



2005

IMPORTANT

**This Packet Contains Your
Sub-Chapter S Corporation Income Tax
Instructions and Return**

DUE DATE: MARCH 15, 2006

PLEASE READ IMPORTANT INFORMATION FOR TAX YEAR 2005 INSIDE

397207

**State of Arkansas
State Income Tax
P. O. Box 1000
Little Rock, AR 72203-1000**

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ARKANSAS

WHAT'S NEW FOR 2005

NOTE: THE FOLLOWING IS A BRIEF DESCRIPTION OF EACH ACT AND IS NOT INTENDED TO REPLACE A CAREFUL READING OF THE ACT IN ITS ENTIRETY.

State Tax Depreciation Unaffected By New Federal Laws

Arkansas has not adopted the depreciation provisions contained in the Job Creation Workers Act of 2002, the Jobs and Growth Tax Relief Reconciliation Act of 2003, the Working Families Relief and American Jobs Creation Acts of 2004 or the Energy Tax Incentive Act of 2005.

While the new depreciation provision may be used for federal returns, many states, including Arkansas, operate under a different tax code. On Arkansas income tax returns, taxpayers must file following the rules in sections 167, 168, 179, and 179A under the Internal Revenue Code of 1986, enacted January 1, 1999.

Arkansas does not recognize the 50% bonus depreciation or the increased Section 179 expense provision, therefore there may be differences in the Arkansas and the federal basis of assets that you dispose of during the year.

HSAs Adopted and MSAs Extended (Act 94 of 2005)

This act adopts specific subdivisions of IRC §223 as in effect January 1, 2005, concerning Health Savings Accounts. Health Savings Accounts are exempt from Arkansas income tax as long as the accounts meet the requirements of §223. The act amends the definition of "gross income" to exclude from the employee's gross income, the contributions by an employer to a Health Savings Account.

The act also adopts the following IRC sections as in effect on January 1, 2005:

1. §129 (exclusion of dependent care assistance from income),
2. §§72, 219, 401-404, 406-416, and 457 (deductibility from income of contributions made to deferred compensation plans), and
3. §220 (deductibility from income of contributions made to a Medical Savings Account by the taxpayer or the taxpayer's employer).

This act is effective on February 10, 2005 and applies to tax years beginning on or after January 1, 2004.

Income Tax Surcharge (Act 63 of 2005)

This act repeals the 3% Income Tax surcharge imposed by Arkansas Code Section 26-51-207 for tax years beginning in 2005.

Subchapter S Corporation Must Have Federal Election (Act 261 of 2005)

The act requires a corporation to have elected Subchapter S treatment for federal income tax purposes if electing Subchapter S treatment for Arkansas income tax purposes for the same tax year. The act is effective for tax years beginning on or after January 1, 2005.

Indian Ocean Tsunami Relief Contributions (Act 53 of 2005)

This act allows a taxpayer who made charitable cash contributions in January 2005 for the relief of Indian Ocean tsunami victims to treat the contributions as though they were made on December 31, 2004 and take the charitable contribution deduction on the 2004 Arkansas income tax return. Contributions taken on the 2004 tax return cannot be taken on the 2005 return also.

Extension of Time to File Clarified (Act 686 of 2005)

This act allows the Director to grant an extension of time for filing an Arkansas income tax return of not more than 120 days, and in extraordinary circumstances, an additional extension of 60 days.

Electronic Payment of Withholding Tax Allowed (Act 389 of 2005)

This act allows employers paying withholding tax or others paying withholding on behalf of an employer to use the state module of the U.S. Treasury electronic payment system. The act allows the taxpayer to avoid filing a monthly return with the payment. The taxpayer must file an annual reconciliation. The act is effective for tax years beginning January 1, 2006.

Income Tax Technical Corrections Act (Act 675 of 2005)

This act amends Arkansas Code to adopt changes to the Internal Revenue Code (IRC). The act adopts or readopts the following IRC Sections:

1. Readopts IRC §1033 relating to the exclusion of gain from the involuntary conversion of a taxpayer's property;
2. Readopts IRC §129 regarding the exclusion from income for dependent care assistance;
3. Adopts IRC §134 regarding the exclusion from income of child care benefits provided to members of the United States military;
4. Readopts Subchapter S of the Internal Revenue Code regarding small business corporations;
5. Readopts IRC §§453, 453A, and 453B regarding the installment method of accounting;
6. Readopts IRC §§72, 219, 401-404, 406-416, and 457 relating to annuities, retirement savings, and employee benefit plans;
7. Readopts IRC §162 regarding trade or business expenses;
8. Readopts IRC §170 regarding deductions for charitable contributions;
9. Readopts IRC §274 regarding the deductions of expenses for entertainment, amusement, recreation, business meals, travel, et cetera;
10. Readopts IRC §198 regarding the deduction of costs paid or incurred for the cleanup of certain hazardous substances;
11. Adopts IRC §194 regarding the amortization of qualified reforestation expenses;
12. Readopts IRC §§611-613, 613A, 614, 616, and 617 regarding computing the depletion allowance deduction for natural resources;
13. Adopts IRC § 470 regarding leasing transactions between taxpayers;
14. Readopts IRC § 248 regarding capitalization and amortization of a corporation's organizational expenses.

This act applies to tax years beginning January 1, 2005.

Pass-Through Entities Required To Withhold Income Tax (Act 1982 of 2005)

This act requires pass-through entities to withhold income tax on the applicable distributions to nonresidents that are attributable to income from sources within the state. A pass-through entity is a business entity (corporation treated as a Subchapter S corporation, a general partnership, limited partnership, limited liability partnership, limited liability company, or a trust) that is not taxed as a corporation for federal or Arkansas income tax purposes.

The pass-through entity is required to file an annual return in electronic format that shows the total amount of income distributed or credited to its nonresident members and the amount of tax withheld and remit the tax.

A pass-through entity is not required to withhold tax for a nonresident if:

1. The member's share of income is less than \$1,000;
2. The member's income is not subject to withholding;
3. The member elects to have the tax paid as part of a composite return filed by the pass-through entity as allowed by the act;
4. The entity is a publicly traded partnership as defined by IRC 7704(b) that is treated as a partnership for federal tax purposes and has agreed to file an annual information return reporting the name, address, and taxpayer identification number of each member with Arkansas income greater than \$500;
5. The entity has filed the member's signed agreement to file and pay Arkansas nonresident income tax; or
6. The member's income is exempt from Arkansas income tax pursuant to Ark. Code Ann. 26-51-202(e)

This act is effective for tax years beginning on or after January 1, 2006

Unpaid Leave Of Absence For Employees (Act 2235 of 2005)

This act requires private employers with one or more employees to grant an employee an unpaid leave of absence of up to 90 days, or more if the employee serves as an organ or bone marrow donor and requests the leave in writing. If the private employer pays the employee's wages during the leave, the employer is entitled to a credit against the employer's withholding tax liability. The credit is equal to 25% of the wages paid to the employee during the leave for 90 days or less. If the leave is greater than 90 days, the credit is limited to the wages paid during the first 90 days. The credit must be taken within 1 year of the date that leave begins. The act does not apply if the employee is eligible for leave under the Family Medical Leave Act.

WHAT'S NEW FOR 2005

(Continued)

NOTE: THE FOLLOWING IS A BRIEF DESCRIPTION OF EACH ACT AND IS NOT INTENDED TO REPLACE A CAREFUL READING OF THE ACT IN ITS ENTIRETY.

Payment Of Interest On Overpayments (Act 262 of 2005)

This act clarifies that interest on overpayments of tax is to be calculated from the due date of the return or the date the return was filed, whichever occurs later. The act allows the Director 90 days from the return due date or the date the return was filed, whichever occurs later, to refund an overpayment of tax without interest.

Amendment To Enterprise Zone Program Of 1993 (Act 443 of 2005)

This act amends Ark. Code Ann. 15-4-1704(h) to require that employees be hired within sixty (60) months of approval into the Enterprise Zone Program of 1993. The act provides consistency with other economic development tax incentive programs and establishes a clear ending point for this program. The economic development tax incentive benefits from the Enterprise Zone Program of 1993 were replaced with the benefits as granted by the provision of the Consolidated Incentive Act of 2003. The Consolidated Incentive Act limits the tax credit to new employee payroll that is paid within 60 months of the financial agreement date.

Withholding from Payments of Deferred Income Required (Act 1309 of 2005)

This act adopts IRC §3405, with certain modifications, to require withholding from certain periodic and lump sum payments of deferred income. For state purposes, withholding from non-periodic payments will be at the rate of 3%. Withholding from rollover distributions will be at the rate of 5%. This act applies to tax years beginning on or after January 1, 2006.

Rice Straw Credit Established (Act 2247 of 2005)

This act allows an income tax credit in the amount of \$15.00 for each ton of rice straw in excess of 500 tons that is purchased by an Arkansas taxpayer who is the end user of the straw (person who purchases and uses the straw for processing, manufacturing, generating energy or producing ethanol). The amount of the credit is limited to 50% of the income tax due for the tax year. Unused credit may be carried forward for 10 consecutive tax years following the year in which the credit is earned. This act is effective for tax years beginning on or after January 1, 2006.

Nonprofit Incentive Act Established (Act 1277 of 2005)

This act establishes the Nonprofit Incentive Act of 2005, which allows a state and local sales and use tax refund and payroll rebate incentives to eligible nonprofit organizations approved by ADED.

The payroll rebate is based on the incentive agreement between the nonprofit organization and ADED. The nonprofit organization must have a minimum of \$1,000,000 payroll for new full time permanent employees to qualify for the payroll rebate. The nonprofit organization must meet the \$1,000,000 payroll requirement within 24 months of initiating the agreement. ADED may authorize the payroll rebate incentive for up to 5 years. The organization will be subject to repayment of the payroll rebate, plus 10% interest if it fails to maintain the \$1,000,000 payroll and the 110% average hourly wage thresholds.

Arkansas Consolidated Incentive Act Amended (Acts 1232 and 1296 of 2005)

Act 1232: The act amends the Targeted Business Special Incentive program by reducing minimum payroll, investment thresholds, and average hourly wage thresholds for increased program participation. Participants may carryforward for up to 9 years the income tax credits calculated on annual payroll. The act also modifies the Research and Development Tax Credits by providing a 5 year renewable term, amends the definition of "industry" to include technology based enterprises, and amends the Tuition Reimbursement tax credit to allow the credit to employers who pay the tuition instead of reimbursing the employee.

Act 1296: This act amends current Arkansas Code provisions of the Arkansas Consolidated Incentive Act of 2003, Ark. Code Ann. §§ 15-4-2701 et seq., by: (1) clarifying definitions; (2) adding intermodal facilities as a business type eligible for incentives; (3) providing authority to the Director of the Arkansas Department of Economic Development to classify additional non-retail businesses as eligible if the business

receives at least seventy-five percent of sales revenue from outside Arkansas; (4) lowers annual payroll thresholds and investment thresholds for determination of qualifying eligibility for the incentive benefits; (5) provides that certain lease payments may be used to determine if investment thresholds have been met; (6) provides that sales and use tax refunds for eligible expenditures exclude those sales and use taxes dedicated to the Educational Adequacy Fund and the Conservation Tax Fund; (7) allows the ADED Director to authorize higher payroll rebate payments to certain businesses; (8) changes tax incentive carry forward periods from 3 years to 9 years for certain businesses; and (9) repeals the provisions of Ark. Code Ann. §15-4-2713 regarding Industrial Development Compacts. This act provides for an effective date of July 1, 2005.

Arkansas Capital Development Company Act Amended (Act 1759 of 2005)

This act amends the Arkansas Capital Development Company Act to limit the maximum amount of tax credits available in any calendar year. The cap is \$5,000,000 per calendar year, with an additional \$1,250,000 allowed if approved by the Director of DFA, who must certify that that issuance of the additional amount will not harm or adversely affect public education or other government programs or functions funded by general revenues.

The act amends the CDCA to clarify and define what types of transactions are permissible and are eligible for the tax credit. It extends by 2 years the period during which a purchaser must invest to be eligible for this tax credit (from 2013 to 2015) and the last tax period in which this tax credit is allowed (from 2019 to 2021).

The act reduces from thirty (30) to fifteen (15) days the amount of time that the governing board has to make a decision whether to allow or deny the transfer of an equity interest or the tax credit associated with it.

Finally, the act provides that if the authority of a capital development company to receive tax credits is terminated prior to 12-31-2015, or if a capital development company is dissolved, the capital development company may assign the administration of any outstanding tax credits to the Department of Economic Development. It further provides that the agreement to purchase shall remain valid and the purchaser entitled to continue to claim the tax credit, so long as the agreement was approved prior to 12-31-2015.

Arkansas Tourism Development Act Amended (Act 2308 of 2005)

The act amends the provisions of the Arkansas Tourism Development Act by modifying definitions, changing minimum investment thresholds, changing the percentage applied to project investment when calculating sales tax credits, and changing the method for calculating income tax credits generated from employment at the project. This act amends the existing provisions of the act by:

1. Establishing a minimum investment threshold of \$1,000,000 for all qualified projects. Under existing code provisions, projects qualify for sales tax credits after an investment of \$500,000 (excluding certain lodging projects requiring \$5,000,000 investment);
2. Providing that sales tax credits available for use against remittances of sales taxes collected are established at 15% of the approved project costs. Under existing code, for approved projects of more than \$500,000 but less than \$1,000,000 the projects credits are established at 10% of the first \$1,000,000 of project costs and 25% for the remaining portion of the project costs that exceed \$1,000,000. For approved projects of more than \$1,000,000 the project credits are established at 25% for all project costs;
3. Modifying the method for determining employees classified as "new full time permanent employees" by removing the requirement that a position be filled for at least 26 consecutive weeks; and
4. Changing the method for calculating the income tax credits earned by the tourism project to equal 4% of the new full-time permanent employees' payroll instead of 100 times the average hourly wage of each net new full-time permanent employee. The act provides that the sales tax credits may not be used against the 2% tourism tax levied by Ark. Code Ann. § 26-52-1002 for deposit to the "Tourism Development Trust Fund" except for "qualified amusement parks" as defined in Act 241 of 2005.

BUSINESS AND INCENTIVE TAX CREDITS

1. Purchase of Common Stock of a County and Regional Industrial Development Corporation

ACA 15-4-1224 allows the original purchaser of common stock of a County and Regional Industrial Development Corporation an income tax credit equal to 33%, increased to 33 1/3% beginning January 1, 1999, of the actual purchase price of the stock. In any one tax year the credit shall not exceed 50% of the income tax liability, after all other credits and reductions in tax have been calculated. Any unused credit may be carried forward for the next 3 succeeding tax years or until exhausted, whichever occurs first. Act 37 of 1999 extended the qualifying years through year 2003 and allows Limited Liability Companies (LLC) to participate in this credit. County and Regional Industrial Development Corporations are exempt from Arkansas income tax but are required to file returns according to ACA 15-4-1223.

2. Purchase of Waste Reduction, Reuse or Recycling Machinery or Equipment

ACA 26-51-506 provides an income tax credit equal to 30% of the cost of approved waste reduction, reuse or recycling machinery and equipment including the cost of installation. No other credits or deductions, except depreciation, may be claimed on that equipment. Any unused credit may be carried forward for the next 3 succeeding years or until exhausted, whichever comes first.

3. Consolidated Incentive Act

Act 182 of 2003 consolidates the current Biotechnology, Economic Development Incentive Act of 1993, Enterprise Zone, Arkansas Economic Development Act of 1995, Economic Investment Credit and Emerging Technology Credits into a comprehensive set of tax credits with new criteria, measuring devices and documentation requirements. Eligible businesses which signed a financial incentive agreement with the Department of Economic Development prior to March 3, 2003 will continue to be provided the benefits of those programs.

Act 182 establishes a Job-Creation Tax Credit equal to 1% of the payroll for new full-time permanent employees for the first 60 months after the incentive agreement is approved. The credits may offset 50% of the business' tax liability. Any unused tax credits may be carried forward for 9 years after the credit is established.

Act 182 creates an investment tax credit equal to 10% of the total investment in land, buildings, equipment and costs of licensing and protecting intellectual property of an approved project. The credit may offset 50% of the business' tax liability. Any unused tax credits may be carried forward for 9 years after the credit is established.

Act 182 expands the research and development tax credit available under ACA 26-51-1102 by allowing an income tax credit equal to 10% of the amount spent on in-house research in Arkansas, or 33% of the amount spent on in-house research in Arkansas for targeted businesses or in a strategic research area approved by the Department of Economic Development and the Arkansas Science and Technology Authority. The credits may offset 50% of the business tax liability. Any unused tax credits may be carried forward for 3 years after the tax credit is established.

Act 182 establishes a targeted business income tax credit equal to 10% of annual payroll during the term of the financial agreement for a period not to exceed 5 years. The credit cannot exceed \$100,000 per year. All credits under Act 182 of 2003 are administered by the Department of Economic Development.

Act 443 of 2005 amends ACA 15-4-1704(h) to require that employees be hired within sixty (60) months of approval into the Enterprise Zone Program of 1993. The Consolidated Incentive Act limits the tax credit to new employee payroll that is paid within 60 months of the financial agreement date. Act 1296 of 2005 amends current Arkansas Code provisions of the Arkansas Consolidated Incentive Act of 2003 by: (1) clarifying definitions; (2) adding intermodal facilities as a business type eligible for incentives; (3) providing authority to the Director of the Arkansas Department of Economic Development to classify additional non-retail businesses as eligible if the business receives at least 75 percent of sales revenue from outside Arkansas; (4) lowers annual payroll thresholds and investment thresholds for determination of qualifying eligibility for the incentive benefits; (5) provides that certain lease payments may be used to determine if investment thresholds have

been met; (6) provides that sales and use tax refunds for eligible expenditures exclude those sales and use taxes dedicated to the Educational Adequacy Fund and the Conservation Tax Fund; (7) allows the ADED Director to authorize higher payroll rebate payments to certain businesses; (8) changes tax incentive carry forward periods from 3 years to 9 years for certain businesses; and (9) repeals the provisions of Ark. Code Ann. §15-4-2713 regarding Industrial Development Compacts.

Act 1232 of 2005 amends the Targeted Business Special Incentive program and the Research and Development Tax Credit program of the Consolidated Incentive Act.

4. Child Care Facility

ACA 26-51-507 provides for an income tax credit of 3.9% of the annual salary of employees employed exclusively in providing child care services if the revenue to the business does not exceed the direct operating costs of the facility. Act 413 of 2001 requires certification of eligible childcare facilities by the Division of Childcare and Early Childhood Education.

ACA 26-51-508 provides that a business which qualifies for the refund of the Gross Receipts Tax or Compensating Use Tax under ACA 26-52-516 or 26-53-132 shall be allowed an income tax credit of 3.9% of the annual salary of its employees employed exclusively in providing child care service, or a \$5,000 income tax credit for the first tax year the business provides its employees with a child care facility. This credit is for a business which operates a child care facility for its employees only. Any unused credit may be carried forward for the next 2 succeeding tax years or until exhausted, whichever occurs first.

5. Water Resource Conservation

(a) Water Impoundment outside and within critical areas:

ACA 26-51-1005 and 26-51-1006 provide an income tax credit equal to 50% of the cost of construction and installation or restoration of water impoundments or water control structures of 20 acre-feet or more. The credit shall not exceed the lesser of income tax otherwise due or \$9,000. Any unused credit may be carried forward for the next 9 succeeding tax years or until exhausted, whichever occurs first. After March 12, 2001, projects used for commercial purposes can qualify for this credit.

(b) Surface Water Conversion:

1. Outside Critical Areas-ACA 26-51-1007 provides an income tax credit equal to 10% of the cost incurred for the reduction of groundwater use by substitution of surface water for water used for industrial, commercial, agricultural or recreational purposes. The credit shall not exceed the lesser of income tax otherwise due or \$9,000. Any unused credit may be carried forward for the next 2 succeeding tax years or until exhausted, whichever occurs first.

2. Within Critical Areas-ACA 26-51-1008 provides an income tax credit equal to 50% of the cost incurred for the reduction of groundwater use by substitution of surface water for water used for industrial, commercial, agricultural or recreational purposes. The credit shall not exceed the lesser of income tax otherwise due or \$9,000 for projects using water for agricultural or recreational purposes. For projects using water for industrial or commercial purposes, the credit is limited to the lesser of the income tax otherwise due or \$200,000. Any unused credit may be carried forward for the next 2 succeeding tax years or until exhausted, whichever occurs first, for projects using water for agricultural or recreational purposes. For projects approved on or after August 1, 1997 and using water for industrial or commercial purposes, any unused credit may be carried forward for the next 4 succeeding tax years or until exhausted, whichever occurs first.

(c) Land Leveling for Water Conservation:

ACA 26-51-1009 provides an income tax credit equal to 10% of the project cost incurred for agricultural land leveling to conserve water. The credit shall not exceed the lesser of income tax otherwise due or \$9,000. Any unused credit may be carried forward for the next 2 succeeding tax years or until exhausted, whichever occurs first.

(d) Wetland and Riparian Zone Creation and Restoration:

ACA 26-51-1505 provides for an income tax credit for any taxpayer engaged in the development or restoration of wetlands and riparian zones. The amount of credit shall be equal to the project costs not to exceed the lesser of income tax due or \$5,000. Any unused credit may be carried forward for the next 9 succeeding tax years or until exhausted, whichever occurs first. "Critical areas" means those areas so designated by the Arkansas Soil and Water Conservation Commission.

6. Equipment Donation, Sale Below Cost Or Qualified Research Expenditure

(a) ACA 26-51-1102 provides an income tax credit for a taxpayer who donates or sells below cost new machinery or equipment to a Qualified Educational Institution, or a taxpayer who has qualified research expenditures under a Qualified Research Program. This credit is equal to 33% of the cost of the donation, sale below cost, or qualified expenditure.

(b) ACA 26-51-1103 limits the credit to 50% of the net income tax liability. Any unused credit may be carried forward for the next 3 succeeding tax years or until exhausted, whichever occurs first.

7. Arkansas Economic Development Credit

ACA 15-4-1901 et seq. provides for an income tax credit based on the average wage of the new permanent employees for new or expanding facilities that employ at least 50 new permanent employees and expend at least \$5,000,000 on the project. Twenty-five percent (25%) of the employee's annual bonus can be added to calculate the average hourly wage beginning January 1, 1999. The income tax credit amount may vary according to established guidelines. The amount of income tax credit that may be taken in any tax year shall not exceed the Arkansas income tax liability resulting from the project plant or facility. The project plant or facility's income tax liability is to be computed by adding the sales, payroll and property factors of the plant or facility and dividing the sum by 3. This percentage is multiplied by the corporation's Arkansas income tax liability to arrive at the income tax credit available to offset the income tax liability arising from the project as referenced in the financial incentive plan. Form AR1100AEDA, Income Tax Apportionment Worksheet, may be used to compute the project apportionment percentage and available income tax credit. This form may be obtained by contacting Corporation Income Tax Section, P. O. Box 919, Little Rock, AR 72203-0919.

Act 975 of 2001 expands the definition of distribution centers to include facilities that store products owned by other companies, or sell to the public if at least 75% of sales are from out-of-state customers. All other businesses must also derive at least 75% of sales revenue from out-of-state customers. High unemployment is defined as being 150% of the state rate if it is 6% or below, 3% above the state rate if it is above 6%. The credit is now based on the total amount invested divided by the number of years of the incentive plan, instead of the debt service payments.

8. Workforce Training Credit

Act 609 of 2003 amends ACA 6-50-704 which permits an income tax credit based on a portion of the cost of workforce training. If the training is in an Arkansas state supported educational institution, the credit allowed is the lesser of one-half (1/2) of the amount paid by the company or the hourly training cost up to \$60 per instructional hour. If training is by company employees or company paid consultants, the tax credit cannot be more than \$15 per hour. There is no carryforward period for this credit. Applications for this credit are available from the Arkansas Department of Economic Development at (501) 682-7675.

9. Energy Technology Development Credit

ACA 15-4-2104 allows a tax credit of 50% of the amount spent during the taxable year on a facility located in Arkansas which designs, develops or produces photovoltaic devices, electric vehicle equipment or fuel cells and is put in use after January 1, 2000. The credit allowed may not exceed the amount of the tax imposed for the taxable year reduced by all other state credits allowable. A taxpayer who receives this credit may not claim any other state income tax credit or deduction based on the purchase of machinery and equipment other than depreciation expense. Any unused credit may be carried forward to the next 6 succeeding tax years or until exhausted, whichever occurs first. Act 1284 of 2001 expands the credit to include businesses that design, develop, or produce microturbines, stirring engines or devices reliant on nanotechnology.

10. Tourism Development Credit

ACA 15-11-509 provides for an income tax credit equal to 100 times the average hourly wage paid, up to \$3,000, for each new full-time permanent employee of a tourist attraction project approved on or after March 1, 1999. In high unemployment areas this credit increases by a factor of 4 up to \$6,000 per employee. Any unused credit may be carried forward to the next 9 succeeding tax years or until exhausted, whichever occurs first. The tourist

attraction project will be qualified through the Arkansas Department of Economic Development.

Act 2308 of 2005 amends the provisions of the Arkansas Tourism Development Act by modifying definitions, changing minimum investment thresholds, changing the percentage applied to project investment when calculating sales tax credits, and changing the method for calculating income tax credits generated from employment at the project.

11. Youth Apprenticeship Program

ACA 26-51-509 provides for an income tax credit of \$2,000 or 10% of the wages earned by a youth apprentice, whichever is less, to a business participating in the United States Department of Labor apprenticeship program. The credit may not exceed the income tax otherwise due. Any unused credit may be carried forward for the next 2 succeeding tax years or until exhausted, whichever occurs first.

ACA 26-51-1601 et seq. provides for an income tax credit of \$2,000 or 10% of the wages earned by a youth apprentice, whichever is less, to a business participating in the Arkansas Vocational and Technical Education Division apprenticeship program. The occupation in which the youth apprentice is employed must not be covered by the United States Department of Labor apprenticeship program as in effect on January 1, 1995. The credit may not exceed the income tax otherwise due. Any unused credit may be carried forward for the next 2 succeeding tax years or until exhausted, whichever occurs first.

12. Biotechnology Development And Training Credit

ACA 2-8-101 et seq. provides an income tax credit for a qualified biotechnology business that is approved through the Arkansas Department of Economic Development as follows:

- (a) Biotechnology Facility – 5% of the cost of such facility,
- (b) Biotechnology Training – 30% of the cost of employee training or of the Higher Education Partnership,
- (c) Biotechnology Research – 20% of the cost of qualified research that exceeds the cost of such research in the base year.

Act 1367 of 1999, effective April 12, 1999, amends the Biotechnology Development and Training Act to provide an income tax credit for an Arkansas taxpayer engaged in the business of producing advanced biofuels through biological means other than fermentation. The credit is limited to 30% of the cost of the buildings, equipment, higher education and licenses necessary to manufacture advanced biofuels. These credits can be used to offset the first \$50,000 of income tax liability arising during the credit year and 50% of any remaining tax liability for the year. Any unused credit may be carried forward for the next 9 succeeding years or until exhausted, whichever occurs first. Act 900 of 2001 extends the carryforward period to 14 years and requires the project to be certified before incurring expenditures that qualify for the credit as of August 13, 2001.

13. Biodiesel Incentive Act

ACA 15-4-2801 et seq. establishes an income tax credit to biofuels suppliers equal to 5% of the costs of facilities and equipment used directly in the wholesale or retail distribution of biodiesel fuels. The costs of service contracts, sales tax, or the acquisition of undeveloped land cannot be included in determining the amount of the credit. The credit cannot be claimed by a supplier for any facility or equipment in use on or before the certification of the company for tax credits, or for any facility or equipment for which a supplier previously claimed a tax credit for any other tax year. The limitations on the use of the credit will not apply if an entity is sold and the entity is entitled to credit. The credit can be carried forward for a period not to exceed 3 years. The provisions of the Act apply to tax years beginning on or after January 1, 2003.

14. Tuition Reimbursement Credit

ACA 26-51-1902 permits an income tax credit equal to 30% of the cost of tuition reimbursed by the employer to a full-time permanent employee on or after July 30, 1999. The credit cannot exceed 25% of the business' income tax liability in any tax year. There is no carryforward for this credit. This credit is administered by the Arkansas Department of Economic Development.

15. Family Savings Initiative Credit

ACA 20-86-109, creates the Family Savings Initiative Act, effective July 1, 1999, which provides a tax credit to those taxpayers who make contributions to a designated fiduciary organization created pursuant to this Act. The fiduciary will notify the Department of Human Services of the deposits and will issue a certificate to be attached to the tax return for the first year the credit is taken. The credit allowed is the lesser of the income tax due or \$25,000 per taxpayer. The total tax credit allowed for all taxpayers is \$100,000 per year. Any unused credit may be carried forward for the next 3 succeeding tax years or until exhausted, whichever occurs first.

16. Public Road Improvement

ACA 15-4-2306 provides a tax credit for those taxpayers who contribute to the "Public Roads Incentive Fund" for the improvement of public roads. The credit is limited to 33% of the total contributions made to the fund and in any tax year is limited to 50% of the Arkansas tax liability after all other credits have been taken. This credit is available for tax years beginning on or after January 1, 1999. Any unused credit can be carried forward for the next 3 succeeding tax years or until the credit is exhausted, whichever occurs first. This program is administered by the Arkansas Department of Economic Development.

17. Low Income Housing Credit

ACA 26-51-1702 provides an income tax credit for a taxpayer owning an interest in a qualified low income building which is approved through the Arkansas Development Finance Authority. The tax credit is computed by multiplying the Federal Low Income Housing Tax Credit for the qualified project by 20%. The credit may not exceed the income tax otherwise due. Any unused credit may be carried forward for the next 5 succeeding tax years or until exhausted, whichever comes first.

18. Purchase of Equity in a Capital Development Company

ACA 15-4-1026 allows the original purchaser of an equity interest in a Capital Development Company an income tax credit equal to 33% of the actual purchase price, limited to 50% of the net income tax liability. Any unused credit may be carried forward for the next 3 succeeding tax years or until exhausted, whichever occurs first. No credit will be allowed for any tax year ending after December 31, 2019.

19. Affordable Neighborhood Housing Credit

ACA 15-5-1301 et seq. provides an income tax credit for any business firm engaged in providing affordable housing which is approved through the Arkansas Development Finance Authority. The tax credit is limited to 30% of the total amount invested in affordable housing assistance activities. The

credit may not exceed the income tax otherwise due. Any unused credit may be carried forward for the next 5 succeeding tax years or until exhausted, whichever occurs first.

20. Manufacturer's Investment Tax Credit

ACA 26-51-2001 et seq. provides an income tax credit for investment of at least \$100 million before December 31, 2004 in a qualified paper manufacturing business equal to 7% of the investment. The credit shall not exceed 50% of the income tax liability, after all other credits and reductions in tax have been calculated. Any unused credit may be carried forward for the next 6 succeeding years or until exhausted, whichever comes first.

21. Coal Mining Tax Credit

ACA 26-51-511 provides an income or insurance premium tax credit of \$2.00 per ton of coal mined, produced or extracted on each ton of coal mined in Arkansas in a tax year. An additional credit of \$3.00 per ton will be allowed for each ton of coal mined in Arkansas in excess of 50,000 tons in a tax year. The credit can only be earned if the coal is sold to an electric generation plant for less than \$40 per ton excluding freight charges. The credit expires 5 tax years following the tax year in which the credit was earned.

22. Venture Capital Investment Credit

ACA 15-5-1401 et seq. provides an income tax credit up to \$10 million per year as recommended by the Arkansas Development Finance Authority and approved by the State Board of Finance. The credit may not exceed the income tax otherwise due. Any unused credit may be carried forward for the next 5 succeeding tax years or until exhausted, whichever occurs first.

23. Rice Straw Tax Credit

ACA 26-51-512 allows an income tax credit in the amount of \$15.00 for each ton of rice straw in excess of 500 tons that is purchased by an Arkansas taxpayer who is the end user of the straw (person who purchases and uses the straw for processing, manufacturing, generating energy or producing ethanol). The amount of the credit is limited to 50% of the income tax due for the tax year. Unused credit may be carried forward for 10 consecutive years following the year in which the credit is earned.

This act is effective for tax years beginning on or after January 1, 2006

The Business and Incentive Tax Credit Forms and instructions may be obtained from:

Department of Finance and Administration
Tax Credit/Special Refunds Section
P.O. Box 1272
Little Rock, AR 72203-1272

or call (501) 682-7106

Important Reminders for 2005

1. Subchapter S of the Federal Internal Revenue Code of 1986, as amended, and in effect as of January 1, 2005 has been adopted for Arkansas income tax purposes.
2. If the corporation is the parent of one or more Qualified Subchapter S Subsidiaries (QSSS), the Arkansas Subchapter S Election, Form AR1103, must be accompanied by Federal Form 8869 for each subsidiary that will be filing with the corporation.
3. Small Business Entity Pass Through Act (Act 1103 of 1993)

A Limited Liability Company is a hybrid business entity with characteristics of a Sub S Corporation and a limited partnership. The members of a Limited Liability Company are shareholders in that they have no personal liability for the debts of the Limited Liability Company. A Limited Liability Company is required to file a Partnership Tax Form, AR1050.

Act 479 of 1997 amends State law concerning Limited Liability Companies (LLCs), the Uniform Partnership Act, and the Revised Limited Partnership Act to allow mergers and consolidations between LLCs, corporations and partnerships. Currently, partnerships are not included in the merger provision. The franchise tax provisions are amended to apply to LLCs.

4. Privately Designed Tax Forms

Computer generated substitute tax forms are not acceptable unless the computer generated format is approved (in advance of use) by the Manager of the Individual Income Tax Section.

5. For telephone information or assistance regarding S-Corporation matters, call (501) 682-7276.
6. To expedite processing of the AR1100S, it is essential that the following items are completed:

- A. Tax Year
- B. Corporation name, address, city, state, zip code
- D. FEIN (Federal Identification Number)
- C. Date of Incorporation
- E. Business Code Number
- F. Date began business in Arkansas
- G. Filing Status (check only one box)
- H. Type of corporation (check only one box)

Subchapter S Corporation Return and Instructions

General Information

A corporation may select to be treated as a "Small Business (S) Corporation" for Arkansas income tax purposes. The election may be made only if the corporation meets all of the following tests:

1. It is treated as a Small Business Corporation with the Federal Government.
2. It has no more than one hundred (100) stockholders. Members of a family (and their estates) can be treated as one shareholder for this requirement. All other persons are treated as separate shareholders.
3. It must be a corporation organized or created under the laws of the United States, a state, or territory or it is a similar association taxed as a corporation.
4. Its shareholders are individuals, estates and certain trusts described in IRC 1361.
5. It has no nonresident alien shareholders.
6. It has only one class of stock.
7. It is not an ineligible corporation as defined in IRC 1361.
8. Banks may elect S Corp status even though the bank stock is owned by an individual's IRA rather than the individual.

For an election to be valid, all persons who are shareholders of the corporation on the first day of the corporation's taxable year or on the day of the election whichever is later, must consent to such election. The Arkansas election form is AR1103.

The election is to be filed with the:

**DEPARTMENT OF FINANCE AND ADMINISTRATION
INDIVIDUAL INCOME TAX/S-CORP ELECTION
P. O. BOX 3628
LITTLE ROCK, AR 72203-3628**

The annual income tax return of a Small Business Corporation is to be submitted on Form AR1100S. A "Small Business" election permits the taxable income of the Small Business Corporation to be taxed to the shareholders rather than to the corporation. All resident and nonresident shareholders of S Corporations doing business in Arkansas must file a properly executed Arkansas Income Tax Return with the Department of Finance and Administration. Arkansas Income Tax must be paid on the shareholders' taxable income.

Failure to report and remit on the part of any shareholder is grounds upon which the Director shall be authorized to revoke the corporations' Subchapter S election and collect the tax from the corporation by any manner authorized by the Arkansas Income Tax Act of 1929 as amended.

TO BE RECOGNIZED AS AN ARKANSAS S-CORPORATION

The following must be completed:

1. The business must register with the Arkansas Secretary of State. (501) 682-1010.
2. The business must file an Election by Small Business Form (Federal Form 2553) with the Internal Revenue Service and apply for a Federal Identification Number (Federal Form SS-4). 1-800-829-3676
3. The business must file an Election by Small Business Form (AR1103) with the State of Arkansas. (501) 682-7276

Domestic or Foreign Corporation Income Tax-Subchapter S

GENERAL INSTRUCTIONS

The instruction numbers correspond with the item numbers on the return. Un-numbered instructions give general information.

WHO MUST FILE

Every corporation organized or registered under the laws of this state, or having income from Arkansas Code Section 26-51-201 (with the exception of those corporations exempted by Arkansas Code section 26-51-303) must file an income tax return. Consolidated returns are permitted under certain conditions. D.I.S.C. and F.S.C. Corporations should use Form AR1100CT. Corporations must file Form AR1100S if: (a) they elected to be taxed as an S Corporation within seventy-five (75) days of incorporation or doing business in Arkansas, (b) the State of Arkansas accepted the election, and (c) the election remains in effect. Life insurance companies who pay a premium tax as provided by law are exempt from filing.

TIME AND PLACE FOR FILING

Form AR1100S is due on or before the 15th day of the 3rd month following the close of the Corporation's tax year. Forms must be filed with the Department of Finance and Administration, Individual Income Tax/S-Corp, P. O. Box 3628, Little Rock, Arkansas 72203-3628.

EXTENSION OF TIME FOR FILING

If you have received an automatic federal extension (Form 7004), the time for filing your Arkansas S Corporation Income Tax Return shall be extended until the date of your Federal Tax Return. For any extension beyond the automatic federal extension, or in lieu of the federal extension, you must make a written application on or before the due date of your Arkansas Return. The application should be made on Form AR1055.

PERIOD COVERED/ACCOUNTING METHOD

A corporation must calculate its Arkansas Taxable Income using the same income year and accounting method for Arkansas tax purposes as used for Federal income tax purposes. For tax years beginning after 1986 all S Corporations are required to have a permitted tax year. A permitted tax year is a tax year ending December 31, or any other tax year for which the S Corporation established a business purpose.

Application for changes must be made and forwarded to the Department of Finance and Administration, Individual Income Tax Management, at least 60 days before the close of the proposed or new taxable year or period and/or accounting method. The corporation must provide to the Commissioner a copy of any certification or approval from the Internal Revenue Service authorizing the corporation to change its accounting method or income year.

When the Commissioner of Revenue approves a change in the accounting period, the net income computed on the separate return for a fractional part of a year shall be placed on an annual basis by multiplying the amount of income earned during the taxable period by twelve and dividing by the number of months included in the period. Calculate the tax on the annualized income. The annualized tax is then multiplied by the number of months in the taxable period and then divided by twelve (12). The result is the tax liability.

SIGNATURES AND VERIFICATION

The President, Vice-President, Treasurer, or other principal officer shall certify the return. Such agent may certify the return of a foreign corporation having an agent in the state. If receiver, trustee in bankruptcy, or assignee are operating the property or business of the corporation, such receiver, trustee, or assignees shall execute the return for such corporation under certification.

REPORT OF CHANGE IN FEDERAL TAXABLE INCOME

Revenue Agent Reports (RARs) must be reported to this state within 30 days after the receipt of the RAR or supplemental report reflecting correct net income of taxpayer. Amended returns must be filed with payment of any additional tax due. The Statute of Limitation will remain open for eight (8) years if the taxpayer fails to disclose Federal Revenue Agent Reports.

PENALTIES

Willful failure to pay or file a return required under any state tax law is a Class A Misdemeanor. An additional penalty of \$500.00 will be assessed if any taxpayer files what purports to be a return but does not contain information on which substantial correctness may be judged and such conduct is due to a position which impedes the administration of any tax law.

LIABILITY FOR FILING RETURNS

A corporation subject to the provisions of the Income Tax Act of 1929, regardless of the amount of its net income, is required to file a return.

BALANCE SHEET

The balance sheet submitted with the return should be prepared from the books and should agree therewith, or any difference should be reconciled. All corporations engaged in an interstate trade or business and reporting to the Interstate Commerce Commission and to any national, state municipal or other public office may submit copies of their balance sheets prescribed by said Commission, or state and municipal authorities, as of the beginning and end of the taxable year.

If the balance sheet as of the beginning of the current taxable year does not agree in every respect with the balance sheet which was submitted as of the end of the previous taxable year, the difference should be fully explained.

TYPE RETURN

Whether the S Corporation is filing an Initial Return (first time filing), an Amended Return (making changes to an original return), or a Final Return (going out of business), clearly mark the return and check the applicable box at the top of the form.

INCOME

CAUTION: Report only trade or business activity income or loss on Lines 6 through 11. Do not report rental activity or portfolio income or loss on these lines. Report the Arkansas portion of rental income and expenses and portfolio income and expenses distributable to each shareholder on a Federal Schedule K. Clearly mark "Arkansas" on the Federal Schedule K that contains the Arkansas amounts.

GROSS SALES

If engaged in trading or manufacturing, enter as item 6 on page 1 of return, the gross receipts, less goods returned and any allowances or discounts from the sale price.

COST OF GOODS SOLD

Enter as item 7 the cost of goods sold. Attach schedule and explain fully the method used.

If the production, purchase, or sale of merchandise is an income producing factor in the trade or business, inventories of merchandise on hand should be taken at the beginning and end of the taxable year, which may be valued at the lower of cost or market. Explain fully the method used. In case the inventories reported on the return do not agree with those shown on the balance sheet, attach a statement explaining how the difference occurred.

Balance sheets as of the beginning and close of the year and a reconciliation of surplus must be attached to the return.

GROSS PROFITS

Enter as item 8 the gross profit which is obtained by deducting item 7, the cost of goods sold as extended from item 6, the gross sales.

NET GAIN OR (LOSS) FROM FORM 4797

Enter as item 9, gains or losses from the sale, exchange, or involuntary conversion of assets used in trade or business activity. If the corporation is also a partner in a partnership, include the partner's share of gains (losses) from sales or exchanges, involuntary or compulsory (other than casualties or thefts), of the partnership's trade or business assets. Do not include any recapture of expense deduction for recovery property (Federal Code Section 179).

OTHER INCOME

Enter as line 10 any other taxable trade or business income not listed above and explain its nature on an attached schedule.

DEDUCTIONS

CAUTION: Report only trade or business activity related expenses on lines 12 through 24. Do not report rental activity expenses or expenses related to any portfolio income on these lines. Report the Arkansas rental activity income and expenses and portfolio income and expenses distributable to each shareholder on a Federal Schedule K. Clearly mark "Arkansas" on the Federal Schedule K that contains the Arkansas amounts.

COMPENSATION OF OFFICERS

Enter as item 12 the compensation of officers in whatever form paid.

SALARIES AND WAGES

Enter as item 13 the amount of salaries and wages (other than wages and salaries deducted elsewhere on your return) paid or incurred for the tax year. Do not reduce this figure by Federal jobs credit.

REPAIRS

Enter as item 14 the cost of incidental repairs related to any trade or business activity.

Excess Net Passive Income Tax Worksheet

1. Enter Arkansas gross receipts tax for the tax year (See IRC Section 1362 (d)(3)(C) for gross receipts from the sale of capital assets.)* _____
2. Enter Arkansas passive investment income as defined in IRC* Section 1362 (d)(3)(D) _____
3. Enter 25% of Line 1 (If Line 2 is less than Line 3, stop here. You are not liable for this tax.) _____
4. Excess Arkansas passive investment income (Subtract Line 3 from Line 2.) _____
5. Arkansas expenses directly connected with the production of income on Line 2 [See IRC* Section 1375(b)(2)] _____
6. Net passive income (Subtract Line 5 from Line 2.) _____
7. Divide amount on Line 4 by amount on Line 2. _____
8. Excess net passive income (Multiply Line 6 by Line 7.) _____
9. Enter taxable income (See instructions for taxable income below.) _____
10. Enter the smaller of Line 8 or 9. _____
11. Excess net passive income tax – Enter 6.5% of Line 10. Enter here and on Line 27, page 1, Form AR1100S. _____

*Income and expenses on Lines 1, 2, and 5 are from total Arkansas operations for the tax year. This includes applicable income and expenses from page 1, Form AR1100S, as well as those that are reported separately on Federal Schedule K. See IRC Section 1375(b)(4) for exceptions regarding Lines 2 and 5.

BAD DEBTS

Enter as item 15 the amount of bad debt incurred during the year. The S Corporation can only use the specific charge-off method for figuring its bad debt deduction.

RENT

Enter as item 16 rent paid for trade or business property in which the S Corporation has no equity.

TAXES

Enter as item 17 taxes paid or accrued during the taxable year. Do not include Arkansas income taxes, Federal income taxes, or taxes assessed against local benefits tending to increase the value of the property.

INTEREST

Enter as item 18 only interest incurred in the trade or business activity of the corporation that is not reported elsewhere on the return. Do not include interest expense related to rental activity, portfolio or investment income.

DEPRECIATION

Enter as item 19 depreciation expense from Federal Form 4562. Do not include any expense for recovery property (Section 179) on this line.

DEPLETION

Enter as item 20 depletion expense from Federal Form 4562. Do not include any depletion deduction for oil and gas properties on this line.

OTHER DEDUCTIONS

Enter as item 24 any other authorized deductions related to any trade or business activity for which there is no line on page 1 of this form.

EXCESS NET PASSIVE INCOME TAX

Enter as item 27 the amount of excess net passive income tax due. If the corporation has always been a Subchapter S Corporation, then line 27 tax does not apply to the corporation. If the corporation has Subchapter C earnings and profits at the close of the tax year, has passive investment income that is in excess of 25% of gross receipts, **and** has taxable income at year end, the corporation must pay a tax on the excess passive income. Complete Lines 1 through 3 and Line 9 of the worksheet on this page to make this determination. If Line 2 is greater than Line 3 and the corporation has taxable income it must pay the tax. Complete a separate schedule using the format of Lines 1 through 11 of the worksheet to figure the tax.

Taxable Income (Line 9 of the Excess Net Passive Income Tax Worksheet) - Line 9, taxable income, is defined in IRC Section 1374(d). Figure this income by completing Lines 9 through 32 of **Form AR1100CT**, Arkansas Corporation Income Tax Return. Include the Form AR1100CT computation with the worksheet computation you attached to Form AR1100S. You do not have to attach the schedules etc. called for on Form AR1100CT. However you may want to complete certain schedules such as Schedule D, Form AR1100S.

SCHEDULE D (Form AR1100S)

Enter as item 28 the tax from Schedule D, Form AR1100S, page 2. If net capital gain for Arkansas is \$25,000 or less, the corporation is not liable for capital gains tax. If the net capital gain is more than \$25,000 you must determine if the corporation owes the tax in part A, or part B of Schedule D, Form AR1100S.

Part A – Capital gains tax computation

If the corporation made its election to be an S Corporation before 1987, IRC Section 1374 (as in effect before the enactment of the Tax Reform Act of 1986) continues to impose a tax on certain gains of the S Corporation. Consult the IRS instructions to determine if you are liable for this tax. If so, complete Part A, Schedule D, Form AR1100S.

Part B – Built-in gains tax computation

If the corporation made its election to be an S Corporation after December 31, 1986, IRC Section 1374 provides for a tax on built-in gains that applies to certain S Corporations. Consult the IRS instructions to determine if you are liable for this tax. If so, complete Part B, Schedule D, Form AR1100S.

PAYMENTS

Enter as item 30 payments you made on a 2005 Declaration of Estimated Income Tax Form.

Filing Declaration of Estimated Income Tax

Who must file: Every taxpayer who can reasonably expect to owe an Arkansas income tax in excess of \$1,000 must make an estimate and pay in equal installments tax due thereon. The declaration shall be filed with the Commissioner of Revenue on or before the fifteenth (15th) day of the fourth (4th) month of the income year of taxpayer. Taxpayers whose income from farming for the income year can reasonably be expected to amount to at least two-thirds (2/3) of the total gross income from all sources for the income year, may file such declaration and pay the estimated tax on or before the fifteenth (15th) day of the second (2nd) month after the close of the income year. In lieu of filing any declaration, the taxpayer may file an income tax return and pay the tax on or before the fifteenth (15th) day of the (3rd) month after the close of the income year.

Payment of Taxes

The tax should be paid by attaching to the return a check or money order payable to "Department of Finance and Administration."

WORKSHEET FOR APPORTIONMENT OF MULTIPLE CORPORATIONS

For corporations with income from sources within and without the State:

In general, taxpayers with income derived from activities both within and outside the State (Public Utilities excepted) are required to allocate and apportion the net income under the following provision:

Business and non-business income defined – Article IV 1 (A) defines "Business Income" as income arising from transactions and activities in the regular course of taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's trade or business operation. In essence, all income which arises from the conduct of trade or business operations of a taxpayer is business income. Income of any type or class and from any source is business income if it arises from transactions and activities occurring in the regular course of a trade or business. In general all transactions and activities of the taxpayer which are dependent upon, or contribute to, the operations of the taxpayer's economic enterprise as a whole constitute the taxpayer's trade or business and will be considered "Business Income" unless otherwise excluded by statute.

Business income is to be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus two (2) times the sales factor, and the denominator of which is four (4).

The average value of property owned by the taxpayer means the average of the original cost of the property at the beginning and end of the tax period.

Property rented by the taxpayer is valued at eight times the net annual rental rate.

Tangible personal property includes inventories.

The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the tax period by the taxpayer for compensation, and the denominator of which is the total compensation paid everywhere during the tax period.

Compensation is paid in this state **if**: (a) the individual's service is performed entirely within the state **or**, (b) the individual's service is performed both within and outside the state incidental to the individual's service within the state **or** (c) some of the service is performed in the state **and** (1) the base of operations (or if there is no base of operations the place from which the service directed or controlled) is in the State **or** (2) the base of operations or the place from which the service directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in the state.

The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period and the denominator of which is the total sales of the taxpayer everywhere during the tax period. The sales factor is then doubled.

Sales of tangible personal property are in this state if: (a) the property is delivered or shipped to a purchaser, other than the United States Government, within this State regardless of the f.o.b. point or other conditions of the sale or (b) the property is shipped from an office, store, warehouse, factory, or other place of storage in this State and (1) the purchaser is the United States Government or (2) the taxpayer is not taxed in the State of the purchaser.

Sales, other than sales of tangible personal property, are in this State if the income producing activity is performed both within and without of the State, in which event the income allocable to this State shall be the percentage that is used in the formula for apportioning business income to this State.

The following items of income to the extent that they do not constitute business income are to be allocated to this state:

1. Net rents and royalties from real property located in the state
2. Net rents and royalties from tangible personal property (a) if and to the extent that the property is used in this state or (b) in their entirety if the commercial domicile is in the state and the taxpayer is not organized under the laws of or taxed in the state in which the property is utilized.

The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer tangible personal property is utilized in the state in which the property was located at the time the rental or royalty obtained possession.

3. Gains and losses from sales of assets:
 - a. Sales of real property located in the state
 - b. Sales of tangible personal property
 - (1) The property had a situs in this state at the time of sale, **or**
 - (2) The taxpayers commercial domicile is in this state, **or**
 - (3) The property has been included in depreciation which has been allocated to this state, in which event gains or losses on sales shall be allocated on the percentage that is used in the formula for allocating income to the state.
 - c. Sales of intangible personal property if the taxpayer's commercial domicile is in this state
4. Interest and dividends if the taxpayer's commercial domicile is in the state
5. Patent and copyright royalties: If and to the extent that the patent or copyright is utilized by the taxpayer in this state, or if and to the extent that the patent or copyright is utilized by the taxpayer in a state in which the taxpayer is not taxed and the taxpayer's commercial domicile is in this state.

A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to the states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

Prior approval is required before deviation from the allocation and apportionment method.

If the allocated and apportionment provisions as set out above do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for, or the Director of Revenue, Department of Finance and Administration may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

1. separate accounting
2. the exclusion of any one or more of the factors
3. the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state, or
4. the employment of any other method to effect an equitable allocation and apportionment of the taxpayer's income.