

TAX ADVISORY COUNCIL

2020 ANNUAL REPORT

(Meetings Chaired by Mike Tuohey, Arkansas Society of Certified
Public Accountants)

Definition

Purpose: The Tax Advisory Council (TAC) was created by Act 998 of 1991 (codified at Ark. Code Ann. § 26-18-902). TAC consists of tax professionals and representatives of interested public and professional groups, including the Arkansas Bar Association Tax Section, the Arkansas Society of Accountants, the Arkansas Society of Certified Public Accountants, and employees of the Department of Finance and Administration's Revenue Division. TAC provides input to the General Assembly during the legislative process by studying and recommending changes to tax laws. TAC also promotes a better understanding of those tax laws and changes. At the end of every calendar year, a report summarizing discussions and decisions made by TAC is prepared to inform the chairmen of the Revenue and Taxation Committees and members of the State's House of Representatives and Senate.

Membership

(Arranged by Organization)

Arkansas Bar Association:

Matt Boch and Michael Pollock

Arkansas Society of Accountants:

A.W. Bailey

Arkansas Society of Certified Public Accountants:

Mike Tuohey

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

Paul Gehring, Assistant Commissioner of Revenue for Policy and Legal;

Joel DiPippa, Senior Legal Counsel, Revenue Legal Counsel;

Deanna Munds-Smith, Administrator, Field Audit;

Lynne Reynolds, Administrator, Income Tax;

Andrew Smith, Assistant Administrator, Sales and Use Tax;

Scott Fryer, Assistant Administrator, Corporation

Income Tax;

Andy Morgan, Manager, Central Audit District;

Dale Breshears, Assistant Administrator, Individual Income Tax;

Todd Cockrill, Assistant Administrator, Miscellaneous

Tax;

Tom Atchley, Administrator, Sales and Use Tax;
Brad Young, Attorney, Revenue Legal Counsel
Kevin Melson, Auditor, Individual Income Tax
Wade Gambill, Auditor, Individual Income Tax;
David Rector, Problems Resolution Officer;
Brandon Smith, Public Information Specialist.

Meetings

Members of TAC met three times during 2020 on the following dates:

<u>Meeting dates</u>	<u>Total Present</u>
February 11, 2020	13
August 11, 2020	10
November 10, 2020	7

These meetings were held in Conference Room 2330 of the Joel Y. Ledbetter Building. Meetings averaged thirty-five (35) minutes to one (1) hour in length and were open to the public and to all representatives of the State Senate and House of Representative Revenue and Taxation Committees.

Summary

Tax Advisory Council Activities: The following is a brief summary of what transpired during TAC's 2020 meetings.

Office of Revenue Legal Counsel

Summary of Updates and Tax Legislation Changes from the 2020 General Session:

Updates:

November 10, 2020

- I. Brad Young, Attorney with the Legal Section - Presented highlights and precedents from the most recent tax cases with decisions rendered by the Arkansas Supreme Court.

Tax Legislation Changes:

August 11, 2020

Corporate Income Tax - Scott Fryer, Assistant Administrator of Corporation Income Tax – 2020 Legislative highlights affecting Arkansas Corporation Income Tax.

- a. A handout was provided noting which changes in the Internal Revenue Code were adopted by the legislature as well as those which were not adopted. (Copy attached) Scott also addressed the New and Modified Business Incentive Credits, Act 819 which transfers administration of the Franchise Tax from the Secretary of State to the Department of Finance and Administration. The changes from Act 822 of 2019 were also noted.

Individual Income Tax Administration:

Individual Income Tax Updates for 2020:

February 11, 2020

Dale Breshears, Assistant Administrator of Individual Income Tax – Individual Income Processing.

- a. Income Tax Update: Dale provided the handouts to the Council containing two AR-1 tax forms and IIT processing updates. Dale said there is a change between Tax Year 2018 and 2019 AR forms. The changes between the 2018 and 2019 tax forms are that on the 2018 tax form the tax relevant information is on the first page and on the second page there is a line for direct deposit of refund; the 2019 tax form has a driver's license section and two lines for direct deposit for two separate accounts on the front page. The second page of the form contains the tax relevant information. The AR-1 form change for 2019 was made to make room for the second line of direct deposit. Dale said the change was made to make room for the second line of direct deposit account information concerning refunds.

- b. 1099 G's: 1099-G's are available on the DFA website. Taxpayers will need to click the "Look up my Form 1099-G" icon, type in their social security number and the first four letters of your last name. Taxpayers can see 1099-G's from the last three years. This year the Department mailed 1099-G's to taxpayers that itemize deductions on the federal return and got refund from Arkansas. These taxpayers have to account for income on their federal return. Starting next year taxpayers have the option on their tax return of receiving their 1099-G's by mail (if the taxpayer checks this box on his or her return) or can get it on the DFA website and receive it that way. Dale noted that the move to place the 1099-G's on the DFA website saved the Department approximately \$150,000 in postage. Mike Tuohey said that postage is easy to measure and asked how much the Department has saved in man hours and if the Department has people specifically focused on that. Dale replied that there are different variables that contribute to that such as when people move, or a person calling the Department and saying they did not receive a 1099-G and want one mailed to them. The Department does not have any specific person or group focused on that. The AIRS system has a mechanism for that and the 1099-G system is similar to the "Where is my refund" system. Matt Boch asked if the taxpayer gets an email notice that the 1099-G's are there. What is the outreach of the Department to make sure taxpayers know where to find it? Dale said the 2019 return should have addressed whether a 1099-G was mailed to you or not. Because the federal standard deduction has increased, the Department will see less itemized deductions, so less 1099-G's. The letter that was sent to taxpayers concerning 1099-G's notified taxpayers that starting next year 1099-G's will be online. Mike Tuohey noted that itemized returns dropped to a third of what it used to be. Dale agreed that itemized returns have dropped but it was still wise to place them online (the DFA website) and saving the Department \$50,000. Lynne Reynolds said usually Individual Income Tax processes around 350,000 returns and this year it is around 250,000. So the number of itemized returns have dropped around 100,000 due to the federal change. Matt Boch asked if the Department knew how many Arkansas itemized returns it receives compared to the federal returns. Dale said the Department can get that information from the federal returns but he would surmise that more taxpayers itemize on the Arkansas return than on the federal return. That was one of the reasons that at one time the Department suggested increasing the standard deduction. The main reason being that there would be less itemizing on the Arkansas return.
- c. Income Tax Processing Update: Paper and E-filed returns are about on par this year as it was last year. To date 4,695 paper returns have been filed compared to last year's 4,822 returns that were filed. Last year to date 319,311 returns were e-filed compared to 331,675 returns that were e-filed this year to date. Arkansas participates in the Treasury Offset Program (TOP) which is an agreement between federal agencies and states to collect on delinquent debts. Currently the Department has not collected any money from the TOP program. The federal government will send a list to the state in October to capture refunds on delinquent debt. Last year the Department collected approximately 8 million dollars in delinquent debt. Last year's collection is double the amount collected in previous years.

1,831,490 W-2's have been received by the Department to date and are in the warehouse (AIRS system). W-2 Non-filer's are people who primarily have not filed either their state or federal returns but have state W-2's. The Department has collected \$1,611,474 in W-2 Non-filer to date. The final notice on non-filer's was mailed out in January of this year. Refunds Hold are refunds on a ten day hold in which the AIRS system looks for a number things before it is processed. There are 130,571 refunds that are currently on hold that equates to \$50,090,829. Refunds Review is a variety of things, it could be based on missing information, no W-2 information from the state or fraud. These refunds are usually held until it is verified. The maximum time these refunds are held is twenty days.

August 11, 2020

Wade Gambill, Auditor – Individual Income Tax – Update on the increased occurrence of fraud in the current filing season

- a. In the current filing season, we have noted an increase in the filing of fraudulent returns. Currently we have identified 1197 returns. The result of this identification effort resulted in stopping the release of \$3,138,134 million dollars in refunds. The increase was attributed to an increase in identity theft nationwide.
- b. An update on the processing of returns was presented noting that as of this date we have processed 1,211,651 e-filed returns 154,131 paper returns or 11.29%. Compared to last year at this time we had 159k in paper returns or 12.4%. We have identified 74k of non-filed returns for which we received w-2 information from the federal government. We have billed \$65 million based on these returns and have collected \$6 million of those billings Wade noted the tax rate changes for the coming year and noted that we will be adding new schedules to the Arkansas returns.

Excise Tax:

February 11, 2020

Tom Atchley, Administrator of Excise Tax - Withholding Tax Update

- a. The new and updated income tax withholding tables are available. The regular income tax and low income tax tables as well as the tax formula and the instructions for employers are on the DFA website. The implementation of the withholding tax update begins on January 20th and goes into effect on or after March 1, 2020. The Department announced to employers, tax professionals and pay roll service companies and issued letters to all registered withholding accounts about the withholding change. Approximately 80,000 letters were sent; of the 80,000, 45,000 letters were sent electronically. Those companies set up (registered) an account with the Department for electronic communication. Approximately 35,000 letter were mailed to registered businesses. The tables and formulas will reflect all changes over the last two or three legislative sessions for income tax changes and were brought up to the current tax code. The maximum Arkansas tax rate will go from 6.9% to 6.6%. These formulas and tables reflect that and all other changes in lower income and middle income for the last two sessions. These are for employers to get involved with the implementation process. The Department has been in direct contact with some large employers and retirement systems to make sure that they are aware of what the Department has done. There has been communication with software provider companies and pay roll companies as they prepare to have their systems updated. The Department is asking for these payroll changes be issued for periods ending on or after March 1, 2020.
- b. Beginning March 1, 2020 employers should see reduced withholding. The other ways the Department communicate the withholding changes is the Democrat Gazette reported in an article the Department's withholding tables and formulas on February 2, 2020. The article included examples in how the withholding tables affect different income tax brackets. Tom noted that in the DFA letter to employers, the Department indicated that they may have employees that want to submit a change in withholding after they see the reduction. Some employees may have money from other sources that may not be withheld and may like the fact that they are getting refund of a certain size. Basically, employers should be aware of the change and the Department will work to monitor that. The first tax returns that will reflect the withholding change will be in April. The Department is estimating an approximate 15 million dollar reduction in withholding per month. This money will be reflected in the paychecks of employees and the Department will be monitoring that. A lot of communication primarily coming from software companies and payroll providing companies to make sure they know about the changes. The Department has received very little comment on difficulty concerning the implementation of the withholding changes. The Department will be monitoring the implementation process as it develops and will remain in contact with various companies.

New Business:

February 11, 2020

- a. Concerning withholding Matt Boch stated that he saw a legal opinion (2019-0514) that just came out where it stated that an out of state business whose only employee was basically a back office working from home did trigger an obligation for the out of state company to withhold Arkansas income tax because it was not doing business in the state. From a multi-state perspective that seemed to be a surprising result, perhaps going against the New Jersey Telebright decision that a lot of taxpayers have looked for and so encouraging compliance at the lowest cost. Perhaps if a legislative fix is needed to encourage companies with full time employees to be required to withhold in Arkansas. Paul Gehring said perhaps and certainly for purposes of revenue, the Department is currently working on its 'housekeeping' legislation concerning proposed legislation for the 2021 Session. Once the 'housekeeping' legislation package has progressed through the process of DFA administration and the Governor's Office, the Department will obtain sponsors for the legislation. The Department can not discuss any of it 'housekeeping' legislation until it is a bill that has been filed. Reviewing that specific opinion, the Department understands that there will be companies that have no business in Arkansas, but they have employees that are present in the state. There is a possibility that there is an employee that is unaware and he or she may get a surprise that a federal return was filed using an Arkansas address and his or her obligation to file an Arkansas return. Another concern for that type of employee is that if a federal and Arkansas return is filed, that the withholding may be inappropriate for their Arkansas return. The Department can certainly understand the issue and the need that it may need to be corrected. Matt Boch stated concerning the process of DFA 'housekeeping' bills that to his knowledge that the purpose of the Tax Advisory Council was originally designed to settle tax concerns before it gets to the Legislature and becomes a mess. Matt said it seems to him as if the Department's position somewhere in the decade of the 2000's has shifted to becoming more of having to get the Governor's office' approval and not being able to put out ideas in this group. Matt Boch opined that this shift in position limits the efficacy of this group. He continued by saying that at least this council can send stuff one way to the Department and if there are ways from the tax community it would certainly make for a positive legislative session.

- b. Matt Boch asked about the Department's position on manufacturing and repair parts versus consumable supplies. Matt said he has seen an instance or hear complaints from 'sales tax consultant' contacts that the Department is taking a position that wrenches and widgets that one would think is repair parts are being classified as consumables. He wanted the Department to know that this position is cause for concern with this line between replacement parts versus consumables and the gradual exemption of repair parts.

This is probably the new bright line where there is going to be a lot of contention. Matt concluded his supposition that he hoped the tax community will see something in the revenue rules about that when they are promulgated. Joel said the Department still has active litigation regarding that line and so any opinion letter would probably be premature until the Department has the final resolution. The Department's position is that it is consumable and there are others who state that is a replacement part. The litigation concerning this is still ongoing. Matt Boch asked if this issue was in the courts. Joel said yes, it is the Welspun case. Paul Gehring said the case is currently going before the Arkansas Supreme Court; the state are the appellants in the case. Joel agreed that the question concerning the debate between consumable parts versus replaceable and repair parts is what most of the argument or debate or negotiations are going to be over. Paul said in the interim, if it is not an issue that directly affects an issue that the Department is currently litigating, then the Department is available issue a legal opinion to the taxpayer through the legal opinion process. If the taxpayer is currently under an audit then the Department can not issue a legal opinion. There is a proper course of action if there is an assessment in that audit that the taxpayer pursues a protest through the Office of Hearing and Appeals for an administrative decision.

- c. Sales Tax Rules Update: Matt Boch asked about the status of the Sales Tax rules. Paul Gehring said the Department is finalizing the car wash rules due to the 2019 General Session regarding the water usage fee. These items are priority items to be completed. The is working to have the sales tax rules open to public comment by the next Tax Advisory Council meeting. There is a review process as well, but the goal is to have them ready for public comment by then. Matt Boch asked now that property tax is in the Department's portfolio, are there any rule making activity in property tax. Paul said currently the Arkansas Assessment Coordination Division (AACD) has a requirement to adopt rules which includes the exemption of property as well as inventory. AACD has begun the rulemaking process for purposes of complying with the bill that arose from the Tax Reform Task Force. Guidelines and rules have worked there way through the legislative committees over six months regarding and rules that AACD has adopted. Matt asked concerning government transformation, are these rules AACD rules or DFA rules. Paul said that AACD is a division of the Department. AACD will work through DFA for the purposes of promulgation. AACD has recently hired a new legal counsel, after John Nichols left the division toward the end of 2019. The new legal counsel for AACD has begun the process of looking into all of the issues of before in joint performance review regarding poultry houses as well as the new requirement to adopt those mandatory guidelines for exempt property. Matt Boch suggested that it would be good if someone from AACD would start coming to the Tax Advisory Council meetings since it is a part of DFA.
- d. Matt Boch said although it is not his personal experience, he said he has concerns from some of the 'tax consultants' that auditors from the Department's Office of Field Audit were applying unpublished and non-promulgated sales tax rules. Joel quickly said no, the

Department does not do dry runs of non-promulgated and unpublished rules. Mike Tuohey asked if there is any other new business. The Council did not have any and the meeting was adjourned.

August 11, 2020

- a. Matt Boch introduced information regarding the Coronavirus Aid, Relief and Economic Security Act (CARES) that was enacted by the federal government. Discussion was held regarding the confusion as to what the federal government's position regarding deductibility of expenses.
- b. Matt Boch also brought up the Model Uniform Statute for Reporting Adjustments to Federal Taxable Income and Federal Partnership Audit Adjustments. This is a proposal by a working group consisting of the Multistate Tax Commission (MTC) and several taxpayer professional organizations to define items under the IRC for the audits of partnerships and the reporting of findings by the Internal Revenue Service. (Copy attached) Discussion followed as to the potential benefits to the Department's audit efforts, taxpayer compliance and state revenue. It was noted that only several states have adopted this model so far and that MTC was still working on some additional adjustments to the current model.
- c. Sales Tax Rules Update The car wash rules will be up for public comment next week. The update of sales tax rules would like to be out for comment this year, but that process is ongoing. Matt Boch reiterated the need for updated rule, some of which are quite out of date.
- d. Matt Boch asked if there is any other new business. The Council did not have any and the meeting was adjourned.

November 10, 2020

Michael Tuohey asked if there is any other new business. The Council did not have any and the meeting was adjourned. The next TAC meeting is February 9, 2021 at 10:00 a.m.