

ARKANSAS REGISTER

Transmittal Sheet

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For Office

Use Only:

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Name of Agency Department of Finance and Administration

Department Revenue Services

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Electronic Copy of Rule e-mailed from: (Required under ACA 25-15-218)

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11/18/2022

Contact Person

E-mail Address

Date

CERTIFICATION OF AUTHORIZED OFFICER

I Hereby Certify That The Attached Rules Were Adopted
In Compliance with the Arkansas Administrative Act. (ACA 25-15-201 et. seq.)

Signature

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Title

11/18/2022

Date

Arkansas Elective Pass-Through Entity Tax

I. Citation.

This rule shall be cited as the "Arkansas Elective Pass-Through Entity Tax Rule."

II. Definitions.

As used in this rule:

(a) "Affected business entity" means a business entity in which members that hold more than fifty percent (50%) of the voting rights in the business entity elect on an annual basis before the due date or extended due date of the business entity's income tax return to be taxed under the Elective Pass-Through Entity Act. Ark. Code Ann. § 26-65-101 *et seq.*

(b) "Applicable basis adjustments" means any increase or decrease to an affected business entity's basis in its property as a result of income, gain, loss, distribution, disposition, or transfer necessary to calculate the cost of or investment in such property.

(c) "Business entity" means an entity, including without limitation a general partnership, limited partnership, limited liability company with one or more members, or for federal income tax purposes, a Subchapter S corporation, that, whether privately owned or publicly traded:

(1) Is engaged in a business for profit; and

(2) Is required to file a return under the Arkansas income tax law.

(d) "Member" means a:

(1) Shareholder of a Subchapter S corporation;

(2) Partner in a general partnership, limited partnership, or limited liability partnership; and

(3) Member of a limited liability company.

(e) "Net operating loss" means the same as defined in § 26-51-427.

(f) "Nonresident" means the same as defined in § 26-51-102.

(g) "Pass-Through Entity Tax" means the tax imposed by the Elective Pass-Through Entity Tax Act.

(h) "Pro rata interest" means a member's percentage of allocation of the profits of an affected business entity.

(i) "Resident" means the same as defined in § 26-51-102.

(j) "Secretary" means the Secretary of the Arkansas Department of Finance and Administration or his or her designees.

(k) "Substantially Similar Tax" means a tax that is levied on the aggregate taxable income of each of the persons that have an ownership interest in an entity that is engaged in business for profit. The Department will annually publish a non-exhaustive list of states that have enacted a substantially similar tax on its website prior to February 1 of each year. The final such list will be published in February 2026 unless the Secretary, in his or her sole discretion, decides to publish the list in one or more subsequent years. Any changes in law that affect the levy, collection, implementation, administration, remittance, or calculation of a substantially similar tax could result in that tax being treated as not substantially similar, regardless of its inclusion in the annual list of substantially similar taxes. The fact that a tax is not included on the annual list is not conclusive to the determination of whether the tax is a substantially similar tax.

(l) "Taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which taxable income is computed.

Authority. Ark. Code Ann. § 26-65-102; Ark. Code Ann. § 26-65-105.

III. Election.

(a) The members of a business entity must elect annually whether the entity wishes to be subject to the Pass-Through Entity Tax. All members of an affected business entity are bound by the entity's election for that taxable year.

(b) The annual election must be made prior to the date established by Arkansas law for filing the business entity's income tax return. If the business entity receives an extension to file the income tax return, the annual election must be made prior to the extended due date.

(c) The election shall be filed on forms provided by the Secretary. The election must contain the business entity's federal employer identification number.

(d) A copy of the election shall be provided by the business entity to each member of the business entity making the election to be taxed under the Pass-Through Entity Tax.

(e) An affected business entity may revoke its election by submitting to the Department a revocation on the forms provided by the Secretary prior to the due date or extended due date for the affected business entity's Pass-Through Entity Tax Return. A copy of the revocation shall be provided by the business entity to each member of the business entity submitting the revocation of its election to be taxed under the Pass-Through Entity Tax.

(f) If an affected business entity revokes its election for a taxable year, then, upon receipt of the revocation, the Department will either:

(1) Issue directly to the affected business entity a refund of installment payments paid to the Department for that tax year by the affected business entity. The refund under this paragraph will be paid without interest;

(2) Transfer the installment payments made to the Department to a pass-through withholding or composite tax account held by the same entity that made the installment payments; or

(3) Carry forward the installment payments to count towards the pass-through entity tax owed by that entity in a future year.

(g) The affected business entity must indicate on the revocation form submitted to the Department its desired treatment of its installment payments under paragraph III.f of these rules. If an affected business entity fails to select an option under paragraph III.f of these rules at the time it revokes its election and in the manner described herein, the Department will, if applicable, refund installment payments under paragraph III.f.1 of these rules.

(h) If an entity makes installment payments to the Department for a taxable year and later revokes its election, the Department will not issue a refund of those installment payments to a member of the revoking entity or any other individual or transfer any installment payments to any account other than those described in III.f.2 of these rules.

Authority. Ark. Code Ann. § 26-18-301; Ark. Code Ann. § 26-65-102; Ark. Code Ann. § 26-65-105.

IV. Pass-Through Entity Tax Return and Payment.

(a) An affected business entity shall file a Pass-Through Entity Tax Return with the Department.

(1) An affected business entity shall annually file the required return with the Secretary on or before the fifteenth day of the fourth month following the end of the taxable year covered by the return.

(2) If the fifteenth day of the fourth month following the end of the taxable year covered by the return falls on a weekend or state holiday, the return is due on the next business day immediately following the weekend or holiday.

(3) The return shall be filed on forms provided by the Secretary.

(4) The return shall be signed, and the affected business entity shall attach its federal income tax return thereto. A single-member limited liability company must attach the federal return of the owner member.

(b) An affected business entity shall annually remit the Pass-Through Entity Tax to the Secretary within the time for filing its tax return.

(1) Failure to remit the full amount due will result in the assessment of tax, penalty, and interest against the affected business entity.

(2) If the affected business entity fails to remit the full amount of Pass-Through Entity Tax due, the Secretary may assess tax, penalty, and interest against the

member or members of the affected business entity based on the member or members' pro rata share of the entity's income.

Authority. Ark. Code Ann. § 26-18-301; Ark. Code Ann. § 26-65-102 through Ark. Code Ann. § 26-65-105.

V. Calculation of Pass-Through Entity Tax.

(a) The affected business entity shall calculate its tax rate as follows:

(1) The affected business entity shall pay a tax equal to the top marginal income tax rate for the taxable year under Ark. Code Ann. § 26-51-201(a) on its net taxable income computed as described in this rule.

(2) Any net capital gain earned by the affected business entity, regardless of whether that gain is a short or long-term capital gain or the amount of the gain, shall be taxed at fifty percent (50%) of the top marginal income tax rate for the taxable year under Ark. Code Ann. § 26-51-201(a).

(b) On its tax return, an affected business entity shall compute its net taxable income as determined by the Income Tax Act of 1929. The affected business entity shall make any applicable basis adjustments in computing the net taxable income of the entity.

(c) An affected business entity that receives or earns income tax credits under Arkansas law may elect to apply those tax credits to reduce the Pass-Through Entity Tax owed by the entity. The tax credits shall be subject to the same limitations that would have been applicable had the credit been used to reduce an income tax liability. Entitlement to an income tax credit, deduction, or exemption by a member or members is not relevant to and must not be considered in the computation of the Pass-Through Entity Tax.

(d) If the affected business entity has income from both within and without Arkansas for the taxable year, the business entity shall apportion or allocate its income to Arkansas as required by Ark. Code Ann. § 26-51-701 *et seq.*

(e) An affected business entity that incurs a net operating loss may carry forward the loss for the period of years as allowed by Arkansas Code Annotated § 26-51-427.

(f) An affected business entity may deduct guaranteed payments to its members as ordinary and necessary business expenses to the extent they are not required to be capitalized by Arkansas law and otherwise meet the definition of an ordinary and necessary business expense.

(g) If an affected business entity is a member of one or more other affected business entities, that entity shall subtract its distributive share of the income or add its distributive share of the losses from the other affected business entity or entities, to the extent the income or loss from the other affected business entity or entities was apportioned or allocated to Arkansas or otherwise attributable to Arkansas.

(h) Penalty and interest will be calculated and imposed pursuant to the Arkansas Tax Procedure Act.

Authority. Ark. Code Ann. § 26-18-301; Ark. Code Ann. § 26-65-102; Ark. Code Ann. § 26-65-105; Ark. Code Ann. § 26-65-106.

VI. Members.

(a) An affected business entity must annually report to the Secretary the pro rata interest of each member of the affected business entity.

(1) The annual report is to be filed on forms furnished by the Secretary.

(2) The pro rata interests reported to the Secretary are conclusive for computing a member's tax liability under the Elective Pass-Through Entity Tax Act and Ark. Code Ann. § 26-51-404(b)(35)(A), unless the member demonstrates the reported interests are fraudulent.

(b) An affected business entity is required to annually report to each member that member's respective pro rata share of the Pass-Through Entity Tax paid by the entity for the taxable year.

(c) A nonresident individual who is a member of an affected business entity is not required to file an individual income tax return if, for the taxable year, the only source of income derived from or connected with sources within this state for the member or, if a joint income tax return is filed, the member and his or her spouse, is from one (1) or more affected business entities and each affected business entity files and pays the taxes due under the Elective Pass-Through Entity Tax Act, § 26-65-101 *et seq.*

(d) A member of an affected business entity shall, if otherwise required to file, exclude from gross income on their individual income tax return an amount equal to the product of:

(1) The income subject to the tax paid under the Elective Pass-Through Entity Tax Act, § 26-65-101 *et seq.*, by an affected business entity of which the person is a member; and

(2) The person's pro rata interest, as reported to the Secretary under § 26-65-108, in the affected business entity of which the person is a member.

(e) A resident or part-year resident member shall exclude from gross income on his or her individual income tax return the member's pro rata share of income subject to tax paid to another state or the District of Columbia on the income of an affected business entity, if the taxes paid to the other state or District of Columbia result from a substantially similar tax to the tax imposed under the Elective Pass-Through Entity Tax Act.

(f) A member's pro rata share of the income of an affected business entity that has income from within and without Arkansas shall be allocated or apportioned and then taxed as follows:

(1) If a portion of the affected business entity's income for a taxable year is allocated or apportioned to Arkansas as required by Ark. Code Ann. § 26-51-701 *et seq.*, that portion of the income allocated or apportioned to Arkansas shall be

subject to the Pass-Through Entity Tax as provided in these rules and the member's pro rata share of that income shall be excluded from the member's gross income for Arkansas income tax purposes.

(2) If a portion of the affected business entity's income for a taxable year is apportioned to a state having a tax on pass-through entities that is substantially similar to the tax imposed by the Elective Pass-Through Tax Entity Act and that substantially similar tax is actually paid to that state by the affected business entity, the member's pro rata share of that portion of the income subject to the substantially similar tax in the other state shall be excluded from a member's gross income for Arkansas income tax purposes.

(3) If a portion of the income of an affected business entity for a taxable year is apportioned to a state that is not Arkansas and does not provide a tax on pass-through entities that is substantially similar to the tax imposed by the Elective Pass-Through Tax Entity Act, a member of the pass-through entity who is a full-year or part-year resident of Arkansas shall include their pro rata share of the income apportioned to that state in the member's gross income for Arkansas income tax purposes. If the member lawfully paid a state income tax on their proportionate share of the income to the other state, the member is entitled to a credit for the tax paid to the other state on that portion of the member's income that is subject to income tax both in Arkansas and the other state, subject to the limitations provided in Arkansas law, including Ark. Code Ann. § 26-51-504(a)(1).

(g) Payments made to a member of an affected business entity and not related to the member's pro rata share of the affected business entity's income, such as salaries, guaranteed payments, rent, interest, and royalties paid to the member, are:

(1) Taxable in Arkansas if the member is an Arkansas resident or part-year resident; or

(2) Taxable in Arkansas if the member is a nonresident and the payments are apportioned or allocated to Arkansas or are otherwise attributable to Arkansas.

Authority. Ark. Code Ann. § 26-51-404(b)(35); Ark. Code Ann. § 26-51-504; Ark. Code Ann. § 26-65-103; Ark. Code Ann. § 26-65-105; Ark. Code Ann. § 26-65-108.

VII. Income Tax Withholding on Nonresident Members.

(a) The withholding tax requirements of Ark. Code Ann. § 26-51-919 are not applicable to the share of income of a business entity for a taxable year that is distributed to a nonresident member if:

(1) The members of the business entity elect to be to be taxed as an affected business entity under the Elective Pass-Through Entity Act; and

(2) The election to be taxed as an affected business entity is made on or before the time for filing a return under these rules.

(b) The requirement to withhold income tax from the share of income of the business entity that is distributed to a nonresident member shall continue to apply for any taxable year for which the members of the business entity do not elect to be subject to the Pass-Through Entity Tax.

(c) The provisions of this section do not affect the obligation of the business entity to withhold income tax on the payment of wages.

Authority. Ark. Code Ann. § 26-18-301; Ark. Code Ann. § 26-51-919(e); Ark. Code Ann. § 26-65-103; Ark. Code Ann. § 26-65-105.

VIII. Annual Prepayments.

(a) Each affected business entity filing a Pass-Through Entity Tax return shall be required to make a required annual payment of the tax due for the taxable year.

(b) The required annual payment shall be made in four (4) estimated installments on or before the following dates:

(1) First (1st) payment by the 15th day of the fourth (4th) month of the taxable year;

(2) Second (2nd) payment by the 15th day of the sixth (6th) month of the taxable year;

(3) Third (3rd) payment by the 15th day of the ninth (9th) month of the taxable year; and

(4) Fourth (4th) payment by the 15th day of the first (1st) month of the next succeeding taxable year.

(c) Each estimated installment of Pass-Through Entity Tax shall be twenty-five percent (25%) of the required annual payment.

(d) The required annual payment shall be the lesser of ninety percent (90%) of the Pass-Through Entity Tax due for the taxable year or, if the affected business entity filed a return for the preceding taxable year, one hundred percent (100%) of the amount of tax due as reported on the preceding year's return.

(e) If an affected business entity establishes that its annualized income installment is less than the required annual payment in a manner satisfactory to the Secretary, the required installment payment under this section is the annualized income installment.

(1) However, an affected business entity shall recapture a reduction in a required installment payment by increasing:

(A) The amount of the next required installment payment by the amount of the reduction; and

(B) Subsequent required installment payments to the extent the reduction was not previously recaptured under this subsection.

(2) The annualized income installment is the difference between:

(A) The product of:

(i) The tax imposed under this chapter for the taxable year that would be due if income subject to the tax imposed under this chapter for the months in the taxable year ending before the due date of the installment were annualized; and

(ii) The following percentage:

(a) For the first required installment payment, twenty-two and five-tenths percent (22.5%);

(b) For the second required installment payment, forty-five percent (45%);

(c) For the third required installment payment, sixty-seven and five-tenths percent (67.5%); and

(d) For the fourth required installment payment, ninety percent (90%); and

(B) The aggregate amount of any prior required installments for the taxable year.

(f) The Secretary will impose penalties and interest upon an affected business entity that makes an underpayment of its required annual payment.

(g) The amount of underpayment is the amount by which the required installment exceeds the amount, if any, of the installment paid on or before the due date of the installment.

(h) A payment of estimated tax under this section shall be credited against unpaid or underpaid required installments in the order in which the installments are required to be paid.

(i) Payment of the estimated tax under the Elective Pass-Through Entity Tax Act or any required installment of estimated tax is a payment on account of the tax imposed under the Elective Pass-Through Entity Tax Act.

Authority. Ark. Code Ann. § 26-65-105; Ark. Code Ann. § 26-65-107.

IX. Application of Tax Procedure Act.

The Arkansas Tax Procedure Act (Ark. Code Ann. § 26-18-101 *et seq.*) is applicable to the administration and enforcement of the Pass-Through Entity Tax.

Authority. Ark. Code Ann. § 26-65-105.

X. Effective Date.

The provisions of this rule are effective for taxable years beginning on or after January 1, 2022.