-409(c)(1) Reporting S Corporation Income, Loss, Deductions and Credits

All resident **and** nonresident shareholders of corporations that have elected to be taxed by Arkansas as S Corporations and who receive a share of the corporation's income, loss, deductions or credits, must file an Arkansas individual income tax return reporting the share so received. However, a nonresident shareholder of such a corporation shall only be required to file an Arkansas individual income tax return if **some** or **all** of his share of the corporation's income, loss, credits or deductions are attributable to Arkansas sources. When an Arkansas return is required to be filed, the nonresident must report **all** of his gross income on his Arkansas nonresident return pursuant to ACA 26-51-435 and ACA 26-51-504. Moreover, a shareholder's share of S Corporation income attributable to Arkansas is subject to Arkansas income tax whether or not it is actually distributed to the shareholder.

2.26-51-409(c)(1) Reporting S Corporation Income, Loss, Deductions and Credits + Shareholder Termination

An S corporation's items of income, loss, deduction and credit for its tax year are usually allocated to its shareholders on a per-share, per-day basis. An equal part of a tax year's items is assigned to each day of the tax year, and is divided pro rata among the shares outstanding on the day to which it's assigned. However, if the corporation and all *"affected" shareholders agree, an election could be made to terminate the S corporation's tax year when a shareholder terminated his interest in the corporation. The effect of the election is that the tax year of the corporation is treated as if it consists of two tax years, with the first tax year ending on the date on which the shareholder's interest was terminated. IRC Sec. 1377(a)(2)(A). The items of income, loss, deduction and credit, determined for each separate "tax year" by closing the books, are allocated on a per-share, per-day basis to shareholders who were shareholders during the separate "tax year".

* affected shareholders include the shareholders who terminate their interests and all shareholders to whom the terminating shareholders transfer their shares during the tax year. If shares are transferred to the corporation, all persons who were shareholders during the tax year are treated as affected shareholders. IRC Sec. 1377(a)(2)(B).

3.26-51-409(c)(1) S Corporation Shareholder Basis

An S corporation shareholder's basis is significant because: (1) distributions in excess of his basis may result in gain to the shareholder; and (2) the shareholder can deduct his pro rata share of the corporation's losses only to the extent of his adjusted basis in the S corporation's stock and debt.

The adjusted basis of the shareholder's stock for purposes of computing the limitation on the amount of the S corporation's losses he can deduct (the loss limitation) is computed after the basis is reduced by the year's nontaxable distributions made to the shareholder. IRC Sec. 1366(d).

The adjusted basis of the shareholder's stock for determining the tax effects of the S corporation distributions to him is determined by increasing the basis for his share of the S corporation's income items for the year, but without decreasing the basis for his share of the S corporation's losses for the year. IRC Sec. 1368.

26-51-410 INVENTORY

1.26-51-410 What Constitutes Inventory

In order to reflect the net income correctly, inventories at the beginning and end of each year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor. The inventory should include raw materials and supplies on hand that have been acquired for sale, consumption or use in productive processes, together with all finished or partly finished goods. Only merchandise, title to which is vested in taxpayer, should be included in the inventory. Accordingly, the seller should include in his inventory goods under contract for sale but not yet segregated and applied to the contract and goods out upon consignment but should exclude from inventory goods sold, title to which has passed to the purchaser. A purchaser should include in inventory merchandise purchased, title to which has passed to him, although such merchandise is in transit or for other reasons has not been reduced to physical possession, but should not include goods ordered for future delivery, transfer of title to which has not yet been affected.

There are two tests to which each inventory must conform:

1. It must conform as nearly as may be to the best accounting practice in the trade or business.

2. It must clearly reflect the income.

26-51-411 GAIN OR LOSS - SALES OF PROPERTY

1.26-51-411(a) Amount Realized on Disposition of Property

The amount realized from the sale or other disposition of property is the sum of any money received plus the fair market value of the property (other than money) received. The fair market value of the property is a question of fact, but only in rare and extraordinary cases does the property have no fair market value.

In computing the amount of gain or loss, however, the cost or other basis of the property shall be properly adjusted for any expenditure, receipt, loss or other item properly chargeable to capital account including the cost of improvements and betterment made to the property since the basic date and carrying charges such as taxes on nonproductive property. Where the taxpayer has elected to deduct carrying charges in computing net income or used such charges in determining his liability for filing returns of income for prior years, the cost or other basis may not be increased by such items in computing the gain or loss from the subsequent sale of such property. The cost or other basis of the property must also be decreased by the amount of the deductions for exhaustion, wear and tear, obsolescence and depletion which have, since the acquisition of the property, been allowable in respect of such property whether or not such deductions were claimed by the taxpayer or formally allowed. Adjustments to the cost or other basis on account of such allowable deductions as distinguished from the deductions actually taken in prior years will be made only on the basis of explicit and convincing evidence (calculations based upon a theoretical formula are not such evidence), that the deductions taken were insufficient or excessive, as the case may be, due regard being given to the expenditures made by the taxpayer to maintain the effective usefulness of the property.

In no case shall the amount of the diminution in respect to depletion exceed a depletion deduction computed without reference to discovery in the case of mines, oil and gas wells.

In the case of stock, the basis must be diminished by the amount of distributions previously made in respect of such stock to the extent that they have been a return of capital. The provisions of ACA 26-51-411 shall not be construed so as to conflict with the provisions of ACA 26-51-404(a)(2) which make special provisions for the reporting of income from the sale of property on the installment plan where the initial payment is 30 percentum or less.

2.26-51-411(a) Sale of Shares of Stock

When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots cannot be determined, the stock sold shall be charged against the earliest purchases of such stock. The excess of the amount realized on the sale over the cost or other basis of the stock will constitute gain.

In the case of stock in respect of which any stock dividend was paid, the basis for determining gain or loss from a sale of a share of such stock shall be the difference between the sale price and the quotient of the cost or other basis of the original shares of stock divided by the total number of the old and new shares.

Where common stock is received as a bonus with a purchase of preferred stock or bonds, the total purchase price shall be fairly apportioned between such common stock and the securities purchased for the purpose of determining the portion of the cost attributable to each class of stock or securities but if that should be impracticable in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until out of the proceeds of sales shall have been recovered the total cost.

Where a corporation issues to its shareholders rights to subscribe to its stock, the value of the rights does not constitute taxable income to the shareholder, although gain may be derived or loss sustained by the shareholder from the sale of such rights. In this connection, the following rules may be stated:

(1) If the shareholder does not exercise, but sells, his rights to subscribe, the cost or other basis of the stock in respect of which the rights are issues, shall be apportioned between the rights and the stock in proportion to the respective values thereof at the time the rights are issued and the basis for determining gain or loss from the sale of a right on one hand or a share of stock on the other will be the quotient of the cost of other basis assigned to the right or the stock, divided, as the case may be by the number of rights issued or by the number of shares held.

(2) If the shareholder exercises his rights to subscribe, the basis for determining gain or loss from a subsequent sale of a share of the stock in respect of which the rights were issued shall be determined as in Paragraph 1. The basis for determining gain or loss from a subsequent sale of a share of the stock obtained through exercising the rights shall be determined by dividing the part of the cost or other basis of the old shares assigned to the rights plus the subscription price of the new shares by the number of new shares obtained.

(3) If the stock in respect of which the rights are issued was purchased at different times and at different prices and the identity of the lots cannot be determined, or if the stock in respect of which the rights are issued was purchased at different times and at different prices and the stock rights issues in respect of such stock cannot be identified as having been issued in respect of any particular lot of such stock, the basis for determining the gain or loss from the sale of the old share or the rights in cases where the rights are sold or from the sale of the old or new shares in cases where the rights are exercised shall be ascertained by applying the cost or ascertained value of the rights from the earliest purchased stock.

The taxpayer may at his option include the entire proceeds from the sale of stock rights in gross income in which the basis for determining gain or loss, from the subsequent sale of stock in respect of which the rights were issued, shall be the same as though the rights had not been issued.

3.26-51-411(a) Sale of Real Estate or Personal Property

Sales of real estate or personal property in which more than thirty percent (30%) of the sales price is received in the year in which the sales is consummated will be handled as provided in ACA 26-51-411.

4.26-51-411(a) Sale of Property Acquired by Gift

If the property was acquired by gift, (even though the gift was made in contemplation of or was intended to take effect in possession or enjoyment at or after the donor's death) the basis is the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the donee is unable to ascertain the facts necessary to determine the basis, he shall so state upon his return and the Income Tax Director will, if possible, obtain such facts from the donor or last preceding owner or any other person cognizant therefore. If the Income Tax Director finds it impossible to obtain such facts, the basis shall be the last assessed valuation of the property while in the hands of the donor.

5.26-51-411(a) Basis of Property Acquired On or Before March 9, 1929

In computing the gain or loss from the sale of other disposition of property acquired by gift on or before March 9, 1929, the basis shall be the assessed valuation of the property.

6.26-51-411(a) Patents and Copyrights

A taxpayer disposing of patents or copyrights by sale should determine the gain or loss arising therefrom by computing the difference between the selling price and the cost or other basis, with property adjustment for depreciation as provided in ACA 26-51-411(d).

26-51-412 GAIN OR LOSS - EXCHANGE OF PROPERTY

1.26-51-412(a) Exchange of Property for Like Property

For purposes of the Income Tax Act, no gain or loss shall be recognized in an exchange of property for like property of a similar value.

If property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, certificates of trust or beneficial interest or other securities or evidence of indebtedness) is exchanged solely for property of like kind to be held either for productive use in trade or business or for investment, no gain or loss is recognized.

The words "like kind" have reference to the nature or character of the property and not its grade or quality. Therefore, under this paragraph, no gain or loss is realized by one, other than a dealer, from the exchange of real estate for other real estate. One kind or class of property may not, under this paragraph, be exchanged for property of a different kind or class, as real estate for personal property.

If property, real, personal or mixed, is transferred to a corporation by one person solely in exchange for stock or securities in such corporation and, immediately after the exchange, such person is in control of the corporation, or by two or more persons solely in exchange for stock or securities in such corporation, and if, immediately after the exchange, such persons are in control of the corporation, and the amount of stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange, no gain or loss will be recognized.

If common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation by one person solely in exchange for stock or securities in such corporation and, immediately after the exchange, such person is in control of the corporation, or by two or more persons solely in exchange for stock or securities in such corporation, and if, immediately after the exchange, such persons are in control of the corporation, and the amount of stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange, no gain or loss will be recognized.

2.26-51-412(a) Exchange of Property for Property Not of Like Kind

When property is exchanged for other property not of a like kind, the property received in exchange shall, for the purpose of determining gain or loss, be treated as the equivalent of cash to the amount of its fair market value. If no market exists in which all of the property so received can be disposed of at the time of exchange for a reasonably certain and definite price in cash, the exchange shall be considered as a conversion of assets from one form to another form which no gain or loss shall be deemed to arise and the property received in exchange shall be taken into the records of the taxpayers at the same cost or assessed value, (plus additions and minus depreciation and depletion allowable), as the property which he exchanged.

3.26-51-412(a) Dividends Paid In Securities or Other Property

Dividends paid in securities or other property (other than its own stock) in which the earnings of a corporation have been invested, are income to the recipients in the amount of the market value of such property when receivable by the shareholders. Where a corporation declared a dividend payable in stock of another corporation, setting aside the stock to be so distributed and notifying the shareholders of its action, the income arising to the recipients of such stock is its market value at the time the dividends become payable. Scrip dividends are subject to tax in the year in which the warrants are issued.

4.26-51-412(a) Property Acquired as a Result of an Involuntary Conversion

In the case of property acquired as a result of an involuntary conversion, the basis of the property shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer which was not expended, and increased in the amount of the gain or decreased in the amount of loss to the taxpayer recognized upon such conversion applicable to the year in which the conversion was made. Refer to 1.26-51-404(b)(1).

In any case where the taxpayer elects to replace or restore the converted property, but it is not practicable to do so immediately, he may obtain permission to establish a replacement fund in his accounts in which part or all of the compensation so received shall be held, without deduction for the payment of any mortgage. In such a case the taxpayer should make application to the Director for permission to establish such a replacement fund, and in his application should recite all the facts relating to the transaction and declare that he will proceed as expeditiously as possible to replace or restore such property. The taxpayer will be required to furnish a bond with such surety as the Director may require in an amount not in excess of double the estimated additional income taxes which would be payable if no replacement fund were established. The estimated additional taxes, for the amount of which the claimant is required to furnish security, should be computed at the rates at which the claimant would have been obliged to pay, taking into consideration the remainder of his net income and resolving against him all matters in dispute affecting the amount of the tax. Only surety companies will be approved as sureties. The application should be executed in triplicate, so that the Director, the applicant, and the surety or depository may each have a copy.

1.26-51-412(b) Basis of Stock Received for Property - Real, Personal or Mixed

In the case of the organization of a corporation, the stock or securities of the corporation received for property, real, personal or mixed, transferred to the corporation, shall be deemed to have the same value or cost as the property so transferred and no gain or loss shall arise from the transaction.

The cost or value of the property transferred (adjusted as to depreciation and depletion) shall be entered in the records of the taxpayer as the cost of his stock in the corporation and a record of such cost must be maintained. Gain or loss in future sales of such stock shall be measured by the difference between the individual cost per share determined as above applied to the selling price of such stock.

1.26-51-412(c) Stock or Securities Exchanged in a Reorganization

If stock or securities in a corporation, a party to a reorganization are, in pursuance to the plan of reorganization, exchanged for stock or securities in such corporation, or in another corporation, a party to the reorganization, and other property or money, the gain, if any, to the recipient shall be recognized in an amount not in excess of the sum of the money and the fair market value of other property. No loss from such an exchange will be recognized.

2.26-51-412(c) Stock or Securities Received in a Reorganization

If without any surrender of his stock or securities, a shareholder in a corporation, a party to a reorganization, receives in pursuance of the plan of reorganization, stock or securities in such corporation or in another corporation, a party to the reorganization, no gain to the shareholder will be recognized.

3.26-51-412(c) Basis of Stock or Securities Received in a Reorganization

In the case of stock or securities acquired by a shareholder in connection with the transactions described in 1.26-51-412(c), the cost or assessed value of the stock in respect of which the distribution was made, shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis of each share will be the quotient of the cost or assessed value of the old shares of stock divided by the total number of the old and new shares.

Where the stock distributed in reorganization is materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion as nearly as may be to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class.

Where the stock in respect of which a distribution in reorganization is made was purchased at different times and prices, and the identity of the lots cannot be determined, any sale of the original stock will be charged to the earliest purchases of such stock (see 2.26-51-411(a)), and any sale of the stock distributed in reorganization will be presumed to have been made from the stock distributed in respect of the earliest purchased stock.

Where the stock in respect of which a distribution in reorganization is made was purchased at different times and prices, and the stock distributed in reorganization cannot be identified as having been distributed in respect of any particular lot of such stock then any sale of the stock distributed in reorganization will be presumed to have been made from the stock distributed in respect of the earliest purchased stock.

26-51-413 CORPORATE LIQUIDATIONS

1.26-51-413 Amounts Distributed in Complete Liquidation

Amounts distributed in complete liquidation of a corporation are to be treated as in full payment in exchange for the stock, and the amounts distributed in partial liquidation are to be treated as in part or full payment in exchange for the stock so canceled or redeemed. The phrase "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of all of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

The gain or loss to a shareholder from a distribution in liquidation is to be determined by comparing the amount of the distribution with the cost or other basis of the stock. In the case of amounts distributed in partial liquidation, other than a distribution in pursuance of a plan of reorganization as described in ACA 26-51-412, the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of ACA 26-51-411 for the purpose of determining the taxability of subsequent distribution by the corporation.

2.26-51-413 Corporate Liquidation -- Stock Purchase Treated as Asset Acquisition

A taxpayer who has elected to be treated as an S corporation for federal income tax purposes but not for state income tax purposes (therefore retaining its C corporation status), must file a §338 election with the Department's Individual Income Tax Section stating that it desires to be taxed in accordance with IRC Section 338. This is so despite the fact that the taxpayer may already have a §338 election on file with the IRS.

If the taxpayer has elected to be treated as an S corporation for **both** federal and state income tax purposes, and the taxpayer has also filed a §338 election with the IRS, the taxpayer need not file a separate §338 election with the Department -- the taxpayer will automatically receive §338 treatment by the Department for state income tax purposes as well.

If the taxpayer has elected to be treated as a C corporation for **both** federal and state income tax purposes, and the taxpayer has also filed a §338 election with the IRS, the taxpayer need not file a separate §338 election with the Department -- the taxpayer will automatically receive §338 treatment by the Department for state income tax purposes as well.

Under IRC Sec. 338, certain stock purchases will be treated as asset acquisitions for purposes of income taxation.

26-51-414 DEFERRED COMPENSATION PLANS

1.26-51-414 Deferred Compensation Plans - IRAs

A nonworking spouse can open up his or her own IRA and contribute up to $2,000.00 per year to the IRA. Under prior law, a nonworking spouse did not have the option of owning his or her own "spousal" IRA. To determine the deductibility of the contributions made to a married couple's IRAs, refer to IRC Sec. 219(c). The requirement of filing a joint return under IRC Sec. 219(c)(2)(A) in order to deduct contributions shall not apply.

2.26-51-414 Deferred Compensation Plans - Lump-Sum Distributions

Lump-sum distributions from qualified retirement plans will no longer be eligible for special 5 year income averaging beginning with the 2000 tax year. Except for older taxpayers eligible for the 1986 Tax Reform Act transition rules (i.e., 10 year averaging and capital gains treatment for the pre-1974 portion of the distribution), distributions from qualified plans will be taxed in the same manner as other income, regardless of the form of distribution. IRC Sec. 402(e)(4)(D).

3.26-51-414 Deferred Compensations Plans Self-Employed Ministers

A "church plan" is a retirement plan established and maintained by a tax exempt church or association of churches for its employees. These plans can cover ministers, regardless of the source of the ministers' compensation. A self-employed minister covered under a church plan is treated as his own employer. IRC Sec. 414(e)(5). Therefore, the minister can deduct his contributions to the church plan. IRC Sec. 404(a)(10). Prior to the 1997 tax year, self-employed ministers could participate in church plans, but their contributions were not deductible because the contributions were treated as made by the church itself, rather than the ministers.

4.26-51-414 Deferred Compensation Plans - Section 457 Plan Distributions

Amounts that a participant defers under an "eligible deferred compensation plan" of a tax-exempt or state or local governmental employer (i.e., a "section 457 plan") are includible in gross income after the participant separates from service only in the tax year in which the amounts are actually paid or otherwise "made available" to the participant.

Amounts deferred under a section 457 plan generally may not be "made available" to an employee before **the earlier of:** (a) the calendar year in which the participant attains age 70½, (b) when the participant is separated from service with the employer, or (c) when the participant is faced with an unforeseeable emergency.

Amounts payable are not treated as "made available," and thus, will neither be includible in a participant's gross income under the constructive receipt rules, nor run afoul of the Code Sec. 457 distribution rules, in the following circumstances:

In-service section 457 plan distributions are not treated as "made available" if:

(1) the total amount payable doesn't exceed $3,500;

(2) There has been no prior distribution from the 457 plan to the participant. IRC Sec. 457(e)(9)(A).

5.26-51-414 Penalty-Free Withdrawals from IRAs and Qualified Retirement Plans

A taxpayer may make an early withdrawal of funds from an IRA or other qualified retirement plan free of the 10% penalty normally associated with such early withdrawals under the following two circumstances:

1 Payment of medical expenses in excess of 7½% of the taxpayer's adjusted gross income (AGI). For example, a taxpayer's AGI is $40,000.00. 7½% of $40,000.00 is $3,000.00. The taxpayer incurs medical expenses of $10,000.00 and makes an early withdrawal of $10,000.00 from his IRA to pay

the expenses in full. The first $3,000.00 of the withdrawal would be subject to the 10% penalty. However, the remaining $7,000.00 would not be subject to the 10% penalty. IRC Sec. 72(t)(2)(B).

2 The taxpayer is unemployed at the time the withdrawal is made and meets the following criteria:

a The taxpayer has received unemployment compensation for at least 12 consecutive weeks;

b The withdrawal does not exceed the total amount paid during the tax year by the taxpayer for premiums for health insurance coverage for the taxpayer, the taxpayer's spouse and children;

c The withdrawal must be made in the year the unemployment compensation is actually received or the following year. IRC Sec. 72(t)(2)(D).

The actual retirement funds withdrawn do not have to be paid towards the health insurance premiums to qualify for the break from the 10% penalty.

6.26-51-414 Savings Incentive Match Plan for Employees (SIMPLE)

Beginning in tax years after 1996, eligible employers may maintain SIMPLE retirement plans to provide a tax-favored means of providing for employees' retirement. An eligible employer is an employer that:

1. Employs no more than 100 employees who each received at least $5,000 of compensation from the employer the preceding year, and

2. Does not maintain another employer-sponsored retirement plan to which contributions were made or benefits accrued.

An eligible employer who establishes and maintains a SIMPLE plan for at least one year, but thereafter fails to qualify, continues to be treated as an eligible employer for the two years following the last year in which it did qualify.

An employee is eligible to participate in any calendar year if he or she received at least $5,000 of compensation from the employer during each of the two preceding calendar years and is reasonably expected to receive at least $5,000 in compensation during the current calendar year. A self-employed individual is treated as an employee and may participate in a SIMPLE plan if the compensation threshold is met.

There are two types of SIMPLE plans.

1. Cash or deferred arrangement (CODA) incorporated in a qualified plan (IRC Sec. 401(k)(11)(c)); or

2. An IRA established for each participating employee.

A SIMPLE plan must permit each eligible employee to elect to have the employer make payments either (1) directly to the employee in cash or (2) as a contribution to the SIMPLE account. No contribution, other than elective contributions, employer matching contributions, and nonelective employer contributions may be made to a SIMPLE account. However, a rollover from another SIMPLE account may be received.

Elective contributions are limited to $6,000 for any calendar year. The employer must match the elective contribution of an employee in an amount not exceeding three percent (3%) of the employee's compensation. However, the employer may elect to limit its match, for all eligible employees, to a smaller percentage of compensation not less than one percent (1%). The election may not be made in more than two out of every five years.

Nonelective contributions may be made as an alternative to matching contributions. The employer may elect to make nonelective contributions of two percent (2%) of compensation for each employee who is eligible to participate and who has at least $5,000 of compensation from the employer for the calendar year. The compensation that may be taken into account in determining the two percent nonelective contribution may not exceed an indexed dollar amount. For 1996, this amount is $150,000 for most plans.

Elective contributions of employees are not includable in gross income when made. They are taxed only under the distribution rules that govern distributions from conventional IRAs. IRC Sec. §408(p)(i)(A). Any elective contributions under this plan are included in the sum of elective deferrals, subject to an annual limit on the amount that can be excluded from income. IRC Sec. 402(g)(3)(D).

The employer is entitled to a deduction for its contributions to a SIMPLE account. For deduction purposes, the employer contributions to a SIMPLE account are treated as if they were made to a plan subject to the requirements of IRC Sec. 404(m).

For self employed persons, the contribution is not a business expense, therefore it is not deductible on the schedule C. In the case of a sole proprietorship the contribution may only be claimed as an adjustment to income.

Example: XYZ Company maintains a SIMPLE retirement plan for its eligible employees. Melinda Jones earns $30,000 from XYZ Company. The company matches the elective contribution in the amount of 3% of the employee's compensation. Ms. Jones elects to contribute $6,000.00 to her SIMPLE account. Ms. Jones has no other income deferrals. XYZ Company makes a matching contribution of $720.00 to Ms. Jones' SIMPLE account. [($30,000 - $6,000) x 3%]. Ms. Jones' wages reported on her W-2 are $24,000.00 and XYZ Company may deduct the $720.00 as an expense.

26-51-416 DEDUCTIONS - TAXES

1.26-51-416 State Income Taxes

No deduction will be allowed for Arkansas state income taxes in the computation of net income. All other states' income taxes are deductible as a miscellaneous deduction not subject to the two percent of AGI reduction unless said taxes are taken as a credit.

26-51-419 DEDUCTIONS - CHARITABLE CONTRIBUTIONS

1.26-51-419 Charitable Contributions

Arkansas has adopted IRC Sec. 170 as referenced in ACA 26-51-419. IRC Sec 170(d)(2)(B) does not allow unused contributions to increase NOL carry forward. It merely decreases net taxable income by accumulated contributions carry forward first up to 10%, therefore, decreasing the amount of NOL used and thus results in an increase of NOL for future years.

26-51-423 DEDUCTIONS - EXPENSES

1.26-51-423(a) Types of Deductions

In computing an individual's taxable income, the individual is permitted to claim certain deductions, Some of these deductions may be subtracted from gross income, while other types of deductions must be claimed as itemized deductions and subtracted from the individual's adjusted gross income. A Deduction from adjusted gross income is generally referred to as a "itemized deduction". To be deductible as a trade or business expense, an expense must be:

(1) an ordinary and necessary expense of the taxpayer's trade or business,

(2) paid or incurred during the tax year in which it is deducted,

(3) connected with a trade or business conducted by the taxpayer.

The business expenses of a sole proprietorship or a "statutory employee" are claimed on Schedule C of Form 1040.

A "trade or business," although not defined in the tax law, has been characterized as an activity carried on for a livelihood or for profit.

A profit motive must be present and some type of economic activity must be conducted. With respect to the profit motive, an activity is considered a business if it is entered into and carried on in good faith for the purpose of making profit. Moreover, a trade or business is characterized by regularity of activities and transactions and the production of income.

1.26-51-423(a)(1) Business Expenses -- Long-Term Care Insurance Premiums

A self-employed taxpayer can deduct as a business expense on U.S. Form 1040, Schedule C, a percentage of the premiums paid during the tax year for "qualified" long-term care insurance. The definition of "qualified" long-term care insurance is set forth in IRC Sec. 7702B(b)(1). The applicable percentage begins with 40% for the 1997 tax year and increases up to a maximum of 80% in 2006. The percentages are as follows:

1997	40%	2004	60%
1998 through 2002	45%	2005	70%
2003	50%	2006 or thereafter	80%

1.26-51-423(a)(2) Medical Expenses -- Long-Term Care Insurance Premiums

Under certain circumstances, expenses incurred by a taxpayer for eligible long-term care insurance premiums may be taken as an itemized deduction. This deduction for unreimbursed medical expenses can be taken only to the extent such expenses exceed 7.5% of the taxpayer's AGI. IRC Sec. 213(d)(1)(D).

"Eligible" long-term care insurance premiums may be deductible as medical expenses when such premiums are paid towards "qualified" long-term care insurance. The definition of "qualified" long-term care insurance is set forth in IRC Sec. 7702B(b)(1).

1.26-51-423(b) Travel and Entertainment

For tax years beginning before 01/01/95, IRC Sec. 274 as in effect 01/01/89 shall apply. For tax years 1995 and 1996, IRC Sec. 274 as in effect on 01/01/95 shall apply. Beginning with the 1997 tax year, IRC Sec. 274 as in effect on 01/01/97 shall apply. 80% of qualified expenses will be allowed for tax years beginning before 01/01/95, and 50% of qualified expenses will be allowed for tax years beginning on or after 01/01/95.

1.26-51-423(c)(1) Business Expenses -- Medical Care Insurance Premiums

A self-employed taxpayer can deduct as a business expense on U.S. Form 1040, Schedule C, a percentage of the premiums paid during the tax year for insurance which constitutes medical care for the taxpayer, his spouse and dependents. The applicable percentage begins with 40% in 1997 and increases up to a maximum of 80% in 2006. IRC Sec. 162(l). The percentages are as follows:

1997	40%	2004	60%
1998 through 2002	45%	2005	70%
2003	50%	2006 or thereafter	80%

26-51-424 DEDUCTIONS - LOSSES

1.26-51-424(a)(1) Losses

Losses sustained during the tax year, and not compensated for by insurance or otherwise are fully deductible if:

1) Incurred in a trade or business;

2) Incurred in any transaction entered into for profit;

3) Losses of property not connected with a trade or business if these losses arise from fires, storms, shipwrecks, other casualty, or theft, only to the extent that the amount of the loss from each casualty or theft shall exceed one hundred dollars ($100.00) and if the aggregate amount of all such losses sustained by an individual during any one (1) income year exceeds ten percent (10%) of the net income of the individual for that income year.

There shall be allowed any loss attributable to a disaster occurring in an area subsequently determined by the President of the United States to warrant assistance by the Federal government under the Disaster Relief Act of 1974. A taxpayer may elect to deduct this loss, less one hundred dollars ($100.00), for the year immediately preceding the tax year of the disaster. For example, if a taxpayer experiences a loss in 1993 and elects to carry the loss back to 1992, the loss is deductible only to the extent that it exceeds ten percent (10%) of the adjusted gross income for 1992.

2.26-51-424(a)(1) Transfer of Property to Related Person

No loss is realized by the transfer of property by gift, by death or by sale to any person related by blood or marriage at less than the fair market value.

3.26-51-424(a)(1) Voluntary Removal or Demolition

Losses due to the voluntary removal or demolition of old buildings, scrapping of old machinery, equipment, etc., incident to renewals and replacements, are deductible from gross income. When a taxpayer buys real estate upon which is located a building which he proceeds to raze with the intent of erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building and no deductible expense on account of the cost of such removal, the value of the real estate, exclusive of old improvements, which is presumed equal to the purchase price of the land and building plus the cost of removing the useless building.

4.26-51-424(a)(1) Obsolescence

When, through some change in business conditions, the usefulness in the business of some or all of the capital assets is suddenly terminated so that the taxpayer discontinues the building or discards such assets permanently from use in such business, he may claim as a loss for the year in which he takes such action the difference between the cost of the assets less depreciation, etc., and the salvage value thereof. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized, nor does it apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be fully explained in the return of income.

5.26-51-424(a)(1) Shrinkage in Value of Stock

A person possessing stock of a corporation cannot deduct from gross income any amount claimed as a loss merely on account of shrinkage in the value of such stock through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the stock is disposed of. If such stock of a corporation becomes worthless, its cost or other basis may be deducted by the owner in the tax year in which the stock became worthless.

6.26-51-424(a)(1) Farm Losses

Losses incurred in the operation of farms as business enterprises are deductible from gross income. If farm products are held for favorable markets, no deductions for shrinkage in weight or physical value or by reason of deterioration in storage, shall be allowed except as such shrinkage may be reflected in an inventory, if used to determine profits. The total loss by frosts, storm, flood or fire of a prospective crop is not deductible loss in computing net income. A farmer engaged in raising or selling stock, cattle, sheep, horses, etc., is not entitled to claim as a loss the value of animals that perish from among these animals that were raised on the farm, except as such loss is reflected if an inventory is used. The cost of any feed, pasture, or care which has been deducted as an expense of operation shall not be included as part of the cost of the stock for the purpose of ascertaining the amount of deductible loss. If gross income is ascertained by inventories, no deduction can be made for livestock or products lost during the tax year, whether purchased for resale or produced on the farm, as such losses will be reflected in the inventory by reducing the amount of livestock or products on hand at the close of the tax year. If any individual owns and operates a farm, in addition to being engaged in another trade, business, or calling, and sustains a loss from such operation of the farm, then the amount of loss sustained may be deducted from gross income received from all sources, provided the farm is not operated for recreation or pleasure.

26-51-425 DEDUCTIONS - WORTHLESS DEBTS

1.26-51-425 Worthless Debts

Worthless debts shall be allowed as deductions from income after being ascertained as such. There are two types of bad debts an individual may incur, business and non-business. A business bad debt is created and deductible from the taxpayers ordinary net income computation. A non-business bad debt is listed on a Federal schedule "D" with documents and deducted as a short term capital loss. There shall accompany the return a statement showing the propriety of any deduction claimed for bad debts. Before a taxpayer may charge off and deduct a debt in part, he must ascertain and be able to demonstrate with a reasonable degree of certainty the amount thereof which is uncollectible. An amount subsequently received on account of a bad debt, or on account of a part of such debt previously charged off and allowed as a deduction for income tax purposes must be included in gross income in the tax year in which received.

Bankruptcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt. Actual determination of worthlessness in bankruptcy cases is sometimes possible before and, at other times, only when settlement in bankruptcy shall have been made. Where a taxpayer ascertained a debt to be worthless and charged it off in one tax year, the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later tax year, confirming the conclusion that the debt is worthless, will not authorize shifting the deduction to such later tax year. If a taxpayer computes his income upon the basis of valuing his notes or accounts receivable at their fair market value when received, which may be less than their face value, the amount deductible for bad debts in any case is limited to such original valuation.

Worthless debts arising from unpaid wages, salaries, rents and similar items of taxable income, will not be allowed as a deduction unless such items have been entered as income in the books of the taxpayer in a prior tax year or in the tax year in which the deduction was made. Only the difference between the amount received in distribution of the assets of a bankruptcy and the amount of the claim may be deducted as a bad debt. The difference between the amount received by a creditor of a decedent in distribution of the assets of the decedent's estate and the amount of his claim may be considered a worthless debt. A purchaser of accounts receivable which cannot be collected and are subsequently charged off the books as bad debts is entitled to deduct them, the amount of the deductions to be based upon the price he paid for them and not upon their face value.

2.26-51-425 Mortgaged or Pledged Property Sold for Less Than the Amount of the Debt

Where mortgaged or pledged property is lawfully sold (whether to the creditor or another purchaser) for less than the amount of the debt, and the mortgagee or pledgee ascertains that the portion of the indebtedness remaining unsatisfied after such sale is wholly or partially uncollectible and charges it off, he may deduct such amount (to the extent that it constitutes capital or represents an item the income from which has been reported by him) as a bad debt for the tax year in which it is ascertained to be wholly or partially worthless and charged off. In addition, where the creditor buys in the mortgaged or pledged property, loss or gain is realized, measured by the difference between the amount of those obligations of the debtor which are applied to the purchase or bid price of the property (to the extent that such obligations constitute capital or represent an item the income from which has been returned by him) and the fair market value of the property. The fair market value of the property shall be presumed to be the amount for which it is bid in by the taxpayer, in the absence of clear and convincing proof to the contrary. If the creditor subsequently sells the property so acquired, the basis for determining gain or loss is the fair market value of the property at the date of acquisition.

Accrued interest may be included as part of the deduction only when it has previously been reported as income.

3.26-51-425 Bonds or Other Similar Obligations

Bonds, when ascertained to be worthless, may be treated as bad debts to the amount actually paid for them. Bonds of an insolvent corporation secured only by a mortgage from which, on foreclosure, nothing is realized for the bondholders, are regarded as ascertained to be worthless not later than the tax year of the foreclosure sale and no deduction for a bad debt is allowable in computing a bondholder's income for a subsequent tax year.

A taxpayer (other than a dealer in securities) possessing debts evidenced by bonds or other similar obligations, cannot deduct from gross income any amount merely on account of market fluctuations, when a taxpayer ascertains, however, that due to the financial condition of the debtor or conditions other than market fluctuations, he will recover upon maturity none or only a part of the debt evidenced by the bonds or other similar obligations and so demonstrates to the satisfaction of the Director, he may deduct, in computing net income, the uncollectible part of the debt evidenced by the bonds or other similar obligations.

26-51-427 DEDUCTIONS -- NET OPERATING LOSS CARRYOVER

1.26-51-427 Net Operating Loss Carryover

The net operating loss carryover (NOL) is the excess of allowable deductions over gross income derived from a trade or business for the taxable year. This loss may be carried over to the next succeeding taxable year and annually thereafter for a total period of three (3) years, succeeding the year of the year of the net operating loss, if the loss occurred in an income year before January 1 1987, and five (5) years if the loss occurred on or before January 1, 1987, or if the loss has been exhausted or absorbed by the taxable income of any succeeding year, whichever is earlier. The NOL must be carried forward in the order named above.

Taxable income as used in the paragraph above is the amount realized after the deduction of personal itemized deductions from the adjusted gross income (AGI), and if no itemized deductions, then taxable income will be the same as the AGI. The NOL calculated from a qualified previous year may be exhausted or absorbed in part by this amount.

The NOL must be reduced by all non-taxable income, less any expenses properly and reasonably incurred in earning non-taxable income, not required to be reported as gross income.

Non-taxable income includes, but is not limited to, the first six thousand dollars ($6,000.00) of military pay or retirement, the first six thousand dollars ($6,000.00) of a public or private employment - related retirement or disability system, and any other income that is exempt under ACA 26-15-404.

Gross income is the total income of all items listed, except an NOL, on the lines of the individual returns and before any adjustments are considered.

Gross income not derived from a trade or business is also known as non - business income. Non - business income includes, but is not limited to, personal savings interest, dividends, annuity distributions, endowments, and non - taxable income not required to be reported. Non - business deductions are those expenses incurred during the year and reported on the itemized deduction schedule with the exception of unreimbursed employee expenses.

In the case of a taxpayer other than a corporation, non - business deductions shall be eliminated from the deduction otherwise allowable for the taxable year to the extent that they exceed non - business income. Personal exemptions and credit for dependents shall not be a deduction for the purpose of computing a net operating loss.

EXAMPLE 1: Mr. Smith reported the following income items on his 1995 tax return:

Wages...	$ 5,000.00
Interest..	$ 500.00
Business (Sch. C)	($ 25,000.00)
Capital Gain....................................	$ 2,000.00
Farm (Sch. F)...................................	($ 15,000.00)
Pension..	$ 6,000.00
IRA Distribution..............................	$ 2,500.00

Other items on Mr. Smith's tax return include forfeited interest penalty on premature IRA withdrawal of $50 and itemized deductions consisting of mortgage interest, contributions and miscellaneous deductions totaling $8,000.

Adjusted gross income (AGI) for Mr. Smith is ($30,000) and taxable income is ($38,050) calculated as follows:

INCOME:

Wages...	$ 5,000.00
Interest..	$ 500.00
Sch C Loss.....................................	($ 25,000.00)
Capital Gain....................................	$ 2,000.00
IRA..	$ 2,500.00

Sch F Loss	($ 15,000.00)
Pension $ 6,000.00	
Less Exemption *($ 6,000.00)*	$ 0.00
Total Income	($ 30,000.00)

ADJUSTMENTS:

Forfeited Interest Penalty	($ 50.00)
AGI:	($ 30,050.00)
Itemized Deductions:	($ 8,000.00)
Taxable Income	($ 38,050.00)

NOL CALCULATION:

NON-BUSINESS INCOME:

Interest	$ 500.00
Capital Gain	$ 2,000.00
IRA	$ 2,500.00
Pension	$ 6,000.00

Total Non-Business Income ....$ 11,000.00

NON-BUSINESS DEDUCTIONS:

Itemized Deductions	($ 8,000.00)
Forfeited Interest	($ 50.00)

Total Non-Business Deductions ....($ 8,050.00)

Net Non-Business Income (Non Bus Income - Non Bus Deductions) ....$ 2,950.00

BUSINESS INCOME:

Wages	$ 5,000.00
Schedule C	($ 25,000.00)
Schedule F	($ 15,000.00)

Total Business Income ....($35,000.00)

BUSINESS DEDUCTIONS:

None..	$ 0.00
Total Business Deductions...	$ 0.00

Net Business Loss (Bus Income - Bus Deductions) .... ($ 35,000.00)

NET OPERATING LOSS (Net Non-Business Income - Net Business Loss) ......($ 32,050.00)

EXAMPLE 2: Same information as Example 1 except Itemized Deductions are $10,000 and includes a $2,000 deduction for Unreimbursed Employee Expenses.

AGI equals ($30,050) and taxable income equals ($40,050) computed as follows:

INCOME:

Wages...		$ 5,000.00
Interest..		$ 500.00
Sch C Loss		($ 25,000.00)
Capital Gain		$ 2,000.00
IRA...		$ 2,500.00
Sch F Loss..		($ 15,000.00)
Pension	$ 6,000.00	
Less Exemption	*($ 6,000.00)*..........	$ 0.00
Total Income.....................................		($ 30,000.00)

ADJUSTMENTS:

Forfeited Interest Penalty	($ 50.00)
AGI:	($ 30,050.00)
Itemized Deductions:	($ 10,000.00)
Taxable Income	($ 40,050.00)

NOL CALCULATION:

NON-BUSINESS INCOME:

Interest..	$ 500.00

Capital Gain	$ 2,000.00
IRA	$ 2,500.00
Pension	$ 6,000.00

Total Non-Business Income	$ 11,000.00

NON-BUSINESS DEDUCTIONS:

Total Item Deducts	($10,000.00)	
Less Bus Expenses	$ 2,000.00	($ 8,000.00)
Forfeited Interest		($ 50.00)

Total Non-Business Deductions	($ 8,050.00)

Net Non-Business Income (Non Bus Income - Non Bus Deductions)	$ 2,950.00

BUSINESS INCOME:

Wages	$ 5,000.00
Schedule C	($ 25,000.00)
Schedule F	($ 15,000.00)

Total Business Income	($35,000.00)

BUSINESS DEDUCTIONS:

ID - Unreimbursed Bus Expenses	$ 2,000.00	
Total Business Deductions		($ 2,000.00)

Net Business Loss (Bus Income - Bus Deductions)	($ 37,00.00)[sic]

NET OPERATING LOSS (Net Non-Business Income - Net Business Loss)	**($ 34,050.00)**

2.26-51-427 Net Operating Loss Carryover - Adjustments

The fact that the statutory period for assessment of income taxes for the year in which the loss was sustained has expired does not preclude the making of such adjustments as may be necessary to correct the net operating loss deduction. The net operating loss may be increased or decreased by any such adjustment.

26-51-428 DEDUCTIONS - DEPRECIATION; EXPENSING OF PROPERTY

1.26-51-428(a) Depreciation

For property placed in service during tax years beginning before 01/01/95, IRC Sections 167, 168 and 179 as in effect on 01/01/91 shall apply. The IRC Sec. 179 deduction is limited to $10,000. Any IRC Sec. 179 expense disallowed because of the limitation may be depreciated by regular depreciation methods appropriate for that property or can be carried forward.

Property placed in service during tax years beginning before 01/01/95 will have a useful life as determined by IRC Sec. 168 as in effect on 01/01/91. Property placed in service during tax years beginning on or after 01/01/95 will have a useful life as determined by IRC Sec. 168 as in effect on 01/01/95.

Any differences in basis because of depreciation differences must be included in the determination of gain or loss upon disposition of the property.

1.26-51-428(c) Amortization of Intangibles

For tax years beginning before 01/01/95, IRC Sec. 197 regarding amortization of intangibles shall apply. For tax years beginning on or after 01/01/95, IRC Sec. 197 shall apply.

Any differences in Arkansas and Federal basis must be considered in calculating gain or loss upon disposition of the intangibles.

26-51-435 NONRESIDENTS OR PART-YEAR RESIDENTS

1.26-51-435(a)&(b) Computing Taxable Income

Nonresidents or part-year residents of Arkansas shall compute their taxable income as if **all** their income was earned in Arkansas, despite the fact that a portion of their income may have been earned in another state or foreign country. Nonresident or part-year residents of Arkansas shall use Arkansas income tax rates to compute their Arkansas tax liability on their taxable income. The computed tax liability is then prorated to Arkansas based on a percentage calculated according to 1.26-51-435(d).

1.26-51-435(c) Credit for Income Tax Paid to Another State

After a nonresident or part-year resident's Arkansas tax liability has been computed as set forth in 1.26-51-435(a) & (b), all allowable tax credits should be deducted to determine the amount of income tax due the State of Arkansas. However, credit may not be taken for individual income taxes paid to another state (or states) during the tax year at issue unless the taxpayer is a resident of Arkansas **and** can clearly prove that he or she would be subject to "double taxation" if the other-state-tax-credit was not allowed.

1.26-51-435(d) Computing Percentage of AGI Attributable to Arkansas

The percentage (%) that Arkansas adjusted gross income (AGI) represents of **all** AGI received by a nonresident or part-year resident during the tax year shall be computed as follows:

$$\div \quad \frac{\text{AGI from Arkansas Sources}}{\text{AGI from All Sources}} = \%$$

1.26-51-435(e) Calculating Arkansas Income Tax Due

In order to determine the proper amount of income tax that must be paid to the State of Arkansas by a nonresident or part-year resident, the tax shall be computed as follows:

Tax liability minus allowable credits as set forth in 1.26-51-435(c)	X	Percentage (%) as determined in 1.26-51-435(d) = Tax Due

1.26-51-436(2) Deductions -- Passive Activity Loss

If all gain or loss realized on the disposition of an entire interest in a passive activity is recognized, then **the excess of**:

Any loss from the activity for the tax year of disposition (including losses carried over from earlier years)

OVER

Any net income or gain for the tax year from all other passive activities (including losses carried over from earlier years)

is treated as a loss that is not from a passive activity. IRC Sec. 469(g)(1)(A). As such, any gain from disposing of a passive activity would offset any loss from the activity for the tax year of the disposition. The balance of the loss would then be applied first against any net income or gain from other passive activities, and finally against nonpassive income.

2.26-51-436(2) Passive Activity Credits -- Oil and Gas Properties

Passive activity credits can only be used to offset taxes allocable to income from passive activities. A working interest in oil or gas property which the taxpayer holds either directly or through an entity that does not limit his liability is not a passive activity. However, if the taxpayer has any loss for any tax year from such an interest, then any net income from the property for any later tax year is treated as income that is not from a passive activity, notwithstanding that the activity may otherwise have become passive with respect to the taxpayer. IRC Sec. 469(c)(3)(B).

The 1996 Act provides that if, under the above rule, the net income from a working interest in an oil or gas property is treated as income that is not from a passive activity for any tax year, then any credits attributable to the property for that year are not treated as credits from a passive activity. The credits are treated as not from a passive activity even for a tax year in which the activity is no longer treated as not being a passive activity (i.e., the activity has become passive with respect to the taxpayer).

26-51-436 MEDICAL SAVINGS ACCOUNTS

1.26-51-436(5) Medical Savings Account (MSA) -- Defined

An MSA is a trust or custodial account that is created or organized in the United States exclusively for the purpose of paying the qualified medical expenses of an "account holder" (i.e., taxpayer) as well as the taxpayer's spouse and/or dependents. IRC Sec. 220(d)(1). The IRS has a MSA pilot program for employees of small businesses and self-employed persons. The accounts must be used in conjunction with "high deductible" health insurance. Participation is limited to the first 750,000 taxpayers utilizing MSAs each year for the tax years 1997 through 2000.

2.26-51-436(5) Medical Savings Account (MSA) -- Eligibility

In order to be eligible, a taxpayer must have insurance coverage only under a "high deductible" health plan. An "eligible individual" is more specifically defined at IRC Sec. 220(c)(1)(A). "High deductible health plan" is defined at IRC Sec. 220(c)(2)(A).

3.26-51-436(5) Medical Savings Account (MSA) -- Deductibility from Income

The amount of MSA contributions made by a taxpayer should be broken down on a month- by-month basis. For any given month, the limitation on the deduction that can be taken for that particular month is set forth at IRC Sec. 220(b)(1)&(2). Other key points regarding deductibility of contributions include:

* The annual contribution limit is the sum of the limits determined separately for each month, based on the individual's status and health plan coverage as of the first day of the month;

* The deduction for MSA contributions cannot exceed the taxpayer's compensation. For employees, see IRC Sec. 220(b)(4)(A). For self-employed individuals, see IRC Sec. 220(b)(4)(B).

* No deduction is allowed to an individual if any other person is entitled to a personal exemption on account of the individual, whether or not the personal exemption is actually taken;

* Contributions to an MSA for a tax year can be made until the due date for filing the individual's tax return for the year (determined without regard to extensions). For example, with respect to Arkansas individual income tax returns, the deadline for contributions that a taxpayer wishes to deduct on his 1997 return would be May 15, 1998;

* MSA contributions are taken into account in arriving at AGI (i.e., they are taken above-the-line). As such, MSA contributions can be deducted even if the taxpayer does not itemize deductions.

4.26-51-436(5) Medical Savings Account (MSA) -- Exclusion from Income

Employer contributions to an MSA on behalf of an eligible individual are excludable from gross income. The amount excludable from gross income cannot exceed the MSA **deduction** limit applicable to the individual. See Regulation 3.26-51-436(5); IRC Sec. 106(a)&(b). **However, employer contributions to an MSA are not excludable from gross income if made at the election of the employee under a salary reduction arrangement under a cafeteria plan.** Other key points regarding excludability of contributions include:

* Any employer contribution to an MSA (if otherwise allowable as a deduction) is allowed only for the tax year in which it is actually made;

* Every individual required to file an income tax return for the tax year must include on the return the aggregate amount contributed by employers to the MSAs of the individual or the individual's spouse for the tax year.

1.26-51-436(6) Medical Savings Account (MSA) -- Taxability of Account Earnings

MSA earnings are exempt from income taxation. However, if an MSA ceases to be an MSA, the account's subsequent earnings would be subject to taxation. IRC Sec. 220(e).

1.26-51-436(7) Medical Savings Account (MSA) -- Taxability of Account Distributions

Distributions from an MSA that are used to pay the *qualified medical expenses of an individual or the individual's spouse or dependents are excludable from gross income. IRC Sec. 220(f)(1).

*"qualified medical expenses" are any expenses for medical care as defined under the rules relating to the itemized deduction for medical expenses. See IRC Sec. 220(d)(2)(A).

1.26-51-440 Subchapter M

Subchapter M (§851 et seq.) of the Internal Revenue Code of 1986, as in effect on January 1, 1997 has been adopted for the purpose of computing Arkansas income tax liability with respect to regulated investment companies (RICs), real estate investment trusts (REITs) and financial asset securitization investment trusts (FASITs).

26-51-440 FASITs

2.26-51-440 Subchapter M -- FASITs - Definition

A new type of statutory entity called a financial asset securitization investment trust (FASIT) has been created to facilitate the securitization of debt obligations such as credit card receivables, home equity loans, and auto loans. An entity that qualifies as a FASIT can issue instruments that are treated as debt for Federal income tax purposes (and interest on which is therefore deductible) whether or not they would be so treated under normal tax principles. In addition, a FASIT itself generally isn't taxable, and any taxable income or net loss which it has (after taking into account deductions for interest on the debt) flows through to the equity owner of the FASIT.

3.26-51-440 Subchapter M -- FASITs - Qualification Requirements

To qualify for status as a FASIT, an entity must meet several requirements, which are specifically set forth at IRC Sec. 860L(a)(1). Any entity, including a corporation, partnership or trust may be treated as a FASIT.

The ownership of a FASIT (i.e., the "ownership interest"), must be held directly by an "eligible corporation." IRC Sec. 860L(a)(1)(C). An eligible corporation is a nonexempt domestic C corporation which does not qualify as a RIC, REIT, REMIC or cooperative. Moreover, the ownership interest of a FASIT must generally be entirely held by a single domestic C corporation. IRC Sec. 860L(a)(2).

The FASIT issues debt instruments, called "regular interests," which are in the nature of bonds. These regular interests would normally be purchased by investors and feature the following characteristics:

a. The investor is unconditionally entitled to receive a specified amount of principal;

b. Interest is paid on the principal;

c. A stated term to maturity of usually no more that 30 years;

d. In some cases, a FASIT may issue a high-yield interest rather than a regular interest. The tax treatment to investors of a high-yield interest is different from a regular interest. IRC Sec. 860L(b)(1)(B).

For an entity to qualify as a FASIT, substantially all of its assets must consist of "permitted assets" as defined at IRC Sec. 860L(c)(1). The assets of a FASIT are considered to be owned directly by the holder of the ownership interest.

4.26-51-440 Subchapter M -- FASITs - Taxation of FASITs

A FASIT is not subject to income tax, and is not treated as a trust, partnership or corporation. Instead, all of the FASIT's assets and liabilities are treated as the assets and liabilities of the FASIT's owner. Any income, gain, deduction, credit or loss of the FASIT is allocable directly to its owner.

Any FASIT income subject to Arkansas income tax shall be taxed at the corporate rates set forth in ACA 26-51-205. No special Arkansas income tax return has been created specifically for FASITs which are located within Arkansas. As noted above, FASIT income passes through to the FASIT's owner. The FASIT's owner is responsible for reporting any such income on the owner's return and paying any Arkansas individual income tax due. Once an election to be a FASIT is made, the election applies for that tax year and all subsequent years until such time that the election is revoked with the consent of the IRS.

All members of an affiliated group filing a consolidated return are to be treated as one taxpayer. IRC Sec. 860J(d). Specifically, the provision that the taxable income of a holder of a FASIT ownership interest cannot be less than the taxable income with respect to the FASIT interest applies to any consolidated group of corporations of which the holder is a member as if the group were a single taxpayer.

The holder of a FASIT ownership interest cannot offset income or gain from the FASIT ownership interest with nonFASIT losses. IRC Sec. 860J.

The taxable income of a FASIT (in determining the taxable income of the holder of an ownership interest) should be calculated using an accrual method of accounting. IRC Sec. 860H(b)(2).

5.26-51-440 Subchapter M -- FASITs -- Taxation of Regular Interests.

The holder of a regular or high-yield interest in a FASIT (normally an investor), is generally taxed in the same manner as a holder of any other debt instrument. IRC Sec. 860H(c)(1).

6.26-51-440 Subchapter M -- FASITs -- Prohibited Transactions

In order to ensure that FASITs are not used for purposes other than securitization, a 100% federal excise tax is imposed on any income not related to securitization (that is, income derived from prohibited transactions). Prohibited transactions are specifically set forth at IRC Sec. 860L(e)(1)&(2).

7.26-51-440 Subchapter M -- FASITs -- Transfers of Assets to FASITs

Where the holder of the ownership interest in a financial asset securitization investment trust (FASIT) or a related person sells or contributes property to the FASIT, gain is recognized immediately in an amount equal to the excess (if any) of the property's value on the date of the contribution over its adjusted basis on that date. This gain is recognized notwithstanding any other income tax Code provision, and the basis of any property is increased by the amount of gain recognized. IRC Sec. 860I.

Losses on assets contributed to the FASIT are not allowed upon their contribution, but may be allowed to the FASIT owner upon their disposition by the FASIT.

1.26-51-447 Deduction -- College and Technical School Tuition

An itemized deduction from the taxpayer's AGI shall be allowed for a portion of the tuition paid by the taxpayer for the taxpayer, the taxpayer's spouse or dependent(s) to attend post-secondary educational institutions which fall into the following classifications:

a. Four-year colleges and universities;

b. Two-year community colleges;

c. Technical institutes and colleges.

The deduction shall be limited to the lesser of:

a. 50% of the amount actually paid for tuition; or

b. 50% of a "weighted average tuition" for post-secondary educational institutions within the **same** classification. On or before November 30th of each year (beginning with November 30th, 1998), the Office of Income Tax Administration shall obtain and make available the weighted average tuition for each of the three classifications.

This deduction includes tuition paid to qualifying post-secondary educational institutions located both inside and outside of Arkansas.

The deduction will be allowable for tax years beginning on or after January 1, 1998.

26-51-502 HOUSEHOLD AND DEPENDENT CARE SERVICES

1.26-51-502(a)&(b)(1) General Requirements for the Credit

A credit against individual income tax owed to the State of Arkansas is allowed for expenses associated with household and dependent care services **that are necessary for the taxpayer to obtain or hold gainful employment**. Section 21 of the Internal Revenue Code of 1986, as amended and in effect on January 1, 1997, has been adopted for purposes of calculating this credit. The corresponding Treasury Regulation, as of January 1, 1993 remains IRC Reg. 1.44A-1.

As set forth in IRC Reg. 1.44A-1 (1993), five (5) general requirements must be satisfied before the credit can be taken:

1. The taxpayer must maintain a household. IRC Reg. 1.44A-1(a)(2) and (d);

2. One or more "qualifying individuals" must be a member of the taxpayer's household. IRC Reg. 1.44A-1(a)(2) and (b);

3. The household and dependant care expenses must be necessary for the taxpayer to obtain or hold gainful employment. IRC Reg. 1.44A-1(a)(2) and (c);

4. The services provided, whether they are provided inside the household or outside the household (including services provided by dependent care centers), must meet the specific requirements of IRC Sec. 21. IRC Reg. 1.44A-1(c)(2), (c)(3), (c)(4) and (c)(5).

5. The household and dependent care expenses must actually be paid during the tax year for which the credit is being claimed. IRC Reg. 1.44A-1(a)(3).

1.26-51-502(b)(2) Ten Percent (10%) Standard Credit

The amount of the credit shall be ten percent (10%) of the total federal credit allowable under IRC Sec. 21 as in effect on January 1, 1997.

1.26-51-502(c)(1) Twenty Percent (20%) Approved Child Care Facility Credit

A credit against individual income tax owed to the State of Arkansas is allowed for expenses incurred by a "qualified individual" for child care services provided by an "approved child care facility." The amount of this credit shall be twenty percent (20%) of the total federal household and dependent care credit allowed under Section 21 of the Internal Revenue Code as in effect on January 1, 1993. Three (3) general requirements must be satisfied before the credit can be taken:

1. A federal household and dependent care credit must be allowable under IRC Sec. 21 as in effect on January 1, 1993.

2. A "qualified individual" is a taxpayer who:

   i. Has a dependent child with respect to whom the taxpayer is entitled to a credit under ACA 26-51-501(a)(3); **and**

   ii. Incurs child care expenses necessary to obtain or hold gainful employment at an approved child care facility;

3. An approved child care facility is a child care facility which:

i. Provides an "appropriate early childhood program." Such programs are developmentally appropriate for young children, ages three through five (3-5), and are approved by the Arkansas Department of Education; and

ii. Has been certified by the Arkansas Department of Education. ACA 6-45-109.

2.26-51-502(c)(1) Refundability

The twenty percent (20%) Arkansas "approved child care facility" credit is refundable. The excess of this credit over the taxpayer's Arkansas tax liability will be returned to the taxpayer as an overpayment of tax.

1.26-51-502(c)(2) Election of Credits

A taxpayer cannot claim both the 10 percent and the 20 percent child care credit on the same expenses. If an individual has a federal child care credit that includes expenses from a facility that qualifies for the 20 percent credit and expenses from a facility that only qualifies for the 10 percent credit, the credit must be prorated based on the number of days the child attended each facility.

1.26-51-503 Tax Credit – Mentally Retarded Child

A taxpayer who is maintaining, supporting and caring for a mentally retarded child shall be entitled to a $500.00 credit per tax year for the child. If the taxpayer is caring for more than one mentally retarded child, the taxpayer shall be entitled to one $500.00 credit per child.

REQUIREMENTS

The following criteria must be satisfied in order to properly claim the exemption:

1. A physician (medical doctor) must certify in writing that the child is mentally retarded. Such certification shall be valid for state income tax purposes for five (5) years.

2. The individual must meet the eligibility requirements for admission to a Human Development Center, (ACA 20-48-404) which are:

   a The taxpayer has resided in the state of Arkansas for at least three (3) years prior to the claim for credit;

   b The child is so mentally deficient that he is incapable of managing himself or his affairs, and his welfare requires the special care, training, and education provided at a center; and c The child’s physician has used standard tests and examinations in determining that the child is mentally deficient and in need of the special training provided at a Human Development Center.

3. The mentally retarded child must be:

   a. The taxpayer's biological child; or

   b. The taxpayer's adopted child; or

   c. Clearly related **by blood** to the taxpayer.

4. The taxpayer must be caring for the mentally retarded child in the taxpayer's home.

26-51-504 INCOME FROM SOURCES OUTSIDE ARKANSAS

1.26-51-504(a) Calculating the Credit

When the gross income of an Arkansas resident includes income derived from sources outside the State of Arkansas, such as property or business activity, the Arkansas income tax liability shall first be computed as if **all** of the Arkansas resident's income was derived from sources within the State of Arkansas. However, a credit shall be allowed against the resident's Arkansas income tax liability in the amount of any income tax **actually owed** by the resident for the tax year at issue to any other state or territory.

Any credit given shall not be allowed to exceed what the tax would be on **all** the Arkansas resident's income, from wherever derived, if such tax was calculated using Arkansas income tax rates. No credit shall be allowed against the resident's Arkansas income tax liability unless the resident can clearly show that he or she would be subject to double taxation on a portion of his or her income unless the credit is allowed.

Example: Mr. and Mrs. Jones file a full year resident return in the state of Arkansas. Mr. Jones works in Arkansas and earns $30,000. Mrs. Jones works in Oklahoma and also earns $30,000. Mrs. Jones paid $1,500 tax to Oklahoma. The Jones' file as status "4" married filing separate on same return.

	Mr. Jones		**Mrs. Jones**
Income	$30,000.00		$30,000.00
Arkansas Tax	$1,364.00		$1,364.00
Total Tax		$2,728.00	
Personal Credits		($40.00)	

Other State Tax Credit	***($1,364.00)**
Tax Liability	$1,324.00

***The other state tax credit is limited to what the amount of Arkansas tax would be if the Oklahoma income was earned in Arkansas

The Jones' **must** attach a copy of their Oklahoma tax return to their Arkansas tax return in order to receive this credit.

1.26-51-504(b) Prerequisites to Claiming the Credit

Before a resident of Arkansas may properly claim a credit for income tax paid to another state or territory, he or she shall include with their Arkansas income tax return the following information:

1. The amount of income tax owed to any other state or territory; and

2. If so requested by the Department's Individual Income Tax Section, information which shows in detail the amount of gross and net income derived by the Arkansas resident from sources outside the State of Arkansas.

1.26-51-504(c) Restriction of Credit

The credit against Arkansas individual income tax liability for income taxes actually owed to another state or territory **shall only be available to Arkansas residents or part-year residents**. Nonresidents are not eligible for this credit.

The credit shall also be available to fiduciaries and partnerships residing or domiciled in Arkansas which either:

1. Are subject to Arkansas income tax;

or

2. Have to report income for purposes of Arkansas income tax.

26-51-801 RETURNS BY INDIVIDUALS

1.26-51-801(a) Who Should File

Every person receiving gross income from Arkansas sources shall file an Arkansas individual income tax return for the tax year such gross income was received with the Revenue Division of the Arkansas Department of Finance and Administration. Arkansas "sources" shall include real or personal property located within Arkansas and business or personal activity carried on within Arkansas. However, gross income received by **nonresident** individuals from entirely "passive" sources within Arkansas is not subject to Arkansas individual income tax and thus need not be reported by such individuals to the Arkansas Department of Finance and Administration. Examples of gross income derived entirely from passive sources would be interest earned on a bank account located within Arkansas or dividends from stocks held by an investment firm located within Arkansas as part of its client's investment portfolio.

2.26-51-801(a) Filing Status "4" -- Married Filing Separately on the Same Return

Married taxpayers who **both** have a net taxable income for the tax year may find that this method of tax computation will provide the greatest reduction in their tax liability over any other filing statuses that are available. The net result will be either a combined refund or a combined tax due. If there is tax due, both spouses will be considered jointly liable for it even though they are filing separately.

1.26-51-801(c) Completing and Signing Returns

If, for whatever reason, a taxpayer does not complete his or her own Arkansas individual income tax return, the return should be completed by an authorized agent or by a guardian or other court appointed person charged with caring for the taxpayer, the taxpayer's estate, or both. An "authorized agent" may be designated by power of attorney, Will or any other form of authorization made by the taxpayer that is clear and unambiguous and that was made by the taxpayer while of sound mind and without duress or coercion. If the authorized agent is merely a paid tax return preparer hired by the taxpayer, **both** the tax return preparer **and** the taxpayer must sign the return.

1.26-51-801(d)(1) Head of Household

A taxpayer shall be considered the head of a household if, and only if, the following three conditions are met:

1. The taxpayer is not married at the close of his tax year;

2. The taxpayer is not a "surviving spouse" as defined by IRC Reg. 1.2-2(a); and

3. The taxpayer maintains as his home a household which constitutes (for the tax year at issue) **the principal place of abode**, as a **member** of such household, at least one of the individuals described in IRC Reg. 1.2-2(b)(3)(i) or (ii);

   or

   The taxpayer maintains, whether or not as his home, a household which constitutes (for the tax year at issue) **the principal place of abode** of at least one of the individuals described in IRC Reg. 1.2-2(b)(4).

1.26-51-801(d)(2) Surviving Spouse

The term "qualifying widow or widower with dependent child" shall mean the same thing as the term "surviving spouse." A surviving spouse's Arkansas individual income tax return **for each of the next two (2) tax years following the tax year in which the other spouse died** shall be treated as a joint return and therefore taxed at the joint return rate **if** the surviving spouse:

a) Has not remarried at any time before the close of the tax year;

b) "Maintains" (pays more that 50% of the costs of) a household as his or her home which is the principal place of abode of a son or daughter (including adopted or foster children) or a stepson or stepdaughter;

c) Is entitled to a dependency deduction for at least one child; and

d) Was entitled to file a joint return with the deceased spouse for the year of death.

This "surviving spouse" rule does not apply to the tax year in which the spouse died. A joint return may be filed for a husband and wife (thus using a joint return tax rate) where their tax years start on the same day and end on different days because of the death of either or both. However, if the surviving spouse remarries before the close of his tax year, he cannot file a joint return for himself and his deceased wife.

1.26-51-801(d)(4) Dependent Defined

A person qualifies as a taxpayer's "dependent" only if all of the following provisions are met:

a) Relationship test -- the person is *related to the taxpayer or is a member of the taxpayer's household. The person will be considered a member of the taxpayer's household if, for the taxpayer's **entire** tax year, the person had as his **principle place of abode** the home of the taxpayer;

b) The person's gross income does not equal or exceed the exemption amount. However, this gross income test does not apply to a child of the taxpayer who either:

   i) has not reached the age of 19 at the end of the calendar year in which the taxpayer's tax year begins; or

   ii) is a student who has not reached the age of 24 at the close of the calendar year.

c) Support test -- except for a divorced or separated parent claiming his child as a dependent, a taxpayer can claim a person as a dependent only if he furnishes more than 50% of such person's support during the calendar year in which the taxpayer's tax year begins. A taxpayer who provides at least 10% of a person's support under a multiple support agreement may also meet the "support" test. Refer to IRC Reg. 1.152-3. The support test for a child of divorced or separated parents is set forth in IRC Reg. 1.152-4 and 1.152-4T.

**Support funds can take many forms. However, where the claimed dependent is in an institution supported by a state, charity, etc., the amount spent by the institution on the claimed dependant is part of support and is treated as furnished by the institution.

d) The person does not file a joint return under certain conditions. A taxpayer cannot take a dependency exemption for a married person who files a joint return with his or her spouse for a tax year beginning in the same calendar year that the taxpayer's tax year begins. However, an exemption may be claimed for a married dependent if neither the dependent nor his or her spouse is **required** to file a return but they file only to claim a refund of all tax withheld.

e) To qualify as a dependent, at some time during the calendar year in which the tax year of the taxpayer begins, a person must be:

   i) a citizen or resident of the United States;
   ii) a resident of the Canal Zone, Panama, Canada or Mexico; or
   iii) a "national" of the United States.

***Relationship test.**

A person meets the relationship test only if he has one of the following relationships to the taxpayer:

- child or descendant of child;
- stepchild;
- brother, sister, by whole or half blood;
- stepbrother, stepsister;
- father, mother or ancestor of either (grandparent, great-grandparent, etc.);
- stepfather, stepmother;
- nephew, niece;
- brother or sister of father or mother (uncle, aunt);
- brother-, sister-, father-, mother-, son-, or daughter-in-law. IRC Reg. 1.151-3(a).

A child born alive qualifies for the full dependency exemption (if other tests are met) even if the child lives only momentarily.

A person is treated as the taxpayer's **child** if the person is:

- legally adopted by the taxpayer. IRC Reg. 1.152-2(c).
- a member of the taxpayer's household, and is placed with the taxpayer by an authorized placement agency for legal adoption by the taxpayer under a formal

application filed with the agency -- the agency must be authorized to place children for adoption by a government or governmental subdivision (state, foreign country, etc.) IRC Reg. 1.152-2(c)(2).

- a foster child **if** he or she meets the "member of household" test. IRC Reg. 1.152-2(c)(4).

The **relationship** must exist with respect to the taxpayer claiming the dependency exemption on the taxpayer's separate return. On a joint return, the relationship need exist with respect to only one spouse, and it does not matter which spouse furnished the dependent's support.

These individuals do not meet the relationship test: taxpayer's grandnephew, grandniece, stepchild's descendant, aunt's husband, foster parent.

****Support test -- definition of support**

Support includes:

- food, school lunches, toilet articles and haircuts;
- clothing;
- recreation, including toys, summer camp, horseback riding, entertainment and vacation expenses;
- medical and dental care, including premiums on accident and health insurance;
- child care expenses, even though a credit is also allowed for these expenses;
- allowances, gifts;
- son's or daughter's wedding costs;
- lodging -- when furnished in kind, it is measured by its fair market value rather than actual cost. IRC Reg. 1.152-1(a)(2).
- education -- these costs include board, uniforms at military schools, and tuition, even where free schooling is available. Scholarship payments received by a dependent are treated as support furnished by someone other than the taxpayer. However, scholarships are not counted in determining whether the taxpayer furnished more than fifty percent (50%) of the dependent's support **if** these tests are met:

    i) the dependent is a child (including stepchild, foster child, or child adopted or placed for adoption) of the taxpayer, **and**

    ii) is a full-time student at an educational institution. IRC Reg. 1.152-1(c);

- Social Security benefits received by a child and used for his support are considered provided by the child. IRC Reg. 1.152-1(a)(2)(ii);
- Armed Forces dependency allotments -- the amount contributed by the government **and** the amount withheld from the pay of the member of the Armed Forces are treated as contributed by the member.

1.26-51-801(e) Withholding for Low Income Employees

If a person's gross income is not high enough to subject the person to Arkansas' individual income tax, such person must complete and submit to his employer Form AR4ECSP. This form, also known as the employee's special withholding exemption certificate, must be signed and dated by the employee. This form allows an employer, who would normally withhold Arkansas income tax from the wages of such an employee, to refrain from doing so.

26-51-802 PARTNERSHIP RETURNS

1.26-51-802(a) Partnership Returns -- Generally

For a tax year in which a partnership receives any income from Arkansas sources, a partnership return (AR1050) must be filed on behalf of the partnership and must be signed by at least one (1) of the partners. The partnership return must include the names and addresses of all partners of whatever nature who are entitled to a share of the partnership's income **and** the percentage or amount of each such partner's share.

1.26-51-802(b) Partnership Income From Arkansas Sources

All partnership income from activities carried on within Arkansas or from real or personal property located within Arkansas must be allocated to Arkansas.

26-51-803 FIDUCIARY RETURNS

1.26-51-803 Fiduciary Returns -- Generally

A fiduciary return (AR1002) is used to report the income of an estate or trust. The income received by an estate or trust will be considered attributable to Arkansas when the estate or trust's trustee, administrator, executor or personal representative **is a resident of Arkansas**. Likewise, the income received by an estate or trust shall be attributable to Arkansas when the estate or trust is physically located within Arkansas. As such, a fiduciary return must be filed by every resident (AR1002) and nonresident (AR1002NR) fiduciary under the following circumstances:

1. Any income of such estate or trust is currently distributable.
2. The tax is payable by the beneficiaries or by the grantor.
3. The net income of such estate or trust is $3,000.00 or over.
4. Any beneficiary of such estate or trust is a nonresident.

Pursuant to ACA 26-51-201(b) and (c), a limited exemption from Arkansas income tax has been established for **resident** fiduciaries under the following circumstances:

1. The trust or estate was created by a nonresident individual; or
2. The beneficiary of a trust is a nonresident.

26-51-806 FILING RETURNS -- TIME AND PLACE -- FORMS

1.26-51-806(a) Due Date and What Constitutes Filing

The due date for the filing of Arkansas individual income tax returns shall be as follows:

a) May 15 for tax years based on a calendar year.
b) Four and one-half (4½) months from the closing date of the period covered for tax years based on a fiscal year.

A tax return is "filed" with the Department at the time and date it is actually received by the Department. However, there is one exception to this rule for tax returns mailed to the Department through the United States Postal Service. ACA 26-18-105. This statute states that the postmark date on the envelope containing the tax return (or returns) shall be considered the return's filing date with the Department. **Only** tax returns mailed through the **United States Postal Service** qualify for this filing break. Tax returns sent through private carriers such as United Parcel Service or Federal Express will be considered "filed" when such returns are actually received by the Department. If the due date falls on a Saturday, Sunday or legal holiday for which the Department is closed in observance of, the due date shall be the next working day that the Department is open for business.

1.26-51-806(b)(1) Responsibility for Obtaining and Filing Returns

When a taxpayer requests that the Department send the taxpayer a tax return or related form, such as through the mail or via facsimile transmission, the Department must make a good faith effort to comply with all such requests that are **reasonable**, even though the Department has no legal obligation or duty to deliver tax returns or forms to taxpayers via public or private carrier. However, it is ultimately the **taxpayer's responsibility** to obtain, properly complete and file all Arkansas individual income tax returns and related forms required by Arkansas law to be completed and filed. A taxpayer may not avoid responsibility for any tax, penalty or interest properly due the State of Arkansas merely because the Department did not send the taxpayer the appropriate return or forms, even where personnel of the Department advised the taxpayer that such return or forms would be sent by the Department to the taxpayer.

1.26-51-806(c) Signing Returns

Every taxpayer filing an Arkansas individual income tax return must sign and date the return. Where a married couple files a joint return or files separately on the same return, both taxpayers must sign the return. Tax returns that have not been signed will not be processed although otherwise complete. If the taxpayer paid someone else to complete the return, the paid preparer must also sign and date the return (in addition to the taxpayer).

Arkansas individual income tax returns that are filed electronically by computer or by telephone must still be signed by the taxpayer. However, the signature can be entered electronically by keystroke or spoken over the telephone for such alternative filing options.

Any taxpayer who files an Arkansas individual income tax return that has been fraudulently prepared is guilty of a Class D felony. ACA 26-18-203.

26-51-807 FILING RETURNS -- EXTENSIONS OF TIME

1.26-51-807(a) Extension of Time -- Generally

A taxpayer who requests an **automatic** extension of time for filing his or her federal income tax return (by filing Form 4868 with the IRS) shall be entitled to receive the same extension of time to file the taxpayer's **corresponding** Arkansas income tax return. However, in order to take advantage of the federal automatic extension for state purposes, the taxpayer must check the appropriate box on the corresponding Arkansas return indicating that he or she has already requested an automatic federal extension. Beginning with the 1997 tax year, the Department will no longer require that a copy of Form 4868 be attached to a taxpayer's state return. The federal extension provided by Form 4868 extends the due date for filing a federal individual income tax return by four (4) months from April 15 to August 15 (for a calendar year taxpayer). This federal extension is provided automatically and need not be approved by the IRS provided Form 4868 is properly completed and filed. Assuming the box on the taxpayer's Arkansas income tax return indicating that the taxpayer has already requested an automatic federal extension has been checked, the return must be filed with the Department on or before August 15 (for a calendar year taxpayer).

"Corresponding" means the same type of state and federal income tax return. For example, a properly completed Form 4868 for a federal individual income tax return will also apply to an Arkansas individual income tax return. However, this automatic extension cannot be used to obtain an extension of time to file a noncorresponding Arkansas income tax return, such as a fiduciary or partnership return.

A taxpayer who requests and is granted an extension of time for filing his or her federal income tax return beyond the automatic four (4) month extension period **and who attaches a copy of the document granting the additional federal extension to the taxpayer's corresponding Arkansas income tax return,** shall automatically receive an additional extension of time until the due date of the federal income tax return to file the corresponding Arkansas income tax return. Federal Form 2688 is used to request an extension beyond the four (4) month period that is automatically available. In undue hardship cases, an extension of up to six (6) months from the original due date of the return will be granted. For a calendar year taxpayer, a six (6) month extension would push the filing due date for the taxpayer's federal and Arkansas individual income tax returns to October 15.

As set forth in 1.26-18-505, a taxpayer who does not obtain any type of federal extension may nonetheless request an extension of the due date for filing his or her Arkansas individual income tax return. Moreover, an extension can be requested from the Department even when a federal extension (4 or 6 months) has been taken. However, such a request must be submitted **before** the federal extension period expires. Arkansas Form AR1055 must be properly completed for such requests and filed with the Department. When no federal extension has been taken, Form AR1055 must be filed **before** the due date for filing Arkansas individual income tax returns, which is May 15 for calendar year taxpayers. The extension request (up to ninety (90) days), will be granted for good cause shown. An additional extension of up to another ninety (90) days may be granted under extraordinary circumstances. The request for an additional extension of time must be requested in the form of a letter setting forth in detail the reasons why the additional extension is needed, along with a copy of the approved initial (i.e. good cause) extension. The request for an additional extension of time, along with a copy of the approved initial extension and any other supporting documentation, should be sent to:

Mr. Clarence Collins, Manager
Individual Income Tax Section
Arkansas Dept. of Finance & Administration
P. O. Box 3628
Little Rock, AR 72203-3628

Arkansas individual income tax returns filed after the original due date (i.e. late) without the appropriate box checked or without the appropriate state or federal extension documents, will be considered delinquent and thus subject to a "failure to file" penalty.

1.26-51-807(b) Payment of Tax, Penalty and Interest

Although an Arkansas taxpayer receives an extension of time to file his or her Arkansas individual income tax return, this extension does **not** extend to the **payment** of any income tax due the State of Arkansas. A taxpayer should file a "tentative" return in the form of estimated tax voucher #5 on or before the original due date for filing the return (May 15 for calendar year taxpayers) and include with the return payment in full of any tax estimated to be due the State of Arkansas. Interest at the rate of ten percent (10%) per annum will be assessed on all unpaid tax due the State of Arkansas from the original due date for filing the return (May 15 for calendar year taxpayers). A "failure to pay" penalty will also be assessed on all unpaid tax due the State of Arkansas from the original due date for filing the return. However, no "failure to file" penalty will be assessed where the taxpayer has **properly requested** an extension of time to file his or her Arkansas individual income tax return.

26-51-808 FAILURE TO FILE RETURN OR INCLUDE INCOME

1.26-51-808(a)&(b) Taxpayer Required to File Return or Amended Return

The Department shall have the authority to **require** a taxpayer to file an Arkansas income tax return or an amended Arkansas income tax return under the following circumstances:

1. The taxpayer has failed to file a return; or

2. The taxpayer has failed, through error, to include items of taxable income in the taxpayer's return; or

3. The taxpayer has intentionally failed to include items of taxable income in the taxpayer's return.

A return or amended return filed under such circumstances **must** include **all** items of income received by the taxpayer during the tax year, whether or not such income is subject to Arkansas individual income tax.

1.26-51-808(c) Penalties, Prosecution, Jeopardy Assessments

Even though a taxpayer fully complies with a request by the Department to file a return or amended return, any penalties justifiable under ACA 26-18-208 may be assessed against the taxpayer. Moreover, in the case of intentional failure to disclose taxable income (i.e. fraud), a referral to the appropriate Prosecuting Attorney for criminal prosecution may be appropriate. ACA 26-18-201 et seq.

Where a taxpayer refuses to promptly comply with a request by the Department to properly prepare and file a return or amended return, the Department may make a jeopardy assessment against the taxpayer as set forth in ACA 26-18-402.

26-51-809 RECEIPTS FOR TAXES

1.26-51-809 Receipts -- Generally

The Department shall provide, upon request, to any taxpayer making a tax payment a written or printed receipt containing the following information:

1. The amount paid;
2. The account to which the payment will be credited; and
3. If applicable, the installment period to which the payment will be credited.

26-51-810 FORMS FOR TAX PRACTITIONERS

1.26-51-810 Fee Charged by Department

The Department may charge a postage fee for blank tax returns and related forms mailed to any person, partnership, limited liability company or corporation who prepare tax returns for a fee.

26-51-811 INFORMATION AT SOURCE AS TO RECIPIENTS OF INCOME

1.26-51-811(a) Recipients of Income -- Generally

Every individual, fiduciary and business entity of whatever type or nature (payor) located within Arkansas shall report to the Department, on Form 1099, all payments totaling $2,500.00 or more made to taxpayers (payees, such as individuals, fiduciaries or business entities) during the tax year. **Such payments shall include:** interest; rent; salaries; wages; premiums; annuities; compensation; remuneration; gains; profits and other income. When such payments are not properly reported to the Department, the Department can disallow the payments as deductions or credits in computing the payor's Arkansas income tax liability. Moreover, the Department can require payors making payments as described above to withhold Arkansas income tax from such payments and remit the tax directly to the Department. ACA 26-51-812; ACA 26-51-901 et seq.

26-51-813 CONFIDENTIALITY OF REPORTS AND RETURNS

1.26-51-813 Confidentiality -- Generally

All employees of the Department **must** keep **all** taxpayer information strictly confidential. This includes: information gained through an audit or investigation conducted by the State of Arkansas, any other state or the U.S. Government; information from any tax returns, reports, forms or other related documents filed with the State of Arkansas, any other state or the U.S. Government; and tax-related information provided in any other form from any other source whatsoever. The provisions of ACA 26-51-813 shall complement and be read in conjunction with those of ACA 26-18-303, which is the confidentiality statute of the Arkansas Tax Procedure Act. The provisions of both ACA 26-18-303 and ACA 26-51-813 shall be strictly interpreted to ensure the highest degree of taxpayer confidentiality.

2.26-51-813 Confidentiality - Exceptions

Taxpayer information may be disclosed, but only to the extent necessary, under the following circumstances:

1. The taxpayer and the Department are involved in a proceeding, either administratively or judicially, involving any issue related to Arkansas' individual income tax;

2. To income tax officials of any other state or the U.S. Government if:

    i) The taxpayer is required by the law of the other state or the U.S. Government to file an income tax return; and

    ii) The other state or the U.S. Government have substantially the same confidentiality laws as the State of Arkansas.

3. To the Arkansas Attorney General or any other legal representatives of the State of Arkansas when the taxpayer and the Department are involved in an administrative or judicial proceeding (or such a proceeding is at least necessary and/or pending) involving any issue related to Arkansas' individual income tax;

4. To the Office of Child Support Enforcement (OCSE) with respect to a parent from whom OCSE is charged with collecting child support. However, only the following information may be disclosed: last known address; last known whereabouts; and last known employer. The Department will only allow OCSE to examine the parent's tax return (both personal and business) **and** will only provide any other tax-related information regarding the parent when specifically compelled to do so by order of the Arkansas Supreme Court or any Arkansas Chancery Court.

5. To the Arkansas Student Loan Authority or the Student Loan Guarantee Foundation of Arkansas with respect to any person from whom these agencies are charged with collecting a student loan indebtedness. However, only the following information may be disclosed: last known address; last known whereabouts; and last known employer. These agencies shall not be allowed to examine any tax returns or related documents filed with the Department.

6. To the State Department of Higher Education or any Arkansas public institution of higher education with respect to any person from whom these institutions are charged with collecting student indebtedness. However, only the following information may be disclosed: last known address; last known whereabouts; and last known employer. These institutions shall not be allowed to examine any tax returns or related documents filed with the Department.

26-51-815 COMPUTING CAPITAL GAINS AND LOSSES

1.26-51-815(a) Computing Capital Gains and Losses -- Generally

With respect to capital gains and losses realized or incurred during tax years beginning after December 31, 1990, the following Internal Revenue Code and Regulations shall apply:

- IRC Sections 1211 through 1237, and 1239 through 1257 as in effect on January 1, 1997.
- Corresponding regulations promulgated by the Secretary of the Treasury as in effect on January 1, 1997.
- Any other provisions of the Internal Revenue Code and Regulations necessary for interpreting and implementing the above cited code sections as in effect on January 1, 1997.

However, the provisions of 1.26-51-815(a) shall not apply to C corporations as defined in IRC Sec. 1361 as in effect on January 1, 1997.

1.26-51-815(b) Computation of Tax

If a taxpayer has a net capital gain for a given tax year, the tax on such capital gain shall not exceed the sum of:

1. A tax computed at the rates and in the same manner as if this subsection had not been enacted on **the greater of**:

   A) Taxable income reduced by the amount of the net capital gain;

   or

   B) The amount of taxable income taxed at a rate below six percent (6%);

PLUS

2. A tax of six percent (6%) on the amount of taxable income in excess of the amount determined under subdivision (1) above.

IRC Section 1222 defines "net capital gain" as the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year.

CAPITAL GAINS

EXAMPLE 1: Mr. Jones, a single taxpayer with no dependents, reported a net taxable income of $40,000.00 after itemized deductions. The income and deductions were comprised of the following:

Wages	$	30,000.00
Interest	$	500.00
Net Capital Gain	$	15,000.00
Total Income	$	45,500.00
Less Itemized Deductions	($	5,500.00)
Net Taxable Income	$	40,000.00

Mr. Jones' Tax Liability is calculated as follows:

ORDINARY INCOME:

Wages	$	30,000.00

Interest	$ 500.00
Total Ordinary Income	$ 30,500.00
Less Itemized Deductions	($ 5,500.00)

Subtotal #1 .... $ 25,000.00

Tax on Subtotal #1
(Using the Itemized Deduction Tax Table) .... $ 1,084.00

Net Capital Gain Income .... $ 15,000.00

Tax on Net Capital Gains
(Maximum tax rate of 6%) .... $ 900.00

TOTAL TAX LIABILITY .... $ 1,984.00

REMINDER: Normal Arkansas Tax rates are graduated from 1% to 6% up to $ 25,000.00 and 7% for income $ 25,000.00 and above. The maximum tax rate for Net Capital Gains cannot exceed 6%.

CAPITAL GAINS

EXAMPLE 2: Same as Example 1 but the wages equal $ 15,000.00 and net taxable income equals $ 25,000.00.

Mr. Jones' Tax Liability is calculated as follows:

ORDINARY INCOME:

Wages	$ 15,000.00
Interest	$ 500.00
Total Ordinary Income	$ 15,500.00
Less Itemized Deductions	($ 5,500.00)

Subtotal #1 .... $ 10,000.00

Since Subtotal #1 is less than $ 25,000.00, add
the Capital Gain up to this amount.

Capital Gains .... $ 15,000.00

TOTAL TAX LIABILITY .... $ 1,984.00

CAPITAL GAINS

EXAMPLE 3: Same as Example 1 but wages equal $ 50,000.00 and net taxable income equal $ 60,000.00.

Mr. Jones' Tax Liability is calculated as follows:

ORDINARY INCOME:			
Wages	$ 50,000.00		
Interest	$ 500.00		
Total Ordinary Income	$ 50,500.00		
Less Itemized Deductions	($ 5,500.00)		
Subtotal #1		$ 45,000.00	
Tax on Subtotal #1 (Using the Itemized Deduction Tax Table)			$ 2,484.00
Capital Gains		$ 15,000.00	
Tax on Long Term Capital Gains (Maximum tax rate of 6%)			$ 900.00
TOTAL TAX LIABILITY			**$ 3,384.00**

1.26-51-815(c) Exclusion of Small Business Stock from Gain

IRC Sec. 1202, as in effect on January 1, 1995 regarding the exclusion from gain of certain small business stock, is adopted for the purpose of computing Arkansas income tax liability.

26-51-902 DEFINITIONS

1.26-51-902(1) Agricultural Labor -- Federal Definition

"Agricultural labor" shall be as defined in IRC Sec. 3121(g), as in effect on January 1, 1993.

2.26-51-902(1) Agricultural Labor -- When Nonagricultural Labor is also Performed.

Where an employee performs duties consisting of both agricultural and nonagricultural labor, the agricultural exemption applies only if the employee in question performs services that constitute valid agricultural labor for **at least** one-half (½) of any pay period (a period of not more that 31 consecutive days). When this requirement has been met, all wages paid by the employer to the employee for the given pay period will be exempt from withholding. *See* Ragland v. Pittman Garden Center, 293 Ark. 533, 739 S.W.2d 671 (1987).

3.26-51-902(1) Agricultural Labor -- Landscaping Services

Landscaping services do not fall within the scope of agricultural labor. Services performed at nurseries or garden centers operated primarily for the raising of horticultural commodities do fall within the scope of agricultural labor. However, a nursery or garden center employee is no longer considered to be engaged in agricultural labor at the moment the employee leaves the nursery or garden center to engage in nonagricultural labor. *See* Ragland v. Pittman Garden Center, 299 Ark. 293, 772 S.W.2d 331 (1989).

1.26-51-902(6) Employer

An "employer" is **any** employer, whether a resident or *nonresident of Arkansas, who:

a) Is carrying on business activity within Arkansas;

or

b) Is receiving income from sources located within Arkansas;

and

c) Has control, either directly or through an officer or agent, over the payment of wages to an individual for services performed by such individual **within Arkansas**.

* Nonresident employers include both transient employers and those employers carrying on business activity within Arkansas or receiving income from sources within Arkansas on a long-term (nontransient) basis.

1.26-51-902(12) *Transient Employer

A "transient employer" is an employer who:

a) Is not a resident of Arkansas;

and

b) **Temporarily** engages in any activity within Arkansas for the purpose of producing income for the employer. A temporary engagement is one which, as of any date, cannot reasonably be expected to continue for a period of eighteen (18) consecutive months.

***** *See Also* 1.26-51-908(b)

1.26-51-902(13)(B) Wages for Agricultural Labor -- Cash Remuneration

Pursuant to IRC Sec. 3121(a), **cash** remuneration paid by an employer in any calendar year to an employee for agricultural labor shall not be considered "wages" subject to withholding **unless**:

a) The cash remuneration paid in such year by the employer to the employee for such labor is $150.00 or more;

or

b) The employer's expenditures for agricultural labor in such year equal or exceed $2,500.00. However, this provision (b) shall not apply in determining whether remuneration paid to an employee constitutes "wages" **if** such employee:

i) Is employed as a hand harvest laborer and is paid on a piece rate basis in an operation which has been, and is customarily and generally recognized as having been, paid on a piece rate basis in the region of employment;

ii) Commutes daily from his permanent residence to the farm on which he is employed; and

iii) Has been employed in agriculture less than 13 weeks during the prior calendar year.

2.26-51-902(13)(B) Wages for Agricultural Labor -- Noncash Remuneration

Remuneration paid in any medium **other than cash** for agricultural labor shall not be considered wages, regardless of the amount or quantity paid.

1.26-51-902(13)(B)(i) & (ii) Withholding of Income Tax on Agricultural Wages

When cash remuneration paid for agricultural labor is considered "wages" according to the criteria set forth above, if the agricultural employer pays wages to four (4) or more employees during any reporting period, the employer shall be required to withhold Arkansas income taxes for any such reporting periods. However, if the agricultural employer pays wages to three (3) or fewer employees during a reporting period, the employer shall have the **option** to withhold Arkansas income taxes for any such reporting periods if the employer so chooses.

26-51-908 FILING OF EMPLOYER'S WITHHOLDING RETURN AND PAYMENT OF INCOME TAXES WITHHELD

1.26-51-908(a) Filing Schedule for Employer's Withholding Returns

All employers, resident or nonresident, are initially set-up as monthly filers when their registration for a withholding account (via Form AR4ER) is first processed. Monthly withholding returns are to be filed on or before the fifteenth (15th) day of each month and should include with the return payment in full of all income tax withheld for the preceding (i.e. prior) month.

All employers will remain on a monthly filing schedule regardless of the amount of Arkansas income tax they are withholding. At the request of the employer or on the Department's own initiative, the Department can change the employer's filing schedule from once each month to once each year if the **full** amount of Arkansas income tax that the employer was required to withhold for the preceding (i.e. prior) year was $199.00 or less. Yearly withholding returns must be filed on or before January 31 for the preceding year.

Withholding returns are no longer processed on a quarterly basis by the Department. Therefore, employers should not attempt to file withholding returns on a quarterly basis.

1.26-51-908(b) *Transient Employer

All transient employers shall complete and submit a withholding return (AR941M) to the Individual Income Tax Section of the Revenue Division of the Department of Finance and Administration once each month. The full amount of Arkansas income tax required to be deducted and withheld from the employee's wages for the preceding (i.e. prior) calendar month shall be submitted along with the withholding return for such month.

Transient employers shall file their withholding returns (along with payment in full of all income tax due) with the Department on or before the **last** day of the month following the month for which the income taxes were deducted and withheld from the wages of the employees.

***** *See Also* 1.26-51-902(12)

1.26-51-908(c) Employers Engaged in a Seasonal Business

All employers engaged in any business which is seasonal in nature shall nonetheless be required to complete and file a withholding return on or before the **last** day of each month for wages paid to employees the preceding (i.e. prior) calendar month. The employer shall remit payment in full of all income taxes required to be deducted and withheld along with the withholding return.

1.26-51-908(g) Filing Requirements when Employer no Longer Withholds Income Tax

An employer on a monthly or annual filing schedule who **correctly** no longer withholds and remits income tax to the Department must continue to file monthly or annual reports until such time that the employer gives the Department written notice that the employer no longer has any employees or has no employees based within or regularly working within Arkansas.

26-51-909 ANNUAL WITHHOLDING STATEMENT

1.26-51-909(a) Filing Requirement

Every employer shall file with the Director an annual statement of withholding (Federal Form W-2) for each employee along with an Arkansas Annual Withholding Tax Reconciliation (Form AR-3MAR).

Every employer shall also file with the Director a copy of all Federal Form 1099's issued during the year. The 1099's must be accompanied by a copy of the Federal Transmittal(Federal Form 1096).

1.26-51-909(b) Filing Requirement -- Due Date

The Annual Withholding Tax Reconciliation statement with attached W-2's shall be filed with the Department on or before February 28 following the close of the income year.

The statement from the employer for the employee (Form W-2) shall be provided to the employee on or before January 31 following the close of the income year. However, if the employment of the employee is terminated during the calendar year, the employer shall furnish the W-2 to the employee at the time of termination of the employment.

The Form 1096 Transmittal with attached Form 1099's shall be filed with the Department on or before February 28 following the close of the income year.

Act 1309 of 1997

1.26-51 -___ Tuition Savings Program -- Generally

The Arkansas Tax-Deferred Tuition Savings Program Act of 1997 will become effective on August 1, 1997. This Act is based closely upon the federal law regarding qualified state tuition programs, found at IRC Sec. 529. **For purposes of administering Arkansas' Tuition Savings Program Act, the provisions of IRC Sec. 529 regarding qualified state tuition programs should be considered to have been adopted as Arkansas law.**

Arkansas residents or nonresidents may make cash contributions to a special tax-deferred account for the purpose of accumulating funds to pay the expenses of attending a post-secondary institution of higher education located either inside or outside of Arkansas. The contributions will be held, invested and accounted for by the Arkansas Teacher Retirement System.

"Expenses" shall be limited to tuition, fees, books, supplies and equipment required for enrollment or attendance at the post-secondary institution.

"Post-secondary institutions of higher education" shall include two and four year: colleges; universities; technical schools; and institutes. Institutions that meet all of the following criteria would also qualify:

a) the institution provides not less than a 6-month program of training to prepare students for gainful employment in a recognized occupation;

b) the institution is licensed by the Arkansas State Board of Private Career Education or accredited by a nationally recognized accrediting agency;

c) the institution has been in existence for at least two (2) years; and

d) admits as regular students persons who are beyond the age of compulsory school attendance within the State of Arkansas. IRC Sec. 135(c)(3); 20 U.S.C. Sec. 1201a(10); 20 U.S.C. Sec. 1088.

The account must have a designated beneficiary, which must be either the contributor to the account or a member of the contributor's family. Qualifying family members are limited to the following:

a) an ancestor of the contributor;

b) a contributor's spouse;

c) a lineal descendant of:

   i. the contributor;
   ii. the contributor's spouse; or
   iii. a parent of the contributor; or

d) the spouse of any lineal descendant falling within the scope of (c) above. IRC Sec. 2032A(e)(2).

Act 1309 of 1997

2.26-51-___ Tuition Savings Program -- Tax Consequences

	Contributor's Gross Income	Beneficiary's Gross Income
Contributions To Program	******Nondeductible	Excluded
Earnings on Contributions	Excluded	Excluded
*****Distributions From Program	Excluded	Excluded

*****Any distributions made to the contributor or beneficiary that are not used as qualifying expenses at a qualifying post-secondary institution of higher education must be included in the taxpayer's taxable income.

******Contributions to a tax-deferred tuition savings program account are not deductible "above the line" as an adjustment to the contributor's gross income. Arkansas' tuition savings program is based upon IRC Sec. 529 which does not allow contributions to such programs to be taken as deductions.

Arkansas Individual Income Tax Regulations

Issued and hereby effective this 2nd day of October, 1997 in the City of Little Rock, Pulaski County, Arkansas.

Richard Weiss, Director
Arkansas Department of Finance and Administration

Tim Leathers, Commissioner of Revenue and Deputy Director
Arkansas Department of Finance and Administration